

European Scrutiny Committee

Oral evidence: [EU Withdrawal](#), HC 763

Monday 5 March 2018

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Members present: Sir William Cash (Chair); Geraint Davies; Mr Marcus Fysh; Kate Green; Kate Hoey; Kelvin Hopkins; Mr David Jones; Darren Jones; Stephen Kinnock; Michael Tomlinson; Dr Philippa Whitford.

Questions 183-239

Witnesses

I: Rt Hon Philip Hammond, Chancellor of the Exchequer, and Mark Bowman, Director-General for International and EU, HM Treasury.

Examination of witnesses

Witnesses: Mr Philip Hammond and Mark Bowman.

Q183 Chair: Welcome, Chancellor. The last time we met in this Committee, which was when you were Foreign Secretary, before Theresa May became Prime Minister and before the referendum vote, we were in very different circumstances. You are now Chancellor of the Exchequer, and a lot of water has passed under a lot of bridges since then, including different positions on the EU as matters have evolved, for example in relation to financial services. I will ask the first question on the topic of financial services.

When the Prime Minister delivered her speech at Mansion House on Friday, she did so with the unanimous endorsement of her Cabinet following their meeting at Chequers the previous week. In her speech, the Prime Minister was clear that any future relations agreement would need to respect UK sovereignty—and Parliament's—to choose whether and how to achieve the same regulatory outcomes in financial services as the EU, and also end the jurisdiction of the Court of Justice specifically in the UK and instead seek mutual recognition and insist on an independent arbitration mechanism—you may have noticed she mentioned that five times in Friday's speech—not involving the European Court of Justice as such.

Assuming that you agree with what she said on those matters, could you please tell the Committee whether you agree that the UK Parliament would have sovereign control at the end of the implementation period to diverge from any EU rules on financial services included in EU retained law? I will give an example, because it is a hot issue these days: MIFID II.

Secondly, what would the Government's approach be if a regulation that could adversely affect the UK and UK financial services—for example, a financial transaction tax brought in as a regulation—was proposed that could apply to the UK during the implementation period? Those are the two questions given the general thrust of what she said in her speech about sovereignty, the judiciary and mutual recognition.

Philip Hammond: Thank you, Chairman; it is a pleasure to be here. First, for the record, you may assume that I completely agree with what the Prime Minister said on Friday.

Let us deal with the first question first. Obviously and clearly, Parliament is sovereign and Parliament will ultimately be the arbiter of all decisions that we make in relation to our future arrangements with the European Union. But we also have to contemplate that Parliament may choose, in any area, to agree arrangements that are of an enduring nature—where rules are set down for the way in which we will operate together, whether that is through a treaty or some subordinate agreement. We would not



HOUSE OF COMMONS

necessarily be making parliamentary decisions on each individual case. We may decide a framework within which to operate, but that would always be subject to Parliament deciding to change its mind and to revoke those arrangements. It is a key feature of our constitutional arrangements that no Parliament can bind its successors, and I think our EU interlocutors understand that, and that the concept of parliamentary sovereignty is embodied in that very important principle.

Q184 Chair: Consider the possibility of a proposed regulation, such as a financial transaction tax for example—just to remind you of my second question. If that were to be introduced by the EU during the next few years—I am talking about the implementation period—would you regard that as something we would have to reject? After all, we have said categorically that we are not in favour of a financial transaction tax, but there is nothing on the face of it to prevent the EU from bringing in something like that. I do not just mean a financial transaction tax—there are problems regarding regulations, as I am sure Mr Bowman would be happy to confirm.

Philip Hammond: Tax is a reserved matter for the member states, and not just the UK but many other member states have very strong views and guard jealously their control over taxation decisions. If we look more widely—I think the question you are asking is: if regulations or rules were introduced during the transition period that perhaps we did not like, would we be required to implement them? We think we have very good visibility of the pipeline of potential legislation, and in this case, the relatively slow pace at which the EU sausage machine grinds works in our favour.

We are talking about a transition period and implementation period of around two years from the time we cease to take part as a participant in decision making. As a matter of fact, during the course of 2019, quite a lot of the EU decision-making apparatus will be in a state of suspended animation during a period of European elections and the formation of the new Commission, the election of President and so on. We think it quite unlikely that we will be presented with legislative proposals that come into force during the intended implementation period, and of which we are completely unsighted and have not had an opportunity to comment on and help to shape during our membership.

As the Secretary of State for Exiting the European Union said—I am sure he will say this to you again when he comes before you tomorrow—one issue that we are seeking to clarify for the implementation period is a good-faith assurance that short-cut processes won't be adopted to fast-track legislation that would clearly be discriminatory against us during this period. That I think is the only real, serious risk faced, and we think that the current duty of sincere co-operation would preclude such a course of action. Getting some kind of commitment that was similar for the implementation period would give us the protection that we would like.

Mark Bowman: On the specifics of the financial transactions tax, it is worth remembering that this has been discussed for a long time in Europe, and discussions have not got very far. Secondly, the discussions that have

been ongoing have been in the context of enhanced co-operation, which is just a subset of member states.

Chair: That is fair enough. I didn't focus just on FTT because there are other regulations that can be brought in, and they are pretty draconian when they are. I hear what the Chancellor says, and it is possible that he is right and that they won't jump us. But if they do, we must be aware that the nature of that kind of legal binding instrument can be extremely problematic.

Just to polish off, I note on page 11 of what the Prime Minister said in her speech that it would be "unrealistic" for us to implement new EU legislation automatically and in its entirety. I thought what she said there covered the situation well.

We now turn to the question of the financial settlement.

Q185 **Kelvin Hopkins:** The existing financial settlement was agreed in December. At that time, the Government said that the central estimate for the net cost to the UK was between £35 billion and £39 billion. What are the high and low estimates of the cost? They could well be outside those figures.

Mr Hammond: I will ask Mark Bowman, who led on the negotiation of this, to answer in detail. While it is clear that we have agreed a set of principles that will allow the settlement to be defined, and we can make a reasonable estimate of what the total amount is likely to be—it is made up of specific components—of course there is always scope for movement at the margins, but we think that £35 billion to £39 billion is a realistic range within which the outcome will fall, given the detailed set of agreements we have reached with the EU about how the settlement will be calculated.

