



Select Committee on the European Union

EU Financial Affairs Sub-Committee

Corrected oral evidence: Brexit: EU Budget

Wednesday 14 December 2016

10.20 am

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Members present: Baroness Falkner of Margravine (Chairman); Lord Butler of Brockwell; Lord De Mauley; Lord Desai; Lord Haskins; Baroness Liddell of Coatdyke; Earl of Lindsay; Lord Shutt of Greetland; Lord Skidelsky; Lord Woolmer of Leeds.

Evidence Session No. 1

Heard in Public

Questions 1 - 10

Witnesses

I: Professor Iain Begg, Professorial Research Fellow, European Institute, London School of Economics; Dr Giacomo Benedetto, Senior Lecturer in Politics/Jean Monnet Chair, Department of International Relations, Royal Holloway, University of London.

Examination of witnesses

Professor Iain Begg and Dr Giacomo Benedetto.

Q1 The Chairman: Good morning. I welcome Professor Iain Begg and Dr Giacomo Benedetto to our evidence-taking session on Brexit and an inquiry into the EU budget. You have a list of interests that have been declared by Committee members. This is a formal evidence-taking session of the Committee. A full transcript will be taken. It will be put on the public record in printed form and on the parliamentary website. You will be sent a copy of the transcript and will be able to revise it, if there are any minor errors. The session is on the record, is being webcast live and will subsequently be available via the parliamentary website. Would either of you like to make any introductory remarks?

Dr Giacomo Benedetto: Good morning. I would like to thank your Lordships for the invitation. My background is as a political scientist, looking to some extent at procedures and agreements. The questions that have been drafted are ones that I can deal with in part. I am sure that, in concert with Professor Iain Begg, we will be able to address most of the issues raised.

The Chairman: Professor Begg, I take it that you do not want to make any opening remarks.

Professor Iain Begg: Only two words—many unknowns.

The Chairman: Are they known unknowns or unknown unknowns?

Professor Iain Begg: All of them.

The Chairman: We will not go there.

I wonder whether you could talk us through how the EU budget is structured and agreed between the member states. What are the main factors in determining the United Kingdom's contributions? In particular, what do you think will impact on our contributions over the next few years, both before and after Brexit?

Dr Giacomo Benedetto: On structure, I always explain that there are four parts to the EU budget. There are own resources, which are the source of revenue or financing for the EU budget, a quarter of which are derived from a VAT contribution and external tariffs. A residual—what makes up the rest—is based on GNI: gross national income. Within that, there is a system of rebates—not only the one for the UK, but some other rebate systems for other member states. Occasionally, the balance and quantity of different own resources is changed, most recently with the decision from 2014 that was put into law by the European Union (Finance) Act 2015, passed by the House of Commons. Those have to be changed with the unanimous agreement of all the member states and approval by every national parliament, including the House of Commons.

Within those limits, which provide that finance, multiannual spending programmes are agreed. That is known as the multiannual financial

framework. It is not actually a budget but a series of spending ceilings—spending maximums—set for a seven-year period and agreed unanimously by the member state Governments, although not by their parliaments, together with the European Parliament. That is what sets the current spending arrangements until 2020. There is an annual budget that allows funds to be moved around to a certain extent and spending to be approved, within the limits of the long-term agreement. There are also the audit procedures that follow each financial year, where the accounts are examined by the Court of Auditors and the European Parliament ratifies its recommendations.

Very simply, that is how the budget as a whole is structured. There are spending policies within the budget. There is one for competitiveness, which is worth about 13% of the entire expenditure. Approximately half of that amount is focused on Horizon 2020, which is a research and innovation programme. There are other innovation programmes, notably in areas such as nuclear research and satellites, as well as some education and training programmes, that come under that branch. Next, about a third of the budget is dedicated to cohesion or regional development policy, for the more deprived areas of the European Union. The heading that is termed natural resources, which includes primarily agriculture, accounts for about 40% of the expenditure. Three-quarters of that 40% is allocated to direct payments to farmers. There are some smaller headings as well, which govern matters such as administration, Europe's place in the wider world and security and citizenship.

The Chairman: I notice that you said that a third is spent on cohesion funds, for example. I have read that about a third of the UK's contribution goes into cohesion funds. Does the UK's contribution roughly follow those big breakdowns, or is it concentrated more in one sector versus another?

Dr Giacomo Benedetto: It is not that the UK contributes a certain amount and that amount is then spent specifically in certain areas. What we term the UK contribution is what economists refer to as a residual—it makes up the difference. The own resources—the revenue that belongs to the EU—are a small amount from VAT, as well as tariffs. The rest of it—the remaining three-quarters—comes from national contributions.

The Chairman: Professor Begg, do you want to come in on that point?

Professor Iain Begg: Directly on your question, Lord Chairman, there is not an assessment for each individual spending policy—there is only a global assessment for each member state. Some people will then rework it and say that our contribution to individual spending is X or Y, but it is not computed in that way.

I wonder whether I can add two or three other significant points that will bear on the second half of your opening question. The first is to note that the multiannual financial framework deal is the big deal in determining the EU budget. It is the one that leads to the biggest wrangles. It was settled in 2013 for the period 2014 to 2020. The next one will start to be

under negotiation early in 2018 and will be a very contentious negotiation among whoever is then in the European Union. As Giacomo has spelled out, it gives the headings of spending, but it also gives implied amounts to be allocated to individual member states, under shared management programmes. Those are programmes that are often administered at member state level, but with funding coming from the Commission.

I will make three other quick points. First, there are multiannual programmes, particularly for things like research or economic development—what is called the cohesion policy—that can last well beyond the 2020 deadline for the multiannual financial framework. In particular, cohesion policy is allowed a rule of what is called N+3. For example, Poland has yet to start most of its cohesion policy programmes, even though they are for 2014 to 2020. It can still present bills up to 2023, using the N+3 rule. The second significant point is that there is a difference in the EU budget between commitments, which are a decision to spend in a particular financial year, and the actual payments, which can occur later. That coincides with the N+3 rule. That is the shared management. There are also some directly managed programmes at the EU level.

