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European Scrutiny Committee

Brexit divorce bill and UK participation in EU programmes: how much and who pays?

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European Scrutiny Committee

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Summary

The UK left the European Union on 31 January 2020, but under the terms of the Withdrawal Agreement the Government and the EU have agreed to resolve certain legacy financial obligations vis-à-vis one another.

In particular, the UK will pay for a share of outstanding EU spending commitments made from programmes like the Regional Development Fund under its 2014–2020 “Multiannual Financial Framework” (its long-term budget). In return, the EU will honour any funding allocated from that budget to UK-based organisations, like universities, researchers, or local authorities, even though any remaining payments fall after the UK’s departure. In addition, the Government has agreed to pay for a share of the pension liabilities of EU officials accrued during its period of EU membership. The settlement has also seen the UK assume a partial responsibility for a share of contingent liabilities contained in the accounts of the EU and the European Investment Bank (EIB) that arose prior to Brexit, should these crystallise in the future. The UK will also receive back certain assets, in particular its €3.5 billion of paid-in capital with the EIB over a period of 12 years.

In addition to the settlement, which covers UK and EU financial obligations relating to the period of the UK’s membership of the European Union, the Government has separately reached a provisional agreement with the EU to continue participating in four EU funding programmes until 2027 under the new UK-EU Trade and Cooperation Agreement (TCA). This concerns Horizon Europe, the EU’s flagship research funding programme, as well as three other EU schemes related to satellite observation and nuclear research. This arrangement–strongly supported by the British scientific community - would require a further UK contribution to the EU budget, which is additional to any sums paid pursuant to the settlement in the Withdrawal Agreement. However, the UK’s participation remains to be formalised due to delays on the EU side in approving the necessary Protocols to the TCA, meaning these payments are not yet a certainty.

We retain a close interest in the issue of UK payments to the EU post-Brexit. The aim of this Report is to inform the House and any other interested parties about: (1) the state of implementation of the settlement; and (2) the UK’s continued participation in EU programmes, and to assess the potential costs to the UK Exchequer. Information on these issues has not to date been collated in one place. In particular, we believe it is important to provide comprehensive information on the potential cost of these arrangements to the UK taxpayer, likely to run into tens of billions of pounds; the significant discrepancies in the estimates of the total cost of the Brexit settlement made by the Treasury, the Office for Budget Responsibility and the European Commission respectively; and the continued uncertainty about the UK’s contributions to, and receipts from, EU research funding programmes under the new post-Brexit relationship.

The financial settlement set out in the Withdrawal Agreement in particular translates into a significant net transfer from the UK to the EU. However, its total cost is not fixed. It will only become clear over time, as payments fall due over the coming decades using a complex methodology established in the Withdrawal Agreement. In July 2021, the Treasury released its latest forecast for the overall cost of the Brexit settlement since the UK left the EU on 31 January 2020, estimating a net cost to the UK of £30.4 billion. This

compares to an estimate of £34.1 billion made by the Office for Budget Responsibility (OBR) in March 2021. The OBR (and, separately, the European Commission) have, notably, estimated the overall cost of the UK's share of the EU's pre-Brexit pension liabilities to be significantly higher compared to the Treasury's forecast. Neither the Government nor the OBR currently foresee the UK having to pay any meaningful amounts towards the EU and EIB contingent liabilities to which the Exchequer is exposed under the terms of the financial settlement.

The total size of the settlement could also be affected by two on-going disagreements between the Government and the EU. The first of these relates to whether the UK should have to pay for a share of a Covid-related amendment to the EU budget in 2020, which allowed the EU to spend an additional €2 billion (£1.7 billion) on pandemic-related measures. Technical talks are on-going to determine whether the UK will need to make a contribution towards that EU spending. The second matter concerns a legal case against the UK by the European Commission before the EU Court of Justice, by means of which the Commission is seeking to force the Government to make a retrospective payment of more than €3.8 billion (£3.3 billion) to the EU budget. The case was triggered by an alleged failure by HM Revenue and Customs to address customs fraud on Chinese textile imports at UK ports between 2011 and 2017, which the Commission argues resulted in a substantial evasion of customs duties (which, under EU law, should have been paid into the EU budget). The Court has not yet set a date for delivery of its judgement, and the financial implications of the case for the UK taxpayer therefore remain unclear.

As regards the cost of continued participation by the UK in EU programmes as envisaged by the Trade and Cooperation Agreement, no comprehensive estimate appears to have been published by the Government. However, the Department for Business, Energy and Industrial Strategy has forecast that the UK's gross contribution to 'Horizon Europe' alone–the largest of the four schemes in which the UK wants to continue participating - could be £15 billion over the next seven years, before receipts from the programme flowing back to British universities and other recipients are taken into account. The combined UK contribution to the other three EU programmes in which it is seeking participation is likely to be a fraction of that amount, as they are much smaller financially. However, the delay in formalising the UK's participation under the TCA could raise potential concerns about value for money, because the opportunities for EU-funded grants and procurement agreements from which British organisations are excluded at present will be definitively lost, reducing potential receipts from these programmes flowing back to the UK in return for the Government's financial contribution.

Once continued UK participation in the EU programmes is finalised, taking its obligations under the Withdrawal Agreement and the TCA combined, the Government is likely to make gross payments to the EU budget exceeding £2 billion per year for the foreseeable future. However, the amount will decrease as the Brexit financial settlement is gradually paid off and the UK's contributions begin to relate solely to those EU programmes in which it has chosen to seek continued participation as a non-Member State. We will closely monitor the resolution of the UK's financial obligations to the EU under the Withdrawal Agreement, and the costs and benefits of its continued involvement in certain EU programmes under the new relationship.

1 The financial settlement in the Withdrawal Agreement

Introduction

1. The UK left the European Union on 31 January 2020. Under Part Five of the Withdrawal Agreement governing the UK's exit, the EU and the UK are required to make certain payments to each other beyond the date the UK formally withdrew from the EU.[1] The purpose of this 'Brexit settlement' is for the two parties to resolve their residual financial obligations to each other linked to the period of the UK's membership from 1973 until 2020.[2] Two fundamental principles are that the UK will not finance any commitments that it would not have funded if it had remained a Member State, and that it will receive a share of any financial benefits that would have fallen to it had it remained part of the EU.

2. The settlement, like the UK's payments into the EU budget as a Member State, has been politically controversial.[3] However, Phillip Hammond, Chancellor of the Exchequer at the time the settlement was negotiated in 2017–18, has stated on the record that the Treasury "had pretty clear legal advice about what our obligations were" and that the Government was "going to have a commitment for quite a lot of money here [because] we're liable for it".[4] As such, the fact there would be a settlement "wasn't a big thing from the Treasury's point of view", although Mr. Hammond admits that "handling it in public [and] how we presented it in public was a massive thing".[5] He also suggests the UK's own view of its liabilities was reflected in the Withdrawal Agreement because the EU "didn't really try and push us with any vigour to go beyond that [UK] position".[6]

3. While the settlement technically involves payments in both directions, the overall result of the chosen approach is a significant net transfer from the UK to the EU (estimated by the Treasury in July 2021 to amount to £30.1 billion, as we discuss in more detail below). However, it is important to note that the Withdrawal Agreement does not definitively fix the overall cost of the settlement: rather, it sets out a methodology for establishing the UK's contributions to and receipts from the EU.

1 Agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community, 31 January 2020.

2 The Withdrawal Agreement does not provide for a mechanism for the UK to suspend its payments under the settlement, not even if the EU were to breach its own obligations under that Agreement or the separate UK/EU trade deal (or vice versa). Conversely, the UK-EU Trade and Cooperation Agreement, which is discussed in more detail in chapter 2, does permit either side to suspend their obligations under that Agreement – e.g. a retaliatory re-imposition of tariffs - for a persistent failure to comply with the ruling of the arbitration panel of a breach of the Withdrawal Agreement, including the financial settlement (Article 749(4) TCA).

3 The House of Lords EU Committee in March 2017 concluded that the UK was legally able to "leave the EU without being liable for outstanding financial obligations under the EU budget", but only in the absence of a "withdrawal agreement […] which resolves this issue". As the UK subsequently ratified precisely such a treaty, this assessment is therefore no longer relevant. European Union Committee, Brexit and the EU budget (HL Paper 125, 2016–17).

4 UK in a Changing Europe, November 2020.

5 ibid.

6 Stefaan Van Rijnck, who was involved in the negotiations on the EU side, has also said that "the UK subscribed to the [EU] position paper [on the financial settlement] we had published in May 2017 with just one exception, which was the relocation costs of the [European Banking Authority and the European Medicines Agency]". The final settlement did not contain an obligation on the UK to pay for the relocation of EU bodies previously located in the UK, but the Treasury did contribute to those relocations as they were funded from the EU budget (including the UK contribution).

The methodology for calculating payments under the financial settlement

4. The EU's financial obligations 'undertaken' during the UK's membership from 1973 until 2020, and for which the Treasury has assumed partial liability under the terms of the Withdrawal Agreement, are multifaceted and complex. They could not be definitively established at the point of the UK's formal withdrawal from the European Union on 31 January 2020, and the precise cost of the settlement is therefore not explicitly set out in the Agreement. Instead, it establishes a methodology for calculating the size of payments the UK must make to the EU and vice versa, centred around five different components. This forms the basis on which the Government will be invoiced for payments to the EU twice a year, until all residual obligations as set out in the settlement are extinguished.[7]

5. In summary, the key components of the financial settlement in the Withdrawal Agreement are as follows:

- First, the Government agreed that the UK would pay for a share of all EU expenditure made from its 2014–2020 'Multiannual Financial Framework' (MFF), the EU's long-term budget. Consequently, from the UK's formal exit on 31 January 2020 until the end of the post-Brexit transition period on 31 December 2020, the UK paid into the EU budget as if still a Member State.[8] The UK's contribution was calculated on the basis of the applicable budgetary legislation in force when it ceased to be a Member State, and therefore included its existing budget rebate.[9]

- Second, linked closely to the above, from 1 January 2021 the UK will pay for a share of the EU's *outstanding* financial commitments made from its 2014–2020 long-term budget. In essence, this relates to EU funding awarded before the end of 2020, but not fully paid out by that point.[10] The totality of these outstanding commitments is known in EU parlance as the '*Reste à Liquider*' or RAL. The UK's share of the RAL as it stood at the end of 2020 will be calculated as its average share of contributions to the EU budget over the 2014–2020 period.[11] The settlement does not place the UK under any obligation to contribute towards *new* EU spending commitments made under the EU's new budget for the 2021–2027 period,[12] nor to its €750 billion Coronavirus Recovery Fund.[13]

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7 Article 148 of the Withdrawal Agreement states that the "reference dates for payments by the United Kingdom to the Union or by the Union to the United Kingdom made after 31 December 2020 shall be 30 June and 31 October of every year", with invoices issued in April and September. Actual payments are made on a monthly basis. The Agreement also contains specific rules for the payment of the amounts due under the different components of the settlement.

8 Article 135 of the Withdrawal Agreement.

9 The Treasury estimates that the UK's net contribution to the EU budget from 31 January 2020 until 31 December 2020 amounted to €11.2 billion (£9.6 billion). HM Treasury, EU Finances Statement 2020 (July 2021), p. 78.

10 Article 140 of the Withdrawal Agreement.

11 Article 139 of the Withdrawal Agreement.

12 Council Regulation (EU, Euratom) 2020/2093 of 17 December 2020 laying down the multiannual financial framework for the years 2021 to 2027. However, the Government is seeking continued UK participation in a select number of EU programmes under the 2021–2027 MFF, for which some payments would be required. See chapter 2 of this Report for more information.

13 Council Regulation (EU) 2020/2094 of 14 December 2020 establishing a European Union Recovery Instrument to support the recovery in the aftermath of the COVID-19 crisis.