Mark, do you want to give more detail?

Mark Bowman: The first point, which we have always been clear on, is that it is impossible to put a definitive number on the settlement. When we agreed the financial settlement in December, one of the important principles we secured was that we will only pay for things if they are based on out-turns. So we will meet commitments made during the period of our membership, but in Europe, as in other budgetary systems, not all commitments turn into spending. So we will only pay for things based on out-turn data, and we will not know that out-turn data until well into the future. So it is impossible to put a definitive number on the settlement, but we have set out that we think £35 billion to £39 billion is a reasonable estimate.

Q186 **Kelvin Hopkins:** Can I just press you on that? That is described as a central estimate, which implies that there might be wider variation than in that central estimate. The high figure could be considerably higher than £39 billion.

Mark Bowman: It is probably useful to give you a little bit of detail on the individual components of the settlement. There are three broad



HOUSE OF COMMONS

components to the settlement, and this all flows from the commitments that the Prime Minister made in the Florence speech last autumn. First is the commitment to contribute to the budgets in 2019 and 2020. Secondly, the commitment to meet outstanding budgetary commitments that exist at the end of 2020—the so-called RAL, *reste à liquider*. Thirdly, a commitment to pay our share of liabilities after taking into account the corresponding assets.

In terms of the first two components—the 2019-20 contributions and the share of the RAL—one very important thing to understand is that these amounts are limited by the current MFF agreement. The MFF agreement sets the budget for the full seven years—2019 and 2020 are the final two years of that budgetary process—and sets a ceiling for the total size of the budget and, therefore, by definition, the commitments that can be made under that. In the agreement in December, we secured a commitment: to the extent that the MFF regulations or the “own resources decision”—the mechanism by which the UK’s contribution is determined—change during the implementation period, we will be protected from any of those changes in terms of the financial contributions we will make. So on those two parts of the settlement the range of possibilities is very much constrained by the total MFF ceiling.

Q187 Chair: I want to pursue that a little bit. We were advised that it would be very problematic. If, under the statement put out by the Government about the dates, we were to go beyond 31 December 2020, we would fall into a multiannual financial framework for the following year and then we would get trapped. What you are telling me seems to be in line with another question which might be asked, which is: in the light of what you said about the discussions you had, would you be expecting to add the budgetary provisions of the treaties to the annex that lists EU law from which the UK will be exempt? That might be a way of tying it right down.

Mr Hammond: If I may answer that question in a slightly different way, we are clear that if there were a question about extending the implementation period beyond the end of the MFF, that could not be by way of Britain’s participating in the next MFF. That would create all sorts of potential problems and, conceivably, long-tail liabilities, which we would not be prepared to take on. If we were to entertain that possibility—we have not responded to the Commission’s proposal that 31 December 2020 should be the end of the implementation period—of an extension into the next MFF, that would be on the basis of a negotiated arrangement about any financial implications of that. It would not be by way of the UK’s adhering to and participating in the next MFF.

Chair: That, if I may say so, is extremely helpful.

Q188 Geraint Davies: Chancellor, the last time you were before this Committee as Foreign Secretary, I asked you what economic evaluation had been made about the idea of old age pensioners living in Spain, who were mostly drawing health services, coming back to Britain in exchange for Polish taxpayers going back to Poland. You said, “No evaluation has been made of any economic outcomes, because we do not anticipate



HOUSE OF COMMONS

leaving the EU.” I ask you now, given that the divorce bill is likely to be up to £39 billion and given that the Treasury has said that we are likely to lose something like £45 billion a year in tax receipts, whether it is not the case that the British people were offered to have their cake and Brexit, and that you are now telling them that they will have only half the cake and Brexit. In which case, shouldn’t they be given a vote on the final deal in your view?

Mr Hammond: I am not sure where those numbers are coming from. I do not think they are Treasury numbers; they are certainly not recent Treasury numbers.

Q189 **Geraint Davies:** What is your Treasury figure for the annual loss of tax receipts from hard Brexit?

Mr Hammond: We have made it clear that the Treasury and other Departments across Whitehall will carry out analysis in support of the negotiation process. We have also made it clear that we do not believe it would be in the national interest for us to place that analysis in the public domain. This is support for our negotiators and, clearly, placing it in the public domain here would make it freely available to our interlocutors on the other side of the negotiating table.

Q190 **Geraint Davies:** But you do agree that there will be a considerable loss of tax receipts. The *Financial Times* puts the figure at £350 million a week—coincidentally the same as the Foreign Secretary said we would get for the NHS. Given that at the time the Foreign Secretary—your successor—said he was in favour of a single market, don’t you feel, given that the terms of reference have changed in terms of the cost and not having access to the single market, that the final deal should be put to the British people?

Mr Hammond: No, I do not think that is right. The referendum decision has been made and, as a Parliament and a Government, we now have to take it forward and deliver it in the best way we can to get the very best deal we possibly can.

On the figures, you are aware—I have been clear with the Treasury Committee, and this has since become widely known publicly—that a computable general equilibrium model has been built across Whitehall to be used as a tool to support these negotiations. But as with any economic model, what comes out the bottom will depend on what you pour in the top by way of assumptions. We have not yet had any concrete proposals about what a negotiated future relationship might look like to test against that model. As the negotiations progress, we will use that model to test things like the impact on fiscal revenues, the impact on trade balances and the impact on regional economies.

Q191 **Geraint Davies:** Finally, you would accept that now, today, as opposed to in the future, the LSE says that inflation is 2.7% instead of 1.7%—a percentage point higher—and workers are losing about a week’s pay a year because of that, and the *Financial Times* says that we are losing £350 million of Government revenue that we would have had had we not



HOUSE OF COMMONS

voted to leave? So those impacts are known. Do you think there is any limit to the costs we should pay to leave Europe without the British people having a final say?

Mr Hammond: I do not accept that that analysis can be robust. Sorry, I misunderstood you before. I think what you are saying now is that we are actually today incurring a fiscal cost—

Geraint Davies: We are.

