European Scrutiny Committee
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From: Sir William Cash MP

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COVID-19: UK participation in and exposure to the EU's financial response

The European Scrutiny Committee this week considered the EU's cumulative financial response to the coronavirus crisis, and their potential implications for the UK and the British taxpayer during the post-Brexit transition period and beyond.

We focussed on the depletion of the EU's special budgetary instruments for 2020, the activation of the Emergency Support Instrument to support the provision of healthcare, the discussions on the immediate fiscal "safety net" among EU Finance Ministers. The Committee also took note of the complicated political questions around the establishment of an EU Coronavirus Recovery Fund, including whether it should be funded via any mutualised or common debt instruments issued either by the 27 remaining Member States jointly, or by the EU itself on their behalf.[1]

The Committee recognises that the EU's negotiations on the Recovery Fund in particular remain difficult, and their outcome could have a lasting impact on the process of political integration in Europe. However, it is also mindful of its responsibility to scrutinise these developments in terms of their impact

[1] In particular EU documents: (a) 7159/20, COM(2020) 143; (b) 7161/20, COM(2020) 139; (c) 7147/20, COM(2020) 174; and (d) 7141/20, COM(2020) 175.

on the UK. In that regard, the wider economic and political consequences of the EU's success – or lack thereof - in facilitating a sustainable economic recovery in all its Member States (and the tools it intends to use to achieve it), will be indirect, but – given the EU's continued importance as an economic and security partner – profound. At the same time, it is clear that the UK, following its withdrawal, will not now be required to consider any further transfer fiscal or other competences to the European Union.

Given the uncertainties around the outcome of the Recovery Fund negotiations, we will continue to monitor those talks closely in the coming months. Moreover, based on our discussions, the Committee also has a number of immediate technical questions relating to the extent of the UK's potential financial exposure to the EU's short-term financial support schemes under the terms of the Withdrawal Agreement, as well as the degree to which the UK is making use of the funding opportunities while it remains eligible to access EU programmes for the duration of the post-Brexit transition period.

Unfortunately, due to delays in the submission of your Departmental Explanatory Memorandum on the EU proposals underlying our discussions today, we were unable to consider the Government's position on these matters at our meeting. We are therefore writing to you to ask for this information, in case your forthcoming Memorandum does not cover it. The Committee will consider, based on your response, whether it will make further reports to the House or whether the UK's vital national interest under section 13A of the European Union (Withdrawal) Act 2018 is potentially engaged by any of these EU schemes.

1. *Use of EU funding opportunities*

As you know, the EU has agreed changes to its Structural Funds in 2020, like the Regional Development Fund, to give countries more flexibility to use their national allocation for projects related to the coronavirus crisis.[2] Other existing EU funding pots have also been mobilised to address the pandemic and support businesses, including the activation of the Emergency Support Instrument to help countries increase their hospital and healthcare capacities and the Civil Protection Mechanism, which is co-financing repatriation flights for European citizens stranded overseas.

Given that the UK remains a contributor to the EU budget as if still a Member State until 31 December 2020 under the Withdrawal Agreement, it also remains eligible to access funding from those EU programmes until that date.

[2] The adjustments to the Structural Funds are covered in more detail in our Report of 7 May 2020.

We therefore ask you to provide the Government's estimate of the amount of such support the UK has drawn and is likely to draw from the COVID-related support available from the EU budget this year, in particular:

- **the extent to which the UK's Structural Funds allocation for 2020 is being used for coronavirus-related projects; and**
- **the level of COVID-related funding the Government has received, or expects to receive, from the EU's Emergency Support Instrument, the Solidarity and Globalisation Adjustment Funds, the Maritime & Fisheries Fund, the Fund for Aid to the Most Deprived, and the Civil Protection Mechanism.**

2. *Amendment to the Global Margin for Commitments*

Making available the necessary resources from the EU budget for 2020 to provide the financial support described above, which was of course not foreseen when its budget was approved in November last year, has required the European Commission to make a number of budgetary adjustments and recourse to its "special instruments", or emergency financial reserves.

In particular, you will be aware that the activation of the Emergency Support Instrument (ESI) and the tripling of the annual budget of the Civil Protection Mechanism (CPM) – together requiring more than €3 billion (£2.6 billion) of EU money – required an amendment to the 2013 Regulation establishing the EU's long-term budget (the Multiannual Financial Framework). More specifically, a special EU reserve known as the "Global Margin for Commitments" (GMC) was legally modified, so that it could be depleted of its €2 billion (£1.75 billion) reserves for use towards the ESI and CPM, where previously the money not have been used for this purpose.