- Third, from 2021 onwards, the UK will also pay for a share of certain other EU liabilities, in particular pension entitlements accrued by EU civil servants before 31 December 2020 as they become due.[14] The underlying liabilities these payments could stretch into the 2060s given the age profile of EU staff covered by this arrangement, although there is an option for the UK to settle this aspect of the settlement early if it so wishes. The Treasury will also receive a share of certain EU assets,[15] most notably repayment of the UK's €3.5 billion paid-in capital with the European Investment Bank (EIB) in annual installments over a 12-year period.[16]

- Fourth, the UK will contribute to several 'off-budget' EU programmes (meaning they are, for various reasons, funded by EU Member States directly rather than from their general contributions to the EU budget, but managed centrally by the European Commission).[17] Before Brexit, the UK made specific funding commitments to these schemes, which the Withdrawal Agreement requires it to honour. This category includes, in particular, UK payments to the European Development Funds for development assistance,[18] as well as to the EU's Trust Fund for Africa, the Facility for Refugees in Turkey, and the agencies and operations of the Common Security & Defence Policy (CSDP).[19]

- Fifth, the UK has accepted partial exposure to certain contingent liabilities on the books of the European Union and of the European Investment Bank (EIB), meaning it will have to contribute if these crystallise in the future.[20] In particular, the UK has granted a guarantee that it will, under certain conditions, provide additional capital to the EIB on the same basis as the

14 See Article 142 of the Withdrawal Agreement. The timing of payments varies for the different liabilities. For example, Article 142(6) states that the UK will be contributing to the pensions of regular EU staff from 30 June 2022.

15 See in particular Articles 145, 146 and 150 of the Withdrawal Agreement. The assets to be returned to the UK are fairly limited. They do not include, for example, a share of the money invested by the EU—using the UK's contributions—to its space programme, or the returns generated by the European Investment Bank using its paid-in capital from EU countries including, until 31 January 2020, the UK.

16 The first eleven installments will amount to €300 million each. The twelfth and final instalment will amount to the residual €196 million.

17 Articles 152 to 157 of the Withdrawal Agreement.

18 See in particular the "Internal Agreement" of 6 August 2013 establishing the 2014–2020 European Development Fund.

19 The agencies of the CSDP are the European Defence Agency, the European Union Institute for Security Studies, and the European Union Satellite Centre.

20 Articles 143, 144 and 150 of the Withdrawal Agreement. Aside from the guarantee to the EIB these contingent liabilities include, for example, the EU's macro-financial assistance loans to a number of non-EU countries like Ukraine and Moldova, and pending legal cases against the EU if these result in the need for compensatory payments. The UK also faces a different kind of contingent liabilities in relation to any financial obligations that may arise as the result of any EU Court of Justice judgments for failure to correctly apply EU law before the end of the post-Brexit transition period. Potentially the most significant such contingent liability relates to a pending case in which the European Commission is seeking recovery of over €2 billion in allegedly evaded duties as part of a claim the UK incorrectly applied EU customs rules to imports of Chinese textiles, which is discussed further in this chapter.

remaining Member States if necessary in relation to the Bank's pre-Brexit lending operations.[21] Given the unique nature of these contingent liabilities, they are discussed in more detail in paragraphs 30 to 40.

6. As part of the financial settlement, given that the UK is honouring its share of contributions to the 2014–2020 Multiannual Financial Framework, the UK remain eligible to participate in EU programmes–such as the 'Horizon 2020' research programme or the Regional Development Fund–under that EU long-term budget until their closure. In essence, this means UK-based organisations and individuals will continue to receive any EU funding granted from those schemes before the end of 2020 (even if the money is only paid out in 2021 or later).[22] However, the UK's participation in EU funding programmes from 1 January 2021 onwards under the new UK-EU Trade and Cooperation Agreement (TCA) is much more limited, as set out in chapter 2 of this Report.

7. The size of the UK's payments under the different components of the settlement from 1 January 2021 onwards will, generally speaking, be calculated based on its average share of contributions to the EU budget over the 2014–2020 period (therefore taking into account the effect of the UK rebate in reducing its annual payments to the EU).[23] The European Commission currently estimates this share to be approximately 12.4%.[24] This means, for example, that if the EU's total pension liability to which the UK must contribute were - hypothetically speaking - €100 billion, the UK's share would be €12.4 billion. A definitive calculation of the UK's share will take place in 2022.[25]

8. The Treasury made the final payment in respect of the UK's period of membership of the EU in February 2021.[26] Payments after this point have been, and will be, made in accordance with the methodology set out in the Withdrawal Agreement as described above. In practical terms, the EU will issue two invoices per year, in April and September, with UK payments due in monthly installments thereafter.[27] The first such request for payment of the UK's outstanding net liabilities was made on 16 April 2021, amounting to €3.8 billion (£3.2 billion) payable in equal installments over the subsequent four months.[28] As of 1 April 2021, payments are made by the Treasury under authorisation

21 This means the UK guarantee relates primarily to EIB lending operations which were approved on or before the UK's withdrawal from the EU on 31 January 2020, and "other EIB risks as long as such risks are not related to post-withdrawal lending". The Withdrawal Agreement refers to this as "other such risks that are not associated with specific financial operations and are not attributable to the stock of financial operations built after the date of entry into force of this Agreement". The European Investment Bank has clarified that this liability exists only where "such risks are not related to post-withdrawal lending".

22 Articles 137 and 138 of the Withdrawal Agreement.

23 From its date of withdrawal on 31 January 2020 until 31 December 2020, the UK's contributions were calculated on the basis of the applicable EU budgetary legislation as if the UK were still a Member State, including the rebate.

24 European Commission, Consolidated Annual Accounts of the European Union (July 2021), p. 16. The UK's shares for contributions to the "off-budget" EU programmes under the settlement are calculated separately.

25 Article 139 of the Withdrawal Agreement.

26 HM Treasury, EU Finances Statement 2020, p. 66.

27 The April invoice includes a schedule for equal payments in 4 months (from June to September) and the September invoice is followed by 8 further monthly installments (from October to May). See Article 148 of the Withdrawal Agreement.

28 HM Treasury, EU Finances Statement 2020 (July 2021).

from Parliament via the annual Estimates process, with the exception of those relating to the EU's "traditional own resources", namely the payment into the EU budget of the majority of customs duties collected by the UK on the EU's behalf before the end of 2020.[29]

9. In the following section, we look more closely at some of the recent estimates of the total net cost of the financial settlement to the UK taxpayer.

Estimates for the total cost of the financial settlement to the UK

10. As a result of the methodology chosen to establish the settlement, its net cost to the UK taxpayer will be dependent on various factors and cannot yet be definitively established.

11. In particular, the size of the EU's financial obligations for which the UK is partially liable under the Withdrawal Agreement is still unknown[30] (with the largest uncertainty relating to the eventual cost of the pension liability for EU staff accrued by 31 December 2020, which is dependent on complex actuarial calculations and stretches many decades into the future).[31] In addition, the EU made significant Covid-related changes to its 2020 budget, and the UK is subject to a legal case before the Court of Justice of the EU relating to alleged underpayment of its contributions to the EU budget between 2011 and 2017. The effect of these matters on the size of the UK's obligations under the settlement is unclear (as discussed further below). The net cost will also be affected by the amount of money the Government and private sector organisations ultimately receive back in receipts from the EU budget.[32] Lastly, as the settlement is denominated in Euros, it is vulnerable to fluctuations in the Sterling-Euro exchange rate.

12. The outline of the financial settlement was provisionally agreed between the Government and the European Commission in December 2017, pending formal ratification of the Withdrawal Agreement.[33] The following month, the Treasury published its initial assessment of the cost of the settlement to the UK.[34] This contained the now-famous estimate of a £39 billion net cost to the Exchequer, the upper end of a £35–39 billion range based on the prevailing Euro-Sterling exchange rate at the time.[35] Since then, the Withdrawal Agreement has been ratified and various other developments have taken

29 Section 20 of the European Union (Withdrawal Agreement) Act 2020. Member State contributions to the EU budget consist of the payment of these "traditional own resources" (i.e. customs duties collected on imports from outside the EU), a share of each EU country's VAT base, and a GNI-based contribution proportional to each Member State's economy.

30 The size of the settlement is also affected by so-called "de-commitments" (planned EU spending that is ultimately cancelled), as well as whether any of the EU's contingent liabilities to which the UK is exposed actually crystallise, in particular with respect to its guarantee to the European Investment Bank.

31 The cost of the UK's contribution to the EU's pensions liabilities depends, in particular, on the final salaries of the employees [covered by the EU pension scheme], their years of service and the length of time they live in retirement. In addition, the EU's post-employment benefits for its employees are financed by a notional fund, where contributions, although not actually invested, are "considered to have been invested in the Member States' long-term bonds". This approach means that valuation of the cost of this liability is affected, among other things, by the yield on sovereign debt issued by EU countries, as well as by the expected rate of inflation.

32 Although the Government has warned that "the UK's revenues from the EU may change in the context of withdrawal"—in other words, it may receive less since it is leaving than would otherwise have been the case—it noted that "this risk is mitigated because allocations for most EU expenditure in the UK have already been agreed".

33 UK-EU Joint Report on progress in the Brexit negotiations (8 December 2017).

34 Letter from the Chancellor of the Exchequer to the Chair of the Treasury Committee (24 January 2018).

35 In Euros, the estimate was €40–45 billion. Letter from Philip Hammond, then Chancellor, to Nicky Morgan, then Chair of the Treasury Committee (24 January 2018). This figure however excluded the cost of the UK's contributions to the EU's 'off budget' programmes to which we referred above, and also presumed none of the contingent liabilities for which the UK was to resume partial responsibility would crystallise.

place that affect the size of the settlement. In particular, the Treasury's initial estimate was predicated on the UK leaving the EU on 29 March 2019 (exactly two years after the Brexit process under Article 50 of the Treaty on European Union was initiated). The UK's membership of the EU was subsequently extended a number of times under Article 50 TEU, and consequently it only formally left the EU on 31 January 2020. From an accounting perspective, this had a significant impact on the size of the financial settlement, because it meant that the Treasury paid more 'regular' EU budget contributions while the UK remained a Member State, with this money consequently not needing to be paid post-Brexit as part of the settlement as expected by the Treasury in its initial estimate in 2018.[36]

13. Between the UK's exit on 31 January 2020 and the end of the transition period on 31 December that year, the UK made gross contributions to the EU budget totalling €17.2 billion (£14.7 billion), offset by receipts totalling €6 billion (£5.4 billion) to result in a net contribution of £9.3 billion during that period. As noted, the EU issued the UK with a first request for payment under the settlement since the end of the post-Brexit transition period–amounting to £3.2 billion–in April 2021.[37] For the totality 2021, the European Commission estimates that gross UK payments will amount to €6.8 billion.[38]

14. However, these payments only represent a fraction of the total settlement. Between March and July 2021, the European Commission, the Treasury and the OBR also each published their most recent estimates of the *overall* cost of the financial settlement to the UK over its entire lifetime. The most detailed and comprehensive estimate of the three was set out in the Treasury's annual European Union Finances Statement.[39] The headline figures presented by each of these institutions are shown below:

Institution	HM Treasury	OBR	European Commission
Estimated cost of the settlement to the UK	€43.8 billion (£37.3 billion)[40]	€38.5 billion (£34.1 billion)[41]	€47.5 billion (£40.4 billion)[42]

Comparison of the estimates produced by the Treasury, OBR and European Commission

15. There are clearly significant differences between these estimates, with the Treasury landing halfway in the middle between the OBR on the lower end and the Commission on the higher end. However, it is important to note that there are a number of accounting differences between the approaches underlying these forecasts, which means that they cannot actually be compared like-for-like.