Mr Hammond: As a result of the decision made. I think it is impossible to make that statement and to back it up with any evidence. I certainly have not seen any clear evidence that would support that statement.

Q192 **Kelvin Hopkins:** Would the UK rebate be protected for any contributions from January 2021 onwards, as it will be for the UK's contributions until the end of 2020?

Mr Hammond: This goes back to the point I have already made—that anything beyond the end of the current MFF would be the subject of a negotiation. It would not be based on our share of MFF or anything like that; it would be based on a straightforward negotiation.

Mark Bowman: Can I add to that? The financial settlement agreed in December accommodates an implementation period up to the end of 2020. As the Chancellor has made clear, if that were to be longer, there would have to be a negotiation. I don't think there is any interest in terms of the UK being in the next MFF period, and actually I don't think there is any appetite from the Brussels side for the UK to be in the next MFF period.

Q193 **Kelvin Hopkins:** If I may, I will just ask a left-field question—an appropriate term, that.

Mr Hammond: Absolutely.

Kelvin Hopkins: Is it made clear to the negotiating team on the other side that we effectively donate over £100 billion a year to the EU if you take account of our trade deficit, our budget net contribution and the outward financial flows from remittances by EU citizens and payments to British citizens abroad? All that adds up to over £100 billion a year. Is our generosity recorded?

Mr Hammond: I do not know of an economic model that would allow the conflation of net financial flows with trade surpluses and deficits, I'm afraid. I am not sure that that is a robust methodology.

Q194 **Kelvin Hopkins:** But the reality is that £100 billion more goes out than comes in.

Mr Hammond: It makes a good headline in a tabloid newspaper maybe—

Kelvin Hopkins: I think £100 billion is a lot of money.

Mr Hammond: —but I am not sure it is terribly robust.

Chair: Thank you, Kelvin. We now move on to the Ireland section of the December joint report.

Q195 **Stephen Kinnock:** Good afternoon, Chancellor. I want to turn to paragraph 49 of the joint progress report. As you will know, of course, it confirmed that all parties to the negotiation agreed that full regulatory alignment would be the fall-back position for dealing with the issue of the Northern Ireland border. Then we have seen the ensuing draft legal text that has been produced by the Commission, which really just codifies what was agreed in the joint progress report. But that legal text has been met by much huffing and puffing from the Prime Minister and other members of the Government. Can you explain why what is apparently just a conversion into legalese of what was agreed in December has created such an adverse reaction?

Mr Hammond: I do not think it does just convert into legal text what is contained in paragraph 49. Paragraph 49 does indeed say that “the UK will maintain full alignment with those rules of the Internal Market and the Customs Union which, now or in the future, support North-South cooperation, the all-Ireland economy and the protection of the 1998 Agreement.” We do not agree with the approach that the Commission has taken in seeking to further define that commitment, in a way that crosses a red line that I believe would be the red line of any UK Prime Minister, any UK Government, because it seeks to present the fall-back option in a way that would undermine the constitutional settlement that exists in the United Kingdom.

Q196 **Stephen Kinnock:** But is not the legal text simply saying that full regulatory alignment between the European Union and the UK post-Brexit will mean just that: common product standards and the basis of what we have now as a customs union? Can you help the Committee to understand what the problem is? What is the difference between the two?

Mr Hammond: As I have understood the Commission’s legal text, it does not say that. It says that this commitment in article 49 would be delivered in a specific way. That is a way that would create a border down the Irish sea, which we have said from the outset would be unacceptable, and I believe it would be unacceptable to the overwhelming majority of Members of Parliament.

Q197 **Stephen Kinnock:** Thank you. Two weeks ago, Brexit Minister Robin Walker said that the fall-back option for resolving the Irish border issue does not actually mean full alignment, but would be outcomes-based, rather than necessarily based on rule taking. How is it possible to have an outcome if you do not have agreement on the input? As you just said in an answer to my colleague, we get out of the bottom what we put into the top. If we are to have this outcome, surely we have to have full regulatory alignment as the input.

Mr Hammond: No. It is quite possible to envisage situations where there is more than one way to deliver the same outcome. In some areas it may be that alignment of regulatory method is considered important, but in many areas we believe that achieving a similar outcome is what is really

required to create the level playing field for an open market and free and fair trade across international borders.

Q198 Stephen Kinnock: You have a background in business yourself, Chancellor. Do you not think that there is a risk that we are getting into this Kafkaesque mess of aligning with some things and not with others—a hotch-potch of three baskets and outcomes not being the same as inputs? For the British business community, isn't this looking like a bureaucratic nightmare?

Mr Hammond: No. I think you could make it sound a lot more complex than it is, but the key thing to remember is that we will be starting from a situation of de facto alignment in every sense. Outcomes, inputs, rules and regulations will be aligned on day one, so the only question of any misalignments arising is where we, Parliament, have deliberately decided to take action to create divergence. As the Prime Minister said on Friday, depending on the details of the agreement we reach with the European Union, if Parliament makes such a decision, it would do so in the full knowledge and understanding of what the consequences of such a decision would be. It would be for us, collectively, to have a debate about the benefits and the disbenefits of any such course of action.

What is important for many people is the principle that Parliament will be the sovereign decision maker. Parliament will decide. Parliament is perfectly capable of weighing up the costs and benefits in any given situation and deciding whether to act to create divergence or not. The important thing is that Parliament has the power to do that, should it choose.

Q199 Mr David Jones: Article 49 of the joint report caused quite a stir back in December when it was first published. I think it is fair to say that the legal translation that was published last week created even more of a stir. What would the Government's legal translation of article 49 look like in respect of the third option—the so-called alignment option?

Mr Hammond: First, let me emphasise the point that you have implicitly made: it is the third option. It is very much a fall-back position, and we are very clear that no one is looking for plan C. Everybody is looking for plan A, and the Prime Minister agreed with the Taoiseach just recently that we will work very closely with Irish and Commission counterparts to develop our thinking around plan A. The Government has not proposed a draft legal text for the fall-back plan C position. It is not clear to us that at this stage we need to go further than we have gone in paragraph 49 of the joint report. Of course, in due course it will be necessary to produce draft legal texts for Parliament and the European Parliament to consider, but we hope that over the next weeks and months we will make progress in developing plan A in a way that reduces the salience of this issue.