How that feeds into the second bit of your opening question is as follows. There will be commitments made today that will result in spending beyond not just 2020 but the putative date for Brexit. If Article 50 is triggered in March next year, two years on from that will be March 2019. If that is the exit date, there will be commitments already made lingering beyond that date. Moreover, the multiannual financial framework is a legally binding document. It is a Council regulation, which appends the headings of expenditure. There is an open question as to whether Britain remains liable for the entirety of that multiannual financial framework even if it leaves before the financial framework is complete. That will almost certainly be a subject for negotiation. It could mean very big liabilities for the remainder of 2019 and 2020, including—obviously this will be very provocative—continuing to pay for the common agricultural policy.

The Chairman: We will come on to that. That is a very important point, which we will cover. Professor Begg, can I take you back just a little? You have told the Committee in the past that there are different methods of calculating the UK receipts. Apparently, the Treasury counts only public sector receipts, whereas the Commission includes payments to the private sector such as research grants, totalling quite a significant sum. You said that it was £1.4 billion in 2013. Could you elaborate on that a little?

Professor Iain Begg: Yes. There is a recent briefing document published in May this year by the ONS, in an attempt to clarify matters. What it succeeded in doing was obfuscating them. It presents a little table, which I can pass to the clerk, saying that the UK net contribution was £9.9 million—if you do it according to its methodology, which counts only receipts accruing through the public sector. The European

Commission has a figure of £7.1 billion, which is in the same table from the ONS because it notes two things. First, the European Commission also includes payments from Brussels going to the private sector. Bizarrely, that includes some of the public sector, such as universities. It is also an average over four years, rather than a figure for a single year, as the ONS calculation is.

To put this in perspective, there is the famous £350 million per week we all know about, which was an ex ante gross contribution. If you take off from that the British rebate, you get the amount that British taxpayers send to Brussels in reality. If you take off from that the spending that accrues under those two headings, you get the alternative figures for the net contribution.

The Chairman: Thank you.

Professor Iain Begg: It is as clear as mud; I know.

Lord Desai: If we have to go on spending in 2019 and 2020, does that mean that we do not get anything in return—for example, in agriculture? Do our receipts stop but our payments continue?

Professor Iain Begg: Many of the receipts would continue, because of the multiannual programmes. One example from our sector of activity is grants accorded to universities under the Horizon 2020 programme. To take one very simple example that I have mentioned before, one of my colleagues is a recipient of a European Research Council grant, which is highly prestigious. It runs for five years. She is just off maternity leave, so it will last until 2021. Yes, that money would continue to flow. As to agriculture, which is the year-by-year one, if we were still paying in, I would expect the counterpart to that to be continuing to receive on the same basis.

Lord Skidelsky: Including the extended period.

Professor Iain Begg: Yes. However, nothing is certain on this. It is all negotiations.

Q2

Lord Woolmer of Leeds: My question is very near to the issues that you have been covering. For the record, can both of you offer a view on the legal status of the current multiannual framework, up to 2020, and whether the UK is legally committed to paying its full share until 2020—or even 2020 plus three?

Professor Iain Begg: I can reassert that it is a legally binding document. It is a Council regulation that has been approved by due process, which includes the Council of Ministers, on which Britain sits. It is there; I believe that the clerk is going to bring along a copy of it. Within that document, which has a number of articles, there is a provision for enlargement of the EU and what happens in those circumstances. There is even a curious little provision for what happens if the island of Cyprus is united. There is not a provision in it for contraction of the EU.

I am not a lawyer, so you may want to consult a legal expert on this. It could mean that it is a legally binding document in much the same way that, if you take out a 10-year golf club membership and say that you are leaving after seven, you are still liable for the 10. It could be negotiated by saying, "Come on, guys, that is not fair. We are no longer in. We should no longer be contributing". That would be a subject for negotiation. However, my starting point—I think that this is the stance that the Barnier task force is taking—is that Britain could well be liable for the full amount.

Lord Woolmer of Leeds: If it is a legal document, who might rule on whether or not the UK was legally bound?

Professor Iain Begg: Ultimately, the European Court of Justice.

Lord Woolmer of Leeds: If there were some doubt about the UK's legal liability, would there be some doubt as to the legal basis on which the UK might wish to maintain the flow of revenue or benefits that it would have received over the period to 2020? In other words, if it were ruled that the UK had to pay the costs, would it be legally entitled to the benefits, even if it were not in the EU through to 2023?

Professor Iain Begg: That returns to Lord Desai's question. My instinct—this is an instinct more than a legal judgment—is yes. If you are paying in, you can expect to continue to receive. The golf club metaphor means that you will continue to be able to do your rounds of golf.

Lord Woolmer of Leeds: That implies that it would be within the legal framework of the EU to be paying out moneys to a country that was no longer a member state of the EU.

Professor Iain Begg: This is where it gets into the realm of speculation. Nobody knows the answer to that.

The Chairman: Several people want to come in on this. Dr Benedetto, do you want to add anything first?

Dr Giacomo Benedetto: Only to concur that it is a question of seeking the correct legal opinion. You can look at previous enlargements of the European Union—most recently, the one to Croatia, but also the ones before that. Croatia joined in 2013. When that happened, an amendment was passed to the then multiannual financial framework to take account of Croatia's arrival—both the spending needs and Croatia's contribution to own resources. If a member state were to leave, one could propose an agreement to amend the MFF accordingly, but that would be reliant on a unanimous agreement by all the other member states, of course.

Professor Iain Begg: With the caveat that there is a provision for enlargement in the regulation, but not one for a contraction.

The Chairman: No. I am looking at the regulation, since you said that the clerk had a copy of it. I am looking at Articles 21 and 22. Article 21 states, "If there is an accession or accessions to the Union between 2014

and 2020, the MFF shall be revised to take account of the expenditure requirements resulting therefrom". Logically, one could assume that if the MFF can be revised to add a member of the club—using your club analogy—surely it can be revised to subtract a member of the club.

Professor Iain Begg: But it is not in the regulation. That is my point.

The Chairman: It is Article 21.

Professor Iain Begg: Enlargement, yes; contraction, no.