16. First, the European Commission's estimate is for direct transfers between the EU and the UK Exchequer only: unlike the Treasury and OBR forecasts, it omits receipts

36 Note that the extensions did not reduce the amount the UK will pay to the EU overall, but rather meant that more of what would have been part of the Brexit settlement ended up being paid while the UK was still a Member State.
37 HM Treasury, EU Finances Statement 2020 (July 2021).
38 European Commission, Consolidated Annual Accounts of the European Union (July 2021).
39 HM Treasury, EU Finances Statement 2020 (July 2021).
40 ibid.
41 Office for Budget Responsibility, Economic and fiscal outlook – March 2021, Supplementary fiscal tables – expenditure (3 March 2021).
42 European Commission, Consolidated Annual Accounts of the European Union 2020 (July 2021).

from EU funding programmes under the Multiannual Financial Framework 2014–2020 that will continue to flow to UK-based recipients such as universities and researchers until the closure of those programmes. Unlike the OBR and Treasury, the Commission also does not include the repayment of the UK's €3.5 billion of paid-in capital by the EIB (not because it disputes this transfer but because it is, legally speaking, separate from the EU budget for which the Commission is responsible). In combination, these factors produce a Commission estimate that is significantly higher than those of the Treasury and OBR. This is offset somewhat by the fact that the Commission figure relates only to UK payments from 1 January 2021, which marked the *end* of the post-Brexit transition period. By contrast, the Treasury and OBR both include payments and receipts from 1 February 2020 onwards, namely from the *start* of that transition period.

17. Second, the Treasury headline figure of £37.2 billion also includes money paid and received by the UK *while it was still a Member State of the EU*, from 29 March 2019 to 31 January 2020. This is to enable a like-for-like comparison with its initial £39 billion estimate for the settlement made in January 2018, when the UK was still scheduled to leave the EU on 29 March 2019. This approach adds a net UK contribution of €7.8 billion to the Treasury's overall estimate, even though that sum formed the UK's routine contributions as an EU Member State. It was not therefore part of the financial settlement (which only took effect when the UK ceased to be a Member State on 31 January 2020). Neither the Commission nor the OBR include this amount in their estimates, since it was paid before the UK left the EU.

18. An added complexity is that while the Treasury has published both gross and net figures relating to the various components of the settlement (namely gross UK contributions to and receipts from the EU budget, and the resulting net UK contribution), the OBR estimates mostly relate to the net amounts only without disclosing its estimates of the underlying gross amounts of UK and EU payments respectively, and the Commission figure–as noted–mostly ignores UK receipts from the EU budget altogether, therefore not giving a net figure.

19. In summary, the headline figures used by the Commission, Treasury and OBR–aside from any other discrepancies–all refer to UK payments (and, for the Treasury and OBR, receipts) over different stretches of time, complicating their comparability. The table below shows the different periods for which UK contributions to and receipts from the EU budget are included in the headline estimates referred to above.

	HM Treasury	OBR	European Commission
UK payments to the EU prior to 29 March 2019	No	No	No
UK receipts from the EU prior to 29 March 2019	No	No	No
UK payments to the EU from 30 March 2019 to 31 January 2020	Yes	No	No

	HM Treasury	OBR	European Commission
UK receipts from the EU from 30 March 2019 to 31 January 2020	Yes	No	No
UK payments to the EU from 1 February 2020 to 31 December 2020	Yes	Yes	No
UK receipts from the EU from February 2020 to 31 December 2020	Yes	Yes	No
UK payments to the EU since 1 January 2021	Yes	Yes	Yes
UK receipts from the EU since 1 January 2021	Yes	Yes	No[43]

20. With the above in mind, we have looked at the detailed estimates produced by the three institutions for the different components of the settlement in an attempt to make their forecasts comparable. When adjustments are made to reflect what is included and what is not in the different forecasts, the Treasury's estimate for the different components of the settlement compares to the Commission and OBR estimates as shown below.[44] The figures in bold denote overall size of the settlement as forecast by the Treasury, OBR and Commission respectively, indicating how they are not directly comparable.

Component of the settlement	HM Treasury[45]	OBR[46]	Commission[47]
Payments from the UK to the EU budget after 31 December 2020			
1. Gross UK contributions to outstanding EU spending commitments (RAL)	€34 billion (£29 billion)	N/a	€35 billion (£29.8 billion)
2. UK receipts from the EU budget after 31 December 2020	-€10.8 billion (-£9.2 billion)	N/a	N/a

43 As noted, the European Commission estimate does not include EU funding flowing back to UK recipients, but it does cover the return of a share of certain EU assets to the UK Exchequer in 2021. However, that is only a small proportion of the overall receipts by the UK under the settlement.
44 Negative amounts denote payments to the UK from the EU, and the Euro-Sterling exchange rate used is €1 : £0.85.
45 HM Treasury, EU Finances Statement 2020 (July 2021).
46 Office for Budget Responsibility, Economic and fiscal outlook – March 2021, Supplementary fiscal tables – expenditure (3 March 2021). The OBR figures have been converted from sterling into euros.
47 European Commission, Consolidated Annual Accounts of the European Union 2020 (July 2021).

Component of the settlement	HM Treasury[45]	OBR[46]	Commission[47]
3. Net UK contributions to outstanding EU spending commitments (RAL)	€23.2 billion (£19.8 billion)	€22.1 billion (£18.9 billion)	N/a
4. UK guarantee for EU contingent liabilities	Considered unlikely to crystallise. No cost to the UK forecast.		
Payments relating to the UK's share of EU assets and liabilities after 31 December 2020			
5. UK share of relevant assets	-€4.9 billion (-£4.1 billion)	N/a	-€1.8 billion (-£1.5 billion)
6. UK contribution to EU pension liabilities	€9.8 billion (£8.5 billion)	€13.4 billion (£11.9 billion)	€14.3 billion (£12.2 billion)
7. Net UK contribution to EU liabilities after receipt of EU assets	€5 billion (£4.3 billion)	€6 billion (£5.1 billion)	N/a
Net total of components 1,4–6 (Commission headline estimate)	€38.9 billion (£33.1 billion)	N/a	**€47.5 billion** **(£40.4 billion)** **This is the full estimate for the settlement in the Commission's forecast**
Payments from the UK to the EU budget between 31 January 2020 and 31 December 2020			
8. Gross UK contributions to the EU budget during the transition period	€17.2 billion (£14.7 billion)	N/a	N/a
9. UK receipts from the EU budget during the transition period	-€6 billion (-£5.4 billion)	N/a	N/a
10. Net UK contributions to the EU budget during the transition period	€11.2 billion (£9.3 billion)	€11.8 billion (£10.1 billion)	N/a

Component of the settlement	HM Treasury[45]	OBR[46]	Commission[47]
Payments relating to the European Investment Bank			
11. Repayment of the UK's paid-in capital with the EIB	-€3.5 billion (-£3.1 billion)	-€3.5 billion (-£3.1 billion)	N/a[48]
12. UK guarantee for EIB contingent liabilities	Considered unlikely to crystallise. No cost to the UK forecast.		
Net total of components 3, 4, 7, 10–12 (OBR headline estimate)	€35.9 billion (£30.4 billion)	**€38.5 billion** **(£34.1 billion)** **This is the full estimate for the settlement in the OBR forecast**	N/a
Payments during the extended Article 50 period (April 2019–January 2020)[49]			
13. Net UK contribution to the EU budget during the Article 50 extension	€7.8 billion (£6.9 billion)	N/a	N/a
Net total of components 3, 4, 7, 10–13 (HMT headline estimate)	**€43.8 billion** **(£37.3 billion)** **This is the full estimate for the settlement in the Treasury's forecast**	N/a	N/a

21. As can be seen, when the UK's payments made before it actually left the EU (component 13 in the table) are stripped out from the Treasury's figures, its estimate for the net cost of the settlement (£30.4 billion) now appears substantially lower than the comparable forecast produced the OBR (£34.1 billion). The European Commission has only produced a gross figure for the cost of the settlement to the UK, which makes overall comparisons difficult.

22. However, there is one component of the settlement for which all three bodies have produced their own forecast of the cost to the UK where there is a clear divergence in their respective estimates: the UK's share of the EU's pensions liabilities accrued prior to the end of 2020. The Treasury estimates this represents a gross cost of €9.8 billion (£8.4 billion), whereas the OBR puts the figure at €13.4 billion (£11.5 billion), resulting in a €3.6 billion (£3.1 billion) difference. The Treasury's EU Finances Statement for 2020 explains the sizable difference between its estimate and that of the OBR (and, by extension, the Commission) as follows:

48 The European Commission does not dispute the fact that the Withdrawal Agreement requires the EIB to repay the UK's paid-in capital to the Treasury. However, this amount is not included in the Commission's estimate of the cost of the settlement, because the Commission is only responsible for the EU's financial accounts, and the EIB accounts – where the repayment will be recorded - are separate.

49 See above for an explanation of why the Treasury includes these amounts in its headline estimate, even though they took place before the UK left the EU on 31 January 2020.

> The OBR does not discount any aspect of the financial settlement. The OBR forecast future public expenditure flows from the financial settlement as they would in their fiscal forecast. In contrast, and in line with the 2017 reasonable central estimate, the Treasury's estimate continues to use a discounted valuation of the UK's EU pensions liability. The effect of discounting this liability is significant because the future cash flows are spread over many decades into the future. The Withdrawal Agreement provides the option for the UK to settle pension obligations early (if the UK so chooses), based upon a discounted amount.[50]

23. The reference to 'discounting' aspects of the financial settlement here refers to calculations made by the Treasury to adjust the UK's share of the EU's pensions bill to expected future actuarial developments.[51] In particular, the Commission notes in the EU's most recent accounts that "in 2020 the real discount rate was negative for the second year running". The discount rate is the rate used to value the *current* cost of *future* pension obligations. In actuarial terms, a negative rate means that "any given amount is worth more today than in the future", which "significantly increases the size of the [pensions] liability at year-end". As a result, the EU accounts for 2020 recorded the estimated net present value of the pensions liability as €116 billion.[52] This is up from €97.7 billion in 2019, €80.5 billion in 2018 and €73.1 billion in 2017.

24. Due to the complexity of the underlying actuarial calculations, the amount contained in the Commission accounts should not be taken as the definitive size of the liability and the UK's share thereof. Indeed, unlike the OBR and Commission, the Treasury's estimate of the pension costs attempts to strip out the effects of the "historically low current net discount rate" to forecast a lower actual cost of the EU pensions bill (at €9.8 billion).[53] By contrast, the European Commission and the OBR appear to have applied the UK's share under the settlement–approximately 12.4 per cent–directly to the current value of the pensions liability, without any further adjustments. Aside from the divergence in the expected cost of the pensions liability, the Treasury has said that its forecast being lower than the OBR's results from the use of non-public data for its modelling for the cost of the *Reste à Liquider* (see paragraph 5), and a different approach to the applicable exchange rate over the lifetime of the settlement (where the OBR forecasts what the Euro-Sterling rate might be in the future).

25. The Government does not appear to have formally commented on the European Commission's estimate that the settlement will be a net cost to the UK of €47.5 billion. However, the Prime Minister has said the UK does "not recognise that figure" (not least, presumably, because of the difference in approaches to estimating the cost of the settlement as described above, which means the Treasury and the Commission are not in

50 HM Treasury, EU Finances Statement 2020 (July 2021).

51 In particular, the EU's post-employment benefits for its employees are financed by a notional fund, where contributions, although not actually invested, are "considered to have been invested in the Member States' long-term bonds" and registered in the EU's annual accounts. This approach means that valuation of the cost of this liability is affected, among other things, by the yield on sovereign debt issued by EU countries, as well as by the expected rate of inflation.

52 European Commission, Consolidated Annual Accounts of the European Union 2020 (July 2021), p. 6.

53 However, if the Government were to decide to make use of the option to settle the UK's contribution to the EU's pension liability early, the amount due would be calculated using the net present value at that point (meaning it is possible there would be a significant difference in the UK's contribution if settled this liability early, or—the default option—as payments fall due in the coming decades).

fact referring to the exact same set of payments and receipts in both directions).[54] On the assets side, part of the discrepancy between the figures produced by the Commission on the one hand, and the Treasury and OBR on the other, is that the latter appear to have a much longer forecast horizon for the amount the UK is due to receive back from various EU financial instruments (component 5 in the table above).[55]

26. In addition, all three headline estimates for the cost of the settlement omit the UK's contributions to the EU's "off-budget" programmes like the European Development Funds, which the Treasury has separately forecast will cost the UK an additional €2.3 billion (£2 billion). This is because these payments are not made into the EU budget, but to funds managed separately by the European Commission on behalf of the EU's Member States. Similarly, none of the estimates published to date envisage the UK incurring any actual costs from being liable for a share of the pre-Brexit contingent liabilities of the EU and the EIB, which we discuss further below.