Q200 Mr David Jones: So is it the case that the Government does not intend to produce its own legal draft of the withdrawal agreement at this stage?

Mr Hammond: At this stage we are not planning to do that ahead of the March European Council.

Q201 **Mr David Jones:** Will you have one ready in time for that Council?

Mr Hammond: I said we are not planning to do that ahead of the March European Council.

Q202 **Mr David Jones:** So the only draft that will be worked to is the draft that has been produced by the European Commission.

Mr Hammond: The European Commission, as you know, has produced a draft legal text. It is not a complete legal text: there are gaps in it. We have not received that formally yet. It has circulated it to the other 27 member states for comments. We expect to receive something formally from the Commission probably later this week. We will respond to it—we will comment on it—but we certainly do not expect to be delivering an alternative legal text ahead of the March European Council.

Q203 **Mr David Jones:** Presumably, however, where there are clauses on which you have a great difference, you will be producing your own text.

Mr Hammond: If we feel that producing an alternative text is the best way forward, we could certainly look to do that, but the Prime Minister, in relation to the Commission's interpretation of paragraph 49 of the joint report, has made clear that she thinks the approach they have taken is fundamentally flawed, in that it crosses a red line that we have always been very clear about.

Q204 **Mr David Jones:** But nevertheless, it does actually address a provision of the joint report, which was of course agreed by the two parties.

Mr Hammond: Our view is that the text the Commission has circulated to the 27 member states goes further than was set out in paragraph 49. It is more explicit as to how we should go about meeting the obligations in paragraph 49 than paragraph 49 is itself.

Mark Bowman: On the question of legal texts, I just want to say something about the bit that I am most involved with, which is the financial settlement, where clearly we are engaged with the Commission in terms of turning the joint report into a legal text. We do not think it is necessarily sensible to have competing texts, but we are engaged in very serious dialogue and we will be in Brussels later this week. As it happens, we do not think that there are significant differences of opinion on the legal text that they produced, but we will be sitting down in a very serious process to understand how exactly they are translating the agreement we came to in December into a legal text. This is a complicated area with lots of references to various bits of EU law. Our lawyers will be all over this, and we will hopefully be having a constructive dialogue, because we have a shared objective of ensuring that we accurately reflect what was agreed in December.

Q205 **Chair:** If I may say so, we are all over it, too. One of the points I want to make about this is that—this is something that has been accumulating like dark clouds over these negotiations—the EU seems to think that it has the right to lay down the terms and then we have to respond to it. Furthermore, it does not seem to have got the message that article 50 is



HOUSE OF COMMONS

actually a complete change in the nature of the constitution of the European Union itself. It changed the European Union—but leave that aside for the moment, because we will be pursuing that later.

One point about this legal draft text is terribly simple, and it is this: it is a hybrid; it is scattered with provisions which assume we are a third country, and, as you will have noticed with your expertise, it also refers to us as if we are a member state. It is neither one thing nor the other. If that is not cherry-picking, I would like to know what is. Do you have a comment on that?

Mark Bowman: I am not sure exactly which bits of the legal text you are referring to—

Chair: I am talking about the whole thing—

Mark Bowman: But it is trying to do two things. It is trying to cover the implementation period but also the period after the implementation period.

Q206 **Chair:** But it is not an EU treaty. Is it an international agreement? Is it meant to be?

Mark Bowman: It is an international agreement.

Chair: Let's come back to that one, because we are pursuing that with our legal advisers.

Q207 **Kate Hoey:** Chancellor, thank you for one thing: when you came before us last time, I told you that you were talking about Britain when you should have been talking about the United Kingdom. I have been watching, and you have got a lot better with your language.

Mr Hammond: I've got the message.

Q208 **Kate Hoey:** It is even more important these days—it is the United Kingdom.

The border between Northern Ireland and the Irish Republic has already got lots of differences, such as currency, excise duties and other tax rates. About six months ago, HMRC said there was no issue really about not having a hard border both here and in the Republic of Ireland, and yet over the last month or two it has suddenly become a huge issue, and all these people who never took any interest in Northern Ireland are now jumping up and down.

Do you not feel that, if the Irish Government really wanted this to work, they should be getting together with the British Government and the officials on either side and looking at the technology and some of the things said about it? Even the European Parliament's own constitutional committee said it could work. There seems to be something stopping that. Indeed, even today or yesterday, in response to the Prime Minister saying that the three—the EU, the Irish Government and British Government—had all been working on this, it was implied that it was really up to the EU; the Irish Government are seeing themselves very much as part of the EU and not as the Irish Government working with us.



HOUSE OF COMMONS

Do you find that a bit disappointing?

Mr Hammond: To deal with the first part, there is at the moment an excise border in the island of Ireland but no customs border. That is the difference that we will face once we are no longer members of the European Union. There will be a customs border there, and that does create new challenges. We are working very effectively with the Irish Government. Indeed, my counterpart, the Irish Finance Minister, was here this morning and we have had a very constructive meeting. As I said earlier, the Prime Minister agreed with the Taoiseach that working-level discussions would progress now to try to put some flesh on the bones of plan A, as we described it.

But it is not the case that the Republic of Ireland is able to operate bilaterally with the UK. This is an EU competence. The common external border of the European Union is a matter for the Commission under the treaties.

Q209 **Kate Hoey:** I am aware of that, Chancellor—we all are. But even if they do not want to be publicly helpful, could they be more helpful behind the scenes?

Mr Hammond: No. Let me say publicly that I do not think that Irish Republic could be more helpful than it is already being, given the constraints that it has of being a continuing member of the European Union and having to respect the respective competences of the member states and the Commission. So, actually, in practice we have a very pragmatic working relationship between the UK, the Republic of Ireland and the Commission in trying to move this forward.