The Chairman: It does not actually say contraction, but it is covered in the sense that there is a provision to change it. That is what I am trying to get at.

Professor Iain Begg: I suspect that if the Treasury devil were trying to argue the case, he would say, "Contraction is negative enlargement". If the other side were arguing the case, they would say, "There is no provision for a contraction".

Lord Desai: Expansion is much easier than contraction.

Lord Haskins: I could understand all this being raised under the Lisbon treaty. There was no attempt to define these issues in the Lisbon treaty, when the right to withdraw became legal. It just was not there.

Professor Iain Begg: We may have to refer to one of your colleagues, Lord Kerr.

Lord Haskins: I thought that that might have been the case.

Lord Skidelsky: As we are on the MFF, could I switch a little from the question of what our legal liability is to the question of what is economically efficient? We have had a written paper—not evidence—from Jorge Núñez Ferrer and David Rinaldi. I will quote one conclusion of theirs. They state, "If or when the UK government triggers Art. 50, it should consider the option of remaining until the end of the current Multiannual Financial Framework and simply stepping out from the next programming period. This would prevent a policy vacuum on regional development and facilitate trade and internal market negotiations". Could you comment on that? Is it a practical proposal? Would it be an option for us simply to say, "Yes, we accept all our obligations during the current period", and then to step out of the next phase?

Professor Iain Begg: It would undoubtedly be neat, because it would avoid any complications about whether you are liable under the existing MFF. Just as a footnote to that, there is one other little area I have been made aware of. You may think that this is extremely obscure, but there is something called the Emissions Trading Scheme at European level, where permits to emit carbon are auctioned. Eighty-eight per cent of the revenue accrues to the member state and 12% is held back as a form of economic development assistance to the countries of central and eastern Europe. That also runs to 2020.

Lord Skidelsky: You say that it would be neat, but what we want to know is whether it would be efficient. That depends on our gains and losses from adopting this strategy, as opposed to a negotiation to get rid of the MFF.

Professor Iain Begg: It really depends on what you think you can secure from negotiations. If the strong case is that you are going to pay anyway, you may as well take your route. If you think that you can extract some benefit from it by negotiating, there is a case for leaving earlier.

Lord Skidelsky: I have just one other question. Maybe we should concentrate a negotiation not on this point but on other points that are more important for our long-term relationship. Those are judgments, obviously.

Professor Iain Begg: A slightly different way of answering that question may be to say that much of what we have been talking about so far is transitional arrangements. There will be a period during which there is ambiguity about what we are liable for, but that will stop in due course. It may stop in 2023. Wolfgang Schäuble, the German Finance Minister, has said that it could last until 2030, but I think that he is exaggerating. What is reasonably clear is that significant amounts of money would end by 2023.

Lord Skidelsky: Do you have any comments on that, Dr Benedetto?

Dr Giacomo Benedetto: This is a matter for negotiation. Of course it would be neat. Assuming that Brexit takes place in 2019, some form of transition lasting 18 months or so, until the end of 2020, would be neat. Would it be efficient? Although Britain is a net contributor, it would guarantee those sectors that receive finance from the EU budget some level of transitional security while new national structures were put in place, so there could be some advantages.

Lord Skidelsky: But?

Dr Giacomo Benedetto: But it is a matter for negotiation. I can see that, politically, it may be problematic, in terms of public opinion, to have continued participation in the EU budget.

Professor Iain Begg: The farm lobby has already been promised that it will continue to receive what it receives today under the common agricultural policy up to 2020. It is similar for regional development. We could be arguing about not very much, in fact.

Lord De Mauley: I wonder whether strength was added to the Treasury devil's argument in the earlier discussion by the fact that Article 50 exists and exit is specifically contemplated. Therefore, if the MFF does not allow or provide for it, it ought to have done.

Professor Iain Begg: Indeed.

Dr Giacomo Benedetto: Indeed. The MFF is not part of the EU's constitution—it is part of the EU's legal system. The treaty has a higher status than the financial regulation or the MFF.

Q3 **Lord Haskins:** The *FT* has a figure of €20 billion for the cost of getting out. That seems to me to be equivalent to about two and a half years of our budget contributions. If the *FT* is anywhere near right, it will be a hugely sensitive issue. In your view, what is the scale of the UK liabilities resulting from our withdrawal from the EU?

Dr Giacomo Benedetto: This figure, which is similar to the one quoted by Wolfgang Schäuble, is at the higher end. We have a system where about half of the expenditure is non-differentiated, which means that co-financing is not necessary. Let me explain what that means. Recipients of agricultural funding, some other sectors and the administrative costs of the European Union are paid almost directly. Payments follow commitments very quickly. That is not the case when it comes to cohesion, competitiveness—including research and innovation—security and citizenship and some of the aspects of overseas spending, all of which require either co-financing on the ground or the successful implementation of programmes by the recipient sectors for the final balance to be paid some years later. That is why there is this lag that, apparently, if we are to believe Wolfgang Schäuble, could go on until 2030.

What we have is N+3. The N+3 principle, which Professor Begg explained some moments ago, pertains to cohesion policy and delivering those programmes, but the moneys can be released some time even beyond that. That is why there is a potential liability for some years beyond 2023.

Professor Iain Begg: Lord Haskins, it can be done only on the back of an envelope—or, if you are slightly sophisticated, on a spreadsheet. I have tried. It will depend on what you think are liabilities and assets that are likely to be put on the table by either side.

The big elements in it are as follows. The first is whether we remain liable, as in the previous discussion, for payments into the EU budget beyond the precise date of Brexit. Once again, that could be the remainder of 2019 and 2020. If Brexit is at the end of quarter one of 2019, that is three quarters of 2019 and four quarters of 2020. If we add that up—I will do orders of magnitude—it could be of the order of €27 billion, as the gross contribution for seven quarters.