27. According to the Office for Budget Responsibility (OBR), the majority of the settlement is likely to have been paid by the mid-2020s, with UK payments under the settlement dipping below £1 billion per year from 2026 onwards and levelling off at around £300 million annually from that point.[56]

28. **The European Union Finances Statement published by the Treasury is an invaluable tool in assessing the fiscal implications of the financial settlement included in the Withdrawal Agreement. We welcome the level of detail it provides on the different financial aspects of the UK's exit from the EU. We note that the Treasury's most recent forecast for the cost of the settlement, once payments made by the UK during the unforeseen extension of its EU membership from March 2019 to January 2020 are taken into account, falls within the range of its original estimate made in January 2018.**

29. **We recommend that the Treasury make clear when publishing any future estimates of the total net cost of the settlement whether the amount includes payments made before the UK left the EU, since this may invite erroneous comparisons with the annual estimate published by the OBR (which, in our view reasonably, only includes payments made after the UK formally withdrew and the financial settlement as set out in the Withdrawal Agreement took effect). This is likely to be confusing to those without detailed knowledge of the methodology of the settlement and the different accounting approaches taken by the Treasury and the OBR when estimating its cost. The approach underlying the estimated cost of the settlement produced by the European Commission in the EU's accounts for 2020 is so different from those forecasts, by omitting a number of components of the settlement, so as to preclude meaningful comparison.**

30. ***It is nevertheless concerning that there is a significant discrepancy in the valuation of the UK's total contribution to EU pension costs under the settlement between the***

54 Reuters, "UK spurns EU's €47.5 billion estimate for post-Brexit tab" (8 July 2021).

55 The EU's consolidated accounts for 2020, in which the European Commission's most recent estimate for the cost of the settlement is set out, only covers the return of assets from the EU to the UK for 2021 (without prejudice to the separate return of the UK's paid-in capital by the EIB). By contrast, the Treasury and OBR both attempt to forecast the value of these assets over the entire lifetime of the settlement.

56 Office for Budget Responsibility, Economic and fiscal outlook – March 2021, Supplementary fiscal tables – expenditure (3 March 2021).

Treasury on the one hand, and the OBR and the European Commission on the other. This is an issue that will require careful attention as payments under the settlement fall due. Having taken note of the Treasury's explanation of the multi-billion pound difference between its estimate and that of the OBR with respect to the pensions liability, we ask the Government to keep Parliament informed of any significant fluctuations in the estimated size of the UK's liability in that respect and, where relevant, if the Government decides to settle the amount early in full in line with the terms of the Withdrawal Agreement.

Potential UK payments relating to EU and EIB contingent liabilities

31. One of the components of the financial settlement in the Withdrawal Agreement relates to the UK's exposure to certain contingent liabilities on the books of the EU and the European Investment Bank (EIB), principally those that were entered into the accounts before the UK ceased to be a Member State on 31 January 2020.[57] The underlying logic is that these liabilities were entered into while the UK was part of the EU, and therefore–in part–on its behalf, and that it should therefore also pay towards a share of any costs these may generate in the future even though it is no longer a Member State.

32. These liabilities, as the term implies, are different from the other elements because the UK will only be required to pay for a share of them if they actually crystallise. If this does not happen, there would be no UK contribution required. Indeed, in relation to some of the potential liabilities recorded in the EU's accounts, the European Commission has already set money aside–'provisioned'–in so-called 'guarantee funds', to avoid or mitigate the impact on planned EU spending if they do crystallise. Where this is the case, the UK will receive back its share of any unused portion of these funds when the underlying liability has fully amortised, as part of the return of EU assets to the UK. Indeed, a small amount has already been returned to the UK this year for that reason.[58]

33. The contingent liabilities covered by this part of the Brexit financial settlement as regards the EU's accounts include, in particular:

- guarantees from the EU budget to support financial operations both inside and outside the EU like the External Lending Mandate, the European Fund for Strategic Investments (EFSI) and the European Fund for Sustainable Development (EFSD);[59] and

57 The Treasury's EU Finances Statement notes that "the exception will be costs associated with legal cases related to the [EU] budget and linked policies and programmes, which will be limited to cases where the facts relate to the period of the UK's participation in the EU budget (before the end of 2020)".

58 European Commission, Consolidated Annual Accounts of the European Union 2020 (July 2021), p. 18.

59 The aim of these three Funds is, broadly speaking, to leverage high-risk investment by the European Investment Bank and other financial intermediaries in pursuit of EU public policy purposes by offering a guarantee from the EU budget, in effect partial indemnity, for certain investments.

- outstanding macro-financial assistance loans provided by the EU not only to Member States Ireland and Portugal,[60] but also to non-EU countries like Ukraine and Jordan.[61]

34. The European Commission has estimated that the UK's share of the EU's contingent liabilities covered by the financial settlement amounted to €12.9 billion (£11 billion) at the end of 2020.[62] However, as noted, no UK contribution is due unless the obligation crystallises in the future, and even then only where no sufficient guarantee funds are in place. In the EU's annual accounts for 2020, the Commission says "this is considered unlikely". The Treasury similarly takes the view that the possibility of an "outflow of resources" (i.e. the UK having to pay the EU) in relation to these contingent liabilities is "remote". Indeed, in July 2021, it estimated this arrangement should result in a €2.1 billion (£1.8 billion) asset for the UK over the lifetime of the settlement, because of the return of previous UK contributions to various EU guarantee funds,[63] reducing overall cost of the settlement to the taxpayer.

Potential UK payments relating to European Investment Bank operations

35. In addition to potential payments and receipts relating to contingent liabilities and their guarantee funds in the EU accounts, the settlement also exposes the UK to certain contingent liabilities related to the financial activities of the European Investment Bank (EIB).

36. These contingent liabilities are dealt with separately in the Withdrawal Agreement because the EIB–while established under the EU Treaties and operated on the EU's behalf - is an independent legal entity, with its own accounts. Its fundamental objective is to provide lending to EU Member States (and, to a lesser extent, non-EU countries) for their economic development: in its Annual Report of May 2021, the Bank reported outstanding borrowing operations amounting to €435 billion (£370 billion).[64] The EIB is funded through a mix of paid-in capital by the EU Member States (which are its only shareholders) and raising its own funds on the capital markets. While the Member States have a legal obligation to provide a full amount known as their 'subscribed capital' to the Bank, in practice only a small amount–8.9 per cent–is actually paid to the EIB in the form of 'paid-in capital'. The difference is termed 'callable capital', which EU countries may be asked to pay "to such extent as may be required for the Bank to meet its obligation".[65]

60 Ireland and Portugal received financial support from the European Financial Stability Mechanism following the sovereign debt crisis, with the funds borrowed by the EU and guaranteed against its budget if these countries do not repay. €46.8 billion of these loans was outstanding at the end of 2019. Other 'bail-outs' made to EU Member States, under the European Financial Stability Facility (used for Greece) and the European Stability Mechanism for the Eurozone, are not guaranteed against the EU budget and therefore the UK is not exposed to them under the financial settlement in the Withdrawal Agreement.

61 At the end of 2019, the EU's outstanding macro-financial assistance loans to non-EU countries amounted to €4.7 billion. Since then however, the EU has authorised a further €3 billion assistance package under this programme for 10 non-EU countries to help them address the economic fall-out of the COVID-19 crisis.

62 European Commission, Consolidated Annual Accounts for the European Union 2020 (July 2021). Signed guarantees from the EU budget under these three schemes amounted to €53.4 billion at end-2019, according to those accounts. The settlement also covers the UK's share of contingent liabilities related to EU guarantees for financial operations under its Multiannual Financial Framework 2014–2020, like the EU's "InnovFin" investment facility for research conducted by small companies under the 'Horizon 2020' Research Framework Programme.

63 HM Treasury, EU Finances Statement 2020 (July 2021), Table E.2, p. 77.

64 European Investment bank, Financial Report 2020 (3 May 2021).

65 EIB, "Statute and other Treaty provisions" (March 2020), in particular Articles 4 and 5.

37. The UK ceased to be a shareholder in the EIB when it left the EU. At that point it became largely ineligible for new investments by the Bank, and–as noted–the Treasury is receiving back the UK's €3.5 billion in paid-in capital in 12 annual installments. UK lending operations approved by the EIB group before Brexit remain unaffected.[66] In addition, the Withdrawal Agreement states that the UK is responsible for a share of certain contingent liabilities of the EIB, primarily in relation to the latter's financial operations–such as loans and investments - approved before the UK's withdrawal on 31 January 2020.[67] This reflects the fact that these operations–which may result in a loss to the Bank - were undertaken while the UK was a shareholder of the EIB. The effect of this provision is that the UK could be required to inject capital into the European Investment Bank if considered necessary in light of the Bank's "payment obligations, the state of its assets and liabilities [or] its standing in capital markets".[68] A decision to make such a capital call that includes the UK would be made by the Board of Directors of the EIB, namely senior officials of the Finance Ministries of the 27 EU Member States, without UK Government input.[69]

38. Some concerns have been expressed that the economic damage caused by the Coronavirus pandemic may jeopardise the financial position of the EIB to an extent that it might require a capital injection by the UK under the terms of the settlement. However, it is important to note that the EIB's ability to require additional capital at the expense of the British taxpayer are curtailed by three important legal safeguards in the Withdrawal Agreement:

> First, as noted, the UK's guarantee to the EIB cannot be called on in relation to the latter's financial operations that were agreed only after the UK left the EU on 31 January 2020.[70] It is for this reason that the UK is not contributing to, liable for or eligible to participate in the EIB's new €25 billion 'Pan-European Guarantee Fund' established in summer 2020 to help businesses struggling because of coronavirus;
>
> Second, the Withdrawal Agreement caps the maximum amount the UK could ever be asked to contribute to the EIB's capital and that amount will decrease over time. The settlement prevents the sums to be paid, if the conditions for the UK guarantee are met, from ever exceeding the value of the UK's subscribed capital with the Bank when it ceased to be a Member State, which amounted to €39.2 billion (£35.2 billion).[71] Moreover, in the longer term, the maximum value of the guarantee will automatically

66 Article 151 of the Withdrawal Agreement.

67 The contingent liability also extends to "other EIB risks as long as such risks are not related to post-withdrawal lending". Such "other risks" may, for example, relate to asset-liability management risks and operational risks.

68 Article 150(6) of the Withdrawal Agreement.

69 Article 5 of the Statute of the European Investment Bank.

70 Article 150(1) of the Withdrawal Agreement defines the UK's liability towards the EIB as "financial operations approved by the EIB before the date of entry into force of this Agreement […] and […] other risks assumed by the EIB". It goes on to state that "the liability of the United Kingdom shall extend to the EIB financial operations and to asset- liability management risks and operational risks attributable to the EIB financial operations", while "for other such risks that are not associated with specific financial operations" the UK only has a liability where these "are not attributable to the stock of financial operations built after the date of entry into force of this Agreement" (i.e. 31 January 2020).

71 This is technically a two-part guarantee, consisting of the UK's €3.5 billion of paid-in capital with the EIB, which is being repaid in twelve annual installments, and its subscribed but uncalled capital of €35.7 billion. See Article 150 of the Withdrawal Agreement, paragraphs 3 and 5.

> decrease over time as the EIB's outstanding operations predating the UK's withdrawal from the EU amortise and drop below that amount, eventually reaching zero (at which point the contingent liability is extinguished);[72] and
>
> Third, the EIB cannot make a capital call on the UK without also making a similar call on the remaining EU Member States. The Bank could therefore not seek to boost its financial position at the expense of the UK while not requiring a capital contribution from the EU Member States themselves.