It is probably worth remembering that Michel Barnier—although he is now in the role that he is—in the past had a very significant personal role in developing the EU's supportive agenda to the peace settlement in Northern Ireland, and I am sure he feels a very close attachment to trying to protect the gains we have made over the last 20 years.

Q210 **Kate Hoey:** Indeed, and when the Northern Ireland Affairs Committee went to see him, he actually said he was sure it could be sorted. So are you feeling optimistic that we might not have to even think about legal requirements and alignment documents and plan C; plan A should be able to work?

Mr Hammond: We have set out two options. The first one—the one we very much prefer—is trying to resolve the challenges at the Irish border in the context of a wider settlement with the European Union. It is easy to forget this, with the focus on the Irish border, but we also have the big challenge at Dover-Calais, which is our most important import gateway. For different reasons—nothing to do with constitutional settlements and peace agreements, but for purely practical logistic reasons, we also need a very free-flowing border at Dover-Calais. As we seek solutions with the European Union, including technology-based solutions, to achieve that



HOUSE OF COMMONS

objective—that lorries coming off the ferry from Calais can roll straight through Dover and vice versa, which has to be our objective—we expect that we will find in that solution the basis for a working solution on the Irish border as well.

Q211 **Kate Hoey:** That sounds very sensible. Just one final point: have you found out who leaked those gloom and doom documents a few weeks ago?

Mr Hammond: The cross-Government economists' analysis?

Kate Hoey: Yes.

Mr Hammond: The Cabinet Secretary—

Kate Hoey: Leaked them?

Mr Hammond: No, the Cabinet Secretary is carrying out an investigation, as always happens when unauthorised leaks of documents occur. I have not heard that he has reached any conclusions yet.

Q212 **Darren Jones:** I was amazed to see on the list how much stuff needs to happen at a customs border, from collection of duties and VAT to security checks to consumer checks to cytosanitary health and safety checks, and on and on. One of the suggestions that has been made—I think it was by Robin Walker—to this Committee last week was that to avoid a border between Northern Ireland and Ireland those border checks could be done outside of the isle of Ireland.

I noted that you talk about Dover and Calais. I represent Bristol North West, which, along with Liverpool, is home to the second largest western-facing port. There are huge amounts of import and export: 600,000 cars every year, and millions of tonnes of liquid and raw materials. If there are any delays in Avonmouth at the Bristol port it will cause gridlock in my constituency. I just wondered whether you know anything further about the potential of moving the border out of Ireland but having a border somewhere else on the English isle.

Mr Hammond: As I understand the comments Robin Walker made, he was talking about using in-depth controls to avoid checks at the border or associated infrastructure at the border, very much in the same way that the excise border in Ireland is managed now, where intelligence-led policing between the Garda and the PSNI means that checks are not made at the border but commercial-scale smuggling of excisable goods is still addressed through intelligence-led policing. That may be by raids on addresses in Belfast, Dublin or any points in between, but not by a process of stopping and checking vehicles at the border.

Q213 **Darren Jones:** And this quite long list: are you confident that for all of these things, at a border, in-depth checks such as that are sufficient to fulfil all of those? How do cytosanitary, veterinary and hygiene controls get done in raids?



HOUSE OF COMMONS

Mr Hammond: Phytosanitary controls, you might be surprised to learn, are largely done by local authorities at ports. In fact local authorities have a very large role in a number of the regulatory controls at ports. HMRC, of course, and Border Force, are also heavily involved. We are acutely aware of the very large range of checks that need to be made. I think it is just important to distinguish between containerised traffic—you talked about the port of Bristol; as far as I am aware the port of Bristol is not a ro-ro port. The real challenge, here, is with roll-on roll-off traffic, where the need is to get the vehicles out of the ports immediately. Containerised traffic, where there is usually a dwell of a day or two, and whether it is a day or two or three or four probably does not make a huge difference, is very different from ro-ro traffic, where it is of the essence of the business model that the traffic needs to move pretty much straight through without any significant delay.

Q214 **Darren Jones:** I would suggest that if you speak to people that work in the port, or indeed businesses in the region that rely on import and export—especially for just-in-time manufacturing—moving from one to two days to three to four days actually makes huge amounts of difference for them. My final question: you have talked about the role of local authorities and others in being able to provide these checks. Have you made an estimate of how much extra money you will give them in order to do this extra work?

Mr Hammond: As you know, we have set aside the sum of £3 billion for Brexit-related work over the next two years. Obviously, if there is a significant increase in the amount of phytosanitary and other checks that have to be carried out at the border, local authorities will need to be resourced to do that. Some of this is recovered by fees payable by importers. In fact, I think most of it is recovered by fees payable by importers, but obviously that will be reflected in increased costs to consumers.

Q215 **Mr David Jones:** On the issue of resources that you have just mentioned, in the Budget you set aside £3 billion to resource presumably not only local authorities but Customs and Excise and other bodies that might need resourcing in the run-up to Brexit. How much of that money has been spent?

Mr Hammond: To date, we have spent about £700 million. The £3 billion was for 2018-19 and 2019-20, and I expect to announce shortly the allocation of funding from the 2018-19 share of that money to individual Departments and bodies.

Q216 **Mr David Jones:** Is that money being spent on what might be potentially aborted matters, if for example we were to strike an agreement with the EU?

Mr Hammond: Yes, it is being spent on ensuring that we are prepared for a full range of outcomes. Some of it is being spent on preparations for a no deal exit in March 2019. Clearly, we will make this money available to Departments on the basis that we will continually review the situation. They have to get on with this now because obviously there is limited time,



HOUSE OF COMMONS

but as and when it becomes clear that we can discount as any reasonably likely outcome any of the options—for example, once we reach an implementation period deal—I would expect that we would then be able to stand down planning for a no deal exit in 2019. We may very well have to continue with planning for a no deal exit at the end of the implementation period as a contingency, but we will make sure that we are not spending money on outcomes that have been effectively ruled out at any stage.

Q217 Michael Tomlinson: Chancellor, you were asked earlier about a fallback option and earlier on in the Chamber the Prime Minister set out two possible customs arrangements: first, a customs partnership, and secondly, a highly streamlined arrangement. You have already mentioned technology and the like. I would be interested to know your assessment of either the customs partnership or the highly streamlined arrangement? Do you have a preference? Also, what about the technology angle?

