

Select Committee on the European Union

Financial Affairs Sub-Committee

Corrected oral evidence: Brexit: EU Budget

Wednesday 25 January 2017

3.05 pm

Members present: Baroness Falkner of Margravine (The Chairman); Lord Butler of Brockwell; Lord Desai; Lord Haskins; Baroness Liddell of Coatdyke; Lord Shutt of Greetland; Lord Skidelsky.

Evidence Session No. 8

Heard in Public

Questions 68 - 73

Witness

[I](#): Jonathan Arnott MEP, Member, Budget Committee.

Examination of Witness

Jonathan Arnott MEP.

Q68 **The Chairman:** Thank you for agreeing to give us evidence today for our inquiry into Brexit and the EU budget. This session is on the record and we will take a verbatim transcript of proceedings, which will be published in due course. You will of course have the opportunity to correct any minor errors or misunderstandings. I should say at this point that we understand that you are speaking in a personal capacity and not on behalf of the whole European Parliament. Thank you very much again for coming, Mr Arnott.

I wonder whether we could go straight into your understanding of the legal status of the 2014-20 MFF deal and whether you believe that the UK is legally committed to paying its full share until 2020, even if Brexit takes place before then and the UK ceases to be a member of the European Union.

Jonathan Arnott: Because you are asking me a question about legal status I probably ought to preface any comments on this by making it clear for the record that I am not legally qualified. Therefore, any

evidence that I give to this Committee is as a layperson, even though with my budgetary and budgetary control hats on I have a reasonably good layman's understanding of the issues involved, hopefully.

It seems to me that the MFF regulation has a provision within it for amendment of the MFF in the case of either accession of a new member, which is not the case here, or unforeseen circumstances. There is no specific mention of a member leaving, but there is a question as to whether a member state of the European Union leaving the European Union could be seen as unforeseen circumstances. It is critical here that the withdrawal of a member state is actually very, very rarely considered within the treaties. It is mentioned in Article 50 and in very few other places other than Article 50. It is rarely referred to in regulations or in other parts of European Union law.

It seems to me that, with these questions, you have to go back to Article 50 and at the intent of the MFF. It states that the MFF may be revised with the accession of a member state. It is logically consistent to suppose that, with the withdrawal of a member state, the MFF may also be revised and that that is an unforeseen circumstance. It is very difficult in a lot of ways to define what you mean by an unforeseen circumstance. It is one of those things that is always going to be difficult to define. It reminds me of the elephant test: you know it when you see it. Withdrawal of a member state from the European Union is something that has not happened, unless you consider Greenland. Something that has not happened at any time in the last 40 years is going to be an unforeseen circumstance, as far as the European Union is concerned. It is reasonable under the regulation to consider that that would be an unforeseen circumstance, which leaves open the possibility of revision of the MFF.

Also, you have to compare Article 50 of the Lisbon treaty, which is a treaty and pretty much constitutional in nature, with the regulations saying that the treaty has to take priority. Article 50.3 of the Lisbon treaty states as follows: "The treaties shall cease to apply to the state in question from the date of entry into force of the withdrawal agreement or, failing that, two years after the notification referred to in paragraph 2", and then it goes on to give the exception to that. It seems to me that that must override, in any case, anything within the regulation. If, according to Article 50.3, the treaties no longer apply, then regulations made under it should be considered to no longer apply, as a necessary consequence. Therefore, my personal view would be that the multiannual financial framework does not present a legal requirement for the UK to continue paying until the end of that period to fulfil those obligations. I suppose it should be seen more as medium-term financial plan.

The Chairman: If I can pick you up on the emphasis you have placed on the legal position, which we understood very clearly, given that you have placed such emphasis on defining it as the legal position, do you think we ought to be taking a different approach in political terms?

Jonathan Arnott: I initially placed emphasis on the legal position because your initial question placed emphasis on the legal position. Obviously, when it comes to political negotiations, there will be places in which the United Kingdom considers something to be very strong, as part of its negotiating position, and to be an absolute red line. Now, it seems to me that we are talking about something here that is temporary by definition, which will cover a time period from the date of British withdrawal from the European Union. To pluck a figure out of thin air, given Theresa May's comments, you might consider two years from the end of March 2017 to therefore be the end of March 2019. The period between then and the end of 2020 is something in the order of 21 months. It may be less, it may be more, but we are looking at that rough ballpark.

