



BRIEFING PAPER

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Brexit: the financial settlement

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Summary

In the financial settlement (the settlement), the UK and EU have set out how they will settle their outstanding financial obligations to each other, which arise out of the UK's participation in the EU budget and broader aspects of its EU membership. The media have labelled the issue the 'exit bill' or 'divorce bill', the EU see it as a matter of 'settling the accounts'.

The settlement sets out the financial commitments that will be covered, the methodology for calculating the UK's share and the payment schedule.

The settlement was agreed politically by the EU and the UK in a [joint report](#) following the first phase on withdrawal negotiations. It was then turned into legal text in the Withdrawal Agreement (WA), which will become legally binding only once approved by the UK Parliament and the European Parliament.

Definitive figures of the settlement can't be calculated as it depends on future events, such as future exchange rates and actual EU budgets, but estimates have been produced. The latest estimate is that the settlement could cost the UK around £33 billion, based on an exit date of 31 October 2019. This is lower than the widely cited estimate of £39 billion, which was based on an exit date of 29 March 2019. Delaying Brexit means that the UK makes more payments to the EU as a Member State but fewer through the settlement. The net effect for UK payments to the EU is zero.

What has been agreed?

The settlement sets out that the UK will:

- contribute to and participate in the 2019 and 2020 EU budgets, as part of the transition (or implementation) period;
- continue to receive EU funding from the EU's 2014–2020 budget plan;
- contribute towards the EU's outstanding budget commitments at 31 December 2020 (these are budget commitments that have been made, but not yet paid);
- contribute towards some of the EU's liabilities – obligations to pay for certain items following past activities – incurred before 31 December 2020. EU staff pensions are the main source of such liabilities;
- remain liable for the EU's contingent liabilities – potential liabilities that may occur depending on the outcome of an uncertain event – which relate mainly to financial guarantees given and to legal risks;
- receive back the €3.5 billion of capital it has paid into the European Investment Bank (EIB) in 12 instalments from 2019, and receive back the relatively small amount of capital it paid into the ECB on withdrawal;
- remain liable for EIB liabilities approved before the WA comes into force, and will provide a guarantee to the EIB for its stock of outstanding loans which will decrease as EIB loans associated with it decrease;
- continue to participate in some of EU's overseas programmes, such as the European Development Fund, until the current round ends.

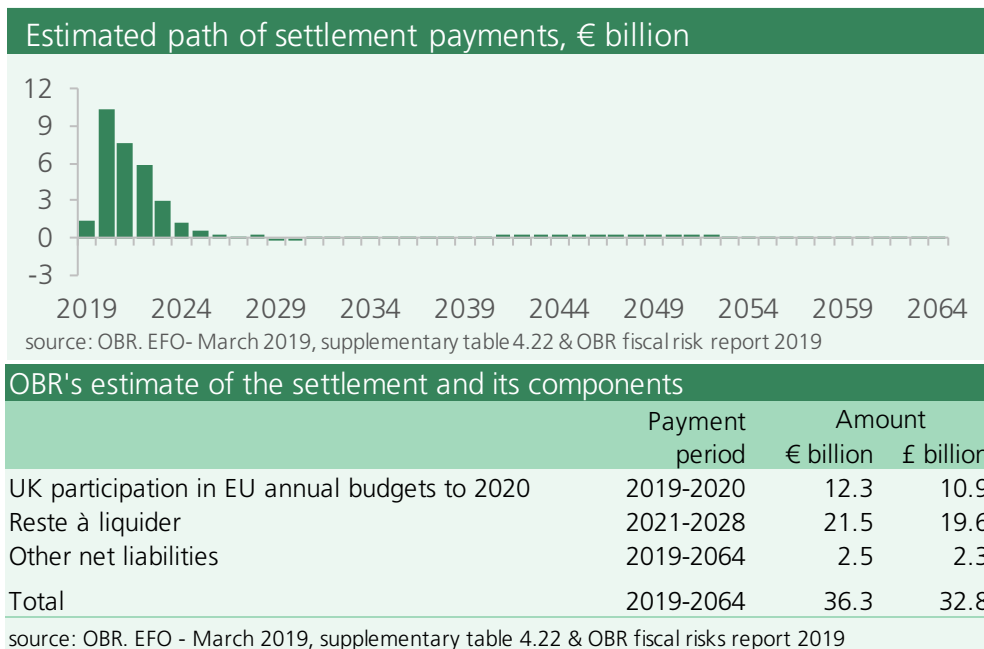
The UK and EU agreed some underlying principles for the settlement:

- no EU Member State should pay more or receive less because of the UK's withdrawal from the EU

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- the UK should pay its share of the commitments taken during its membership; and
- the UK should neither pay more nor earlier than if it had remained a Member State.

The last of these principles implies that the UK should pay based on the actual outcome of annual EU budgets, which means that payments arising from the settlement could continue well after the UK has left the EU. The Office for Budget Responsibility (OBR) – the UK’s public finances watchdog – expect that the UK will make payments over a 46-year period ending in the 2060s, with much of the cost coming in the near future.



Turning the political agreement into a legal agreement

The Withdrawal Agreement (WA) sets out, in legal terms, how the financial settlement will be calculated and administered. It also sets out the practicalities for payments between the UK and EU after 2020.

The WA allows for the transition period to be extended. If this happens the Joint Committee overseeing the WA’s implementation – made up of representatives from the UK and EU – will decide the UK’s financial contribution during the extension. Any extension would not impact on the financial settlement, which would continue as agreed.

The WA – and consequently the financial settlement – will only be legally binding once agreed by the UK and European Parliaments.

What if there is no deal?

In the event of no deal, it is likely that politics and the appetite for an ongoing EU-UK relationship will largely dictate the extent to which the two parties honour the agreement reached over the financial commitments. Both sides recognise it likely that negotiations would take place aimed at reaching an alternative financial settlement.

The EU has established a contingency measure that, should the UK agree to it, would leave the 2019 EU budget largely unaffected by no deal. The UK would have to agree to continue to pay into the budget and in return would continue to receive funding from it. The contingency is seen by the EU as a way of minimising disruption and facilitating an alternative financial settlement between the EU and UK.

1. What's it all about?

The UK and EU recognise that they have financial commitments to each other that will outlast the UK's membership of the EU. These include spending commitments that were agreed by Member States including the UK. The media have labelled the issue as an 'exit bill' or 'divorce bill', the EU see it as a matter of 'settling the accounts'.

The first phase of Brexit negotiations covered how the commitments will be resolved under the heading of the 'single financial settlement' (the settlement). The first phase of negotiations included other separation issues such as citizens' rights and the Irish border.

During the first phase of negotiations the UK and EU aimed to establish what the settlement includes and how the UK's share should be calculated. Actual financial figures were not being agreed, but the methodology for calculating them was.

An agreement in principle was reached, alongside the other separation issues, and published in a [joint report](#) on 8 December 2017. UK and EU negotiators have agreed a [Withdrawal Agreement](#) (WA), which turns the political agreement reached on the settlement, in the joint report, into legal text. The WA will become legally binding once approved by the UK Parliament and European Parliament.

Box 1.1: Paying to participate in EU programmes after Brexit

Putting the settlement to one side, the Government has said that it may want to participate in some of the European Commission's competitive funding programmes after Brexit, and could pay to do so:

And as we move forwards, we will also want to continue working together in ways that promote the long-term economic development of our continent.

This includes continuing to take part in those specific policies and programmes which are greatly to the UK and the EU's joint advantage, such as those that promote science, education and culture – and those that promote our mutual security.

And as I set out in my speech at Lancaster House, in doing so, we would want to make an ongoing contribution to cover our fair share of the costs involved.¹

The Government's July 2018 White Paper on the future UK/EU relationship proposes UK participation in EU programmes, in areas such as research and innovation.²

Non-EU members already participate in some EU programmes. For instance, Turkey participates in Horizon 2020, which is the EU's programme for research and innovation. Negotiations over the UK's future relationship with the EU will determine the UK's participation in the Commission's programmes.

The [draft political declaration setting out the framework for the future EU-UK relationship](#), published in November 2018, says that the EU and UK will establish general principles, terms and conditions for the UK's participation in EU programmes. Any agreement will be subject to the conditions set out in the EU's rules for each of its programmes, including how the UK shall contribute financially.

The Library briefings [The UK's contribution to the EU Budget](#) and [Brexit: UK funding from the EU](#) go into further detail about future participation in Commission programmes.

¹ [PM's Florence speech: a new era of cooperation and partnership between the UK and the EU](#), 22 September 2017

² HM Government, [The future relationship between the UK and the EU](#), July 2018

2. The political agreement reached

On 8 December 2017, the European Commission (the Commission) and the UK Government published an agreed methodology for calculating the settlement. The details were included in a [joint report](#) agreed by the Commission and the UK on progress during the first phase on negotiations.

The joint report – which also covers other ‘separation issues’ such as citizens’ rights and the Irish Border – allowed the Commission to recommend to the European Council – the leaders of EU Member States – that sufficient progress has been made in the first phase of negotiations.³ Subsequently, the European Council agreed that ‘sufficient progress’ has been made and that negotiations should move onto transitional arrangements and the future EU-UK relationship.⁴

The joint report is an “agreement in principle” on the whole package as opposed to individual elements. The agreement is made under the caveat that “nothing is agreed until everything is agreed”, which means that the issues addressed won’t become enforceable until they are part of a Withdrawal Agreement which has been approved by the UK Parliament and European Parliament.⁵

Box 2.1: The EU institutions

European Council

The European Council is the highest-level decision-making forum in the EU, consisting of the heads of state or government of the Member States, together with the Presidents of the European Council and the European Commission. The European Council gives the EU its ultimate political direction.

European Commission (the Commission)

The European Commission is the executive of the EU: it proposes legislation and implements policy within the competences laid down by the EU Treaties. The Commission has the following general functions: policy-making; Treaty guardianship; policy implementation and delegated powers; management of EU funds; representation in trade negotiations and other agreements with third countries.

The Council of the European Union (the Council)

The Council is made up of ministers of the governments of Member States. It is one of the two principal legislative and decision-making bodies of the EU, along with the European Parliament.

European Parliament

The European Parliament is the assembly of elected representatives of EU citizens. The representatives are known as Members of the European Parliament (MEPs). The European Parliament debates and passes law; scrutinises other EU institutions; and debates and adopts the EU’s budget.

³ European Commission, [COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN COUNCIL \(ARTICLE 50\) on the state of progress of the negotiations with the United Kingdom under Article 50 of the Treaty on European Union](#), 8 December 2017; European Commission, [Joint report from the negotiators of the European Union and the United Kingdom Government on progress during phase 1 of negotiations under Article 50 TEU on the United Kingdom's orderly withdrawal from the European Union](#), 8 December 2017

⁴

⁵ Ibid, [para 4 - 5](#)

The UK Government estimates that the settlement will cost around £35 billion-£39 billion.⁶ However, it is very difficult to put definitive figures to the settlement as the actual value depends on future events, including when the UK leaves. Any delay to the UK's withdrawal affects the size of the financial settlement because contributions to the EU that would have formed part of the settlement will be made while the UK remains a Member State, which reduces the size of the settlement (see [section 2.3](#)).

2.1 What has been agreed?

A methodology for calculating the financial settlement is agreed in the joint report. The underlying principles are that:⁷

- no EU Member State should pay more or receive less because of the UK's withdrawal from the EU;
- the UK should pay its share of the commitments taken during its membership; and
- the UK should neither pay more nor earlier than if it had remained a Member State. This implies in particular that the United Kingdom should pay based on the actual outcome of the budget

The final point means that the UK will not be required to make any payments earlier than would have been the case if it had remained a Member State, unless agreed by both sides.

For instance, as discussed below, the UK agrees to contribute towards the pensions of EU employees. The payments to EU employees are made annually in the EU's budgets and the UK will make annual contributions towards these costs. The UK will make a stream of EU pension related payments, which the Office for Budget Responsibility (OBR) – the UK's public finances watchdog – expect to last into the 2060s.⁸

UK participation in Union annual budgets to 2020

The UK will continue to contribute to, and participate in, the EU Budget in 2019 and 2020. Any changes made to the Budget or its financing after the withdrawal date will not apply to the UK, and the UK will not be obliged to contribute to any additional funding beyond what is set out in the Withdrawal Agreement.