39. In addition, the European Investment Bank has other means at its disposal before it makes a capital call on the UK and the remaining 27 Member States, for example by drawing on its accumulated financial reserves. While concerns have been expressed about the impact of the Coronavirus on the financial stability of the EIB (which could make it more likely that it needs a cash injection, and therefore that the UK's guarantee could be called on), the Bank's 2021 Annual Report states:

> The quality of the Bank's loan portfolio remains high, despite the pandemic's impact […], as it relies on a risk management strategy based on adequate levels of security and guarantees, as well as standard protective clauses included in its loan agreements. […] The overall loan portfolio continued to perform well, with only 0.4% impaired loans at end-2020 […]. The portion of payments overdue by more than 90 days remains very low, totalling €117.1m at end-2020 […] and representing only 0.03% of the risk portfolio. […] Conservative risk management policies and thorough project due diligence underpin the Bank's credit standing. Despite the crisis, the EIB generated positive financial results, booking an annual surplus of €1.7 billion for 2020 as compared to €2.4 billion in 2019.[73]

40. As a result, the Treasury in its latest EU Finances Statement of July 2021 still refers to the UK's contingent liabilities under the settlement–including the EIB guarantee - as 'remote' within the 2019–20 accounts of the Consolidated Fund,[74] and accordingly does not currently forecast any cost to the taxpayer associated with them.[75] The estimates produced by the OBR also do not assume any of the EIB contingent liabilities to which the UK is exposed under the financial settlement will crystallise in a meaningful way.[76]

41. **Given its size, the contingent liabilities taken on by the UK under the financial settlement–especially those in respect of the European Investment Bank - will continue to be of concern, even if there is no indication at present that the either the EU or the EIB will require payment from the UK as a result of them crystallising. The Committee will continue to monitor any relevant developments in this regard closely. We ask the Government to be proactive in informing Parliament if any developments occur that undermine these contingent liabilities' current classification as remote.**

72 Article 150(3) and (5) of the Withdrawal Agreement.

73 European Investment bank, Financial Report 2020 (3 May 2021).

74 HM Treasury, Consolidated Fund account 2019 to 2020 (29 September 2020), p. 13.

75 This position is unchanged from the Treasury's original forecast in January 2018.

76 The European Commission's consolidated annual accounts for the European Union, which contain its estimate for the cost of the financial settlement, do not cover the EIB's accounts and accordingly does not contain any information on the likelihood, or lack thereof, of the EIB requiring a capital injection from the EU Member States and the UK.

Impact of the EU's emergency Covid-19 budget on the cost of the settlement

42. As is clear from the preceding section, the largest component of the financial settlement is the UK's contribution to the spending commitments made by the EU from its funding programmes (such as the Cohesion Fund and the Regional Development Fund) before 31 December 2020, but which were yet to be fully paid out on that date. The totality of EU unpaid funding committed to recipients, the '*Reste à Liquider*' or RAL, at the end of 2020 totalled €303.2 billion (£260 billion), of which the UK is liable for a share of approximately 12.4% (£29 billion).[77]

43. The total amount of such spending commitments the EU could make before the end of 2020, and by extension the maximum size of the RAL to which the UK is required to contribute under the settlement, was capped by the EU's Multiannual Financial Framework.[78] This 'MFF' is the EU's long-term budget, which sets spending limits for different areas of EU activity for seven-year period. The last to be established while the UK was a Member State was the iteration for the 2014–2020 period, agreed by all EU countries in 2013.[79]

44. Because the MFF can be amended mid-way through the EU's budgetary cycle, but the UK lost its ability to veto any such changes after 31 January 2020, the Withdrawal Agreement contains specific provisions that protect the Treasury from having to pay towards funding commitments in 2020 that are predicated on an increase in the EU's spending limits agreed after the UK ceased to be a Member State.[80] This safeguard has had practical consequences in the context of the Coronavirus pandemic, which led the EU to adjust its spending plans for 2020 significantly through seven 'amending budgets' and depletion of its financial reserves for that year.

45. However, in one particular instance a difference in interpretation of the extent of the UK's legal safeguards against retrospective increases in the cost of the settlement via changes to the EU's long-term budget has arisen. In April 2020, the 27 remaining Member States formally, and unanimously, approved an amendment to the EU's 2014–2020 Multiannual Financial Framework.[81] This modified an EU financial reserve - namely, a source of funding for unforeseen expenditure - known as the 'Global Margin for Commitments'. In essence, the change allowed the EU to commit an additional €2 billion (£1.7 billion) in funding in 2020 for healthcare-related purposes in the context of the pandemic. Prior to the amendment, this money could only have been used for "policy objectives related to growth and employment, in particular youth employment, and to

77 The estimates produced by the Treasury and Commission are reasonably close together with respect to the gross cost of the outstanding RAL to the UK, at €34 billion (£29 billion) and €35 billion (£29.8 billion) respectively. The net amount would see this reduced by the amount of EU funding flowing back to the UK under the settlement from 1 January 2021 onwards.

78 While the settlement requires the UK to pay for a share of all EU RAL even where related to earlier Multiannual Financial Frameworks (i.e. the 2007–13 EU long-term budget), the amount of outstanding commitments not related to the 2014–2020 budget will be small.

79 See the European Union (Finances) Act 2015.

80 More specifically, any changes introduced to the Multiannual Financial Framework spending limits after the UK's withdrawal on 31 January 2020—and therefore, without the Government's approval—do not apply to the UK "insofar as those amendments have an impact on the United Kingdom's financial obligations".

81 Council Regulation (EU, Euratom) 2020/538 of 17 April 2020 amending Regulation (EU, Euratom) No 1311/2013 laying down the multiannual financial framework for the years 2014–2020 as regards the scope of the Global Margin for Commitments.

migration and security". The bulk of this new money was subsequently used for collective, EU-wide Advance Purchase Agreements for a (then) future Coronavirus vaccine, a scheme in which the Government decided not to participate.

46. The EU has asserted that the UK should pay for a share of this additional €2 billion of EU spending under the financial settlement–irrespective of whether it participated in the vaccine purchase scheme - because the amendment to its long-term budget agreed after the UK's withdrawal was "limited to the purpose" of the Global Margin for Commitments. In other words, the EU argues that it could have decided to spend the additional money anyway *without* the Covid-related legal modification, even if only for a more limited range of public policy purposes, and therefore any such expenditure is covered by the UK's requirement to pay for a share of the EU's spending committed before the end of 2020. Based on the UK's 12.4% share as established under the settlement (see above), if it had to contribute to this additional spending the UK's gross contribution would appear to be approximately €248 million (£213 million).

47. When the Chief Secretary to the Treasury (Steve Barclay MP) submitted an Explanatory Memorandum to us on these changes in May 2020, he did not indicate whether the Government accepted the EU's assertion and, by implication, the obligation for the UK to pay towards this increased EU expenditure.[82] We therefore specifically asked the Minister to clarify the Government's position.[83]

48. However, on 4 June 2020 - before we had received the Minister's reply - it became clear from press reports that the Government did *not* in fact agree with the EU's interpretation of the UK's obligations under the financial settlement to pay for a share of the €2 billion of additional EU spending using the amended Global Margin for Commitments. The Treasury's latest EU Finances Statement of July 2021 notes that "the Government continues to hold technical discussions with the European Commission" on this matter. As such, it is not yet clear whether the UK will be required to pay for a share of the EU's additional €2 billion of Covid-related spending in 2020. The issue could, as a last resort, be referred for a binding ruling by an independent arbitration panel under the dispute resolution procedures set out in the Withdrawal Agreement (potentially also involving the EU Court of Justice if it requires interpretation of EU budgetary law).

49. ***The Government rightly negotiated important safeguards as part of the Brexit financial settlement that prevent the UK from having to contribute to increases in EU spending in 2020 that were agreed only after it ceased to be a Member State. However, discussions on the question of whether the UK must contribute towards €2 billion of additional Covid-related EU spending, unlocked by means of an amendment to the 2014–2020 Multiannual Financial Framework, have been on-going for over a year and appear unresolved. We therefore ask the Treasury to clarify the amount for which the UK is would be liable if the EU's interpretation were to prevail, what progress has been made in resolving the matter, and whether either side has indicated that a formal dispute resolution process may be necessary to resolve the issue.***

82 HM Treasury, Explanatory Memorandum on Proposal for a Council Regulation amending Regulation (EU, Euratom) No 1311/2013 laying down the multiannual financial framework for the years 2014–2020 (5 May 2020).

83 Letter from the European Scrutiny Committee to the Chief Secretary to the Treasury (7 May 2020).

Potential retrospective UK contributions to the EU budget due to customs fraud

50. In March 2017, the European Commission made public serious allegations[84] that HMRC failed to collect €2.7 billion (£2.4 billion) in customs duties on Chinese textile imports between 2011 and 2017, by failing to take action against importers declaring such goods at fraudulently low values and therefore reducing the amount of duty paid. According to the Commission, €2.1bn (£1.9bn) of these alleged missing revenues should have been paid into the EU budget[85] (which is part-funded by the import duty collected by its Member States, which the UK was at the time of the reported failings).[86] It also argues that the UK infringed EU rules on suspension of VAT on such imports, leading to significant tax evasion in other EU countries where the goods were eventually sold on the black market without VAT paid.

51. Having failed to resolve the dispute at political level with the Government, in March 2019 the Commission formally initiated legal proceedings against the UK before the Court of Justice of the EU (CJEU) for alleged breaches of EU customs, VAT and budgetary legislation.[87] In particular, it alleges that the UK failed to pay the €2.1bn in missing customs duties into the EU budget, and must therefore pay them retrospectively. To this amount, the Commission under EU law would have to add an additional sum–estimated at €1.7 billion (£1.5 billion) in the EU's accounts for 2020[88]–in interest for the UK to pay on the late payment.[89] Under the terms of the financial settlement, the UK was required to make its contributions to the EU budget until the end of 2020 as if it were still a Member State, and it can be required to remedy any breaches of the applicable EU budgetary legislation committed before that point.[90] For this reason, the EU Court of Justice retains jurisdiction in infringement proceedings against the UK in relation to alleged infractions of EU budget law committed before the end of the post-Brexit transition period on 31 December 2020. Any judgment by the Court that the UK had failed to apply the EU legislation cited by the Commission in its claim would therefore be legally binding on the UK.

52. The Government rejects both the allegation that it improperly implemented EU budgetary, customs and VAT law and, consequently, the Commission's estimate of duty loss to the EU budget (and claim for interest for late payment). However, it has not denied the fact that - potentially widespread -undervaluation fraud did occur at UK ports during the period in question. It has asked the Court to dismiss the Commission's case in its entirety, meaning no retrospective UK contribution to the EU budget would be needed. The Court heard arguments in the case from both sides at a hearing on 8 December 2020, and Advocate-General Priit Pikamäe, a senior legal advisor to the EU Court, delivered his

84 At that point, the EU anti-fraud body OLAF concluded an investigation into the UK started in January 2015.

85 European Commission, "EU Budget: Commission takes further action to ensure the United Kingdom makes customs duties fallen due, available to the EU budget" (24 September 2018).

86 The Member States act as the EU's 'collecting agent', transferring 80 per cent of customs duty receipts to the European Commission and retaining 20 per cent as a collection fee.

87 Case C-213/19.

88 European Commission, Consolidated Annual Accounts for the European Union 2020 (July 2021), 71.

89 Article 12 of Regulation 609/2014 provides that "any delay [by Member States] in making the entry in the account [of EU revenues] shall give rise to the payment of interest by the Member State concerned".

90 In particular, Article 136 of the Withdrawal Agreement states that "the applicable [EU] law concerning the Union's own resources relating to financial years until 2020 shall continue to apply to the United Kingdom after 31 December 2020, including where the own resources concerned are to be made available, corrected or subject to adjustments after that date".