Then you have the wonderfully named *reste à liquider*—remaining to be liquidated. Those are the things that spill over into subsequent years. It is quite a big number. The big number in 2015 was of the order of €220 billion. Do you remember my distinction between commitments and payments? That is commitments that have already been made, but payments that are yet to be executed, which can last. What tends to happen is that, as more payments are made, the remaining to be liquidated goes down. You have to make some sort of assumption about

what will remain on the date of Brexit. I have taken a back-of-the-envelope figure for this and suggested that it could be of the order of €19 billion for the UK. If you add that to the previous €28 billion that I had, you are now up to €47 billion.

There are potential liabilities for pensions. Very conveniently, the EU accounts provide a capitalised figure for the pension liability, which is of the order of €63 billion. What is then critical is what proportion of that you ascribe to the UK. There are three potential ways of doing it. One is to take the number of current UK nationals employed by the European Commission and other institutions. A second is to take the number of pensioners. Those numbers are respectively 4% and 8%. However, if I were on the other side, I would say, "It is a pay-as-you-go system. The UK is currently paying of the order of 15% of the aggregate revenue of the EU. Therefore, your commitment to the future pay-as-you-go is also 15%". Depending on which of those keys you use, you will get very different figures on the indefinite pension liability. Your buy-out from that will be either 15%, 8% or 4% of the stock of pensions. Am I losing you yet?

The Chairman: You have certainly lost me, but I do not think that you have lost Lord Butler.

Professor Iain Begg: If I may, there is one other element to this. On the other side, there are the assets of the European bodies, which are a combination of the buildings, the equipment, the computers, the software licences and some financial investments. You could say that the UK is entitled to its share of that, using the same key, whether it is 4%, 8% or 15%.

On the basis of all that—assets less liabilities—I have a figure of maybe €6 billion for the UK cost of that. If you think back to my observation on the European Emissions Trading Scheme, there is even a small amount in that that could be a future liability. It gets you to a total—again, depending on assumptions—of maybe €55 billion as the divorce bill. That is in line with what Barnier's team has been saying, which is that it could be of the order of €60 billion. That is much bigger than Giacomo has been saying.

Lord Haskins: What happens if Mr Davis says, "I am not paying that. I am going to pay a quarter of it"? Who picks up the three-quarters that is not covered?

Professor Iain Begg: It would lead to some sort of international treaty court trying to determine whether it is a genuine liability. On the legal dimension of that, I really do not know who the enforcing agent would be if enforcement were sought.

The Chairman: Can I come in with a brief follow-up on Lord Haskins's final question? In other situations—debt going back to the Second World War and other previous liabilities of that nature—there are quite long time periods negotiated to pay down the debt. Do you envisage this being

treated in a similar way?

Professor Iain Begg: Yes, because a one-off payment would be devastating to the UK public finances. I am sure that it would be on a schedule of payments over several years.

The Chairman: Lord Butler has a question on pensions and other things.

Q4 **Lord Butler of Brockwell:** The EU pension fund, like the UK Civil Service pension fund, is conducted on a pay-as-you-go basis. It occurred to me that pay-as-you-go takes on a new significance in these circumstances.

Professor Iain Begg: Indeed.

Lord Butler of Brockwell: You have explained very clearly the different bases on which the liability could be covered. Do you think that it is likely that that element—the pension liability—would be capitalised, or is it something that might be continued on an ongoing basis, over a large number of years?

Professor Iain Begg: The liability could be capitalised. As I said, there is a figure in the EU accounts for their capitalisation of the long-term commitment. However, the cash flow on it could be spread over several years. It could be a lingering bill for 20 years, for all I know.

Lord Butler of Brockwell: That would be a matter for negotiation.

Professor Iain Begg: Yes.

The Chairman: Lord Desai wants to come in on a related point.

Lord Desai: On the back of the envelope, you had 4%, 8% and 15% of something like €67 billion.

Professor Iain Begg: It was €62 billion.

Lord Desai: That cannot be a large sum of money. Sixteen per cent of €62 billion is about €10 billion.

Professor Iain Begg: If it is 15%—

Lord Desai: That is €10 billion.

Professor Iain Begg: I put down a figure of €6 billion, on the basis of 12%—in the middle.

Lord Desai: I was thinking that the sums would be more on the modest side, rather than €60 billion, which is all of it.

Professor Iain Begg: Do not forget that I was adding the liability for two years of MFF, plus the *reste à liquider*.

Lord Woolmer of Leeds: Is the capital value of the pension liability reached by applying a discount rate? In other words, is the capital value

historically very high at the moment because of low rates? Is that susceptible to a change in interest rates?

Professor Iain Begg: It is. They have a very low interest rate. It has gone down from 0.7% to 0.6%, which increased the capital value. Who knows? We are in an era of low interest rates, so it may persist.

Lord Woolmer of Leeds: So your ongoing liability would depend very much on the rate of interest that was in operation at the time when the deal was done.

Professor Iain Begg: I find it hard to believe that the interest rate will be much changed in two years' time from what it is now.

Lord Woolmer of Leeds: It could be in 10 years' time.

Professor Iain Begg: Yes.

Q5 **Lord De Mauley:** The subject of agricultural subsidies has come up several times in the conversation. Although my question has absolutely nothing to do with them, I ought to declare my interest as a recipient of them.

You have more or less answered the question that I was going to ask, but I will try to go a step further. You mentioned the EU's assets: buildings, machinery, equipment and so on. Indeed, I think that there is a wine cellar.

Professor Iain Begg: We hope so.

Lord De Mauley: Don't we just? What I am really asking is whether, legally, we own a share in those. You rather made the assumption in your earlier answer that we did and that, therefore, that would go into the equation for what money went in which direction afterwards. However, do we legally own a share in those?

Professor Iain Begg: I am afraid that I cannot answer that categorically. I am assuming it as an economist, rather than declaring it as a lawyer.

Lord De Mauley: Do you know how they were financed in the first place? Was it out of an up-front contribution or out of revenue contributions, as time went along?

Professor Iain Begg: I do not know about 1973, but I asked the question of one of the Slovenian negotiators, who told me, "No, there was not a contribution on entering the EU to pay towards assets". What they did have to pay towards was the European Investment Bank.

Lord De Mauley: Which is separate from all of this.

Professor Iain Begg: I stress that this is by way of informal evidence, rather than hard facts.

Lord De Mauley: Quite. This will just come down to a negotiation,

ultimately.