In March 2019, the OBR forecast that the UK will make gross contributions – after the rebate – of around €16 billion in 2019 and €19 billion in 2020.⁹ When the OBR made this estimate the UK was set to leave the EU on 29 March 2019. The OBR therefore expected the UK

⁶ [HC Deb 11 Dec 2017:c25](#)

⁷ These principles are laid out in the [communication from the Commission to the Council on the state of progress of the negotiations with the United Kingdom under Article 50 of the Treaty on European Union](#), 8 December 2017

⁸ OBR. Economic and fiscal outlook – October 2018: supplementary fiscal tables, [Table 2.39](#)

⁹ OBR. Economic and fiscal outlook – March 2019: supplementary fiscal tables, Table 4.12

to contribute as a Member State in one quarter of 2019 and make contributions under the settlement in the remaining three quarters. The Article 50 extension means that the UK will now make contributions under the settlement for a smaller proportion of 2019.

EU Budgets are subject to corrections or adjustments after the year is over. The UK will take part in any revenue adjustments relating to the 2020 EU Budget. Any amounts to be returned to, or returned by, the UK will be calculated as if the UK remained in the EU. The agreement says that the UK and EU may consider simplifying the adjustment process in the second phase of negotiations

The UK's rebate (see [Box 4.5](#)) will continue to apply in 2019 and 2020.

UK participation in programmes

The UK will continue to participate in EU programmes funded from the current budget plan (MFF 2014 – 2020; see [Box 4.2](#)) until they close. The UK and UK beneficiaries will be required to respect all relevant EU legal provisions including co-financing.

EU programmes take two forms – funding is either provided to the UK Government to manage, or funding is allocated directly to beneficiaries by the Commission.

The funds managed by the UK Government include the European Structural & Investment funds and the direct payments to farmers. The OBR forecasts that the UK will receive around €6 billion funding for these programmes in both 2019 and 2020.¹⁰

The funding allocated directly by the Commission is largely through Horizon 2020 – the EU's research and innovation programme. The OBR forecasts that the UK beneficiaries will receive around €2 billion from the Commission in both 2019 and 2020.¹¹

The second phase of negotiations may include some simplification of the UK's participation in EU programmes. For instance, the joint report says that the UK and EU could decide to simplify procedures to avoid unnecessary administrative burdens.

The Library briefing [Brexit: UK Funding from the EU](#) has more on EU funding programmes.

EU budget outstanding commitments (reste à liquider)

In their annual budgets the EU commit to some future spending without making payments to recipients at the time. The commitments will become payments in the future. The EU refer to outstanding commitments as *reste à liquider* (RAL). The UK will contribute towards the financing of the RAL outstanding at 31 December 2020.

¹⁰ *ibid*

¹¹ OBR. Economic and fiscal outlook – March 2018, [Annex B](#)

The total applicable RAL will be adjusted to account for the actual amount implemented. An adjustment will be made for decommitments – commitments that are cancelled as they are not going to be converted into payments – and assigned revenues, which are largely revenues from non-EU countries to EU programmes.

At the end of 2017, the EU's total accumulated RAL is €267 billion.¹² The extent to which this will be adjusted for decommitments and assigned revenues won't be known until they happen. Some of the RAL will be receipts that the UK is due to receive.

The OBR estimates that the UK will make gross RAL payments of £29.8 billion and that the UK will receive €10.2 billion in RAL receipts, leaving a net RAL payment of €19.6 billion, between 2021 and 2028.¹³

Liabilities

The UK will share the financing of the EU's liabilities incurred before 31 December 2020. Liabilities with corresponding assets will be excluded as will assets and liabilities related to the spending and financing of the EU Budget (see [Box 4.2](#) and [4.3](#)). Payables and accrued charges, which largely relate to farming subsidies, aren't to be included. [Box 2.2](#) lists the excluded assets and liabilities.

In its original [position paper](#) the EU expected payables and accrued charges to be included in the settlement. However, as the UK will be contributing to the EU Budget in 2019 and 2020, and payables and accrued charges relate to the operation and financing of the Budget, they are not included.

The pensions and other benefits of EU employees are the most significant liabilities included in the settlement. Like the UK civil service pension scheme, the EU's pension scheme is unfunded and operates on a 'pay-as-you-go basis', which sees costs being covered by the EU Budget as they arise. It is likely that the UK will contribute towards these pensions over many years – as discussed above, the UK will not have to pay for anything earlier than they would have if they had remained in the EU.

At the end of 2017, the EU's liabilities for pensions and other employee benefits stood at €73 billion.¹⁴ This figure is an estimate of what these future payments are worth now – it is based on discounting the future payments by a rate that adjusts for the time value of money (the discount rate). Therefore, at this time it isn't possible to say precisely how much the UK will have contributed once all the annual payments for EU pensions have been made.

¹² European Commission, [Consolidated accounts of the European Union and Financial Statement Discussion and Analysis](#), June 2018, [Table 4.5](#)

¹³ HM Treasury, [EU Finances 2018](#), June 2019, [Table E.1](#)

¹⁴ European Commission, [Consolidated accounts of the European Union and Financial Statement Discussion and Analysis](#), June 2018, [page 22](#)

Box 2.2: Assets and liabilities excluded from the financial settlement

The joint report provides a list of the assets and liabilities that would not be included in the financial settlement.

Assets

- EU financial assistance loan assets and the associated balance sheet liabilities
- assets corresponding to property, plant and equipment and provisions related to the Joint Research Centre nuclear sites dismantlement
- lease-related obligations and all provisions other than in respect of fines, legal cases and financial guarantee liabilities
- intangible assets and inventories
- assets and liabilities relating to the management of foreign currency risk
- accrued and deferred income
- assets relating to EU space programmes (EGNOS, Galileo & Copernicus) are not part of the financial settlement. The UK's past contribution to the financing of space assets could be discussed in the context of possible future access to the services offered.

Liabilities related to the budget and its financing

- Outstanding pre-financing advances
- Receivables
- Cash
- Payables, and accrued charges including those related to EAGF or already included in the budgetary RAL will not be included for the calculation of liabilities

Contingent liabilities

The UK will remain liable for its share of the EU's contingent liabilities as established at the date of withdrawal. Contingent liabilities are potential liabilities that may occur depending on the outcome of an uncertain event in the future. These liabilities include those related to financial operations – for instance for financial guarantees given on loans and financial assistance programmes – and legal cases. [Box 4.4](#) discusses an example of a contingent liability.

HM Treasury and the European Commission deem these contingent liabilities to be remote, which means they think it unlikely that they will result in a future cost.¹⁵

For those contingent liabilities related to financial operations, the UK's liability will only be affected by decisions adopted before the date of withdrawal.

For contingent liabilities related to legal cases as a result of participation in the budget, programmes and policies, the cut-off date will be 31 December 2020.

If any contingent liabilities are triggered, the UK will receive any subsequent recoveries from meeting those liabilities. The UK will also

Contingent liabilities are potential liabilities that may occur depending on the outcome of an uncertain event in the future. They relate mainly to financial guarantees given (on loans and financial assistance programmes) and to legal risks. They are unlikely to result in future payments.

¹⁵ The size of the remote contingent liabilities are shown in [Table E.3](#) of HM Treasury's EU finances report.

receive its share of paid-in guarantees when the financial operations associated with some contingent liabilities decline.¹⁶

The UK's share

The financial commitments discussed above are accounted for on an EU-wide basis. The joint report suggests that the UK's share of these commitments should be based on the UK's percentage share of total contributions to the EU Budget over 2014 – 2020.

The exception is the UK's continued participation in Budget 2019 and 2020 – here there is no need to calculate a UK share.

In its original [position paper](#) on the settlement the EU expected the UK's share to be calculated using the same approach, but covering the period 2014 – 2018. It is thought that including contributions in 2019 and 2020 may make the UK's percentage share lower.¹⁷ This is because the pound weakened against the euro following the EU referendum result and has remained at a lower level since. This makes the UK economy appear relatively smaller and means the UK will make relatively smaller contributions to the EU Budget.

The OBR estimates that the UK's share over 2014 – 2020 may be 12.3%.¹⁸

The currency of payments

Except for the UK's participation in the EU budgets for 2019 and 2020, which will be under the current arrangements and paid in sterling, the settlement will be drawn up and paid in euro. This means that the UK's actual contribution in pounds will be contingent on the future exchange rate.

2.2 Areas outside of the EU Budget

European Investment Bank

EU Member States are members of the European Investment Bank (EIB). As an EIB member the UK agrees to provide €39 billion of the EIB's capital, which is known as unpaid, or callable, capital. The UK also has €3.5 billion of paid-in capital with the EIB.

The UK will provide a guarantee to the EIB equal to its callable capital – an amount the UK currently agrees to provide if required. This guarantee will decrease as EIB loans associated with it decrease.

On withdrawal from the EU the UK will no longer be a member of the EIB. The UK's €3.5 billion of paid-in capital will be repaid to the UK in

¹⁶ The UK will also receive a share of the net asset of the European Coal and Steel Community in liquidation and of the European Investment Fund decided before the withdrawal date, as the financial operations supported by these mature.

¹⁷ FT, [Britain prepares case to cut Brexit divorce bill](#), 17 November 2017

¹⁸ OBR, Economic and fiscal outlook – March 2019, supplementary table 4.13

twelve annual instalments starting at the end of 2019.¹⁹ The paid-in capital will be replaced by an additional callable guarantee.

European Central Bank

The UK will be reimbursed for its paid-in capital of €55 million in the European Central Bank. The paid-in capital will be returned to the Bank of England after the UK's withdrawal.

European Development Fund (EDF)

The EDF is the EU's main instrument for providing development aid overseas. The EDF is broken down over time into 'EDF funds'. The EDF is outside of the EU Budget and the UK contributes to the fund. UK contributions are treated overseas aid and count towards the UK's [target for overseas aid spending](#) of 0.7% of Gross National Income.

The UK will remain part of the EDF until the close of the 11th EDF fund. The 11th EDF is running between 2014 and 2020. The UK will honour its share of the total commitments made under this EDF and the payments related to its share of the outstanding commitments made under previous EDFs. The practicalities of making payments will remain as they currently are, unless otherwise agreed in the second phase of negotiations. The Treasury expects the UK to make £2.9 billion of payments to the EDF, with payments ending in 2026.²⁰

The UK has a share of the EDF's Investment Facility (around £0.4 billion).²¹ This funding will be returned to the UK as the investments end.

For further information on the EDF see the European Parliament Research Service's briefing [European Development Fund](#).

Facility for Refugees in Turkey and EU Trust funds

The UK will continue to honour the commitments it has made on the Facility for Refugees in Turkey and the European Union Emergency Trust Fund. These contributions – worth roughly £146 million²² – also count towards the UK's overseas aid target. The practicalities of the UK's participation in these schemes will continue on the current basis after withdrawal, unless changes are agreed in the second phase of negotiations.

The [Facility for Refugees in Turkey](#) was established as part of a wider framework to address the migration crisis. The Facility focuses on humanitarian assistance, education, migration management, health, infrastructure, and socio-economic support.

EU Trust Funds are development tools that pool together resources from different donors in order to enable an EU response to an emergency or post-emergency situation. The European Parliament Research Service's

¹⁹ The first eleven payments will be €300 million and the final one will be €196 million.

²⁰ NAO. Exiting the EU: The financial settlement – follow-up report, November 2018, [para 2.3](#)

²¹ op cit, [para E.53](#)

²² ibid, [Table E.4](#)

briefing [EU Trust Funds for external action: First uses of a new tool](#) has more on the EU's trust funds.

2.3 What's the cost of the settlement?

The Office for Budget Responsibility (OBR)'s latest estimate of the net cost of the settlement is £32.8 billion, assuming an exit date of 31 October 2019.²³ This is lower than the widely cited estimate of £39 billion, which was based on an exit date of 29 March 2019.

Before the UK's departure from the EU was delayed – through extensions to Article 50 – both the Government and Office for Budget Responsibility (OBR) estimated the settlement's cost at around £39 billion. Leaving the EU later than previously assumed means that the UK will now make some payments as a Member State, rather than through the financial settlement (during the transition period). The net effect on the UK's EU contributions is zero.

There is further information in the Library Insight [How does extending Article 50 affect the UK's financial settlement with the EU?](#)

It is difficult to estimate the cost

It is very difficult to put definitive figures to the settlement as it depends on future events, such as the exchange rates and actual budgets of the EU, as was explained by a Treasury official:

....it is impossible to put a definitive number on the settlement.