Opinion (non-binding legal advice to the judges) on 9 September 2021.[91] In his Opinion, the Advocate-General largely sided with the European Commission, arguing that the UK did indeed breach EU budgetary and customs law by not addressing customs fraud and subsequently paying fewer customs duties into the EU budget. However, he refused to endorse the Commission's calculation of the revenue losses to the EU - the €2.1 billion referred to above - that the UK would have to make up retrospectively.

53. The Court has not yet announced a date for its judgement, against which there is no further appeal. Until its ruling is published, it will remain unclear if the Court will follow the Advocate-General's Opinion and, in particular, whether it would quantify the loss to the EU budget even if it did agree with the Commission's allegations that the UK failed to take the necessary steps to address the undervaluation fraud at its ports and, consequently, underpaid customs duties into the EU budget. The judgement would, in any event, be declaratory: the Court will declare whether the UK did breach any EU laws relevant to the dispute, and if so which. If any such breaches are identified by the judges, the Government would then be under an obligation under EU law[92]–applying 'residually' to this case as a legacy from the time when the UK was a Member State–to "to take the necessary measures to comply with the judgment of the Court". This infringement case is unusual in the sense that the impact of breaches of EU law cannot always be undone retrospectively, but in the case of missing budget contributions the EU can pursue the UK for payment of sums allegedly owed (with, as noted, penalty interest added).

54. Therefore, if the Court does identify a UK breach of EU customs and budgetary legislation, the UK would have an obligation under the Withdrawal Agreement to remedy that failure (in particular, by paying the EU any missing amounts of customs duties[93] plus a statutory penalty for late payment[94]). However, should the Court do so without specifically quantifying the losses–if any - to the EU budget resulting from the UK's actions, the amount of any retrospective UK payments may still have to be resolved between the Commission and the Government, potentially through further legal action if political dialogue fails.

55. **We do not take any position on the merits of the arguments made by the Government and the Commission respectively in relation to the scale of, and duty losses associated with, undervaluation fraud at UK ports, as the matter remains *sub judice*. However, it is important to set out some factual context to the dispute given that it could, potentially, have significant fiscal implications under the financial settlement in the Withdrawal Agreement if the UK were retrospectively found to have underpaid EU budget contributions from 2011 to 2017 based on customs duties. There may also be wider issues for consideration by Parliament relating to the robustness of the UK's customs controls. Once the EU Court of Justice has delivered its ruling in this case,**

91 Opinion of Advocate-General Pikamäe, delivered on 9 September 2021, in Case C213/19 (European Commission v United Kingdom of Great Britain and Northern Ireland).
92 In particular, Article 260 TFEU which requires EU countries to "take the necessary measures to comply with the judgment of the Court".
93 As all Member States, then still including the UK, would automatically have made higher contributions to the EU budget over the period concerned to compensate for the reduced revenues from customs duties, the total cost to the UK would be somewhat lower as it would be entitled to the return of some of those additional contributions.
94 The size of any additional financial penalty for late payment would depend on the size of the underpayment of EU budget contributions linked to the missing customs duties.

should the Government's case for dismissal not prevail, we expect the Treasury to provide Parliament with its assessment of the legal and financial implications without delay.

2 UK participation in EU funding programmes under the Trade and Cooperation Agreement

Introduction

56. The payments required of the UK under the terms of the financial settlement in the Withdrawal Agreement are not the only contributions it is likely to make to the EU budget following its departure. As part of the new post-Brexit partnership with the EU, the Government also secured a provisional agreement on continued UK participation in several of the EU's funding schemes under the latter's 2021–2027 Multiannual Financial Framework, primarily related to scientific research, as well as access to certain services provided by the EU's space programme. There are four EU programmes for which the new UK/EU Trade and Cooperation Agreement (TCA) foresees UK participation from 2021 to 2027.[95] This is often referred to as "third country association" in EU parlance. Within these, UK universities, researchers and other relevant organisations and individuals would, broadly speaking, be eligible to receive EU funding on the same (competitive) basis as their counterparts based in the EU and other "associated countries".[96]

57. The four EU programmes concerned are:

i) 'Horizon Europe', the EU's flagship funding programme for scientific research, excluding the 'European Defence Fund' element of that scheme and the EIC Fund (the loan/equity instrument of the European Innovation Council);[97]

ii) The Euratom programme for nuclear research, which has previously provided funding for the Culham Centre for Fusion Energy in Oxfordshire;

iii) The 'Fusion for Energy' programme, the EU's contribution to the international 'ITER' nuclear fusion research project; and

iv) The 'Copernicus' satellite earth observation programme.[98]

95 In principle, the TCA provides that the UK's participation in the above EU programmes will last until the end of 2027, with the possibility of an extension beyond that date into the EU's next MFF by mutual consent. However, both the UK and the EU can unilaterally terminate the UK's participation a specific programme before 2027 where certain specific conditions are met.

96 The TCA also sets out a number of rules, for example allowing the UK to send observers to meetings of EU Member States where funding priorities are discussed, but also requiring the Government to make "every effort" within its new immigration system to "facilitate the entry and residence of persons involved in the implementation" of the EU programmes in which it participates. In addition, certain EU institutions will have specific powers within the UK to ensure the "sound financial management" of EU funding granted to, or managed by, UK-based entities, including rights of inspection for the European Commission, its anti-fraud body OLAF, and the European Court of Auditors.

97 The UK's participation in the 'Horizon Europe' research programmes does not extend to the European Defence Fund element of that scheme, which funds research into, and development of, new military technology.

98 The UK's access to the Copernicus Emergency Management Service (which provides mapping services for emergency situations) and Security Service components (which delivers mapping for border and maritime surveillance), are yet to be set out in a supplementary agreement. No announcement that a deal to that effect has been reached between the UK and the EU has been made as of X October 2021.

58. In addition, the UK has negotiated access under the TCA to data generated by the EU's Space Surveillance and Tracking programme (but not the military-level 'public regulated service' of the Galileo satellite navigation programme, or the services provided by the EU's Geostationary Navigation Overlay Service (**EGNOS)).**[99] The UK and EU have also made a political commitment for a continuation of the EU's pre-Brexit 'Peace PLUS' programme, which funds cross-border projects on the island of Ireland in the context of reconciliation following the conflict there. As Peace PLUS is focussed on a particular region, rather than the UK as a whole, the financial arrangements for it are not covered by the TCA itself but will be the subject of a separate agreement.[100]

59. The arrangement for UK participation in the four EU programmes above related to science and space enjoys strong support from the British scientific community.[101] However, it is yet to be formalised, as we discuss further below. Once that process is complete, the UK's participation will require a further financial contribution by the Government to the EU budget for the duration of the UK's involvement in those programmes (above and beyond any payments required under the financial settlement as discussed in chapter 1). In May 2021, the Department for Business, Energy and Industrial Strategy estimated that the UK's gross contribution to Horizon Europe–which has the largest budget of the four EU programmes in which the Government is seeking participation–would be in the region of £15 billion over the next seven years.[102] The methodology that determines the calculation of the UK's future contributions, and what factors might affect it, is set out in more detail in paragraphs 64 to 70.

Adoption of the Protocols formalising the UK's participation in EU programmes

60. As noted, the UK's participation in the above EU programmes–and the rights and obligations that flow from it - is yet to be formalised. This will require the UK and EU to jointly adopt two Protocols[103] to the Trade and Cooperation Agreement. Legally, this approval will take the form of a formal Decision of the UK-EU 'Specialised Committee on Participation in Union Programmes' (one of the many thematic governance bodies established by the Agreement).

61. While a draft of these Protocols was provisionally agreed between the Government and the EU in a Joint Declaration in December 2020,[104] they were not ratified alongside the TCA because the European Parliament and the EU's Council of Ministers were, at that point, still in the process of adopting the legal acts that underpin the EU's funding

99 According to the European Commission, the UK requested the access to the service provided by EGNOS with no financial contribution which the EU rejected. Conversely, the EU proposed full UK participation in EGNOS (rather than access only to the service), which the UK rejected.

100 The EU has also suggested a joint UK-EU funded support scheme for Gibraltar and the neighbouring Spanish region under a new UK-EU Agreement on Gibraltar, which the Government is seeking to negotiate in the coming months.

101 See for example the Joint statement of European university groups, including the Russell Group, on "The future of Horizon Europe and restriction of access to quantum & space programmes" (23 April 2021).

102 Letter from Amanda Solloway, the Minister for Science, to Sir William Cash, Chair of the European Scrutiny Committee (25 May 2021).

103 One relating to the UK's participation in Horizon Europe, Euratom research programme, Fusion for Energy and Copernicus; and the other relating to the UK's access to services provided by the EU's Space Surveillance and Tracking programme.

104 UK-EU Joint Declaration on participation in Union programmes and access to programme services.

programmes for the duration of its 2021–2027 Multiannual Financial Framework. The UK could not formally commit to participation until the legal acts were in place to formally establish the relevant programmes under EU law.[105] The Joint Declaration expresses:

> [The] Parties' firm intention that [they] […] will adopt the Protocols at the earliest opportunity to allow their implementation as soon as possible, in particular with the ambition that United Kingdom entities would be able to participate from the beginning of the programmes and activities identified".[106]

62. While the EU legal acts underpinning the relevant programmes are now all in place (and have been since May 2021), the Protocols remain to be formally agreed due to delays on the EU side. In particular, the European Commission is yet to make a formal proposal to the EU's Council of Ministers to approve the aforementioned Protocols to the TCA.[107] As such, the UK is not yet a participant in the EU funding programmes, but in the interim the Commission has confirmed that UK entities applying for EU funding from the relevant programmes will be "treated as if the UK is an associated country throughout the process, from admissibility and eligibility to evaluation". However, actual grant agreements "can only be signed once the association has come into force".[108]

63. Given that the EU adopted the legal acts underpinning the programmes in May, the UK raised the delay on the EU side in completing the processes necessary for the approval of the necessary Protocols at the first meeting of the new UK-EU Partnership Council on 9 June 2021. According to the minutes, the UK delegation–led by Lord Frost - pushed for a formal Decision of the Specialised Committee to involve the UK in the research and space programmes "quickly", warning that "the delay is already having practical impacts and could have lasting effects on the development of the Programmes moving forward", especially in relation to procurement exercises under the Copernicus programme. However, the Commission's timetable for initiating the process to formally allow the UK to join the programmes remains unclear.

64. It appears that the delays on the EU side are not merely procedural, but also linked to the on-going political disagreements between the EU and the Government over the Northern Ireland Protocol.[109] Norway and Iceland formally achieved 'association' to Horizon Europe (the most significant of the EU programmes in which the UK is seeking

105 Not least because these legal acts have to formally provide for the option of participation of non-EU countries like the UK, and also set the envisaged spending from the EU budget on the different programmes (which, as discussed further starting in paragraph 64, affects the UK's contribution in return for its participation).

106 Joint Declaration on Participation in Union Programmes and Access to Programme Services.

107 Procedurally, on the EU side, the European Commission must present a proposed EU position for consideration by the 27 Member States in the Council of Ministers. This will include the finalised text of the Protocols in the form of a draft Decision of the Specialised Committee on Participation in Union Programmes (presumably informally agreed with the UK beforehand), and a Council Decision expressing the EU's consent to them. Once approved by the Council, this will form the EU's formal position, authorising the European Commission to approve the Protocols in the Specialised Committee.

108 European Commission, "Q&A on the UK's participation in Horizon Europe" (25 February 2021), accessed 16 September 2021. The same treatment is also being granted to applicants from other 'associated countries' currently engaged in the active process of (re)association with EU funding programmes.

109 Science/Business noted in June 2021 that "UK researchers are being encouraged by the government to go ahead and apply for Horizon Europe grants, despite lack of a formal agreement to associate with Horizon Europe and the fraught stand-off over implementation of the Northern Ireland protocol". Similarly, on 29 September 2021 Dutch newspaper De Volkskrant reported that the European Commission had briefed EU Member States that the UK could be shut out from EU funding programmes as part of a broader response to the UK's position on the Protocol.

participation) on 24 September 2021.[110] The European Commission has also said the arrangements are being formalised with 12 other countries besides the UK, including Turkey, the Faroe Islands and Ukraine.[111]Switzerland, which is also seeking association with Horizon Europe, is likely to be excluded from the programme for the time being amid the political fallout of its rejection of a new trade and partnership agreement with the EU.[112] It is unclear how the Government intends to proceed if other countries are permitted to join the EU's funding programmes but the UK's participation is delayed much longer.