Professor Iain Begg: I think so. The assets that the European bodies now own, with normal depreciation, will all have been paid for while Britain was a member.

The Chairman: I wonder whether I could build on that. Dr Benedetto, please come in where you can. Would you like to say something on that now?

Dr Giacomo Benedetto: Yes. The acquisition of assets, certainly in recent times, will have been financed from heading 5 in the budget, which is devoted to administration and accounts for about 6% of expenditure. That covers the costs of buildings, including rental, as well as salaries and pensions.

The Chairman: My question follows neatly from that. Assets such as the Berlaymont building are owned by whom?

Professor Iain Begg: I think that the Berlaymont is owned by the Belgian Government, but there are other EU buildings that are owned by the European institutions.

The Chairman: Different institutions or the European Commission?

Professor Iain Begg: I really do not know. I guess that the Parliament is owned by a combination of the Belgian Government and the Parliament. The Committee of the Regions building is on the Rue Belliard and may be assigned to that committee. I do not know the detail of that.

The Chairman: Right. In so far as some of these assets are owned by European institutions, in accounting terms, do they not count as assets of the European institutions? Therefore, if the funding for their renovation, their building or anything else was done in the name of the European institution, of which the United Kingdom was a shareholder, in effect, by contributing to that through its budgetary contributions, could one not argue that a certain amount of that should go on the asset side of the ledger?

Professor Iain Begg: Indeed.

The Chairman: Of the UK ledger.

Professor Iain Begg: The assets shown in the accounts, excluding the loans—I am talking about the fixed capital and some of the investments in, for example, the European Investment Fund—come up to around €20 billion. You could say that that is the bit the UK could reasonably claim a share of. Then you come back to the question of which key to use to allocate it.

Lord Haskins: Equally, there could be some long-term leases, which would be liabilities. The Belgian Government could be leasing these properties. There would be a huge long-term liability.

Professor Iain Begg: Lord Haskins, I can assure you that I tried to read through the accounts. My accountancy training is not sufficient to make enough sense of it, but you may have better luck.

The Chairman: Do you believe that the Committee would benefit from speaking to the Court of Auditors about this?

Professor Iain Begg: Perhaps—or maybe just an accountant who is skilled in reading this kind of balance sheet.

Dr Giacomo Benedetto: Absolutely. As has been said, the question of assets is a case for negotiation, but it is also a case for legal expertise. The one case of a separation of states I can think of that was orderly is the dissolution of Czechoslovakia. I do not know to what extent the subsequent Slovak Republic could claim a share of assets based on, let us say, buildings in Prague. This is something that could be the focus of an investigation that might set some precedent.

Q6 **Earl of Lindsay:** My question is very much in the same vein. Is there any more clarity about the one-off down payments in the European Investment Bank and the European Coal and Steel Community that you make on joining the EU? Could those be regarded as financial investments that we made then and that remain ones that could be valued? In the case of the European Investment Bank, in particular, are they investments we are receiving a dividend for and could capitalise?

Professor Iain Begg: I took the liberty of consulting Sir Brian Unwin, who, as you may know, was formerly in charge of the European Investment Bank. These are not completely up-to-date figures, but he thinks that they are still the same. He said that the overall subscribed capital of the EIB is €232 billion, but only about 5% or 6% of that is called up. That suggests that the amount in question overall, of which 16.1% is British, is not that enormous: 16.1% of 6% of €232 billion would represent the British amount.

Earl of Lindsay: In a negotiation, as a shareholder in the EIB, could we demand the return of that capital sum?

Professor Iain Begg: Potentially, yes. There is an amount that could be recovered, but it may be of interest simply to leave it as an investment that generates a rate of return. The counterpart to this is whether in future Britain would want to have access to EIB loans. Brian Unwin says that one of the risks of Brexit is that we will no longer have this loan facility for infrastructure financing.

Lord Skidelsky: Because we are not allowed to pay for it if we are not a member of the EU.

Professor Iain Begg: It could be.

Earl of Lindsay: I did not quite hear Lord Skidelsky's question; you may have covered the point that I am about to put. Would we be allowed to remain a shareholder if we were not a member of the EU?

Professor Iain Begg: I do not think that any of us knows. It would be a negotiable point, rather than a certainty.

Earl of Lindsay: Are there any other non-EU shareholders at the moment—for example, Norway?

Dr Giacomo Benedetto: I am afraid that I do not know. What I can say is that the EIB is a vehicle for some other funds that have budgetary effect. Alongside the formal EU budget, which is worth 1% of GNI, there are other funds, such as the European Fund for Strategic Investments, also known as the Juncker fund, which have been invested with very large sums of capital up to 2020 and from which the more developed member states, including the UK, have been beneficiaries. I do not have the figures in front of me. The money for those funds is provided by the private sector. The EIB is involved. A degree of guarantee comes from the EU budget as well in order to underwrite the investments, which can have great economic potential. Membership of the EIB is a requirement in order to be on the receiving end of such investments.

Lord De Mauley: Professor Begg, you were rather dismissive of the value of the UK's equity in the EIB. It is worth saying that, under corporate law, the interests of a member or shareholder extend beyond the called-up share capital to, for example, good will, retained earnings and so on. Very often, those dwarf the called-up share capital. Do you have any view on what they might be?

Professor Iain Begg: You are beyond the limits of my competence on this. I am just trying to give you some of the basics on it.

Lord Haskins: The fundamental question here is, is EU membership required to participate in the EIB? Is a thing like the space programme outside or inside? Presumably that is outside. Non-members can participate.

Professor Iain Begg: I think that the space programme is part of the EU budget. There is funding for space research. The late lamented Galileo was part of the EU budget.

Lord Haskins: It is very unlikely that the British Government would want to withdraw from that. Would they therefore continue to contribute to it?

Dr Giacomo Benedetto: There are several programmes. Of course, there are those that involve non-EU member states such as Switzerland. Under the competitiveness heading I talked about earlier this morning, which is dedicated to research and innovation for the most part, there is a significant tranche that is invested in European satellite systems and so on. There is certainly a very important role for the EU budget within those, but there will also be overlap with other funds and programmes that are not EU specific but in which member states, including countries outside the EU, such as Switzerland, have buy-in.