When we agreed the financial settlement in December, one of the important principles we secured was that we will only pay for things if they are based on out-turns. So we will meet commitments made during the period of our membership, but in Europe, as in other budgetary systems, not all commitments turn into spending. So we will only pay for things based on out-turn data, and we will not know that out-turn data until well into the future.

So it is impossible to put a definitive number on the settlement...²⁴

The OBR's estimate

Since March 2018, the Office for Budget Responsibility (OBR) – the UK's public finances watchdog – has produced an estimate of the settlement. Its latest estimate of the net cost of the settlement is £32.8 billion, assuming an exit date of 31 October 2019.

The OBR expect payments to be made over a 46-year period ending in the 2060s, with much of the cost coming in the near future. The OBR estimate that by 2022 around 70% of the net payments will have been made. They estimate payments after 2031 will average €170 million a year.

[Annex B](#) of the OBR's March 2018 forecast discusses the settlement in detail. The OBR updated its estimate in its March 2019 forecast, but the

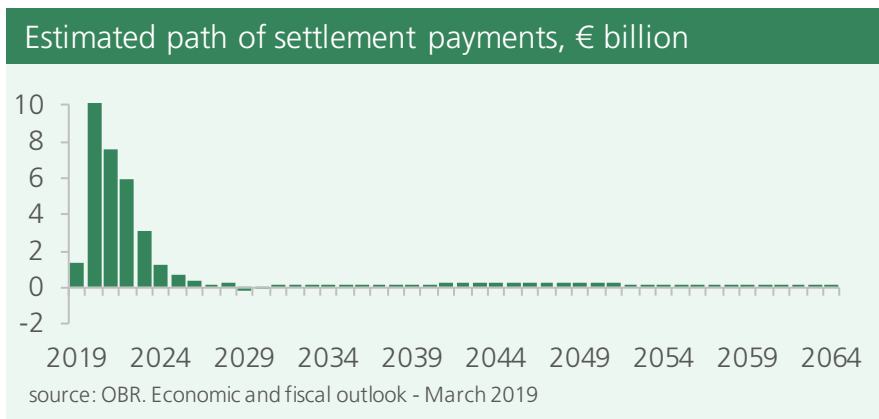
²³ OBR. Fiscal risks report – July 2019, [para 5.139](#)

²⁴ European Scrutiny Committee, Oral evidence: EU withdrawal, HC 763, [Q185](#)

March 2018 document has the best explanation of their approach. Appendix 1 of this briefing includes a breakdown of the OBR's estimates.

OBR's estimate of the settlement and its components			
	Payment period	Amount € billion	£ billion
UK participation in EU annual budgets to 2020	2019-2020	12.3	10.9
Reste à liquider	2021-2028	21.5	19.6
Other net liabilities	2019-2064	2.5	2.3
Total	2019-2064	36.3	32.8

source: OBR. EFO - March 2019, supplementary table 4.22 & OBR fiscal risks report 2019



The Government's estimate

In December 2017, the Treasury estimated the settlement at around £35 billion- £39 billion,²⁵ assuming an exit date of 29 March 2019.

HM Treasury's estimate of the settlement and its components			
	Payment period	Amount € billion	£ billion
UK participation in EU annual budgets to 2020	2019-2020	17-18	15-16
Reste à liquider	2021-2026	21-23	19-20
Other net liabilities	2021-2064	2-4	2-4
Total	2019-2064	40-45	35-39

source: NAO. Exiting the EU: The financial settlement, Figure 1

The National Audit Office (NAO) examined the reasonableness of the Treasury's estimate of the settlement's cost. The NAO found the estimate to be reasonable based on the parameters set by the Treasury,

²⁵ [HC Deb 11 Dec 2017:c25](#)

but that the actual value was uncertain because it depends on future events, including:²⁶

- the UK's economic performance relative to EU Member States, which will determine the UK's contribution to the EU Budget in 2019 and 2020;
- whether the UK continues to receive EU receipts at the same rate. The NAO said that it is possible "that the UK's revenues from the EU may change in the context of EU withdrawal."
- the impact of future events on the EU's pension liabilities. The current estimate of EU pension liabilities is based on assumptions about future events such as mortality rates, salary increases and discount rates. If any of these turn out to be different from assumed, then actual payments for EU pensions will be different from the Treasury's estimate;
- the future exchange rate.

The NAO made some further points about the Treasury's estimate:²⁷

- it includes receipts that go directly from the Commission to the private sector. This means that the Treasury's estimate is not the same as the payments and receipts that will be recorded in the public sector finances;
- it does not include the £2.9 billion that the UK is expected to contribute to the European Development Fund after the UK leaves the EU. The Treasury excluded this cost as the EDF is not part of EU Treaties and sits outside of the EU budget;
- it does not include contingent liabilities. The Treasury and the Commission believe these liabilities to be remote, so they don't expect them to lead to future payments.

The Public Accounts Committee (PAC) also considered the settlement,²⁸ following the NAO's report. The PAC's views largely echoed those of the NAO, with the headline finding that the final cost of the settlement is uncertain.

The PAC reported that the UK's financing share – described as the [UK's share](#) above – is the main area of uncertainty according to the Treasury. The financing share depends on a range of factors such as the UK's relative economic performance and a final figure will not be known until 2020 audited EU accounts are published in 2022.

The PAC said that the Treasury has not conveyed the uncertainty attached to the settlement's value to Parliament or the taxpayer. They also made the wider point that the financial settlement only includes the cost of meeting the obligations set out in the settlement. There may be

²⁶ NAO. Exiting the EU: The financial settlement, [paras 11-22](#)

²⁷ *ibid*

²⁸ House of Commons Committee of Public Accounts, Exiting the EU: The financial settlement, HC 973, 27 June 2018

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other costs associated with the UK withdrawing from the EU and its future relationship with the EU.

The Treasury explained to the PAC why it hadn't included payments to the EDF in its estimate of the settlement. The commitments are part of the UK's legal obligation to spend 0.7% of Gross National Income on overseas aid and if this budget was not spent through the EDF, the Government would be required to spend it through another route.

3. The Withdrawal Agreement

Part 5 of the Withdrawal Agreement (WA) turns the political agreement reached on the financial settlement into legal text. It includes how each component of the settlement such be calculated and administered. It also sets out the practicalities for UK payments to the EU after 2020.

The WA also allows for the possibility of the transition period being extended beyond 31 December 2020. If this happens the UK will make a financial contribution for the duration of the extension, reflecting its status during the transition. The Joint Committee – the Committee of UK and EU representatives, overseeing the WA - would agree the amount and a schedule for making payments as part of the decision on extension.

The WA will require UK legislation to implement it in domestic law. The UK Government is intends to introduce the EU (Withdrawal Agreement) Bill shortly after the UK Parliament gives its approval to the WA.

3.1 The financial settlement in the Withdrawal Agreement

Part 5 of the WA turns the political agreement reached on the financial settlement into legal text.

Broadly speaking, each area of the settlement agreed in the joint report is included in an article or series of articles in the WA.

UK participation in Union annual budgets to 2020

During the transition period until 31 December 2020, the UK will continue to contribute to, and participate in, the EU Budget in 2019 and 2020. The UK will make contributions to the EU Budget as if it were still a Member and will continue to receive funding from EU programmes funded from the current budget plan ([Multiannual Financial Framework 2014-2020](#))

Article 135 sets out that the UK's contribution to and participation in the 2019 and 2020 EU Budgets will be in accordance with the rules set out for the transition period. Article 135(2) says that any changes made to how the EU budget is spent or financed adopted after the date of withdrawal will not apply to the UK. This notably keeps the UK rebate in place in 2019 and 2020.

Contributions to the EU Budget are subject to corrections or adjustments after the year is over. Article 136 says that this process shall apply to the UK after 31 December 2020 for the financial years up to 2020 and sets out how this process would work. Article 136(3) allows for the UK to attend meetings of EU committees that could impact on resource corrections or adjustments. UK representatives can attend upon invitation, on a case-by-case basis, without voting rights. Article

136(3) also says that corrections or adjustments based on revisions to VAT or GNI – which can be significant²⁹ – will be time limited.

Article 141 says that the UK shall receive a share of EU-levied fines decided before 31 December 2020 and collected by the EU. This excludes fines that have already been included as part of EU Budget revenue.

UK participation in EU programmes in 2019 and 2020

Article 137 sets out that the UK's participation in EU programmes will be in accordance with the rules set out for the transition period until 31 December 2020. The UK shall be able to participate in programmes – and receive funding from them – under the current 2014-2020 budget plan and previous budget plans. However, the UK will not be part of direct payments for farmers in 2020.

The UK shall only be eligible for programmes provided that the relevant instruments were established by the EU prior to the date that the WA comes into force (Article 137(2)).

Article 138 lays out the EU laws the UK must adhere to while still receiving funding from EU programmes and sets out the UK's relationship with the programmes during the transition period. Article 138(3) says that the UK will be able to attend meetings of EU committees that assist the Commission on the implementation and management of EU programmes. UK representatives will attend upon invitation, on a case-by-case basis, without voting rights.

EU budget outstanding commitments (reste à liquider)

In their annual budgets the EU commit to some future spending without making payments to recipients at the time. The commitments will become payments in the future. The EU refer to outstanding commitments as *reste à liquider* (RAL).

The UK will contribute towards the financing of the RAL outstanding at 31 December 2020, less the amount of RAL due to the UK. The RAL will be adjusted to account for the actual amount implemented. An adjustment will be made for decommitments – commitments that are cancelled as they are not going to be converted into payments – and assigned revenues, which are largely revenues from non-EU countries to EU programmes.

Article 140(1) says that in addition to the EU's outstanding commitments on 31 December 2020, the UK will contribute to commitments made in 2021 that were carried over³⁰ from the 2020 Budget. It also says that the outstanding commitments won't include

²⁹ For instance see the Library Insight [The UK's EU surcharge](#), November 2014

³⁰ This is an exception to the principle of annuality in the EU Budget in so far as appropriations that could not be used in a given budget year may, under very strict conditions, be exceptionally carried over for use during the following year.

those related to areas where the UK has an opt out, or those areas that are financed by specific revenues (assigned revenues).³¹

Articles 140(2), 140(3) and 140(4) set out how future payments for outstanding commitments shall be calculated and administered. Article 140(5) provides that the UK can make a lump sum payment to cover its outstanding commitments. After 31 December 2028, the UK can request that the EU make an estimate of what the UK has left to pay, and the UK can choose to pay this in advance.

Liabilities

The UK will share the financing of the EU's liabilities incurred before 31 December 2020. Liabilities with corresponding assets will be excluded as will assets and liabilities related to the spending and financing of the EU Budget (Article 142 (1)).

Pensions and other benefits of EU employees are the most significant liabilities included in the settlement (Article 142 (2)). Like the UK civil service pension scheme, the EU's pension scheme is unfunded and operates on a 'pay-as-you-go basis', which sees costs being covered by the EU Budget as they arise.

Article 142(3) to Article 142(6) sets out how the outstanding liabilities will be calculated and administered. Article 142(6) allows for the UK to pay its outstanding liabilities relating to EU staff (pensions and Joint Sickness Insurance Scheme) early. The UK can request that the EU make an estimate of what the UK has left to pay, and the UK can choose to pay this in advance in a number of instalments.

Contingent liabilities

Contingent liabilities are potential liabilities that may occur depending on the outcome of an uncertain event in the future. The UK will remain liable for its share of the EU's contingent liabilities as established at the date of withdrawal. Both the Treasury and European Commission deem that it is unlikely that each of these liabilities will result in a future cost.

Most of the EU's contingent liabilities relate to financial operations – for instance for financial guarantees given on loans and financial assistance programmes – and would only be called upon in the case of a borrower default. The EU's other contingent liabilities primarily relate to legal cases.

The UK will receive back its share of any unused guarantees related to these liabilities and subsequent recoveries following the triggering of the guarantees for such loans.

Contingent liabilities for loans related to financial assistance and the EIB

Article 143 sets out how contingent liabilities relating to loans for financial assistance, financial operations managed by the EIB (such as

³¹ For more on assigned revenues see European Parliament Research Service's, [Assigned Revenue in the EU Budget](#)

the European Fund for Strategic Investment) and the European Fund for Sustainable Development will be calculated and administered. This includes how provisioning – recognising in the budget that a past event is more likely than not to mean a future liability – will work. Article 143 sets out that the UK will receive back its share of unused provisioning and any amounts recovered by the EU from those defaulting on loans.

Liabilities arising from financial instruments of EU programmes

Article 144 sets out how liabilities arising from financial instruments of EU programmes shall be calculated and administered, including where the EU may be liable to make some payments to the UK for unused provisions or recoveries from defaulters.