UK financial contribution in return for participation in EU programmes

65. Provided that the UK does become a formal participant in the four EU scientific and nuclear programmes through adoption of the Protocols to the TCA, the Government would have to make a substantial financial contribution to the EU budget. The methodology underpinning the UK payments to the EU is set out primarily in Part Five of the Trade and Cooperation Agreement.[113] Such contributions would–broadly speaking–be calculated based on the EU's own spending on the relevant programmes under its long-term budget 2021–2027. The UK's payments in a given financial year is also subject to various retrospective adjustments which, depending on the circumstances, could increase or decrease the sums involved. The UK contribution to the EU budget in return for participation in EU programmes consists of two components:

- An operational contribution, which adds[114] to the EU's own allocated financial commitments to the operation of the programmes in question from the EU annual budget. The operational contribution is calculated by applying the ratio of the UK's GDP compared to that of the EU (the "contribution key") to the EU's own budget for each of the programmes in which the UK participates. This key is currently approximately 15.6%. This means, for example, that if the EU allocates a financial envelope of €100m in a given year to an EU programme in which the UK participates, the Treasury's initial operational contribution will be €15.6 million; and

110 Decision of the EEA Joint Committee No 263/2021 of 24 September 2021 amending Protocol 31 to the EEA Agreement, on cooperation in specific fields outside the four freedoms.

111 European Commission documents COM(2021) 469 and COM(2021) 220. See also the European Commission's list of non-EU countries associated with Horizon Europe (accessed 16 September 2021).

112 In September 2021, the European Commission said that "As a consequence of the termination of the EU-Swiss Institutional Framework Agreement (IFA) negotiations on 26 May, Switzerland is not considered as a candidate to association at this stage."

113 More specifically, Part Five of the TCA, supplemented by an Annex on 'implementation of the financial conditions' and by the draft Protocol on UK participation in EU programmes. This specifies for example that the contribution will have to be paid annually, in biannual installments, in Euros. Late payment of the contribution would trigger penalty payments in the form of interest on the amount due. For Horizon Europe, the largest programme in financial terms in which the UK is participating, the TCA contains a special payment schedule that reduces payments in the first few years of the UK's participation but increases them proportionally in later years.

114 The UK's operational contribution is additional to the EU's own budget for the schemes concerned; in other words, it increases the total funding for those programmes overall.

- A participation fee, which could be seen as a general 'entry fee' and is calculated as a percentage of the operational contribution for each of the EU programmes in which the UK participates. The percentage will rise in annual increments, from 0.5% in 2021 to 4% by 2026.

66. The methodology for the financial contribution is subject to further complexities, reflecting the amount of public money at stake. In particular, the UK's annual operational contribution will be subject to retrospective adjustments to reflect:

- The EU's actual spending on the programme in which the UK participates in a given year, rather than the *planned* spending as set out in advance in its annual budget (for example to take into account budgetary increases, or cancelled spending).[115] The adjustment process will be carried out each year until the programme ends and its funding has been fully implemented.[116] Depending on the circumstances this adjustment process could lead to a retrospective increase or decrease in the UK's contribution for the year concerned;
- The actual ability of UK entities to bid successfully for EU funding from the relevant programmes. This means the financial contribution will be reduced proportionally to the amount of funding under 'competitive award procedures' for which the UK's eligibility was *de jure* restricted. This would be the case where the UK does not participate in specific actions or grant procedures under programmes in which it is otherwise involved,[117] including where it chooses of its own volition to restrict its participation so that it does not have to pay more where the EU increases its budget for a particular programme in the future under the 'financial increases review'.[118] In addition, there is a specific process for determining whether the UK was *de facto* 'quasi-excluded' from a particular EU grant procedure, which would also reduce the UK's contribution.[119]
- The application of an 'automatic correction' to the UK's contribution to Horizon Europe research scheme specifically, which the EU has insisted on to prevent the UK from becoming a significant net beneficiary of EU research funds. This is effectively an ex-post increase in the UK's contribution, triggered where the UK's receipts from competitive grants under the Horizon Europe programme exceed its (adjusted) contribution by a certain amount and several other

115 For example, the EU can adopt 'amending budgets' throughout the year that can increase as well as decrease its funding allocation for specific programmes; it may not spend the full amount which it had planned; or planned spending can be 'de-committed' (cancelled).

116 In Article 714(8) of the TCA, this is described as "the budgetary commitments made on the commitment appropriations of that year, their implementation through legal commitments and their decommitment".

117 Some specific calls for funding may not be open to the UK. For example, the UK will not participate in the European Innovation Council (EIC) Fund under the Horizon Europe programme, and the Agreement foresees a proportionate reduction in the UK's contribution to that programme as a result. In addition, calls for funding may not be open to UK entities where the UK's participation in a particular EU programme has been suspended or terminated.

118 Specific conditions are attached to the UK's ability to trigger the financial increases review, principally relating to the significance of the EU's budgetary increase for any of the programmes in which the UK participates.

119 Such 'quasi-exclusion' would occur, broadly speaking, where the participation rate of UK entities in a relevant EU grant procedure is at least 25% lower compared to the average UK participation rate in similar grant procedures. However, the determination that quasi-exclusion has taken place must be taken by the Specialised Committee i.e. with the EU's agreement.

conditions are met.[120] The mechanism does not operate in the other direction if the UK's contribution exceeds its receipts. However, if the UK's becomes a net *contributor* to Horizon Europe by a certain margin it does have the right to trigger a 'performance review' to assess how either its success in securing funding could be improved or its financial contribution reduced;[121] and

- The suspension or termination of the UK's participation in a specific EU programme.[122] In the case of the UK's involvement in an EU programme being ended prematurely by the EU or the UK itself before the end of 2027, the Government's contribution for the relevant years will be reduced proportionally to the amount of competitive award procedures under the programme in question from which the UK was excluded by reason of that suspension or termination.[123]

67. In summary, the UK's operational contribution in a given year will depend on the planned EU spending for the programmes in which the UK participates for that year after the necessary adjustments and corrections are made to its contribution in previous year(s), which could entail either an increase or a reduction depending on the precise circumstances. Conceptually, this is not dissimilar to how the UK's EU budget contribution and rebate operated while it was an EU Member State, as the size of these were also adjusted retrospectively to take into account actual implementation of EU spending. Any UK payments to the EU budget in return for participation in EU programmes will be made under Section 35(1) of the Future Relationship Act. This is a known as a 'Baldwin provision'[124] that authorises expenditure arising out of the implementation of the Trade and Cooperation Agreement. No such payments are due until the EU and UK formally agree the Protocols on the UK's participation in the Specialised Committee.

Estimated UK contribution for the 2021–2027 period

68. As noted, the Department for Business, Energy and Industrial Strategy estimates the gross UK payments for the Horizon Europe scheme alone would amount to £15 billion from 2021 to 2027 (or, on average, £2.1 billion per year), provided the UK formally associates with the programme with retroactive effect to the start of 2021. That sum does not take into account receipts flowing back from the EU to the UK, which will reduce the overall net contribution. Indeed, the Department has said that it would "expect the

120 The 'automatic correction mechanism' applies, broadly speaking, where the UK's receipts from competitive grants from Horizon Europe in a given year exceeded its operational contribution to such grants by at least 8% for two consecutive years, in which case the UK has to pay the difference so that its receipts and contributions are matched. The mechanism does not operate in the other direction: the UK will not get an automatic rebate on its contribution to Horizon Europe if its receipts are significantly below what it pays in.

121 A performance review can only be triggered if, in a given year, the difference between the UK's adjusted contribution to Horizon Europe and its receipts from the programme exceeds 12% of its contribution. That would trigger the UK and EU discussing "appropriate measures" to close the gap. Ultimately, if certain conditions are met, the UK could terminate its participation in Horizon Europe altogether by reason of the gap between receipts and payments.

122 The TCA contains specific conditions that must be met before either the EU or the UK could suspend or terminate the UK's participation in a particular EU programme. See in particular Articles 718–720 TCA.

123 See Articles 718 to 720 TCA.

124 In other words, the section is drafted to satisfy the general principle of constitutional propriety (often known as the 'PAC Concordat' or 'Baldwin Convention') that new functions involving expenditure "which is neither modest nor temporary" should be authorised by specific legislation – in this case the Future Relationship Act 2020 - and not by Supply and Appropriation Acts alone.

majority of this funding to flow back to UK businesses and researchers in the form of grants", meaning the expectation is that the net contribution will be less than half of that amount.[125]

69. Horizon Europe has by far the largest allocation from the EU budget of the four programmes in which the UK is seeking participation. With a maximum financial endowment of €95.5 billion (£81.4 billion), it dwarfs Fusion for Energy (€5.6 billion), Copernicus (€5.4 billion) and the Euratom research scheme (€1.4 billion).[126] Given that the UK's contribution is calculated by direct reference to the EU's own budget for these programmes, it follows that its payments for each of the remaining three programmes over the 2021–2027 period will be substantially lower than the £15 billion estimated for Horizon Europe. However, we are not aware of the Government having published similar estimates of the gross cost to the UK of these other programmes. The Treasury has indicated that it will include detailed information about the costs of the UK's participation in EU programmes under the TCA in its annual EU Finances Statement, beginning in 2022.[127]

70. With respect to the size of the UK contribution, the delays in formalising the UK's participation in these EU programmes also raise a concern about value for money. While the EU has delayed the approval of the Protocols to the TCA, UK entities are currently not able to sign any grant or procurement agreements financed from these schemes. They will not be able to recover those lost opportunities–which will increase as time goes on–as and when association is formalised. It is not yet clear how this reduction in potential receipts from the programmes for UK recipients, if there are further delays, would be reflected in the size of the Government's financial contribution in the form of a reduction.

71. As noted, the UK and EU are also jointly continuing the 'Peace PLUS' programme to fund reconciliation projects on the island of Ireland. As this programme is focussed on a particular region, rather than the UK as a whole, financial arrangements for its operation are not covered by the methodology to calculate a UK contribution as described above, but will be "subject of a separate financing agreement" (separate from the arrangements for the UK's participation in the EU's science and space programmes).[128] This agreement does not yet appear to have been struck as of 20 October 2021, but the Government has announced the UK will pay for £730 million of its £1 billion budget over a seven-year period (with the remainder to be contributed by the EU and Ireland).[129]

72. The TCA provides for the possibility of the UK joining additional EU programmes, like the Erasmus+ scheme for student exchanges or the Creative Europe programme that invests in international audiovisual productions, at a later stage.[130] This would require

125 Letter from Amanda Solloway MP, Minister for Science, to Sir William Cash MP, Chairman of the European Scrutiny Committee (25 May 2021).

126 It should be noted that the budget for the Euratom research programme only covers the years from 2021 to 2025, with its budget for 2026 and 2027 to be set at a later date.

127 HM Treasury, EU Finances Statement 2020 (July 2021), Annex F.

128 The EU has also suggested a joint UK-EU funded support scheme for Gibraltar and the neighbouring Spanish region under a new UK-EU Agreement on Gibraltar, which the Government is seeking to negotiate in the coming months.

129 Northern Ireland Office, "UK announces majority contribution to PEACE PLUS funding" (4 September 2021).

130 The TCA also contains a basic framework that would cater for future UK involvement in the 'InvestEU' programme, a scheme that will leverage European Investment Bank (EIB) funding in participating countries for major projects in areas like industrial, transport, energy and telecommunications infrastructure. While the Government had previously suggested it would seek a new partnership with the EIB, for the time being it has chosen not to make use of the possible option to that effect provided by InvestEU at this stage (as the Treasury notified the European Scrutiny Committee by letter dated 30 September 2020).

an additional financial contribution in line with the principles outlined above. The Government currently has no plans to exercise the option to expand the range of EU programmes in which the UK participates beyond those foreseen in the draft Protocol to the TCA.