Earl of Lindsay: Is there some confusion as to whether or not you can remain a shareholder of the EIB once you have stopped being a member

of the EU?

The Chairman: My understanding was that the shareholders of the EIB are the 28 member states—or 27, as will be the case after Brexit—but that the EIB has partnership agreements with other states that are not full members of the European Union. Does either of you know anything about that?

Professor Iain Begg: I do not.

Dr Giacomo Benedetto: No.

The Chairman: We will look it up and try to find out from the EIB whether that is the case.

Professor Iain Begg: I guess that there will be an article in the treaty somewhere that should shed light on it, but I do not know the answer.

Q7 **Lord Shutt of Greetland:** We have touched on this slightly already. I am talking about the multiannual receipts coming from the EU. You have told us about the agreement made in 2013, which covers the period 2014 to 2020. It includes items where, at that point, there was every expectation that there would be a return to the UK in that period—and that, indeed, it might not be paid until 2023. What do you think is the certainty of that under the agreement?

The second point in my question is this. I cannot believe that the disposition of every single euro—how it will be spent between 2014 and 2020—was promised in 2013. If we are in until we are out, what is the position on what I will call discretionary receipts back? It could be suggested, “Well, they are on their way, so perhaps we need not bother”. However, if we are in until we are out, what is the position on the UK getting its money’s worth, based on what would have been the expectations for percentages and so forth in certain programmes?

Professor Iain Begg: Many of the headings, particularly the cohesion policy and the research heading in the EU budget, involve contracts being signed by recipients and the European Commission. I will take one simple example of something I am involved in. It is a Horizon 2020 funded research project. There is a legally binding document that is signed. That means that, as long as you fulfil the conditions of the grant, you will receive the money up to whatever is set out in the contract.

There is, however, the distinction that Dr Benedetto introduced at the beginning between the multiannual financial framework, which is headings of expenditure, and the annual budget. As I indicated at the beginning, the headings of expenditure are the big deal. There is so much for agriculture, so much for cohesion and so on. When it comes to the annual budgets, they go through line by line saying exactly where each euro will be spent. That is the second answer to your question. As long as we are in the EU, we continue to participate in that annual exercise. If we continue with the date of spring 2019, it means that we will continue to be part of the negotiation of the annual budget up to that point. What

happens beyond that goes back to the answers to Lord Desai. We could continue it. We could have the neatness of persevering up to 2020, but that is for discussion.

The Chairman: Dr Benedetto, do you want to come in on that?

Dr Giacomo Benedetto: Not only are the contracts—particularly those under headings 1a and 1b, which are, first, competitiveness, and, secondly, cohesion—legally binding when they are signed, but, to put Horizon 2020 or any of the cohesion programmes into effect, a legal decision is taken separately from the multiannual financial framework, using the ordinary legislative procedure. There is a legal act passed by the European Union that governs each and every one of these different funds. Among other things, that also guarantees an end point, because all these funds expire at the end of 2020—at least, the commitments for them do; payments will follow later. There is a level of guarantee, not only in the MFF but in the legal spending decisions that are taken for each of the constituent funds.

Q8 Baroness Liddell of Coatdyke: I want to turn the emphasis slightly on to the impact of British withdrawal on the EU budget for other member states. You will have seen the debate in the press about how we have to be kind to the EU, whenever we depart. Professor Begg, in your very interesting paper *The EU budget and UK contribution*, you make the point that Britain's contribution amounts to roughly a third of the cohesion funds. Would British withdrawal mean that the other EU member states would have to either increase their contributions or reduce the scale of the programmes they are involved in?

Professor Iain Begg: I have used the back of my envelope for another purpose, which is to try to calibrate this. The amount sent by British taxpayers—here I refer to the gross contribution after the rebate has been deducted—is pretty much equivalent to the gross contribution, after paying their contribution to the British rebate, of all 12 member states that joined the EU in 2004 and 2007. Of the order of 12% to 15% of the budget will be withdrawn when Britain leaves. With the multiannual financial framework, there are commitments to those expenditure levels. That means that somebody else will have to pay up in the short term, for the current multiannual financial framework. The Germans will resist it, because they have domestic reasons for saying, "We are less happy than we used to be about the EU". The other countries will say, "We are not terribly happy about it either". They will all curse the Brits, because they are the ones causing the problem of how you finance it.

That then slides into the next multiannual financial framework, where there will be significant pressures to reduce the level of expenditure—not least because of Britain's departure, which takes away a net contributor. Then you have the usual wrangles. The Poles will say, "We need the money for cohesion", the Romanians and the French will say, "We need the money for agriculture", and the Germans will say, "We need to pay less". Those are incompatible positions, which we have witnessed in round after round of these negotiations. It has the potential to be

particularly toxic as a British legacy to what goes on. To come back to your expression “be nice to them” or “be friendly to them”, they will see withdrawing our contribution to the budget as a pretty hostile act.

Baroness Liddell of Coatdyke: There is another paper by Ferrer and Rinaldi. They make the point that, whether or not we subsequently join the single market, tariff costs to the United Kingdom will probably end up roughly equal to the contributions that are being made. Do you have a view on that?

Professor Iain Begg: I do. I think that they are making a mistake in perception. When you pay a tariff as a citizen, that is a tax. It is a tax that accrues to your Government. If the tariff component goes up, it means that the GNI component goes down, but you are still paying the tax as a citizen. The pressure on the German, Slovenian or Portuguese taxpayer would still be the same. The difference would be that, instead of paying through income tax, they would be paying through tariffs.

Baroness Liddell of Coatdyke: Dr Benedetto, do you have a view on the realpolitik of how other member states will react to the withdrawal of funds and the pressure that is put on them?