Contingent liabilities related to legal cases

Article 147 states that in each year the EU shall let the UK know of any payments arising from legal proceedings and the UK's share of any subsequent recoveries.

European Investment Bank

On withdrawal from the EU the UK will no longer be a member of the European Investment Bank (EIB). The UK's €3.5 billion of paid-in capital will be repaid to the UK in twelve annual instalments starting at the end of 2019.³² Article 150(4) says that starting from 15 December 2019, the UK will receive eleven instalments of €300 million and a final instalment of €195.9 million. Should any liabilities be triggered, then the UK will still be liable for its share of the paid-in capital. In other words, the paid-in capital will be replaced by a callable guarantee.

Article 150 sets out that the UK shall remain liable for financial operations approved by the EIB before the WA enters into force and explains how this liability will be managed in the future. The UK shall provide a guarantee to the EIB equal to its current callable capital – an amount the UK currently agrees to provide if required. This guarantee will decrease as EIB loans associated with it decrease. Article 150(6) sets out how any triggered liabilities will be dealt with.

Once the WA enters into force, including during the transitional period, the UK will not be eligible for new funding from EIB reserved for Member States. Any projects approved by the EIB prior to the WA entering into force can proceed as approved (Article 151).

The UK would like to explore options for a future relationship with the EIB after the UK has left the EU. This intention is included in the [draft political declaration](#) on the future EU-UK relationship. The political declaration sets out the basis for further negotiations on the future EU-UK relationship.

³² The first eleven payments will be €300 million and the final one will be €196 million.

European Central Bank

At January 2015 the UK had €0.06 billion (€56 million) of paid-in capital in the ECB.³³ The paid-in capital will be returned to the Bank of England after the UK's withdrawal (Article 149).

European Coal and Steel Community

Article 145 states that the EU will make five payments to the UK for its share of the liquidated net assets of the European Coal and Steel Community on 31 December 2020. Five equal payments will be made on 30 June of each year starting on 30 June 2021.

European Investment Fund

Article 146 states that the EU will make payments to the UK for its share of the capital paid into the European Investment Fund (EIF) by the EU. The EIF is part of the EIB group and provides risk finance to benefit small and medium-sized enterprises (SME). Five equal payments will be made on 30 June of each year starting on 30 June 2021.

European Development Fund

The EDF is the EU's main instrument for providing development aid overseas. The EDF is broken down over time into 'EDF funds'. The EDF is outside of the EU Budget and the UK contributes to the fund.

The UK will remain part of the EDF until the close of the 11th EDF fund. The 11th EDF is running between 2014 and 2020. The UK will honour its share of the total commitments made under this EDF and the payments related to its share of the outstanding commitments made under previous EDFs. Article 152 sets this out in legal terms. The UK's committed to the EDF is estimated at approximately £2.9 billion; the payments for which also contribute to its target of spending 0.7% of GNI on overseas aid.

Article 152(2) says that the UK may participate, as observer, without voting rights, in the EDF Committee and the Investment Facility Committee.

The UK has a share of the EDF's Investment Facility. This funding will be returned to the UK as the investments end. Article 152(4) says that the UK will be reimbursed using the same method as for [financial instruments arising from EU programmes](#). Article 153 sets out that funding not committed or decommitted under the 10th EDF or previous EDFs shall not be reused.

Facility for Refugees in Turkey and EU Trust funds

The UK will honour the commitments it has made on the [Facility for Refugees in Turkey](#) and the [EU Emergency Trust Funds](#). Article 155 sets out that this commitment extends to any future EU Emergency Trust Fund created before the WA comes into force.

³³ ECB, [Capital subscription](#)

Article 155(2) allows the UK to participate, as a third country, in bodies related to the Facility for Refugees in Turkey.

Defence related agencies

Article 156 says that during the transition period the UK will continue to contribute to the funding of several defence-related agencies, including the European Defence Agency, and any CSDP operations. That funding will continue on the same basis as at present.³⁴

Article 157 says that beyond 31 December 2020 the UK will be required to pay (by June 2021) its share of the pension liabilities for personnel of the EDA and other defence-related agencies, assuming that it has not already done so by the end of the transition period.

Other key aspects of the settlement

The UK's share

Once the transition period ends, the UK will share the EU's outstanding commitments, liabilities and contingent liabilities according to its calculated share. Article 139 says that the UK's share of these commitments should be based on the UK's percentage share of total contributions to the EU Budget over 2014 – 2020.

The currency of payments

Except for the UK's participation in the EU budgets for 2019 and 2020, which will be under the current arrangements and paid in sterling, the settlement will be drawn up and paid in euro (Article 133). This means that the UK's actual contribution in pounds will be contingent on the future exchange rate.

Payments after 2020

Article 148 proposes the practicalities for payments between the UK and EU after 2020, setting out, for instance, when payments will be made and the exchange rate that will be used. The majority of payments will have reference dates of 30 June and 31 October each year. In advance of the reference dates, the EU will inform the UK of the required payments, which will be made in four equal monthly instalments for payments with a reference date of 30 June or eight equal monthly instalments for payments with a reference date of 31 October.

Auditors

Article 134 says that the UK can appoint auditors to assure the implementation of the financial settlement. The EU will provide the auditors with information and assistance to help them complete their task.

³⁴ CSDP operations are financed through the [Athena mechanism](#) ; while contributions to the EDA budget are made by Member States according to a GNI-based formula, whereby contributions are proportional to the share of each Member State's GNI within the total GNI aggregate of the participating states.

Specialised Committee

A specialised Committee on the financial provisions is established in Article 165(1(f)). The Committee, which will be in addition to the Joint Committee that governs the whole WA, will include representatives of the EU and the UK.

3.2 UK's contribution if the transition period is extended

The WA allows for the transition period to be extended beyond 31 December 2020 (Article 132). An extension would be decided by the Joint Committee overseeing the WA's implementation and application. The Joint Committee will be made up of representatives from the UK and EU.

The UK will make financial contributions to the EU during an extended transition period. The Joint Committee shall determine what the UK's financial contribution will be. The Joint Committee will agree both the amounts – taking into account the UK's status during the period – and the schedule for making payments.

The wider financial settlement, set out in Part 5 of the WA, (and discussed in this briefing) will not be effected by the transition period being extended: the UK and EU will continue to settle their financial commitments to one another as agreed in the financial settlement.

If the transition period is extended the UK:

- would be treated as a third country for EU programmes under the next budget plan ([Multiannual Financial Framework 2021 – 2027](#)) – the UK would be able to participate in such programmes but would do so according to the EU's rules for third countries;
- would no longer contribute to the EU Budget as if it were a Member State. More technically the EU's [own resources](#) regulation would no longer apply to the UK;
- would not be part of the EU's [Common Agricultural Policy](#), but there would be some constraints over the amount of direct support the UK could provide for agriculture

3.3 Legislating for the Withdrawal Agreement in the UK

The Withdrawal Agreement will require UK legislation to implement it in domestic law. The Government intends to introduce the EU (Withdrawal Agreement) Bill (the Bill) and has published a White Paper on the Bill.³⁵

³⁵ Department for Exiting the European Union, [Legislating for the Withdrawal Agreement between the United Kingdom and the European Union](#), 24 July 2018

The White Paper sets out a potential legislative approach for making the payments required under the settlement to the EU.³⁶ It also proposes an approach for scrutinising these payments.

Legislating

Financial settlement: Payments to the EU

According to the White Paper, the Bill will include a standing service provision to allow the UK Government to make the payments required by the settlement.³⁷ This means that the Bill will seek authority to make payments directly from the Consolidated Fund (the Government's general bank account). The White Paper says that a standing service provision will provide the flexibility needed to make payments due under the settlement.

Allowing payments to be made directly from the Consolidated Fund would mean that annual approval from Parliament would not be required – in other words the payments would sit outside the Estimates process.³⁸

The approach put forward in the White Paper looks similar to that currently followed by the UK for payments to the EU Budget. The authority to make payments to the EU is provided in the European Communities Act 1972, which allows payments to be made directly from the Consolidated Fund.³⁹

Financial settlement: Payments to the UK from the EU

The White Paper says that the Bill will also specify that payments coming from the EU – for areas such as European Steel and Coal Community, European Investment Fund or European Investment Bank – are to be paid into the Consolidated Fund or the National Loans Fund. Without such a provision payments would typically be made to the Consolidated Fund. However, if sums were originally paid out of the National Loans Fund, standard practice would be for the reimbursement from the EU to return to that fund.

International development programmes

Currently, UK contributions to international development programmes (European Development Fund, EU Trust Funds and Facility for Refugees in Turkey) are paid through powers provided in the International Development Act 2002. The White Paper expects this to continue for any future contributions to these programmes agreed in the settlement.

³⁶ *ibid.*, [section 4E Legislating for the financial settlement](#)

³⁷ Consolidated Fund Standing Services are discussed in Chapter 5 of HM Treasury's [Supply Estimates: a guidance manual](#)

³⁸ See Library briefing [The Estimates process and 2017-18 Main Estimates](#) for more on this process.

³⁹ European Communities Act 1972, [s. 2\(3\)](#)

Payments arising from future UK/EU relationship

The Bill will only provide authority for payments under the settlement: it will not be able to be used for payments relating to any future agreements between the UK and the EU.

Scrutinising

The White Paper says that “It will be important to ensure the payment mechanism balances the Government’s legal responsibility to pay the financial settlement with Parliament’s duty to scrutinise the financial settlement and ensure that the payments are consistent with the terms set out in the Withdrawal Agreement.”⁴⁰ The White Paper proposes laying an annual statement before Parliament presenting information on payments under the settlement. This approach follows the practice currently followed for contributions to the EU, where the Government currently lays an annual statement before Parliament on European Union Finances that presents information on our contributions and receipts.

To strengthen Parliamentary scrutiny, the White Paper says that the Bill could include a requirement on the Government to provide regular updates on payments over the past year and on forecast payments and receipts to and from the EU:

This could be in the form of a Ministerial Statement providing Parliament with an analysis of the required payments and the UK receipts from the EU. This would provide a greater degree of transparency than has existed with payments made during our membership. In addition to a potential statutory reporting requirement in the Bill, Government would work with Parliament to identify the most effective option for scrutinising these updates.⁴¹

⁴⁰ op cit., [para 134](#)

⁴¹ ibid

4. What happens if there is no deal?

The terms of the settlement will only become legally binding once the Withdrawal Agreement is ratified by the EU (by votes in the European Parliament and Council) and the UK. If there is no withdrawal agreement – a situation widely described as no deal – the political agreement reached on the financial settlement will not be legally binding.

There is uncertainty about what would happen to the outstanding UK-EU financial obligations if there is no deal. It is likely that politics and the appetite for an ongoing EU-UK relationship will largely dictate the extent to which the two parties honour the agreement reached over the financial commitments in an alternative negotiated financial settlement.

4.1 What have the UK Government and EU said?

The UK Government recognises that it would have outstanding financial commitments to the EU if it were to leave without a deal and not honouring these could see the UK being regarded as an unreliable partner.^{42,43} Ministers have suggested that an alternative settlement would have to be negotiated, which might not necessarily follow the precise terms set out in the financial settlement.⁴⁴

The EU believes that a no-deal Brexit should not affect the agreed principle that the UK and EU will honour their financial commitments.⁴⁵ They expect an alternative financial settlement to be agreed “in a future international agreement” between the UK and EU.⁴⁶

The EU proposes that the UK continues to participate in EU Budget 2019

In the event of no deal, a contingency measure adopted by the EU allows for the UK to continue to contribute to the 2019 EU budget and for UK beneficiaries to continue receiving EU funding from it despite the UK then being outside of the EU (a third country).⁴⁷

The UK Government hasn't said whether it would take part in this contingency measure if no deal becomes a reality. For the contingency

⁴² [HC Deb. 3 December 2018 c570](#)

⁴³ Treasury Committee, Oral evidence: Budget 2018, HC 1606, [Q290-292](#)

⁴⁴ [ibid](#); House of Lords Committee on the EU, Oral evidence: Scrutiny of Brexit Negotiations, 29 August 2018, [Q7](#)

⁴⁵ This is reflected, for instance, in the [introduction to withdrawal agreement](#) agreed by the 27 Member States and the United Kingdom government.