It is possible that if something very good were offered by the European Union of the kind of deal on other issues that we would wish to see as the United Kingdom, the United Kingdom might be prepared to make a concession with regard to this. You have to do so from the basis of stating that there is no legal obligation to do so, in order for it to be considered a concession in the first place.

Q69 **Lord Haskins:** You have answered my first point. The 21-month gap is the critical period where most of this money is being incurred. We have been given various figures of potential obligations to look at, between €20 billion and €50 billion, but at the end of the day it is going to be cash. Assuming we could not get an agreement, and Mrs May has talked about not getting an agreement, and we had to resort to the WTO deal from March 2019, it would mean higher tariffs on their exports to the UK, higher tariffs on our exports to the EU, and therefore more costs on both sides. Is there not a trade-off between that and the 21-month period that we are talking about? In other words, there is a saving of €10 billion on the budget in one year and the MFF. I do not know the figure; it is a big figure.

Against that, there are additional costs that we would incur as businesses and consumers within this country. Have you given any thought to how that might be worked through?

Jonathan Arnott: I certainly take your point, Lord Haskins, that there is the potential for that 21-month period to be used within the negotiations as some form of trade-off. I am not convinced that the situation is likely to be so bleak from either side, even putting to one side that 21-month period, as to lead to a deal that would merely be trading on WTO terms, with tariffs involved. That would not be in the United Kingdom's interests, but it would not be in the European Union's interests either. My feeling is that while I would consider that this could be used as part of the broader negotiation, I am not convinced that it is required to be used as a bargaining chip specifically on that point, because I do not believe that a bargaining chip will be needed on that point. From both sides, there will be some form of understanding from the start that we are not going to end up with that WTO position. Where we have a bargaining chip, I would

prefer to be using it to try to cash in on something that we are not already expecting to get.

Lord Haskins: You are ruling out a WTO option.

Jonathan Arnott: From my personal perspective, I do not see that the WTO option would be in either the United Kingdom's interests or the European Union's interests. Essentially, a tariff regime would cause the United Kingdom certain problems with our exports. It makes our exports less competitive. That said, as a net importer from the European Union, the tariffs that would be charged on European Union business would then be greater than the tariffs that would be charged on UK business being sold to the European Union. Whether you look at it from the United Kingdom's perspective or from the European Union's perspective, I do not see that that option is likely to be in either party's interests.

I would also refer to Article 8 of the Lisbon treaty, which describes the spirit of neighbourliness and co-operation in which deals should be sought between the European Union and its neighbouring countries. A tariff regime would be perceived as punitive but also, to use the phrase, as cutting off their nose to spite their face.

Q70 **Lord Shutt of Greetland:** What is your view of the European Union's assets? Is it possible that the UK could get a share of those in the break-up?

Jonathan Arnott: The European Union, as of the last consolidated accounts available, those for 2015, had listed €154 billion of assets on the consolidated balance sheet. When we speak of that, there is obviously great variety in what we mean by "assets". Some €57 billion of that is in loans. Indeed, roughly five-sixths of the EU's assets in total are financial assets in one form or another. The obvious ones to mention, which are tangible, would be buildings and land owned by the European Union, which is €8.7 billion of that total. Then of course you have the various points that have been described in the tabloid press under headlines such as "Give us wine, art and property". The less obvious items are the various space satellites and the fixed assets, so we are talking about a very broad range of assets. The United Kingdom could certainly make that pitch.

However, it is notable from the same set of accounts that the European Union notes a liability of €226 billion, which is greater than the amount of assets. If the UK were to pursue a position of going after the European Union's assets, even if we were to consider ourselves entitled to do so, the European Union could then very easily say to us, "Yes, but you also have a share of liabilities". The United Kingdom could end up finding itself in quite a difficult position if it were to push too hard on that one. Certainly if the European Union were to request that the UK pay anything in terms of EU liabilities, the first thing that we would mention in a response is the assets, I would hope.

Lord Butler of Brockwell: When you refer to liabilities, are you

referring to the reste à liquider?

Jonathan Arnott: Yes. The consolidated balance sheet of the EU from 2015 lists pensions and other employee benefits, borrowings, payables, accrued charges and deferred income, and what it describes as “other liabilities”, so broadly yes.

Lord Butler of Brockwell: You mentioned pensions. As we understand it, pensions are a liability of the community. That is a relationship with its employees. Why do you say that the UK might have a liability in respect of pensions after we have ceased to be members?