Dr Giacomo Benedetto: The EU institutions are certainly aware of it. I am not aware that this has been discussed at the national level in other member states. I would agree with Núñez Ferrer and Rinaldi. We can quibble about precise figures. Of course, one of the uncertainties that we face is that we do not know exactly when Brexit will take place, whether total exit from the budget will happen at the same time or what the conditions of that will be. The argument of Núñez Ferrer and Rinaldi is that either the UK will continue to contribute to the budget in order to have access to the single market or, if it does not, it will be faced with tariffs. There will not be a rebate paid to the UK any longer, so the net loss from the EU budget’s revenue side will be containable.

There will be some level of discord, potentially, between some other member states, because there are some other rebates in place—smaller ones—that apply to certain member states. Those will be challenged by the others. For example, France, Belgium and Italy are comparatively wealthy member states that have no rebate—of any kind—whereas the Netherlands, Germany, Denmark, Austria and Sweden receive rebates of a sort. Undoubtedly, an increase may be faced in the GNI contribution from each of the member states, but always in proportion to their GNI.

Baroness Liddell of Coatdyke: Do you have any advice on the negotiating position that Britain should adopt, given that degree of complexity?

Professor Iain Begg: One approach, which we discussed earlier, would be to try to time the financial settlement to the multiannual financial framework and, therefore, end it at the end of 2020, rather than in spring 2019.

The Chairman: Dr Benedetto, do you have any advice that you would like to give?

Dr Giacomo Benedetto: Yes. I agree with that. It might allow the UK, if it wished, to have single market commercial access. If the UK remained a member of the EU's budget until the end of 2020, a tariff could hardly be charged against the UK until after that date. Transitionally, it is something that offers some prospect.

Lord Haskins: Is it fair to assume that the poorer countries of the east are likely to be the big sufferers as a result of this change to the budget?

Professor Iain Begg: They will be, if the other net contributors say, "We are at our limit". We are all aware of the political pressures from the likes of Alternative für Deutschland and the Vrijheid party in the Netherlands.

Dr Giacomo Benedetto: Unless the multiannual financial framework is amended, the current requirement for expenditure is 0.95% of GNI EU-wide—just below 1%. That has to be met. It is the GNI figure, rather than a gross sum of money, that is binding. The current framework requires that that amount of expenditure be met. The gross level of GNI will shrink, because Britain will be leaving, but there will still be a legal obligation to honour what is left. If there is not an agreement on a new multiannual financial framework after 2020, the pre-existing commitments roll over. The 1% of GNI will stay in place unless there is a new multiannual agreement agreed for the period beyond 2020.

Lord Haskins: That would mean the GNI figure going up from 0.95% to 1.05%, or something like that.

Dr Giacomo Benedetto: No. If the EU 27 is the EU without the UK, it will be that 0.95% of the GNI of the 27 member states.

Lord Haskins: Which would be a smaller figure.

Dr Giacomo Benedetto: Yes.

Lord Skidelsky: The same percentage, but a smaller figure.

Dr Giacomo Benedetto: The same percentage.

The Chairman: Does either of you have any line of sight into the deliberations of the high-level group—the Monti group—on the EU budget? Do you think that its conclusions will have any impact on the reconfiguring of the MFF going forward after 2020?

Professor Iain Begg: I doubt it. The arguments have been going around in circles for the last 25 years—30 years, nearly—since the first Delors paquet in 1988. The major difficulty is that the GNI resource is an extremely successful resource. It is one that every Finance Minister in the world would love to have, because it expands to fill the expenditure need. If you switch to any kind of alternative means of raising money for the

EU, you are subject to vagaries in the yield of that particular tax instrument. You can say, "A carbon tax would make sense", but carbon taxes can fluctuate because people have more efficient cars or better heating systems. Any individual tax will be subject to that kind of constraint.

The Monti group has also focused on sources outside the conventional budget and alternative financing, particularly around the difficulties in the euro area, and on getting rid of the corrections. Taking the UK out of the equation will make a big difference to the corrections, because the Thatcher rebate from 1984 has dominated that particular story. To Baroness Liddell, I make one small point about the net contributions. An extremely Kafkaesque element in all of this is that four countries get a rebate on their contribution to the British rebate.

Dr Giacomo Benedetto: Yes—a rebate on the rebate. The report will be published by the Monti group, with its recommendations, in January, so it is not very far away. GNI may remain in the formula as a residual, because it guarantees security of income. Potentially, you could draw on all sorts of tax, but it is never guaranteed that that will provide a steady form of revenue in the same way as GNI.

Professor Iain Begg: More than security, there is also sufficiency of income. The EU budget has to balance. The GNI is the balancing resource. It is automatic. That is why, as I said, Finance Ministers elsewhere would kill for that kind of thing.

Q9 **Lord Desai:** Will it be possible for us to cherry-pick after our exit things we can go on participating in, such as research, where the European value added is very high?

Dr Giacomo Benedetto: As with everything else, that is a matter for negotiation. Switzerland and Norway make a contribution towards spending within the single market, to which they have access. In the case of Norway, there is full membership of some of the spending policies. It pays a reduction, compared with what a member state pays, to reflect the fact that Norway takes no part in the common agricultural policy or fisheries policy. The effect of what Norway pays is similar to a net contribution, because it is a wealthy country, minus whatever proportion it is that it does not have to pay because of agriculture.

The policy areas under heading 1a—Horizon 2020, which we have already talked about, and the other programmes on nuclear research, satellite systems and so on—are the areas of value added that may be advantageous for the UK. I have to declare an interest, since my Jean Monnet chair is co-financed under heading 1a. The question is whether it would be a contribution above the financial value of those payments. It would probably need to be, because that is the precedent set by the Norwegian and the Swiss examples. Norway's net contribution is based on a contribution, which the Swiss also pay, to cover some aspects of cohesion policy, to address levels of competitiveness by the less prosperous or less competitive parts of the European Union's internal

market. There would be some demand there. This is a matter for negotiation. Switzerland contributes less than Norway and has a reduced level of access, compared with Norway, to the benefits that the single market and some of the spending programmes offer.

Earl of Lindsay: Are you able to provide us with a short paper or to point us to a source of information that summarises those two financial relationships—the one between Norway and the EU and the one between Switzerland and the EU?