73. **The Government has decided that, on balance, making further contributions to the EU budget above and beyond the terms of the financial settlement in the Withdrawal Agreement is acceptable in order to secure continued UK participation in certain EU programmes related to science and space. We note the strong support for that approach in the UK scientific community and higher education sector. However, this arrangement is yet to be agreed because of delays on the EU side in approving the relevant Protocols to the Trade and Cooperation Agreement, which are becoming increasingly difficult to justify as merely procedural. Drafts of the Protocols were included in the TCA, and the Commission has made formal proposals to the EU Council of Ministers to formalise the participation of Norway and Iceland in various EU programmes for the 2021–2027 period.**

74. ***We note the Government's assessment that this delay "is already having practical impacts and could have lasting effects on the development of the Programmes moving forward". In particular, it is impeding participation by British organisations in projects and procurement exercises funded from these EU programmes, potentially reducing the balance of benefits between the UK's receipts from and contributions to them. In light of this, we ask the Government to clarify what steps are being taken to expedite the process of formalising the UK's participation, and how it intends to respond if it is delayed further.***

75. **We also welcome the Government's intention to include information on the UK's contributions and receipts related to participation in EU programmes under the TCA in the annual EU Finances Statement, and ask it to provide information to Parliament expeditiously if–in due course - any of the review processes foreseen in the Trade and Cooperation Agreement that could lead to significant increases in UK payments, leading to potential modifications or suspension of the UK's participation in EU programmes, are being considered.**

76. ***We also ask the Government to clarify the status of the negotiations with the EU on the continuation of the Peace PLUS programme for Northern Ireland and Ireland, in particular when the negotiations are expected to conclude.***

Conclusions and recommendations

The financial settlement in the Withdrawal Agreement

1. The European Union Finances Statement published by the Treasury is an invaluable tool in assessing the fiscal implications of the financial settlement included in the Withdrawal Agreement. We welcome the level of detail it provides on the different financial aspects of the UK's exit from the EU. We note that the Treasury's most recent forecast for the cost of the settlement, once payments made by the UK during the unforeseen extension of its EU membership from March 2019 to January 2020 are taken into account, falls within the range of its original estimate made in January 2018. (Paragraph 28)

2. We recommend that the Treasury make clear when publishing any future estimates of the total net cost of the settlement whether the amount includes payments made before the UK left the EU, since this may invite erroneous comparisons with the annual estimate published by the OBR (which, in our view reasonably, only includes payments made after the UK formally withdrew and the financial settlement as set out in the Withdrawal Agreement took effect). This is likely to be confusing to those without detailed knowledge of the methodology of the settlement and the different accounting approaches taken by the Treasury and the OBR when estimating its cost. The approach underlying the estimated cost of the settlement produced by the European Commission in the EU's accounts for 2020 is so different from those forecasts, by omitting a number of components of the settlement, so as to preclude meaningful comparison. (Paragraph 29)

3. *It is nevertheless concerning that there is a significant discrepancy in the valuation of the UK's total contribution to EU pension costs under the settlement between the Treasury on the one hand, and the OBR and the European Commission on the other. This is an issue that will require careful attention as payments under the settlement fall due. Having taken note of the Treasury's explanation of the multi-billion pound difference between its estimate and that of the OBR with respect to the pensions liability, we ask the Government to keep Parliament informed of any significant fluctuations in the estimated size of the UK's liability in that respect and, where relevant, if the Government decides to settle the amount early in full in line with the terms of the Withdrawal Agreement.* (Paragraph 30)

4. Given its size, the contingent liabilities taken on by the UK under the financial settlement–especially those in respect of the European Investment Bank - will continue to be of concern, even if there is no indication at present that the either the EU or the EIB will require payment from the UK as a result of them crystallising. The Committee will continue to monitor any relevant developments in this regard closely. We ask the Government to be proactive in informing Parliament if any developments occur that undermine these contingent liabilities' current classification as remote. (Paragraph 41)

5. *The Government rightly negotiated important safeguards as part of the Brexit financial settlement that prevent the UK from having to contribute to increases in EU spending in 2020 that were agreed only after it ceased to be a Member State. However,*

discussions on the question of whether the UK must contribute towards €2 billion of additional Covid-related EU spending, unlocked by means of an amendment to the 2014–2020 Multiannual Financial Framework, have been on-going for over a year and appear unresolved. We therefore ask the Treasury to clarify the amount for which the UK is would be liable if the EU's interpretation were to prevail, what progress has been made in resolving the matter, and whether either side has indicated that a formal dispute resolution process may be necessary to resolve the issue. (Paragraph 49)

6. We do not take any position on the merits of the arguments made by the Government and the Commission respectively in relation to the scale of, and duty losses associated with, undervaluation fraud at UK ports, as the matter remains *sub judice*. However, it is important to set out some factual context to the dispute given that it could, potentially, have significant fiscal implications under the financial settlement in the Withdrawal Agreement if the UK were retrospectively found to have underpaid EU budget contributions from 2011 to 2017 based on customs duties. There may also be wider issues for consideration by Parliament relating to the robustness of the UK's customs controls. Once the EU Court of Justice has delivered its ruling in this case, should the Government's case for dismissal not prevail, we expect the Treasury to provide Parliament with its assessment of the legal and financial implications without delay. (Paragraph 55)

UK participation in EU funding programmes under the Trade and Cooperation Agreement

7. The Government has decided that, on balance, making further contributions to the EU budget above and beyond the terms of the financial settlement in the Withdrawal Agreement is acceptable in order to secure continued UK participation in certain EU programmes related to science and space. We note the strong support for that approach in the UK scientific community and higher education sector. However, this arrangement is yet to be agreed because of delays on the EU side in approving the relevant Protocols to the Trade and Cooperation Agreement, which are becoming increasingly difficult to justify as merely procedural. Drafts of the Protocols were included in the TCA, and the Commission has made formal proposals to the EU Council of Ministers to formalise the participation of Norway and Iceland in various EU programmes for the 2021–2027 period. (Paragraph 73)

8. *We note the Government's assessment that this delay "is already having practical impacts and could have lasting effects on the development of the Programmes moving forward". In particular, it is impeding participation by British organisations in projects and procurement exercises funded from these EU programmes, potentially reducing the balance of benefits between the UK's receipts from and contributions to them. In light of this, we ask the Government to clarify what steps are being taken to expedite the process of formalising the UK's participation, and how it intends to respond if it is delayed further.* (Paragraph 74)

9. We also welcome the Government's intention to include information on the UK's contributions and receipts related to participation in EU programmes under the TCA in the annual EU Finances Statement, and ask it to provide information to Parliament expeditiously if–in due course - any of the review processes foreseen in

the Trade and Cooperation Agreement that could lead to significant increases in UK payments, leading to potential modifications or suspension of the UK's participation in EU programmes, are being considered. (Paragraph 75)

10. *We also ask the Government to clarify the status of the negotiations with the EU on the continuation of the Peace PLUS programme for Northern Ireland and Ireland, in particular when the negotiations are expected to conclude. (Paragraph 76)*

Formal minutes

Wednesday 20 October 2021

Members present:

Sir William Cash, in the Chair

Jon Cruddas

Margaret Ferrier

Mr David Jones

Marco Longhi

Craig Mackinlay

Greg Smith

Document scrutiny

Draft Report (*Brexit divorce bill and UK participation in EU programmes: how much and who pays?*), proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 76 agreed to.

Summary agreed to.

Resolved, That the Report be the Ninth Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

Adjournment

Adjourned till Monday 25 October 2021 at 1.45 pm

List of Reports from the Committee during the current Parliament

All publications from the Committee are available on the publications page of the Committee's website.

Session 2021–22

Number	Title	Reference
1st	Documents considered by the Committee on 12 May 2021	HC 121-i
2nd	Documents considered by the Committee on 26 May 2021	HC 121-ii
3rd	Documents considered by the Committee on 9 June 2021	HC 121-iii
4th	Documents considered by the Committee on 23 June 2021	HC 121-iv
5th	Documents considered by the Committee on 7 July 2021	HC 121-v
6th	Documents considered by the Committee on 19 July 2021	HC 121-vi
7th	Documents considered by the Committee on 8 September 2021	HC 121-vii
8th	Documents considered by the Committee on 22 September 2021	HC 121-viii

Session 2019–21

Number	Title	Reference
None	30th—Documents considered by the Committee on 25 November 2020	HC 229-xxvi
1st	The EU's mandate for negotiating a new partnership with the UK	HC 218
2nd	COVID-19 pandemic: the EU's policy response and its implications for the UK	HC 275
3rd	Documents considered by the Committee on 26 March 2020	HC 229-i
4th	Documents considered by the Committee on 23 April 2020	HC 229-ii
5th	The EU's mandate for negotiating a new partnership with the UK: outcome of Select Committee consultation	HC 333
6th	Documents considered by the Committee on 30 April 2020	HC 229-iii
7th	Documents considered by the Committee on 7 May 2020	HC 229-iv
8th	Documents considered by the Committee on 14 May 2020	HC 229-v
9th	Documents considered by the Committee on 21 May 2020	HC 229-vi
10th	Documents considered by the Committee on 4 June 2020	HC 229-vii
11th	Documents considered by the Committee on 11 June 2020	HC 229-viii
12th	UK-EU Joint Committee: Decision of 12 June 2020 amending the Withdrawal Agreement	HC 465

Number	Title	Reference
13th	Documents considered by the Committee on 18 June 2020	HC 229-ix
14th	Documents considered by the Committee on 25 June 2020	HC 229-x
15th	Documents considered by the Committee on 2 July 2020	HC 229-xi
16th	Documents considered by the Committee on 9 July 2020	HC 229-xii
17th	Documents considered by the Committee on 16 July 2020	HC 229-xiii
18th	Documents considered by the Committee on 23 July 2020	HC 229-xiv
19th	Documents considered by the Committee on 3 September 2020	HC 229-xv
20th	Documents considered by the Committee on 10 September 2020	HC 229-xvi
21st	Documents considered by the Committee on 16 September 2020	HC 229-xvii
22nd	Documents considered by the Committee on 24 September	HC 229-xviii
23rd	Documents considered by the Committee on 1 October 2020	HC 229-xix
24th	Documents considered by the Committee on 8 October 2020	HC 229-xx
25th	Documents considered by the Committee on 15 October 2020	HC 229-xxi
26th	Documents considered by the Committee on 21 October 2020	HC 229-xxii
27th	Documents considered by the Committee on 4 November 2020	HC 229-xxiii
28th	Documents considered by the Committee on 11 November 2020	HC 229xxiv
29th	Documents considered by the Committee on 19 November 2020	HC 229-xxv
31st	Documents considered by the Committee on 3 December 2020	HC 229-xxvii
32nd	Documents considered by the Committee on 9 December 2020	HC 229-xxviii
33rd	Documents considered by the Committee on 16 December 2020	HC 229-xxix
34th	Documents considered by the Committee on 20 January 2021	HC 229-xxx
35th	Documents considered by the Committee on 3 February 2021	HC 229-xxxi
36th	Brexit: The future operation of the Channel Tunnel Fixed Link	HC 1062
37th	Documents considered by the Committee on 10 February 2021	HC 229-xxxii

Number	Title	Reference
38th	Documents considered by the Committee on 24 February 2021	HC 229-xxxiii
39th	Documents considered by the Committee on 10 March 2021	HC 229-xxxxiv
40th	Documents considered by the Committee on 17 March 2021	HC 229-xxxv
41st	Northern Ireland Protocol: Withdrawal Agreement Joint Committee Decisions and declarations of 17 December 2020	HC 1343
42nd	Documents considered by the Committee on 24 March 2021	HC 229-xxxvi
43rd	Documents considered by the Committee on 14 April 2021	HC 229-xxxvii
44th	Documents considered by the Committee on 21 April 2021	HC 229-xxxviii