Jonathan Arnott: I intended to say that the European Union might claim that the UK has a liability, rather than to concede a point. I was saying what I expect the European Union to consider as part of its negotiating position. I feel that it is somewhat difficult here, because you are almost asking me to say what the other side’s negotiating position is going to be in a negotiation. I suppose it would argue that those pension rights have been accrued while the UK was a member of the European Union. It would no doubt then argue that we have a responsibility towards them.

Lord Butler of Brockwell: May I infer that your personal position would not necessarily be that that is valid?

Jonathan Arnott: Indeed, I would certainly seek to take a different position personally in the negotiation. I regret that, as I stated at the start, I am not a lawyer; the legal position on this one could well prove to be very complex indeed. I note, though, in relation to the calculation of European Union assets and liabilities in general, that when a new member state accedes to the European Union there is no question of assets and liabilities. The European Union does not make a payment to that member state because of the liabilities that they are supposedly taking on being greater than the assets that they are supposedly gaining. If this is not a calculation that is made when a member joins, there is certainly an argument that could be made to suggest that this calculation should not be made when a member leaves either.

It is also worth noting on pensions that there are a number of different ways of calculating the UK’s share of any pension rights that are accrued. I note, for example, that although the UK’s gross contribution to the EU budget, after the rebate, is in the order of 12.5% of the total EU budget, the figure for British staff working in the European Union institutions is in the region of 4%. There are 3.8% in the Commission, 4.8% in the Parliament and 3.2% in the Council. Even if the European Union were to push that point, and even if, for whatever reason, that point were conceded, the question then would be whether we would concede that point at 12.5% of the EU’s pension liability or at 4%. Personally, of course, I hope we do not reach the stage where we are conceding such points in negotiation.

Q71 **Lord Desai:** Further to that, what would you think about the UK buying access in particular matters, as Norway and Israel do? We could go for

specific schemes with specific remits, such as Horizon 2020, and just buy that. We would pay for that.

Jonathan Arnott: In my opinion, this is a matter for negotiation, because in any transaction in business the price has to be right. If the access that we are offered comes at a price that affords value for money, there is a point at which it is reasonable for the United Kingdom to accept the deal that is on offer. Particularly in research there are very strong grounds for collaboration, and I am sure across a number of other policy areas as well, but research is the one, to my mind, for which there is perhaps the strongest case.

There is huge discrepancy between the models for which buying access might be applied. You mentioned Norway. In the area of research, Israel also buys into projects, but the difference in the requirements on Israel and Norway, aside from the money they put in, is essentially that the requirements upon Israel are broadly speaking financial; the requirements upon Norway are political as well as financial. For me personally, that area is a red line. If there is something for sale that we can buy that benefits the United Kingdom, I have no objection whatever. If, on the other hand, it requires not fully regaining the sovereignty that we might expect to gain from leaving the European Union, that would be a very different matter altogether. I certainly would not rule out the possibility of buying access to certain schemes if the price was right. I would note, although research is not my personal area of expertise, that Israel receives more back than it puts in. Almost by definition, there is a pretty good deal for Israel when it comes to research.

Finally on that point, the United Kingdom in particular would be a very attractive partner for the European Union. When you look at the lists of the world's top 25 universities, depending on which list you look at, five or six of them are in the United Kingdom. None is in any of the other member states of the European Union. To me, it would be important from the European Union's perspective to do business with the UK. That does not mean that it is not important for the United Kingdom to do business with the European Union. Both are important, but I would simply say that it is important for the European Union as well. We have a very strong hand in the negotiations in this area.

The Chairman: On the universities point, Mr Arnott, you are of course right to say that the United Kingdom is in the top league tables, and almost all the league tables, in much greater numbers than the rest of the EU. That accrues partly to the fact that certain kinds of universities, such as German universities, do not conform to the criteria by which league tables are drawn up. Anyway, I should say that the Ludwig-Maximilians University of Munich is very much in the top 25, as are French and Spanish universities, so there are a few. Did you want to come back on that point?

Jonathan Arnott: For the record, the figures that I looked at today were from the *Times Higher Education*. The top EU university on that list was number 27, but there are clearly different rankings. I concede that there

are different rankings, but I would defend the point I had previously made as being accurate, just as yours no doubt is, according to a different league table.

