House of Commons

European Scrutiny Committee

Brexit divorce bill and UK participation in EU programmes: how much and who pays?: Government response to the Committee's Ninth Report

Third Special Report of Session 2021–22

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European Scrutiny Committee

The European Scrutiny Committee is appointed under Standing Order No.143 to examine European Union documents.

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Committee reports are published on the Committee's website and in print by Order of the House.

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Third Special Report

The European Scrutiny Committee published its Ninth Report of Session 2021–22, Brexit divorce bill and UK participation in EU programmes: how much and who pays? (HC 815), on 25 October 2021. The Government response was received from Rt Hon. Simon Clarke MP (Chief Secretary to the Treasury) on 8 December 2021 and is appended below.

Appendix: The Government's response

1. The Government welcomes the Committee's continued interest in the transparency of formal reporting to Parliament on the financial settlement under the Withdrawal Agreement (WA) and on programme participation under the Trade and Cooperation Agreement (TCA). The Committee's conclusions are both timely and valuable as HM Treasury considers how forty years of reporting on the UK's financial relationship with the EU must change to align with our current relationship, and the substantial erosion of mutual liabilities over the next few years.

2. The Government's practice has been for HM Treasury to publish an annual Command Paper on the UK's financial relationship with the EU ('the Statement').[1] This draws upon several Government financial reports but is considered to be the most comprehensive narrative because it is not bound by the requirements of specific accounting standards and is able to take a holistic approach to the financial relationship.[2] It has evolved to take account of the changing nature of that relationship, for example

a) in the 2018 edition the long-standing main report was supplemented with a new Annex considering the impact of EU withdrawal, to be updated annually in line with commitments to the Public Accounts Committee

b) in the 2019 edition the Government published a revised point estimate of the UK's liabilities under the WA and included additional sensitivity analysis

c) in this year's edition the Government used the Statement to report in more detail on expected programme participation within the TCA

3. The Government considers that the Statement will need to continue to evolve in future years. The long-standing structure and focus of the report are no longer appropriate for the UK's status outside of the EU. For example, content relating to the completed 2014–20 EU Multiannual Financial Framework (MFF) is now either out of date or of diminishing interest to Parliament. Accordingly, the first objective for future editions of the Statement is a proportionate adjustment of focus from our period of EU membership to the current scope of the WA and TCA.

1 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1005905/210706_FINAL_European_Union_Finances_Statement_2020.pdf
2 EU Finances Statement at Paragraph E.64

4. HM Treasury therefore intends to make the following broad changes starting from the next edition of the Statement by:

- removing most of the current detailed reporting on historic contributions and receipts under the MFF, and the associated control framework implemented by the Government, contained in Chapters two to five of the latest edition. We may, however, retain brief summaries of relevant conclusions on fraud, disallowances and the tail of programme receipts from the 2014–20 MFF while these continue to be of significant relevance to our payments under the WA.

- leading the next edition of the publication with the material on administration of the WA and TCA which has been the subject of the annexes in previous editions, but which is now central to the UK's financial relationship with the EU.[3] The effect of these first two changes will be to reverse the structure and emphasis of the current Statement.

- acknowledging, where relevant, that expenditure related to our future participation in EU programmes is paid and scrutinised by other departments who will be best placed to report on it in detail to Parliament (with HM Treasury's role limited to providing an overview and links to other relevant documents rather than attempting to consolidate them). This is different to the nature of contributions while the UK was a member of the EU, since contributions did not fund specific items of expenditure.

5. As the nature of our remaining liabilities under the WA continues to evolve, and diminishes rapidly, it is likely that it will be sensible to make further changes over time. HM Treasury is also considering whether the revised nature of the Statement means that it is possible to bring forward the publication date.

Responses to Committee recommendations

Recommendation 1 from the Committee's Report (paragraph 29):

We recommend that HM Treasury make clear when publishing any future estimates of the total net cost of the settlement and whether the amount includes payments made before the UK left the EU.

6. The Government agrees with this recommendation. The Committee's report rightly acknowledges that one impact of the UK's delay leaving the EU was that some payments which were expected under the WA were made while the UK remained a member state. When the Government provided its first updated estimate of the financial settlement in 2019, and the most recent estimate in July, the net liability was reconciled back to original estimate in order to ensure that Parliament remained able to compare the most recent liability estimate with the original range on a consistent basis. Alongside this a new point estimate that was adjusted to remove all payments made before the UK left the EU was also provided.