⁴⁶ European Commission. [Proposal for a Council Regulation on measures concerning the implementation and financing of the general budget of the Union in 2019 in relation to the withdrawal of the United Kingdom from the Union](#)

⁴⁷ [COUNCIL REGULATION on measures concerning the implementation and financing of the general budget of the Union in 2019 in relation to the withdrawal of the United Kingdom from the Union](#)

measure to take effect the UK will have to confirm in writing that it will continue to contribute to the 2019 EU budget. The UK will also have to continue to accept controls and audits of EU funding and make its first payment to the EU budget for the period after its withdrawal.

Mika Lintilä, Minister for Finance of Finland, which holds the Council presidency until 31 December 2019, summarised the EU's position:

A no-deal scenario does not affect the basic principle that the EU27 and the UK should honour the financial commitments they have both made together. The measures agreed today will help ensure this. They will benefit UK individuals and entities, and avoid possible disruptions to other beneficiaries of EU funding.⁴⁸

Ultimately, if the UK leaves without a deal, the EU expect the two parties to negotiate an alternative financial settlement in a future international agreement.⁴⁹ The contingency measure is aimed at ensuring that the EU Budget is implemented smoothly in the meantime.

4.2 Legal arguments about EU Budget items

In December 2018, the Attorney General set out the legal arguments surrounding the UK's financial commitments if there is no ratified WA. He also offered his view on these arguments and addressed the wider political considerations:

The position on money is this. The view of the Government, and my view, is that we would have obligations to pay a certain amount of money were we to leave the European Union without a deal. The House of Lords European Union Committee concluded that there would be no obligation under EU law. That is a stronger argument—not necessarily an incontestable one—as to our obligations under EU law, but the Committee also concluded that we might have obligations under public international law, and with that I agree. There is an argument that we would not have an obligation under public international law, but it is an argument unlikely to be accepted by any international tribunal.

My view is therefore that we would owe a presently unquantifiable sum were we to leave the European Union without a deal. It is impossible at this stage to say how much. It is true that the European Union is not a member state and is not a state, and therefore it is unable to take the case to the International Court of Justice. It might therefore be difficult to enforce the public international law obligation that existed. However, I ask the House to reflect on the fact that if this country, acknowledging that such obligations probably exist or do exist, did not pay them, it would be likely to cause the deepest resentment, just as it would to any of us who were unpaid a debt. If we leave a club, we pay the bar bill. If we do not pay the bill, we are not likely to get a lot of consideration from the other side.⁵⁰

The Attorney General referenced conclusions of the Lords European Union Committee. The Committee considered the UK's legal liability for

⁴⁸ Council of the European Union Press Release, [2019 EU budget: Council adopts contingency measures for a no-deal Brexit](#), 9 July 2019

⁴⁹ op cit, [paragraph \(1\)](#)

⁵⁰ [HC Deb. 3 December 2018 c570](#)

items related to the EU Budget if there is no withdrawal agreement in early 2017.⁵¹ Legal expert witnesses to the Committee had different opinions on the legal status of these items. However, the Committee concluded that under EU law, without a withdrawal agreement Article 50 TEU allows the UK to leave without being liable for outstanding financial obligations.⁵² The Committee also concluded that individual EU Member States may seek to bring a case against the UK for outstanding payments under public international law, but also that “international law is slow to litigate and hard to enforce. In addition, it is questionable whether an international court or tribunal could have jurisdiction”.⁵³

The Lords Committee said that the political and economic consequences of the UK leaving without making any payment “are likely to be profound”.⁵⁴

The Institute for Government has also suggested that if the UK refused to make any payments to the EU, then redress may be sought through the International Court of Justice or the Permanent Court of Arbitration.⁵⁵

4.3 The European Investment Bank

Under the European Investment Bank (EIB) Statute, the shareholders are the EU Member States,⁵⁶ so it is likely that the UK will cease to be a member of the EIB, whether there is a ratified WA not. The financial settlement explains how the UK’s financial involvement in the EIB will be wound up. It sets out:

- the schedule for the gradual return of €3.5 billion of paid in capital to the UK;
- that the UK will provide a guarantee to the EIB equal to its callable capital (up to €39 billion) – an amount the UK currently agrees to provide if required. The UK will also provide a guarantee equal to the amount of paid in capital returned to it. The guarantees will decrease as EIB loans associated with it mature.

What happens in a no deal scenario with respect to these financial aspects is not clear. Given that there is no clear process in the Bank’s Statute to deal with this situation, it seems likely that negotiations would be required, potentially as part of any negotiations on an alternative financial settlement.

4.4 UK participation in the European Development Fund

The European Development Fund (EDF) is the EU’s main instrument for providing overseas development assistance to countries in Africa, the

⁵¹ House of Lords EU Committee, [Brexit and the EU Budget](#), 4 March 2017

⁵² *ibid.*, [paras 135-137](#) and [para 159](#)

⁵³ *ibid.*

⁵⁴ *ibid.*

⁵⁵ Institute for Government, [The EU divorce bill](#), March 2018

⁵⁶ EIB, [Statute and other Treaty provisions](#), 1 July 2013

Caribbean and the Pacific. For historical reasons, it is separate from the general EU Budget in a legal and accounting sense. The EDF is broken down over time into 'EDF funds'. The UK's spending through the EDF contributes towards its commitment to spend 0.7% of gross national income (GNI) on overseas aid.⁵⁷

The financial settlement says that the UK will remain part of, and will contribute to, the EDF until the close of the 11th EDF fund in December 2020. The UK also has a share of the EDF's Investment Facility. This funding will be returned to the UK as the investments end.

Each EDF fund is set out in a separate treaty – called an 'internal agreement' – outside the EU Treaties.⁵⁸ Strictly speaking, the EDF internal agreements are not subject to the Article 50 process, so if there is no deal and the EU Treaties cease to apply in the UK after 29 March 2019, the EDF internal agreements *will not cease*. This suggests that in the event of 'no deal' the UK's legal obligation to make contributions to the EDF would persist in a legal sense, unless the UK can end its involvement in the internal agreements some other way.

Whatever happens, it is unlikely that the UK's total spending on overseas aid will decrease. In 2016, £1.5 billion of the £13.4 billion spent by the UK on overseas aid went through the EDF.⁵⁹ Continuing to meet the statutory target for UK overseas aid of 0.7% of GNI would necessitate channelling any spending no longer going through the EDF to other overseas aid programmes. It is reasonable to anticipate that about 10% of the UK's 2019-20 aid budget will potentially be available for reallocation in the event of a no-deal Brexit.

4.5 Politics and future EU-UK relations

Politics and the appetite for an ongoing EU-UK relationship are likely to dictate the extent to which financial commitments are settled if there is no deal. For instance, the EU has said that it will only begin trade negotiations once divorce issues, such as the financial settlement, have been sorted.

The UK Government has said that after Brexit it would like to participate as a third country in some EU programmes and agencies, such as the next research and innovation programme (Horizon 2020 is the current programme) and the European Defence Fund.⁶⁰ If there is no deal it seems unlikely that the EU would allow the UK to participate in any of its programmes unless an alternative financial settlement is negotiated.

⁵⁷ For information on the UK's aid target, see Commons Briefing Paper 3714, [The 0.7% aid target: June 2016 update](#), 20 June 2016.

⁵⁸ European Scrutiny Committee, Documents considered by the Committee on 25 April 2017, [28 European Development Funds](#)

⁵⁹ House of Lords Library Briefing, [Brexit: Overseas Development Assistance](#), 6 February 2018

⁶⁰ The Government White Paper on the [future relationship between the UK and the EU](#) proposes continued UK participation in several EU programmes and agencies.

There are other areas where the UK and EU would favour an ongoing relationship and, in the event of 'no deal', coming to an agreement on the financial settlement could help to facilitate such co-operation.

Reaching an agreement would also help to minimise disruption to the EU budget. The UK is a net contributor to the EU Budget: it pays more into the EU Budget than it receives in EU funding. The EU Budget could be significantly disrupted if UK payments to the EU ceased following a no deal exit. This is particularly important for the final two years of the current EU budget plan – 2019 and 2020 – as the UK's involvement was expected.

The Lords Committee concluded that “the political and economic consequences of the UK leaving the EU without responding to claims under the EU budget are likely to be profound”.⁶¹

⁶¹ House of Lords EU Committee, [Brexit and the EU Budget](#), HL Paper 125, 4 March 2017, [paras 135-137](#)

5. June – December 2017: the negotiations

The joint report of December 2017, and the European Council's view that it reflected that sufficient progress had been made, brought the first phase of Brexit negotiations to a close. The financial settlement was one of the key issues addressed during these negotiations.

Broadly speaking, the negotiations focused on a European Commission [position paper](#) on the financial settlement.

5.1 The EU's position

A [paper published](#) by the European Commission, in June 2017, set out its position on the financial settlement.⁶² The Commission's paper fleshed out the European Council's wishes regarding the settlement as laid out in its [negotiating directives](#), which is the mandate for the EU negotiators.⁶³

Michel Barnier, the European Commission's Chief Negotiator, says that the EU expects the financial commitments undertaken by 28 Member States (including the UK) to be honoured by all 28, not just the remaining 27.

Box 4.1: The EU institutions

European Council

The European Council is the highest-level decision-making forum in the EU, consisting of the heads of state or government of the Member States, together with the Presidents of the European Council and the European Commission. The European Council gives the EU its ultimate political direction, which it does by adopting 'conclusions' at the end of its meetings. The European Council has no powers to pass laws.

European Commission (the Commission)

The European Commission is the executive of the EU: it proposes legislation and implements policy within the competences laid down by the EU Treaties. There are 28 members, one from each Member State, known as Commissioners. The Commission has the following general functions: policy-making; Treaty guardianship; policy implementation and delegated powers; management of EU funds; representation in trade negotiations and other agreements with third countries.

The Council of the European Union (the Council)

The Council is made up of ministers of the governments of Member States. It is one of the two principal legislative and decision-making bodies of the EU, along with the European Parliament. It shares responsibility with the Parliament for setting the EU's annual budget. It is headed by a rotation of Member States which act as its President, otherwise known as the Presidency of the Council of the EU. The composition of the Council varies according to the business under discussion. For example the Economic and Affairs (Ecofin) Council gathers finance ministers to discuss economic policy.

European Parliament

The European Parliament is the assembly of elected representatives of EU citizens. The representatives are known as Members of the European Parliament (MEPs). The European Parliament debates and passes law; scrutinises other EU institutions; and debates and adopts the EU's budget.

⁶² European Commission. [Position paper transmitted to the UK: essential principles on the financial settlement](#), 12 June 2017

⁶³ The Council of the European Union, [Negotiating directives for Article 50 negotiations](#), 22 May 2017

Why does the EU expect the UK to make a settlement?

The EU said that the UK must honour its share of the financial commitments undertaken while it was a member of the EU. For instance, the UK agreed to the EU's spending plans (see [Box 4.2](#)) and committed to funding them by agreeing revenue raising measures (see [Box 4.3](#)), and the EU believes these commitments should be met.

On the same basis, the EU said that the UK should continue to benefit from EU funding programmes until the programmes close. This means the UK continuing to receive funding in areas such as economic development, agriculture and research and innovation until the current funding period ends. Continued participation would require the UK to obey the EU's legal rules for the programmes.

Box 4.2: EU spending plans: multiannual financial frameworks

The EU plans its spending over seven-year periods through the Multiannual Financial Framework (MFF).⁶⁴ The MFF broadly sets out maximum EU spending across different categories. It also sets an overall maximum for the amount of actual payments the EU can make in a year.

The MFF provides a framework through which the annual budgets are negotiated. It aims to ensure that the EU's spending evolves in line with its policies.

The MFF is negotiated by the European institutions and requires unanimous agreement at the European Council – which means each Member States' head of government must agree to it – and agreement by the European Parliament. It is [laid down in a Council Regulation](#).

The current MFF covers 2014-2020. It allows the EU to commit to spend up to €960 billion over the period and make payments of €908 billion (in 2011 prices). This spending is equivalent to around 1% of the Gross National Income (GNI) of the whole EU.

The [regulations](#) for most of the EU's spending programmes are adopted alongside the MFF. These legal bases provide a reference amount of money to be spent on the programme over the period.

Further details are available in the Library briefing [A guide to the EU budget](#).

Box 4.3: Raising the EU's revenue: the Own Resources Decision

The Own Resources Decision (ORD) lays out how Member States contribute to the EU Budget. The regulation is negotiated at the same time as the Multiannual Financial Framework (MFF) but the two are set out in different regulations.

The [current ORD](#) says that Member States should contribute: through the custom duties and sugar levies they collect; a share of their adjusted VAT-base; and, a share based on their national income.