- Q72 The Chairman:** Let me put a wider point to you, which is that you have spoken extremely clearly to us today but in very transactional terms. The United Kingdom is known for tending to take a transactional attitude towards things. You have spoken in terms of cost-benefit analysis, and we have heard, and it has been said since the 23 June vote again and again by senior EU figures and people from within the institutions, that the point of Article 50 withdrawal from the EU's perspective is that nobody who leaves the European Union should, by virtue of negotiations, end up in a better position than they would be in by remaining a member. In the light of your rather transactional position and the position that membership brings greater benefits than non-membership, would you be prepared to contemplate that in order to have not just the transactional nature of our relationship clarified in the negotiation—you have quoted Article 8 on the spirit of neighbourliness—we should also be good neighbours? In your opinion, should we also attempt, perhaps not on a pure cost-benefit analysis, to extend the hand of greater co-operation, more than a simple money-sharing exercise would dictate?

Jonathan Arnott: When I gave quite a transactional and quasi-legal approach to this in giving evidence my understanding was that I had been asked here as a member of the committee on budgets in the European Parliament and that this Committee sought evidence from me on that basis. For that reason, I have attempted to ensure that my answers cover primarily the transactional side of arrangements. When we look at broader political questions, there will always be a broader political answer. I suppose that, to take a business analogy again, you might very well be trying to get the best deal when negotiating a business deal, but at the same time you very much want to be friends with the person who you are doing business with. I can understand the idea that you do not take a completely legalistic approach to absolutely everything that you do in a negotiation. I completely accept that.

That being said, when you do so, the hand of friendship must be extended in both directions. It can never be used as an excuse for the hand of friendship to be extended on one side but not on the other, so I will accept that that should be the case, provided that it works two ways. I note some of the comments made to the European Parliament Conference of Committee Chairs on 12 January this year. Michel Barnier, the lead negotiator for the Commission, was being questioned and his responses were very much on a transactional basis. I am quite happy for this to be more than a transactional arrangement. Of course we want to be good neighbours, good trading partners and good partners in foreign policy with our neighbours in the European Union post-Brexit, but we must not lose sight of the transactional side of things. We must not allow ourselves to get a bad deal as a result.

- Q73 Lord Butler of Brockwell:** I have one very final short question, because we have very little time. Going back to your saying that it is in neither

side's interest to go to a WTO basis, which I sympathise with, negotiating in between where there are trade agreements in particular sectors is a very complicated business. We are really talking about a UK-EU bespoke trade deal. Do you think it is practicable to negotiate that within the two years after Article 50 is triggered?

Jonathan Arnott: It depends upon the nature of the deal that both sides wish to achieve. If both sides wished to achieve, for example, a deal the nature of which was simply to say that it would be a tariff-free area and there would be zero tariffs on either side, that would be relatively straightforward. However—and this perhaps gets to the nub of the issue of Brexit a little more than we have done as yet today—the European Union might have its own views of what it wishes to achieve and what it wishes to protect.

From a broader perspective, the European Union wishes to protect the integrity of its so-called four freedoms. If the United Kingdom, as it clearly does, wishes to negotiate a deal where there is no free movement of people, the European Union may well respond by saying, "If you do not have the free movement of people, we will not allow you the free movement of services", for example. I suspect that if the political will was there on both sides, it would be very easy to do such a deal with no tariffs. I suspect that the question of how easy it will be to do that deal within the two-year period will depend on the extent to which that political will exists.

I would also suggest that, particularly in relation to the budget, there are issues that the European Union will have as well as the UK in relation to its own financial planning and organisation in the two-year negotiation period. It is not merely an issue for the United Kingdom to ensure that we have very clear planning for what happens when we are about to enter a negotiation period; the European Union will have its own constraints as well. I suspect that both parties will essentially need to try to work out the fundamentals of a deal as early as possible.

The danger is that you have the classic euro fudge, where everything is determined at the 11th hour. The nature of almost everything that I have seen in the European Parliament and that we see throughout most European Union institutions is that deals are often reached a very, very short time before a deadline. The deadline is what causes the deal to happen, because there is a realisation that something has to happen before the absolute deadline. The danger here is that if the broad principles are not ironed out relatively quickly in that negotiating period, if those principles are only agreed towards the end, there could be difficulties towards the end of that two-year period. It will be a case of trying to cram an awful lot into a much shorter period than two years.

The Chairman: Thank you very much, Mr Arnott. It has been really illuminating for us to hear from you and we much appreciate the time you have given us today. This concludes the session.