Given that the UK, under the terms of its Withdrawal Agreement, is exempt from having to apply any changes to the EU's long-term budget adopted after 31 January 2020 that would "have an impact on [its] financial obligations",[3] the EU has asserted that the UK will have to contribute to this novel use of the GMC because the change is "limited to [its] purpose".[4]

[3] See Article 135(2) of the Withdrawal Agreement.
[4] Recital 4 of Regulation 2020/538/EU, which contains the amendment to the MFF, in full reads: "Amendments set out in this Regulation are limited to the change of the purpose of the use of the Global Margin for Commitments and do not increase financial obligations. Therefore, it is appropriate to clarify that, for the purposes of Article 135(2) of the Withdrawal Agreement, the amendments set out in this Regulation do not have an impact on the financial obligations of the United Kingdom and, as such, are applicable to the United Kingdom". In other words, the EU could have decided to spend the additional €2 billion using this reserve anyway without the legal modification, but for different purposes.

We would like you to confirm if the Government accepts the EU's interpretation that its amendment to expand the use of the Global Margin for Commitments applies to the UK under the Brexit financial settlement, and if so what your estimate is of its impact on the overall net cost of that settlement; or, if the Government does not accept the EU's interpretation, we ask you to explain how the Government intends to contest the assertion that the change to the GMC applies to the UK.

3. UK exposure to contingent liabilities under the "SURE" loan facility

As you will be aware, the EU is currently in the process of establishing a €100 billion support facility called "SURE", which will provide low-cost loans to EU Member States to help them finance their national income retention schemes.[5]

Given the total EU budget for new spending in 2020 is €168.7 billion, "SURE" would not be funded by the budget directly but instead rely on the EU issuing debt bonds. These obligations would be paid off with the repayments made by Member States lending money from the facility. However, given the theoretical possibility of a sovereign default where such repayments may not be made, the debt bonds would also be a contingent liability guaranteed against the EU budget.[6]

Although the UK continues to pay into the EU budget for the duration of the post-Brexit transition period, Article 143 of the Withdrawal Agreement states the Treasury is only "liable to the Union for its share of crystallised contingent financial liabilities of the Union arising from financial operations" which are "relate[d] to loans for financial assistance" under specific EU programmes, of which "SURE" is not one as it did not exist when the Agreement was ratified. The interaction between the UK's continued contribution to the general EU budget on the one hand, and its exemption from having to pay for any new EU contingent liabilities – like those to be created under "SURE" – created post-withdrawal, is not clear.

We are therefore seeking confirmation from you whether it is theoretically possible that Britain's contributions to the EU budget during the transition period could, in part, be used to pay off any EU debt obligations created under the "SURE" loan facility if the budget

[5] Namely, programmes analogous to the UK's the Coronavirus Job Retention Scheme and the Self-employment Income Support Scheme.

[6] To limit the EU's total potential exposure, further counter-guarantees would be provided by the Member States' national treasuries, amounting to a proposed €25 billion.

guarantee has to be used during that period (and, if not, how the relevant share of those liabilities would be deducted from the UK's contribution in such a scenario).

4. UK exposure to the liabilities of the European Investment Bank

The Committee has taken note of the EU's intention to establish a new €25 billion Coronavirus Guarantee Fund within the European Investment Bank, with the aim of leveraging €200 billion of support for the real economy. Although EIB support is typically reserved for EU Member States, its Statute also allows it to operate in other countries on an ad hoc basis. It is not clear if the new Guarantee Fund is reserved for Member States only.[7]

As regards the UK's exposure to the financial liabilities of the EIB, we note that Article 150 of the Withdrawal Agreement excludes any UK liability with respect to the EIB's financial operations that were agreed after the UK's exit from the EU on 31 January this year (including any entered into on the basis of the aforementioned new Guarantee Fund).

However, the Treasury retains significant potential exposure to the Bank's liabilities that *predate* the UK's withdrawal, up to a theoretical maximum of its total subscribed capital – paid-in plus callable capital - as it stood on 31 January (€39.2 billion, or approximately £34 billion under current exchange rates). In the latest accounts for the Government's Consolidated Fund, published in July 2019, the UK's contingent liability in relation to the EIB – i.e. the possibility that it may have to increase its paid-in capital to the Bank by any amount – was described as "remote". However, that assessment predates the current economic crisis by several months.

In light of the above, we would like you to clarify:

- **whether the Government has received any indication from the EU that the Treasury's guarantee to the European Investment Bank guarantee under the Withdrawal Agreement may be called on, and whether it still classifies this contingent liability as "remote" given the wider economic circumstances; and**
- **if the new EIB Guarantee Fund provides scope, however limited, for investment support to non-EU countries like the UK, and if so whether the Government intends to make use of it.**

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[7] The EIB's website states that "The guarantee fund is designed to ***primarily*** support private sector final beneficiaries in EU Member States that are high-risk but viable in the long-term and, in the absence of the COVID-19 pandemic, will meet a lender's or other financial intermediaries' requirements for commercial financing" (emphasis added).

We look forward to receiving your response to the above questions by 20 May 2020.

I am copying this letter to Rachel Reeves MP, Chair of the Business, Energy and Industrial Strategy Committee and Rebecca Davies, Clerk of that Committee; the Rt Hon Mel Stride MP, Chair of the Treasury Committee, and Gosia McBride, Clerk of that Committee; to Lord Kinnoull and Christopher Johnson in the Lords; to Les Saunders at the Cabinet Office; and to Joe Livesey at your Department.

CHAIR