The ORD also includes the UK's rebate and other correction mechanisms for Member States.

Further details are available in the Library briefing [A guide to the EU budget](#).

What should the settlement cover?

Broadly speaking the EU wanted the settlement to include:

- the UK's participation in the EU Budget

⁶⁴ The MFF must cover a period of at least five years.

- termination of the UK's membership of EU bodies and institutions, such as the European Investment Bank
- the UK's participation in specific EU funds and facilities, such as the [facility for Refugees in Turkey](#).

[Annex 1](#) of the EU's position paper provides an indicative list of over 70 bodies and funds to be included in the settlement.

The most significant commitments are those arising from the UK's participation in the EU Budget. Of particular significance are the spending committed in the EU Budget but not yet paid to recipients – often described as 'reste à liquider' – and the outstanding funding agreed for EU spending programmes in the current budget period.

Which parts of the EU Budget were included in the position paper?

The EU believes that the UK's approval of EU spending plans and revenue raising measures commit it to providing funding for the financial commitments arising from the EU Budget.

Below are the five types of financial commitment that the EU expected the UK to contribute to, along with a short description of each.

(1) EU budget outstanding commitments (reste à liquider)

In their annual budget the EU commit to some future spending without making payments to recipients at the time. The commitments will become payments in the future. The EU refer to outstanding commitments as reste à liquider (RAL).⁶⁵

At the end of 2016, the EU's total accumulated RAL is €239 billion.⁶⁶

(2) Financial programming, 2014 to 2020

When the EU agreed its spending for 2014 – 2020 it adopted regulations setting out the rules and amounts allocated to individual spending programmes. Programmes covering areas such as economic development, skills, cohesion, agriculture and asylum and migration all have regulations setting out rules and allocated amounts. The spending under these programmes has been legally committed by the EU – through EU regulations – to provide certainty for the recipients.

The EU's [position paper](#) on the settlement lists close to 70 programmes whose spending has been agreed through regulations – the EU expected the UK's settlement to cover a share of the outstanding spending of these programmes.⁶⁷

⁶⁵ From the French for 'yet to be paid'.

⁶⁶ European Commission, [Consolidated accounts of the European Union and Financial Statement Discussion and Analysis](#), June 2017, [Table 4.5](#)

⁶⁷ European Commission, Essential Principles on Financial Settlement, 12 June 2017, [Annex 2](#). The regulations are available from the [European Commission's website](#).

The EU's financial programming allocates €169 billion in 2020 for these programmes.⁶⁸

(3) Liabilities which are not balanced by corresponding assets

Liabilities are, generally speaking, obligations to pay for something. The EU's position paper said the settlement should include EU liabilities recorded in the EU's accounts which are not balanced by corresponding assets, such as pensions and other employee benefits.⁶⁹ Below we discuss the specific liabilities listed in the position paper.

Pensions and other employee benefits

This covers the costs of providing pensions and other benefits to EU employees. Like the UK civil service pension scheme, the EU's pension scheme is unfunded and operates on a 'pay-as-you-go basis', which sees costs being covered by the EU Budget as they arise.

At the end of 2016, the EU's liabilities for pensions and other employee benefits stood at €67 billion.⁷⁰

Provisions

Provisions are amounts arising from past events that will probably have to be paid by the EU budget in the future. Over two-fifths of the EU's provisions are for the decommissioning of nuclear sites.⁷¹

At the end of 2016, the EU's liabilities for provisions stood at €2.6 billion.⁷²

Financial liabilities not related to borrowings

At the end of 2016, the EU's financial liabilities not related to borrowings stood at €2.2 billion.⁷³ The majority relate to finance lease liabilities.

Payables and accrued charges other than RAL

Payables are largely unpaid cost claims from grant beneficiaries or other EU funding. They include refunds owed to Member States on their financial contributions to the EU Budget.

At the end of 2016, the EU has around €107 billion of payables and accrued charges. It isn't clear which of these aren't included in RAL: our

⁶⁸ European Commission, Statement of estimates of the European Commission for the financial year 2018, [financial programming section](#).

⁶⁹ Further examples are provided on [page 3](#) of the Single Financial Settlement position paper.

⁷⁰ European Commission, [Consolidated accounts of the European Union and Financial Statement Discussion and Analysis](#), June 2017, [page 18](#)

⁷¹ European Commission, [Consolidated accounts of the European Union and Financial Statement Discussion and Analysis](#), June 2017, [note 2.10](#)

⁷² European Commission, [Consolidated accounts of the European Union and Financial Statement Discussion and Analysis](#), June 2017, [page 18](#)

⁷³ European Commission, [Consolidated accounts of the European Union and Financial Statement Discussion and Analysis](#), June 2017, [note 2.11](#)

interpretation of the EU's accounts suggest that the EU has around €55 billion of payables and accrued charges other than RAL.⁷⁴

(4) Contingent liabilities

Contingent liabilities are potential liabilities that may occur depending on the outcome of an uncertain event in the future. They relate mainly to financial guarantees given (on loans and financial assistance programmes) and to legal risks.

The EU's consolidated accounts record close to €90 billion of contingent liabilities at the end of 2016.⁷⁵

Box 4.4: Example of a contingent liability in the EU budget The European Financial Stabilisation Mechanism

The European Financial Stabilisation Mechanism (EFSM) was created in 2010 as a temporary fund to provide loans to EU Member States in financial difficulty. The EFSM used the EU budget as a guarantee to borrow money on financial markets, which it then subsequently lent to countries who require the funding. The EFSM is no longer used to fund new loans, but the outstanding loans still exist.

If the countries who receive EFSM loans fail to repay them, then the EU budget bears the cost. If, as a result of this, additional money is required to fund the EU budget, further contributions from EU Members may be required. This is where the UK currently has a contingent liability.

(5) The specific costs related to the withdrawal process

This would include, for example, the cost of moving any EU agencies that have to leave the UK following its withdrawal.

What sources should be used?

The EU proposed that its audited consolidated accounts should be used for determining the EU's RAL, liabilities and contingent liabilities at the time of UK withdrawal. The EU also suggest that the latest updated financial programming should be used for determining outstanding financial commitments for spending programmes up to 2020.

How should the UK's share be calculated?

The sources that the EU propose should be used for quantifying the outstanding commitments only show totals for the EU – they don't provide shares for each Member State. A way to calculate the UK's share needs to be negotiated.

The EU proposed that the UK's share of financial commitments should be based on the UK's percentage share of total contributions to the EU Budget over 2014-2018. The UK's rebate (see [Box 4.5](#)) would be included when determining the UK's share of contributions to the EU Budget. This suggests a UK share of around 13%.⁷⁶

⁷⁴ This estimate is based on EAGF payables (€12.2 billion), own resources payables (€10.4 billion), sundry payables (€0.4 billion), EAGF accrued charges (€33 billion)

⁷⁵ European Commission, [Consolidated accounts of the European Union and Financial Statement Discussion and Analysis](#), June 2017, [section 4](#)

⁷⁶ European Commission, [Budget on line](#)

The EU proposed that the UK's payments shall be established and paid in euros.

Box 4.5: The UK's rebate

The UK receives a rebate on its net contribution to the EU budget. The rebate was introduced to address the issue of the UK making relatively larger net contributions than other Member States. When the rebate was introduced, in 1985, the UK received relatively little from the EU budget: it had a small agricultural sector, but most EU spending went on agriculture. At the same time the UK made relatively large contributions to the budget, despite being among the less well-off Member States at the time.

How does the rebate work?

Broadly speaking the formula used means that the UK's net contribution is reduced by 66% relative to what it would be without rebate. However, certain parts of the EU's spending are excluded from the deduction including EU overseas aid, and non-agricultural spending in Member States that joined the EU after April 2004.

The basic concept of the rebate has remained the same since its inception, but changes to its calculation have been made over time as the EU and its methods for raising revenues have changed. The changes aim to keep the calculation similar to what it would have been had the overall system not changed since 1985.

The European Commission calculates the rebate on the basis of its estimates of the likely outturn for payments from the budget in-year and its estimates of Member States' contributions to the budget. These are then corrected in light of actual outturn figures. Corrections may be made up to three years after the year to which the rebate relates, after which a final reckoning is made in the fourth year. The rebate is deducted from the UK's contribution a year in arrears.

The Library briefing [The UK's contribution to the EU Budget](#) has more on the rebate.

Should there be a one off payment?

The EU do not want a single payment, they would rather have a series of payments staggered over time. The EU said that a schedule of payments should "aim at mitigating the impact of the United Kingdom withdrawal on the budget for the Union and on its Member States."⁷⁷

The EU proposes that the schedule should be established in phase 2 of Brexit negotiations.

What about areas outside of the EU's Budget?

As discussed previously, the EU expect the settlement to cover some areas that aren't part of the EU Budget. The EU's position paper proposed that the settlement should also cover the termination of the UK's membership of bodies established in the EU's Treaties (such as the European Investment Bank) and the UK's participation in specific EU funds and facilities.

European Investment Bank (EIB)

When the UK joined the EU it paid capital into the EIB to become a shareholder in the bank. Once the UK leaves the EU it will cease being a member of the EIB. The EU proposed that the UK's capital in the EIB be

⁷⁷ European Commission, Essential Principles on Financial Settlement, 12 June 2017, [pages 4 - 5](#)

paid back once all the EIB's outstanding loans, at the time of UK withdrawal, have concluded.

At the end of 2016, the UK had €3.5 billion of paid-in capital in the EIB.⁷⁸

European Central Bank (ECB)

The UK also has capital in the ECB. The EU proposed that the UK's capital should be reimbursed on withdrawal in line with the payment profile established for the single financial settlement.

At January 2015 the UK had €0.06 billion (€56 million) of paid-in capital in the ECB.⁷⁹

Other areas outside of the EU Budget

Some EU spending is outside the EU Budget, from specific funds and trusts. The EU proposes that the UK continues to meet its outstanding commitments in the same fashion as it currently does in these cases. The UK would therefore continue to contribute to these areas as normal – in line with the specific rules and schedule for each – until they end. Below we briefly discuss the 'other areas' set out in the EU's position paper.⁸⁰

European Development Fund (EDF)

The EDF is the EU's main instrument for providing development aid overseas. The EDF is broken down over time into 'EDF funds'. The Commission wants the UK to honour its commitments to all unclosed funds (8th – 11th EDF). The current EDF will run from 2014-2020.

For further information on the EDF see the European Parliament Research Service's briefing [European Development Fund](#).

EU Trust Funds

These development tools pool together resources from different donors in order to enable an EU response to an emergency or post-emergency situation.

The European Parliament Research Service's briefing [EU Trust Funds for external action: First uses of a new tool](#) has more on the EU's trust funds.

Facility for Refugees in Turkey

The [Facility for Refugees in Turkey](#) was established as part of a wider framework to address the migration crisis. The Facility focuses on humanitarian assistance, education, migration management, health, infrastructure, and socio-economic support.

⁷⁸ EIB, 2016 Financial Report, [Note H](#), April 2017

⁷⁹ ECB, [Capital subscription](#)

⁸⁰ The EU also expect the UK to contribute to the funding of the teachers it seconded to the European schools until 2020/21 and share all the financing obligations of agencies of the Council which are not financed by the EU Budget.

Will the UK continue to receive EU funding as part of the settlement?

The EU's position paper said that if the UK contributes to the EU Budget's outstanding commitments then it should continue to benefit from EU funding programmes until they close. Most programmes cover the period 2014 – 2020, but some spending is expected after 2020. Continued participation would require the UK to obey the EU's legal rules for the programmes.

The EU's programmes include those managed by the UK Government – such as structural and agricultural funding – and those managed directly by the Commission through a competitive bidding process – such as the funding provided through Horizon 2020 for research and innovation.

5.2 The UK's public position

The UK made no formal response to the EU's position paper and did not set out its view in any detail. However, in September 2017 the Prime Minister, Theresa May, suggested that the UK would meet commitments for the current EU budget plan (2014-2020) so that EU Member States would not be worse off as a result of the UK leaving. The Prime Minister also said that the "the UK will honour its commitments made during the period of our membership". The Prime Minister's pledge did not appear to extend to all potential commitments outside of the current budget plan. For instance items such as pensions, according to the Secretary of State for Exiting the European Union, David Davis, remained debatable.

Prior to Mrs May's speech the UK Government had recognised that the UK has financial obligations to the EU, and vice-versa, and that they need to be resolved.