3 EU Finances Statement 2020 Treatment of the financial settlement in government accounts, from Paragraph E.58.

7. The next edition of the Statement will further simplify our presentation of the UK's net liabilities under the WA. HM Treasury anticipates presenting the payment figures in the following manner:

- the amount the EU invoiced us in the calendar year prior to publication. This will be broken down to show how much of that liability the UK paid in that year and how much is left to pay in the following calendar year.
- a separate forecast of what is left to pay under the WA net of all payments made to the EU (or expected to be made) by the reporting date.
- an annexed reconciliation based on the UK's planned Exit date to allow comparison with the original £35–39bn range in the interests of transparency. This will present separately the liabilities paid during the extension of the UK's membership of the EU; those paid during the transition period; payments during 2020 and the estimate of the outstanding liability.

Recommendation 2 from the Committee's Report (paragraph 30):

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.

8. The Government agrees with this request. We have previously undertaken to report to Parliament details of the sensitivity analysis performed on the estimate of the financial settlement and the likelihood that the actual settlement value will fall outside its estimated range.[4] As a consequence of this commitment, we will inform Parliament of any 'significant fluctuations' attributable to changing assumptions underpinning our estimate of pension liabilities.

9. Nevertheless, as context for this request, we further note that forecasts prepared for other purposes (for example, the EU's annual accounts or the OBRs use of undiscounted cashflows) will inevitably differ from HMT's internal modelling and should not be considered as 'significant fluctuations' in their own right. These forecasts will routinely use different methodologies from HM Treasury's internal modelling because they are prepared for different purposes. HM Treasury will reflect on the Committee's helpful comparative analysis of the various different forecasts in the next edition of the Statement, in the interest of furthering its transparency objective.

10. The Government has also previously committed to set out the factors that will be taken into account when deciding the value for money of settling the UK's pension and post-employment sickness benefit liability early; but notes that the initial detailed reporting by the EU on these liabilities, and their payment, has not yet commenced.[5] Early termination of other outstanding commitments is also possible after 31 December 2028.[6] In each case, a decision to meet liabilities early requires the Specialised Committee on Financial

4 House of Commons Committee of Public Accounts 'Exiting the EU: The financial settlement 'Forty-Eighth Report of Session 2017–19, Recommendation 3

5 Article 142(6) Withdrawal Agreement, House of Commons Committee of Public Accounts 'Exiting the EU: The financial settlement 'Forty-Eighth Report of Session 2017–19, Recommendation 3

6 Article 140(5) Withdrawal Agreement

Provisions to propose a Decision for the Withdrawal Agreement Joint Committee to adopt, and this proposed Decision would be reported to Parliament with an Explanatory Memorandum under standing arrangements.

Recommendation 3 from the Committee's Report (paragraph 41):

We ask the Government to be proactive in informing Parliament if any developments occur that undermine these contingent liabilities' (especially those in respect of the European Investment Bank) current classification as remote.

11. The Government agrees with this request, which is consistent with the existing reporting framework and commitments to Parliament. The Government's Financial Reporting Manual (FReM) specifies additional disclosures relating to Parliamentary accountability in respect of remote contingent liabilities which fall outside the accounting standard reporting requirement (IAS37).[7] This requirement is supplemented by further guidance in 'Managing Public Money' and the recently revised Contingent Liability Approval Framework.'[8] If the contingent liability were no longer to be classified as 'Remote' it will be reported to Parliament as a matter of course in the departmental resource accounts.

Recommendation 4 from the Committee's Report (paragraph 49):

We therefore ask the Treasury to clarify the amount for which the UK 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.

12. The Government recognises the Committee's continued interest in this issue, which was first substantively addressed in correspondence from the then Chief Secretary in August 2020 and which was also discussed in the latest Statement. Technical discussions with the Commission continue within the ambit of the Specialised Committee on Financial Provisions and the Withdrawal Agreement Joint Committee. HM Treasury will write to the Committee with an analysis of the financial implications and a summary of likely next steps when our technical engagement reaches the most appropriate juncture.

Recommendation 5 from the Committee's Report (paragraph 55):

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.

13. The Government agrees with this request. We note that the issue remains sub judice and that it would be inappropriate to provide further substantive comment at this time. HM Revenue and Customs is the policy lead for this matter but HM Treasury will provide a timely update to Parliament on the legal and financial implications once the judgment has been delivered and the case has been resolved.