Professor Iain Begg: I provided the Norway one to the clerk previously. Norwegians pay of the order of €900 million per annum. Most of that is contributions to the research budget of the EU and to payments to central and eastern Europe for economic development. There is a small budget for security-related spending. The Swiss number is much lower, but I do not have it at my fingertips. It is publicly available as a number.

Lord Haskins: Is the Norwegian per capita contribution not bigger than the existing UK per capita contribution?

Professor Iain Begg: No, it is marginally smaller. However, I noted that Hungary, a country with double the population of Norway, pays more or less the same into the EU budget as Norway does.

Lord Desai: Is the notion of European value added particular to each country? Does each country have a different EVA? It is not an objective concept. Basically, it is what each country thinks it gets out of it.

Professor Iain Begg: Yes. It is certainly in the eye of the beholder. There have been various studies over the years—both the balance of competences review in the UK and studies done for the European Commission, plus a Dutch study on subsidiarity—that have tried to work out what should be done at which level of government. You know the arguments perfectly well. If you cannot internalise the benefits, you will tend to go for the higher level of government, which is the case for transport infrastructure, in some cases, and for some research. Agriculture does not pass the tests, because you would say that these days agriculture is predominantly a distributive policy that should be pushed down to a lower level of competence.

There is plenty of theology on it. Inevitably, in negotiations, someone will come along to you and say, “Yes, agriculture should be at the European level, because it is about security of food. That is a European added value that transcends what is good for individual countries”. Someone else will say, “No, that is nonsense. Food production is purely a local matter”. It is deeply politically motivated.

The Chairman: Dr Benedetto, do you have anything to say on that? We can move on if you do not.

Dr Giacomo Benedetto: Yes. I agree with that. European value added is about value for money, of course, and economies of scale, but it is also about providing something that is much less easy to provide at national

level—for example, the satellite programme or nuclear research, where there are collective gains. When we talk about value added, we are not talking about redistribution. Very often, when we look at the competitiveness heading, in particular, that counts towards national receipts. Sometimes it does not even do that. In the UK, unless the money is remitted directly to the public sector, it may not enter those balance sheets. However, that kind of expenditure provides programmes that would be very difficult to run at a national level.

The Chairman: Lord Skidelsky will close the session.

Q10 **Lord Skidelsky:** We have been discussing access to specific programmes. Could the UK buy access to the single market with budgetary contributions in excess of its contributions to the specific programmes we have been talking about? What is your view on that—payment just to remain in and to have access to the single market, apart from these programmes?

Professor Iain Begg: In essence, that is what the Norwegians do. They contribute an amount that is hypothecated to economic development in central and eastern Europe as, in effect, their club membership fee. That is beyond the net gains that they will get from the research programme in which they are participants.

Lord Skidelsky: Are you in favour of that kind of deal?

Professor Iain Begg: You cannot ignore the particular elephant in this room, which is that the single market is also about free movement. You could say that the arguments around the single market are free movement, market access, the adjudication of the European Court of Justice and the financial one. You have to put all four together when trying to judge whether it makes sense. If you ask me, yes, Britain is better off in the single market, but it has consequences—the European Court of Justice, or something similar, and not having curbs on free movement.

Dr Giacomo Benedetto: I concur with those points. If we are talking about the single market, it is free movement as well. The Swiss have attempted to negotiate something where the agreement would be the single market minus free movement. I am not sure that it has been altogether successful.

Lord Skidelsky: Not successful?

Dr Giacomo Benedetto: There is some discussion in the UK of a customs union or free movement of goods, but in that case services might be excluded. That would be an example of very partial access to the single market, for certain economic goods and not others.

Lord Skidelsky: That would be reflected in a lower per capita contribution. Presumably, the less access you get, the less you need to contribute.

Professor Iain Begg: This goes back to Lord Desai's question—how much of the cake can you have while still eating it?

Lord Desai: If we were to go for a customs union and did not get services, that would affect the City of London.

Professor Iain Begg: Yes. We are told repeatedly that passporting is the big question. It is worth recalling that the British manufacturing sector is now under 10% of GDP.

Lord Desai: Lord Haskins loves it, but the rest of us—

The Chairman: Lord Woolmer has a point.

Lord Woolmer of Leeds: Is there any paper trail or similar on the negotiations when Norway agreed to pay this market access fee? In other words, is there any basis we can look at, on the EU side and the Norwegian side, when they decided how much would be required for the access that they got and, from the Norwegians' point of view, how much they were willing to pay? There is bound to be, somewhere, some discussion that went on.

Professor Iain Begg: I am sure that there is. I know that three or four years ago—or maybe even before that—a 1,000-page tome was written about the relationship between Norway and the EU. I suspect that it would be in that document, but I cannot point you to the page number.

Lord Woolmer of Leeds: Presumably, the Norwegians or the Commission would know what that was. I am never frightened by 1,000-page tomes. In the end, it usually comes down to one or two points of substance.

Professor Iain Begg: All that I can say is that I am sure that it is there somewhere. I do not know exactly where.

Lord Shutt of Greetland: We seem to spend our time interviewing people who tell us that we should hug Europe as tightly as we can. I think that I understand that. However, it seems to me that, the softer the exit—the tighter the hug—the more expensive it becomes. More is paid, but then there is no influence. Given all the hugging and the costs, do you see any benefit of exit—on a budgetary basis alone?

Professor Iain Begg: In evidence to the Treasury Committee of the House of Commons a couple of weeks ago, Robert Chote—

The Chairman: The head of the ONS.

Professor Iain Begg: No, the head of the OBR—the Office for Budget Responsibility. He suggested that the annual cost to the UK public finances would be of the order of £12 billion. The net contribution—I gave you the figures earlier—is less than that. The basis for his calculation was that the UK economy would grow more slowly, or be smaller overall, than otherwise. If you look at it through the lens of UK public finances, even

saving the entire net contribution would make us worse off in public finance terms.

Lord Skidelsky: That is his estimate.

Professor Iain Begg: It is his estimate. It is a forecast and has to be taken with the usual amounts of salt that accompany all forecasts.

Lord Skidelsky: We know about OBR forecasts.

The Chairman: That concludes today's session. The Committee will now meet in private. Thank you so much for coming. It has been very useful.