David Davis has said that the UK would probe and challenge the EU's position on the settlement during negotiations, with a view to lowering the EU's position. While the UK probed the legal case for the settlement, Mr Davis has said that the Government sees the issue as "more of a political principle, a political obligation, than a legal one."⁸¹

Theresa May's letter triggering Article 50

On 29 March 2017, Prime Minister Theresa May's sent a letter to Donald Tusk – the President of the European Council – giving notice of

Article 50 was inserted into the European Union Treaty by the Lisbon Treaty in 2009. It allows a Member State to leave the EU and sets out a procedure for doing so.

⁸¹ Lords Select Committee on the European Union, [Uncorrected oral evidence Scrutiny of Brexit negotiations](#), 31 October 2017

the UK's intention to leave the EU. The letter triggered Article 50⁸² thereby starting the withdrawal procedure. In this letter the Prime Minister said that the negotiations should determine a 'fair settlement' of the UK's obligations as a "departing member state, in accordance with the law and in the spirit of the United Kingdom's continuing partnership with the EU".⁸³ The Prime Minister went on to say that the settlement should be agreed alongside the terms of the future EU-UK relationship.

2017 Conservative Manifesto

The Conservative Manifesto didn't go into more detail than Mrs May's letter to Donald Tusk:

We will determine a fair settlement of the UK's rights and obligations as a departing member state, in accordance with the law and in the spirit of the UK's continuing partnership with the EU.⁸⁴

Parliamentary statement: July 2017

David Davis went a little further than the Article 50 letter and the Conservative Manifesto. In [a statement](#) to the House of Commons, he recognised the UK has financial obligations to the EU, and vice-versa, and that they need to be resolved:

On the financial settlement, as set out in the Prime Minister's letter to President Tusk, the Government have been clear that we will work with the EU to determine a fair settlement of the UK's rights and obligations as a departing member state, in accordance with the law and in the spirit of our continuing partnership. The Government recognise that the UK has obligations to the EU, and the EU obligations to the UK, that will survive the UK's withdrawal—and that these need to be resolved.⁸⁵

Mrs May's Florence Speech: September 2017

In her Florence speech the Prime Minister said that the UK would honour commitments made during the period of its EU membership. The Prime Minister's speech was ambiguous about exactly which commitments would be honoured. It was clear, however, that the pledge would mean no remaining Member States being made worse off over the current EU budget plan (2014 – 2020) as a result of the UK's decision to leave:

But in this context [of a transition or implementation period] I am conscious that our departure causes another type of uncertainty for the remaining member states and their taxpayers over the EU budget.

⁸² This is the letter which triggered Article 50. Article 50 of the Treaty on European Union was inserted into the European Union Treaty by the Lisbon Treaty in 2009. It allows a Member State to leave the EU and sets out a procedure for doing so.

⁸³ Prime Minister's letter to Donald Tusk triggering Article 50, 29 March 2017, [page 4](#)

⁸⁴ The Conservative and Unionist Party Manifesto 2017, [page 36](#)

⁸⁵ [HC Deb.13 July 2017:c15-16WS](#)

Some of the claims made on this issue are exaggerated and unhelpful and we can only resolve this as part of the settlement of all the issues I have been talking about today.

Still I do not want our partners to fear that they will need to pay more or receive less over the remainder of the current budget plan as a result of our decision to leave. The UK will honour commitments we have made during the period of our membership.⁸⁶

The promise to honour commitments was made within the context of a proposed implementation or transition period after the UK leaves the EU.

David Davis was interviewed by the BBC's Andrew Marr following Mrs May's speech. He suggested that the UK would honour commitments made for the current EU budget period, but whether they would do so for other liabilities – such as pensions – was still debatable:⁸⁷

I mean things like pensions and other things – these are debatable to say the least, arguable to say the least.⁸⁸

5.3 The settlement in the first phase of Brexit negotiations

The first phase of negotiations

The first phase of negotiations largely focused on disentangling the UK from the EU. Besides reaching agreement on the settlement, other objectives for the first phase of negotiations included reaching agreements on citizens' rights, "other separation issues" and the Irish border.⁸⁹

Moving on to the next phase: making 'sufficient progress'

The EU would only allow Brexit negotiations to move on to discussing transitional arrangements and the future EU-UK relationship, including areas such as trade, once 'sufficient progress' had been made in the first phase of negotiations. Progress was therefore required on the settlement.⁹⁰

It was for the leaders of all the other EU Member States to decide on whether sufficient progress had been made on all areas of the first phase of negotiations.

How were the negotiations organised?

The UK's exit negotiations have followed a phased approach starting with the priority objectives – citizens' rights, a financial settlement,

⁸⁶ [PM's Florence speech: a new era of cooperation and partnership between the UK and the EU](#), 22 September 2017

⁸⁷ [Andrew Marr Show, Interview with David Davis MP Secretary of State for Exiting the European Union](#), 23 September 2017

⁸⁸ *ibid*

⁸⁹ European Commission, [Terms of Reference for the Article 50 Treaty on European Union negotiations](#), 19 June 2017

⁹⁰ The Council of the European Union, [Negotiating directives for Article 50 negotiations](#), 22 May 2017, para 19

“other separation issues” and the Irish border – moving on to the UK’s future relationship with the EU once ‘sufficient progress’ is made in these areas. It was for the other 27 EU Member States to decide whether sufficient progress has been made.

Generally speaking negotiations in the first phase followed four-week cycles. The first two weeks in each cycle were for preparations, with officials from both sides meeting to establish negotiating positions. The third week was for negotiations between the chief negotiators Michel Barnier and David Davis. Week four was for reporting back on any progress to the governments of the EU27.

Negotiations took place as follows:

- Opening 19 June
- Second round w/c 17 July
- Third round w/c 28 August
- Fourth round w/c 25 September
- Fifth round w/c 9 October

The European Council – the leaders of EU Member States – met on 19/20 October. The European Council (the Council) was not able to conclude that ‘sufficient progress’ had been made in the first phase of negotiations. The Council called for negotiations to continue and build on progress in order for talks to move onto the second phase of negotiations.⁹¹

Negotiations continued with a sixth round on 9 and 10 November. Subsequently, the Commission and UK negotiators had constant direct contact.

July round

In the week before July’s negotiations, the UK Government recognised that the UK has financial obligations to the EU that will survive the UK’s withdrawal, and vice versa, and that they need to be resolved.⁹²

The UK Government has not publicly said precisely which obligations they recognise. Instead David Davis said he would challenge the EU’s proposals during negotiations, and only after that might an alternative proposal be published by the UK.⁹³

After July’s negotiations Michel Barnier – the EU’s Chief Negotiator – made the following points on the financial settlement:⁹⁴

⁹¹ European Council, [European Council \(Art. 50\) meeting \(20 October 2017\) - Conclusions](#), 20 October 2017

⁹² [HC Deb 13 July 2017:c15-16WS](#)

⁹³ House of Lords Select Committee on the European Union, [Uncorrected oral evidence: David Davis evidence session](#), 11 July 2017.

⁹⁴ European Commission, [Speaking points by Michel Barnier at the press conference following the second round of Article 50 negotiations with the United Kingdom](#), 20 July 2017

- negotiations had focussed on a detailed legal analysis of the EU's position on which financial obligations should be included the settlement
- by recognising that obligations exist the UK has made it possible for the two sides to engage in identifying the specific obligations to be settled
- clarification of the UK's position is indispensable to negotiate and achieve 'sufficient progress' on the settlement.

David Davis's statement referred to 'robust but constructive talks' on the financial settlement:

On financial settlement, we both recognise the importance of sorting out the obligations we have to one another, both legally, and in the spirit of mutual cooperation.

We have had robust but constructive talks this week.

Clearly there is a lot left to talk about, and further work before we can resolve this. Ultimately getting to a solution will require flexibility from both sides.

But as Michel said, we shouldn't expect incremental progress in every round.⁹⁵

At the end of the week's negotiations, the BBC reported a Downing Street spokesman as saying that there are no plans to produce a position paper on the financial settlement.⁹⁶

August round

Negotiations continued on the scale and scope of the payments for which the UK will be liable on leaving the EU, but little progress was made towards agreeing precisely which obligations would be included. The EU pressed the Government for a "clear position" on the UK's recognition of its "legal and moral" commitments to a financial settlement. At the opening press conference on 28 August, Michel Barnier stressed that "we need UK positions on *all* separation issues", an emphasis that David Davis apparently did not miss, given his response that "for the United Kingdom, the week ahead is about driving forward the technical discussions across all the issues – *all* the issues".

Referring to the UK's financial settlement, Michel Barnier said in his [statement](#) at the end of the negotiations "this week the UK explained that these obligations will be limited to their last payment to the EU budget before departure". He criticised this position by listing examples of commitments that the UK had made that extend past the UK's departure, including loan guarantees for Ukraine and funding for developing countries, and said "after this week, it is clear that the UK

⁹⁵ [David Davis' closing remarks at the end of the second round of EU exit negotiations in Brussels](#), 20 July 2017

⁹⁶ BBC, [Brexit: UK and EU at odds over 'exit bill'](#), 21 July 2017

does not feel legally obliged to honour these obligations after departure”.

David Davis’s [response](#) did not directly address this concern, except to acknowledge that “it is fair to say, across the piece, we have a very different legal stance”. The statement suggested that the UK has presented its own legal analyses of its potential financial obligations. Mr Davis did, however, seek to emphasise that “the settlement should be in accordance with law and in the spirit of the UK’s continuing partnership with the EU”. His conclusion was that “we have succeeded in building mutual understanding, but it is also clear that there are still significant differences to be bridged”.

In the Q&A following these statements, David Davis expanded on his position:

the European Union made a claim on the United Kingdom – on the United Kingdom taxpayer – for a large sum of money, unspecified but undoubtedly large, and on the basis of what it determined to be our legal obligations. And so the proper approach to that is to go through line by line and see whether or not we believe those legal obligations are correctly codified.⁹⁷

He went on to say that “we’re a country that meets our international obligations... but those obligations have got to be well specified and they’ve got to be real. They don’t necessarily have to be legal – we also recognise moral obligations sometimes”.

Barnier’s response was that:⁹⁸

...in order to make these discussions simpler, we set out a very precise list of commitments and accounts [referring to [the EU position paper](#) published before the first round of negotiations] that have to be resolved, that the 28 subscribed to and the 27 will not agree to having to pay on their own based on the current financial perspectives, and we have a list of all the legal bases underpinning these commitments.

September round

The September round was preceded by Mrs May’s Florence speech (see [section 3.1](#)). Broadly speaking negotiations focused on two areas arising from Mrs May’s Florence:

- the UK explained what was meant by Theresa May’s assurance that the UK’s departure would not make EU Member States worse off during the current budget plan. Michel Barnier reported that this reassurance was limited to 2019-2020.
- technical discussions were held on Theresa May’s pledge that “the UK will honour its commitments made during the period of our membership”. The UK is not yet ready to specify exactly which commitments the settlement should include.

⁹⁷ European Commission, [Press conference following the 3rd round of Article 50 negotiations with the UK](#), 31 August 2017

⁹⁸ *ibid*

David Davis felt that discussions on the UK's financial commitments were 'very constructive'.⁹⁹ Mr Barnier said that the discussions were 'useful'. However, Mr Barnier was also stated that for 'sufficient progress' to be reached on the settlement requires the UK to honour all of the commitments undertaken while it was a member of the EU.¹⁰⁰ On the Tuesday following the negotiations Mr Barnier told the European Parliament that 'serious divergences' still existed on the financial settlement.¹⁰¹ At the 2017 Conservative Conference David Davis reiterated that the UK's approach to negotiations would be to challenge the EU's position.¹⁰²

At the start of September's negotiations David Davis said that a conclusion on the financial settlement could not be reached in the first phase of negotiations. In Mr Davis's view the settlement could only be concluded "in the context of and in accordance with our new deep and special partnership with the EU";¹⁰³ in other words, alongside talks on the future EU-UK relationship. This view is at odds with the EU's expectations. The EU expects a methodology for the financial settlement to be agreed during the first phase of exit negotiations. Michel Barnier was asked about the link between the financial settlement and the UK-EU future relationship in the Q&A following the statements closing the September negotiations. Mr Barnier sees the two subjects as separate issues:

...there is no link, there is no possible link the way we see it, no possible link between that discussion [the second phase of negotiations on the UK-EU future relationship] and a discussion about separating the - the separations issues – and the commitments entered into the past.¹⁰⁴

October round

The October round saw further discussions on technical aspects of the settlement, with no negotiation over which commitments are to be included in the settlement. In the press conference at the end of October's negotiations David Davis said that the UK are not in a position to agree specific commitments and that "this can only come later":

In line with the process agreed at our last round of talks, we have undertaken a rigorous examination of the technical detail where we need to reach a shared view.