Mr Hammond: Both involve the application of technology and both have advantages and disadvantages. You are well aware that we have a series of objectives and outcomes that we are trying to achieve, and different outcomes are more or less favoured by each of those models. We are working now. We have got external consultants working on these models for HMRC. This is a work in progress. We are actively developing the models and looking at how we can refine them and their impact on our desired deliverables.

Q218 Michael Tomlinson: From that answer, you have no preference as to either. You say they are both options and you are exploring both, but there is not an (a) this is the first priority and (b) this is the second priority. You think both are perfectly viable.

Mr Hammond: We do not have all the information that would be needed to make a definitive ranking between the two at the moment. We are investing in more work to understand better what the two different options would mean in practice.

One very important point I ought to make is that, of course, in either of those options there will be a requirement for agreement with the European Union; neither of them are things that we can do unilaterally. Both of them would require the EU to make some adjustments to its way of doing business at the border, so it has got to be a collaborative approach.

Q219 Dr Whitford: Chancellor, I assume that you recognise and accept the concern of people on both sides of the border about infrastructure. I mean, there has been a lot of discussion as if technology—number plate recognition etc.—at the border solves it. But like many in the north, having lost family to the Troubles, I know that simply a camera on a pole ends up being a defended camera on a pole, which could end up being a patrolled, defended camera on a pole. Is that clear within Government here—the concerns about infrastructure?

Mr Hammond: Yes. To reassure you, in the late 1970s I crossed that border twice a week every week, and I am exactly familiar with what any



HOUSE OF COMMONS

infrastructure at the border would mean, and we are absolutely clear that we are not going back there.

Q220 Dr Whitford: Okay. Do you recognise how unhelpful people on the island of Ireland have found comments that have emanated from senior people within this building, talking about the Good Friday agreement needing to be scrapped, when, after 30 years of people dying—not just in Northern Ireland but people here, people just outside this building, people in Brighton, in Birmingham, etc. losing their lives—to hear this flippancy of, you know, “We want that tidied out of the way”? That does not create a good atmosphere to try and get solutions.

Mr Hammond: I hope people pay attention to the statements that the Prime Minister makes as the definitive position of the Government. The Prime Minister could not have been clearer that we are committed to the Good Friday agreement and we are committed to no infrastructure at the border. We do not regard these as constraints upon us. We regard them as commitments freely made by us as part of our ongoing engagement in the peace settlement in Ireland, which has delivered so much over the last 20 years. So, I would advise those people, if they are tempted to listen to others, to focus on what the Prime Minister has said very clearly and unambiguously.

Q221 Dr Whitford: May I ask about a couple of suggestions that have been made? One is that small businesses would simply be excluded and that in the UK doing trade deals elsewhere, and perhaps having almost two classes of imports—things imported for the EU and things imported for the UK—takes you back to the kind of excise for different strengths of alcohol and different levels of quality? Do not both of those increase the risk of smuggling at that border, if small players are simply not expected to be part of any system? And if the UK is importing goods, some of which are at a high standard—premium goods marked for the EU in some fashion—and others are things we have decided, because of a free trade deal, perhaps with America, that we are going to accept, there will actually be a real danger because we will have two streams of qualities of goods, which would make things more complex?

Mr Hammond: First, on the question of small traders, what is understood here is that, for example, tradesmen—the local plumber—may live on one side of the border but service clients on the other side of the border. It would clearly be absurd to try to impose some kind of border control on somebody like that, or ask them to account for different levels of tax on a piece of copper pipe that they were moving across the border in the course of their trade. So I think this is a pragmatic suggestion for dealing with what is economically insignificant but very important socially and politically—

Q222 Dr Whitford: The challenge then would be defining the cut-off point.

Mr Hammond: But of course, as in all such matters, there will be those who seek to exploit any concession that is made, and that is where intelligence-led policing will come in.



HOUSE OF COMMONS

I will just come to the second part of your question, which I think refers to the proposed hybrid option—the new customs partnership. It would not work quite like that. The intention is that the UK would act as the customs agent for the European Union, collecting European Union-level tariffs on goods imported into the UK, with those tariffs being rebated to the importer once it could be certified that their place of final destination was the United Kingdom. Everything would be levied at the higher level of tariff on entry, and it would then be rebated domestically.

Q223 Dr Whitford: Even if the UK had a free trade deal with, say, America, and was bringing in food or beef or whatever that the EU did not accept?

Mr Hammond: That would be the implication of such an arrangement—that an agreement with a third country to allow tariff-free access under such a hybrid arrangement would require a tariff to be paid on import that was then reclaimed and recovered. In a way that importers are familiar with, there would be a system quite possibly involving deferment for trusted traders.

Q224 Dr Whitford: You do not think there is a danger of having those two quality streams of people looking to—

Mr Hammond: You are perhaps implying a second question there, which is not about tariffs at all but regulations on goods quality.

Q225 Dr Whitford: Yes, it was more about the control of goods.

Mr Hammond: That is a separate issue. Of course, the proposal on the new customs partnership is a proposal around customs arrangements. There would also be a requirement to look at what levels of regulatory alignment were required to make that work.

Q226 Kate Green: In your earlier answer to Stephen Kinnock, you said that if there were a need to pursue the option of regulatory alignment, we would be starting from alignment now. It would only be if this Parliament, with its eyes wide open, chose to change things that we would put those arrangements in jeopardy, with potential consequences for the Irish border.

However, at the same time, as we move forward, the EU will presumably make ongoing changes to its rules, while we may wish to stand still with the nature of the rules that exist now. Are you concerned that the very strong assurances that you gave about the Government's view on keeping the border open today might be difficult to sustain—or at least that it might be difficult for the Government to make that assertion so confidently in the future?

Mr Hammond: In negotiating and agreeing those wider arrangements, we will always have to have sight of the commitment around the Irish border, and we will have to ensure that the arrangements that we have in place for the Irish border will be compatible with the wider arrangements that we have in place with the EU more generally.