14. The Financial Settlement establishes the methodology by which the UK and the EU pay for their respective agreed liabilities relating to the UK's period of membership of the

7 Government Financial Reporting Manual (FREM) 6.7.1(b)
8 Contingent Liability Approval Framework, August 2021

EU. HM Treasury's annual resource accounts and the estimate of the Financial Settlement also include a provision for contingent liabilities related to legal cases to which the EU was a party before the end of 2020.[9] This is distinguishable from presentation of the UK's own cost of liability arising from future legal cases, if any, which would be presented outside the Financial Settlement.

Recommendation 6 from the Committee's Report (paragraph 74):

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.

15. The Government stands ready to formalise the United Kingdom's association to the agreed European Union programmes at the earliest opportunity but is disappointed there have been persistent delays from the European Union. The Government continues to engage with the European Union through both formal and informal routes to resolve the issue and have formally requested a Specialised Committee on Participation in Union Programmes (SCPUP) to meet the week beginning 13 December 2021 to adopt the Protocols, or alternatively do so by written procedure. As Lord Frost set out to the Committee on the 25 October, the Government sees no legal or practical reason why the United Kingdom should not be able to associate.

16. The Government remains clear that our priority is to support the United Kingdom's research and development sector, as made evident in the budget with our commitment of £7 billion in funding for participation over this parliament. To provide reassurance to UK based applicants the Government announced, on the 29 November 2021, that we would guarantee funding for those eligible who successfully bid for Horizon Europe funds in the first wave of calls but are unable to sign grant agreements. Further detail on the guarantee will be set out in the coming weeks.

17. In the event that the UK is unable to associate to the programmes, the funding allocated to association will go to UK government programmes, including those to support international partnerships.

Recommendation 7 from the Committee's Report (paragraph 75):

We 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.

18. The Government welcomes the Committee's continued interest in administration of the TCA, including future plans for transparency and reporting. We would like to take this opportunity to refer the Committee to the provision for the cost of participation HM Treasury made as part of the Spending Review. As set out, the current estimate for the

9 HM Treasury Annual Report and Accounts 2020–21 (HC 436) Disclosure notes 17.2 and 23.

cost of participation over this Parliament is £7bn.[10] However, Union programme budgets are agreed for the entire MFF, running from 2021 to 2027; and our current estimate of the total cost of participation over the lifetime of the programme is around £17 billion. This breaks down to in the region of £15 billion for Horizon Europe; £1.2 billion for Euratom R&T, and £800 million for Copernicus. As estimates, these are sensitive to several underlying assumptions regarding participation and the principal factors include the UK's contributions being determined by its relative GDP share and based on EU programme budgets; changes in foreign exchange rates, and the application of any detailed financial terms in the agreement.

19. Nevertheless, the role of HM Treasury in implementation of the TCA can be clearly distinguished from its role in administration of the WA. In respect of the latter agreement, HM Treasury is responsible for central payment of almost the entire liability as Annually Managed Expenditure from its departmental resource accounts. It follows from central ownership of the liability that the department remains best placed to report on the financial implications of the WA. Conversely, management of participation in EU programmes and payment under the TCA remains with other Government departments under delegated expenditure limits set during the Spending Review.

20. Accordingly, as noted in the last Statement, HM Treasury do not plan to replicate or consolidate financial reporting on the TCA in future editions of the Statement.[11] In addition, we do not intend to report annually our revised estimate of liabilities expected under the TCA because actual costs will in future years appear in departmental resource accounts.

21. Each Government department will remain responsible for reporting to Parliament on implementation of the TCA, including setting out financial contributions made to the EU and receipts received by the UK where applicable. These will be reported in departments' annual report and accounts and as part of normal budgetary disclosures in the supply estimates delivered to Parliament. The Government notes the programmes agreed are managed by the EU and funding will be disbursed directly to beneficiaries rather than received by the Government where it would be identified as public sector receipts.

Recommendation 8 from the Committee's Report (paragraph 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.

22. The Government notes that negotiations sit outside the TCA; are ongoing and at an advanced stage. The Government remains deeply committed to PEACE PLUS and confirmed in September 2021 that the UK will be investing more than £730 million[12] into the programme to support economic stability, peace and reconciliation in Northern

10 As published in the Autumn Budget and Spending Review 2021, estimates are rounded to the nearest billion.

11 EU Finances Statement 2020 at F.4 "The exact cost of participation will be determined annually in line with the terms set out in the agreement and reported by Government in departmental accounts."

12 This figure has been calculated from the total figure in Euros, using an exchange rate of £1:€1.16448, noting this will change over the Programme period. This figure also includes match funding from the Northern Ireland Executive.

Ireland. This represents almost 75% of the total budget of almost £1 billion - the biggest PEACE programme to date - and delivers in full on the UK's commitments to the programme.