Q227 Kate Green: Some of your answers have talked about the need for



HOUSE OF COMMONS

making progress. You have talked about the money allocated by the Government for preparatory and negotiating arrangements. Are you confident that the Government overall have the capacity to deliver the arrangements and agreements that will be needed in the time that we have at our disposal, not just in terms of the money you are able to put into that, but the actual thinking capacity, the number of people and the complexity with which they are faced?

Mr Hammond: You are right to identify that. This is too often talked about as if it were just a problem of money. It is actually a problem of real resources: skills, programme managers and project managers across Whitehall. It is a question of prioritisation within Departments but also across Departments. There is an exercise, co-ordinated by the Cabinet Office and DExEU, to ensure that appropriate resources are made available to the Departments that have the biggest needs. That will mean some reprioritisation across Whitehall and some people moving between Departments to ensure that we deal with the pressing needs of this project with the priority that they need.

Q228 Geraint Davies: The Institute of Export and International Trade said that, if the UK is outside the single market and customs union, they and we will need something like 360 million different import and export documents linked to the different products, which would require an extra 10,000 to 30,000 administrators. You have mentioned some of the investment put in on the public sector side, but do you not accept that there is an enormous cost—logistical and in terms of time burden on business—to being able to adapt to that extra complexity? What do you think the impact will be on business and consumer prices?

Mr Hammond: The figure of 350 million, I think, is the HMRC estimate of the number of customs declarations that will need to be made if we assume no new facilitations and assume that every consignment coming from and going to the EU will be treated in the same way as a third country consignment is now. That will represent an additional cost to business; there are no two ways about that.

Q229 Geraint Davies: You have spoken about the £3 billion. Is there any parallel figure for business in terms of how much you think it will cost them to adapt to that?

Mr Hammond: The answer depends very much on how we do these things. We are moving into a world where customs documentation and procedures are increasingly digital. In a sensible world, declarations manifests would be lodged while the vehicle was on the road, the vehicle would be identified and matched with its manifest electronically at the port, and there might not be a need for any physical process at all. That would require good levels of co-operation between the customs authorities on both sides of a border. That is part of the work we are doing now, looking at how we might maximise facilitation at the border by the use of technology.

Q230 Mr David Jones: Coming back to the question of expenditure on the contingencies that I asked you about a few moments ago, Chancellor,



HOUSE OF COMMONS

you indicated that such expenditure would contemplate there being no deal at the end of the transition period. The Prime Minister has made it clear that the transition/implementation period will be fixed. There has been some discussion of how long that period will be, but I think it is generally accepted that it should be about two years. Can you confirm that there would be no question of extending that transition period beyond whatever fixed period is decided on?

Mr Hammond: The Government have said they believe—and incidentally, the EU has also said it believes—that the period would have to be fixed and that there would be no appetite for an open-ended period. That is the basis on which we are proceeding. The contingency planning that is being done is to cover all possible eventualities. One possible, although perhaps rather unlikely, eventuality is that we reach agreement on an implementation period but then fail to reach agreement on a long-term partnership agreement. I hope that will not be the case, but it would be right that we covered that as one of the potential outcomes we planned for.

Q231 **Mr David Jones:** For absolute clarity: the Government would rule out any extension of the transitional phase?

Mr Hammond: We have no plans to make provision for extension, and I expect, because of what the European Union has said, that the structure of the implementation period will have a fixed end date in the agreement we reach with the European Union.

Q232 **Chair:** We were talking about the infrastructure and the basis on which the border arrangement might be set up. You may remember that on 29 November Mr Jon Thompson made some very specific and clear statements with respect to the question of the Northern Ireland border with the Republic, which he described as trade with a “very local economy” to which normal EU border arrangements could not be applied. He went on to say, “We do not believe—and this has been our consistent advice to Ministers—that we require any infrastructure at the border between Northern Ireland and Ireland under any circumstances.” That is a very interesting statement. I know that was 29 November, but I wonder, first, whether that is something you recall, and secondly, what your comment on it is.

Mr Hammond: That is our position: both the maximum facilitation option and the new customs partnership are conceived and developed with a specific specification that they must involve no border infrastructure.

Q233 **Chair:** Can he not get in touch with the people who are making difficulties about all this and straighten it out with them?

Mr Hammond: Unfortunately, my experience through this process has been that merely putting well-informed people in touch with other people does not necessarily change those other peoples’ views.

Chair: That is a very interesting observation.

Q234 **Stephen Kinnock:** Chancellor, on simplicity and the need for business to



HOUSE OF COMMONS

have certainty and simplicity in terms of the basic rules of the game, most business people will say, "We can adapt, but we need to know what the rules of the game are." With the hybrid approach that the Prime Minister set out on Friday, she is in essence trying to invent something new. Do you not think that it would far simpler to commit the United Kingdom to going into EFTA and the European economic area? They are well understood and well established—EFTA since the 1960s, the EEA since 1993. Our business community would understand what it is all about and how it works. In fact, there are many opportunities to influence and shape EU legislation, as Norway has shown many times in the past. Why do you think complexity is being chosen over simplicity?

Mr Hammond: Because we are in a complex situation. Membership of EFTA, as I suspect you know very well, would involve accepting the full freedom of movement provisions between the European Union and an EFTA country. That is something that we have ruled out, as part of our interpretation of the decision of the British people in the referendum of June 2016. The Prime Minister has been very clear that freedom of movement, as we have it now, cannot continue after we leave the European Union.

Q235 **Stephen Kinnock:** But articles 112 and 113 of the EEA agreement allow for an emergency brake and safeguard clauses on all of the four freedoms.

Mr Hammond: They allow for short-term emergency provisions in very specific circumstances, but I think I am right in saying that those provisions have never been used. Norway contemplated them on one occasion, or maybe two, but when they looked at what the potential consequences might have been, they resiled from actually applying them. I think that is right, isn't it?

Mark Bowman: There may be examples of Liechtenstein using them in very specific circumstances.

Chair: Liechtenstein is another example. Shall we pass on from that?

Mr Hammond: I would hazard to suggest to the Committee that Liechtenstein may not be exactly equivalent to the UK.

Chair: Stephen, you can ask the question again tomorrow if you want to.

Stephen Kinnock: Thank you. Don't worry, I will.

Q236 **Chair:** There are one or two questions to come, and we have five minutes or so. With respect to the issue of UK-EU trade agreements for financial services, this is one of the areas that you are quite clearly having very intense discussions about. The EU is already considering detailed new rules on equivalence, prudential requirements for non-EU banks and the relocation requirement for clearing houses that explicitly assume that the UK will have the same market access as any other third country after Brexit. Can you give us your view of the assumption that the UK will be simply "a third country" without preferential access when seeking to



HOUSE OF COMMONS

provide financial services to EU-based customers at the end of the transitional period?

Mr Hammond: I don't think it is credible. I don't think it reflects the real world in which we live, the scale of the UK-based financial services sector and the deep involvement it has in the operation of the real economy of the European Union. I don't think it is in anybody's interest to sever that link in many key areas. The UK financial services infrastructure—the critical mass that we have in several key areas—simply cannot be relocated or replicated. It is a very complex ecosystem. It has grown up, rather than been created—it has happened. It would be a very, very bold move indeed to fragment it, and it would undoubtedly have significant cost to all the clients—all the users—of those services. I don't think it is a credible scenario. I take it as a starting point that any deal has to be fair and attractive to both sides. Given that the shape of the UK's economy is so heavily biased towards services, I find it difficult to envisage what a deal that is fair and attractive to the UK could look like if it doesn't involve access for services.

Q237 **Kelvin Hopkins:** Earlier, I touched on the balance of trade deficit, which is absolutely enormous. We had a trade deficit with the EU this year and last year of more than £90 billion. Are you and fellow members of the Government looking forward to the freedoms that Brexit will give to give more assistance to industry through state aid, public procurement policies and redirecting regional aid so we can really make industrial strategy work, rebuild manufacturing and bring down the trade deficit?

Mr Hammond: We have an industrial strategy that will work, but we won't do it by propping up legacy industries. We have to move on and embrace the new technologies of the future, of which fortunately the UK has a number of global champions. We have to develop our services sectors—services trade is growing faster than goods trade in the world. The big, emerging economies are seeing huge growth in sophisticated services, in which the UK has huge comparative advantage. China is the fastest-growing market for, I think, all the big UK insurers. They are all present there, and it is their fastest-growing market.

We have to recognise that the shape of our economy is changing. We are well positioned as an economy with a large traded services sector and a large presence in the new cutting-edge technologies of the future—nanotechnology, life sciences, artificial intelligence, the internet of things and many other areas—and that is what we have to build on.

Q238 **Chair:** We are now getting very close to the deadline we agreed. I have one question about a guarantee. Anybody can guarantee anything in these circumstances, but can you guarantee that the political agreement on the implementation period will definitely lead to ratification and adoption?

Mr Hammond: The implementation period is, in our view, very much in the interests of both sides to create some certainty, to allow businesses to plan, and to deal with immediate, pressing issues. For example, airlines will need to know on 1 April whether they can safely schedule flights in



HOUSE OF COMMONS

April 2019. There are lots of practical issues that are going to become very problematic across the continent of Europe unless we agree this implementation deal. I believe it will happen for the simple reason that I think it is in everyone's interests that it happens. I hope we will see very strong support for it in the UK Parliament from all parties and in the European Parliament. That will reassure businesses that an implementation period agreed at the March Economic Council will, over the course of the summer and into the autumn, go on to be ratified by both of the relevant Parliaments and become law. That will be a very important step. If I may say so, it is a very big responsibility for parliamentarians both in the European Parliament and the UK Parliament, because it is by sending that reassuring signal about an implementation period deal that we will enable business to bank it and use it as they go about their everyday activities.

Q239 Chair: I am very interested in the fact that you refer to the European Parliament. I was in a meeting this morning and part of this afternoon, in which there were quite a number of Members of the European Parliament. They were quite specific about the sort of line that Mr Verhofstadt is taking. I am only quoting what I heard, but basically there were a lot of people who thought that there wasn't a cat in Hell's chance of the European Parliament signing off the deal that we have in mind. I just mention that to you, despite all the reasonableness that has been expressed in this room today, which I think—if I may say so—is rather different from the situation that we had during the referendum.

I must say, speaking for myself, you have handled the way in which you have answered these questions extremely well. We have a Select Committee system here in this country where people from all parties, from all sides of the argument, can ask questions of the Chancellor of the Exchequer. That is our transparency, our accountability and our sovereignty of our Parliament. I think it is a very good lesson for a lot of other people who have the opportunity to hear the way these discussions are being conducted. They should realise that we are genuinely interested in trying to find the best possible outcome. By asking these questions, from all sides of the spectrum, we show that when the Prime Minister said that the sovereignty of our Parliament is at the heart of this, it is not just about the word "sovereignty". It is about the manner in which we go about these sessions.

Mr Hammond: May I respond to your first point? Just to reassure people, I have also had extensive discussions with senior people in the European Parliament who have expressed, you will be pleased to hear, the precise opposite view.

Chair: I am very glad to hear that.

Mr Hammond: I think it is very important that we think about the context of this as well. The initial decision-maker will be the European Council, representing the member states—politicians who are members of parties, all of which are represented in the European Parliament. This will not be a decision that is made in silos. I hope that it will be a view that is formed



HOUSE OF COMMONS

across the body politic, across Europe, in the member states, and then in the Parliament, so that as the Council reaches its view on the desirability of an implementation period, that view will be transmitted to fellow party members and group members in the European Parliament.

Chair: I am very glad to hear you say that. In conclusion, I just add the point that all over Europe, as we have seen with the outcome of the Italian elections yesterday and today, and in many other countries, there is increasing concern, not necessarily just from the elite—the people who are leading these respective countries—but from the grassroots. They are not happy with the way in which much of this has been conducted as it has affected them.

I conclude my remarks by saying thank you very much for coming. I hope that we will be able to meet up again on another occasion.

Mr Hammond: I am sure we will.