⁹⁹ [David Davis' closing remarks at the end of the fourth round of EU exit negotiations in Brussels](#), 28 September 2017

¹⁰⁰ European Commission, [Press statement by Michel Barnier following the fourth round of Article 50 negotiations with the United Kingdom](#), 28 September 2017

¹⁰¹ European Commission, [Speech by Michel Barnier at the Plenary Session of the European Parliament on the state of play of negotiations with the United Kingdom](#), 3 October 2017

¹⁰² [David Davis' speech to 2017 Conservative Conference](#)

¹⁰³ [David Davis' opening remarks at the start of the fourth round of EU exit negotiations](#), 25 September 2017

¹⁰⁴ European Commission Audiovisual Services, [Article 50 negotiations press conference Q&A](#), 28 September 2017

This is not a process of agreeing specific commitments - we have been clear this can only come later.

But it is an important step, so that when the time comes we will be able to reach a political agreement quickly and simply.¹⁰⁵

David Davis' comments echo his previously expressed view that a conclusion on the settlement will only be reached alongside talks on the future EU-UK relationship. Mr Davis, speaking generally about the negotiations, called for the European Council to recognise the progress made and move negotiations forward. This would allow the ideas explored during the first phase of negotiations to be turned into 'concrete shared proposals'.

At the same press conference Michel Barnier said that talks on the settlement were 'at a deadlock' with the UK unable to clarify which financial commitments it agrees should be in the settlement.¹⁰⁶

With deadlock on the settlement, and outstanding issues in other areas of the first phase of negotiations, Michel Barnier said that he could not recommend negotiations to move onto the future EU-UK relationship. However, he was positive that the deadlock could be broken, and that sufficient progress could be achieved in time for December 2017's European Council:

...we are in a position of deadlock at the moment but I'm sure, as I said, with the necessary will and on the basis of the commitments entered into by Theresa May in Florence we can find a way out of this deadlock.

[...]

Slowly but surely over the next few weeks I will explore the way forward if there is the necessary will. I will explore ways of getting out of this deadlock we find ourselves in on the financial issues, with a view to making sufficient progress by the next European Council. Unfortunately we are not at this stage now.¹⁰⁷

2017 European Council October 19/20

Following its October 19/20 meeting the Council adopted conclusions on the exit negotiations.¹⁰⁸ On the settlement, the Council concluded that the UK had not yet turned its pledge to honour its financial commitments into "a firm and concrete commitment".

In general, the Council was not able to say that 'sufficient progress' has been reached in the first phase of negotiations. The Council called for negotiations to continue and build on progress in order for talks to move onto the second phase of negotiations. The Council would next

¹⁰⁵ [David Davis' closing remarks at the end of the fifth round of EU exit negotiations in Brussels](#), 12 October 2017

¹⁰⁶ European Commission Press Release, [Press statement by Michel Barnier following the fifth round of Article 50 negotiations with the United Kingdom](#), 12 October 2017

¹⁰⁷ European Commission Audiovisual services, [Press conference following the 5th round of Article 50 negotiations](#), 12 October 2017

¹⁰⁸ European Council, [European Council \(Art. 50\) meeting \(20 October 2017\) - Conclusions](#), 20 October 2017

address whether ‘sufficient progress’ had been made at its December 2017 meeting.

November round

Negotiations again focused on technical aspects of the settlement. In the press conference at the end of the negotiations, David Davis reported that “we have made substantial technical progress across all the issues that will need to be addressed”.¹⁰⁹ Michel Barnier echoed this view, saying that November’s negotiation had been about “deepening, clarification and technical work”.¹¹⁰

In general, Mr Davis said that the negotiations had drawn out areas where further political and technical discussions are required – presumably including areas of the settlement. Mr Davis’ view is that political discussions will enable progress to be made.

Mr Barnier was clear that for ‘sufficient progress’ to be made the UK needs to specify which financial commitments it is prepared to include in the settlement. He re-iterated his view, expressed throughout the first-phase of negotiations, that “this is an essential condition to reach sufficient progress in December”.

In the press conference Q&A, Michel Barnier confirmed press reports that he required clarifications on outstanding issues from the UK within two weeks in order to move negotiations onto the second phase in December.¹¹¹

Agreement reached?

On 20 November 2017, the media reported that a sub-committee of the UK Cabinet had reached agreement on expanding the commitments it is willing to include in the settlement.¹¹² The reports suggested that the agreement amounted to increasing the UK’s potential payment from around €20 billion to €40 billion, although at this point in negotiations it is a methodology for calculating the settlement that is being agreed, not actual financial figures.

In late November 2017 it appeared that an agreement-in-principle had been reached on the settlement between the UK and EU.^{113,114} No formal announcement was made.

¹⁰⁹ [David Davis' closing remarks after EU exit negotiations on 9-10 November](#), 10 November 2017

¹¹⁰ European Commission, [Speech by Michel Barnier following the sixth round of Article 50 negotiations with the United Kingdom](#), 10 November 2017

¹¹¹ European Commission Audiovisual services, [Press conference on the state of play of Article 50 negotiations with the United Kingdom](#), 10 November 2017

¹¹² [Theresa May's cabinet agrees to pay more to break Brexit deadlock](#), *The Guardian*, 20 November 2017; [Brexit: UK 'ready to pay more to the EU'](#), *BBC*, 21 November 2017; [Tory backlash as Boris Johnson and Michael Gove agree in Cabinet to increase £20bn Brexit divorce bill](#), *The Telegraph*, 21 November 2017

¹¹³ [Exclusive: Britain and the EU agree Brexit divorce bill](#), *The Telegraph*, 29 November 2017

¹¹⁴ [UK bows to EU demands with breakthrough offer on Brexit bill](#), *FT*, 29 November 2017; [UK could pay £50bn Brexit divorce bill after bowing to EU pressure](#), *The*

Once a consensus had been reached on other separation issues, the UK and Commission were able to publish a [joint report](#) on the first phase of negotiations. The joint report is essentially an agreement in principle between the UK and Commission on the separation issues. The joint report allowed the Commission [to recommend](#) to the European Council that 'sufficient progress' has been made in the first phase.¹¹⁵ In turn, the European Council agreed that sufficient progress had been made, at its December 2017 meeting.¹¹⁶

Guardian, 29 November 2017; *Brexit: UK divorce bill offer worth up to 50bn euros*, BBC, 29 November 2017

¹¹⁵ European Commission, [COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN COUNCIL \(ARTICLE 50\) on the state of progress of the negotiations with the United Kingdom under Article 50 of the Treaty on European Union](#), 8 December 2017; European Commission

¹¹⁶ [European Council \(Art. 50\) meeting \(15 December 2017\) - Guidelines](#)

Appendix 1: OBR estimates

OBR estimates of UK payments to the EU arising from the financial settlement, € billion												
	of which:									Participation in EU budget 2019 and 2020 (net)	Outstanding commitments (net)	Total net payment
	Total net liabilities	Pension liabilities	Fines & recoverables	European Investment Bank	European fund for strategic investments	Guarantee fund for external actions	Financial instruments	European Central Bank	2020 surplus			
2019	-0.30	-	-	-0.30	-	-	-	-	-	7.12	-	6.82
2020	-0.30	-	-	-0.30	-	-	-	-	-	10.69	-	10.39
2021	-0.52	0.21	-0.11	-0.30	-0.06	-0.01	-0.04	-0.06	-0.16	-	8.08	7.57
2022	-0.30	0.22	-0.11	-0.30	-0.06	-0.01	-0.04	-	-	-	6.21	5.91
2023	-0.29	0.23	-0.11	-0.30	-0.06	-0.01	-0.04	-	-	-	3.35	3.06
2024	-0.28	0.24	-0.11	-0.30	-0.06	-0.01	-0.04	-	-	-	1.56	1.28
2025	-0.27	0.25	-0.11	-0.30	-0.06	-0.01	-0.04	-	-	-	0.92	0.65
2026	-0.22	0.25	-0.07	-0.30	-0.06	-0.01	-0.04	-	-	-	0.55	0.33
2027	-0.20	0.26	-0.06	-0.30	-0.06	-0.01	-0.04	-	-	-	0.32	0.12
2028	-0.20	0.27	-0.06	-0.30	-0.06	-0.01	-0.04	-	-	-	0.49	0.29
2029	-0.19	0.27	-0.06	-0.30	-0.06	-0.01	-0.04	-	-	-	-	-0.19
2030	-0.08	0.28	-0.06	-0.20	-0.06	-0.01	-0.04	-	-	-	-	-0.08
2031	0.12	0.29	-0.06	-	-0.06	-0.01	-0.04	-	-	-	-	0.12
2032	0.13	0.29	-0.06	-	-0.06	-0.01	-0.04	-	-	-	-	0.13
2033	0.13	0.29	-0.06	-	-0.06	-0.01	-0.04	-	-	-	-	0.13
2034	0.13	0.29	-0.06	-	-0.06	-0.01	-0.04	-	-	-	-	0.13
2035	0.13	0.29	-0.06	-	-0.06	-0.01	-0.04	-	-	-	-	0.13
2036	0.13	0.29	-0.06	-	-0.06	-0.01	-0.04	-	-	-	-	0.13
2037	0.13	0.29	-0.06	-	-0.06	-0.01	-0.04	-	-	-	-	0.13
2038	0.12	0.29	-0.06	-	-0.06	-0.01	-0.04	-	-	-	-	0.12
2039	0.12	0.28	-0.06	-	-0.06	-0.01	-0.04	-	-	-	-	0.12
2040	0.12	0.28	-0.06	-	-0.06	-0.01	-0.04	-	-	-	-	0.12
2041	0.28	0.28	-	-	-	-	-	-	-	-	-	0.28
2042	0.27	0.27	-	-	-	-	-	-	-	-	-	0.27
2043	0.27	0.27	-	-	-	-	-	-	-	-	-	0.27
2044	0.27	0.27	-	-	-	-	-	-	-	-	-	0.27
2045	0.26	0.26	-	-	-	-	-	-	-	-	-	0.26
2046	0.25	0.25	-	-	-	-	-	-	-	-	-	0.25
2047	0.24	0.24	-	-	-	-	-	-	-	-	-	0.24
2048	0.23	0.23	-	-	-	-	-	-	-	-	-	0.23
2049	0.22	0.22	-	-	-	-	-	-	-	-	-	0.22
2050	0.21	0.21	-	-	-	-	-	-	-	-	-	0.21
2051	0.20	0.20	-	-	-	-	-	-	-	-	-	0.20
2052	0.19	0.19	-	-	-	-	-	-	-	-	-	0.19
2053	0.18	0.18	-	-	-	-	-	-	-	-	-	0.18
2054	0.17	0.17	-	-	-	-	-	-	-	-	-	0.17
2055	0.16	0.16	-	-	-	-	-	-	-	-	-	0.16
2056	0.15	0.15	-	-	-	-	-	-	-	-	-	0.15
2057	0.14	0.14	-	-	-	-	-	-	-	-	-	0.14
2058	0.12	0.12	-	-	-	-	-	-	-	-	-	0.12
2059	0.11	0.11	-	-	-	-	-	-	-	-	-	0.11
2060	0.11	0.11	-	-	-	-	-	-	-	-	-	0.11
2061	0.10	0.10	-	-	-	-	-	-	-	-	-	0.10
2062	0.09	0.09	-	-	-	-	-	-	-	-	-	0.09
2063	0.09	0.09	-	-	-	-	-	-	-	-	-	0.09
2064	0.08	0.08	-	-	-	-	-	-	-	-	-	0.08

notes:

The OBR's estimates are based on the joint report on phase one of negotiations under Article 50.

Pension liabilities: the OBR based this estimate on the Eurostat study on the long-term budgetary implications of pension costs (July 2016)

Fines and recoverables: these assesses include fines levied by the EU and corrections on EU funding (largely agriculture related)

European Fund for Strategic Investments: this fund provides a liquidity cushion against potential losses incurred by the EIB. Based on planned provisioning, and assuming no further profit of loss, € 1 billion will be returned to the UK

Guarantee Fund for External Actions: this fund covers any defaulting loans guaranteed by the EU Budget. The OBR expects € 0.3 billion to be returned to the UK

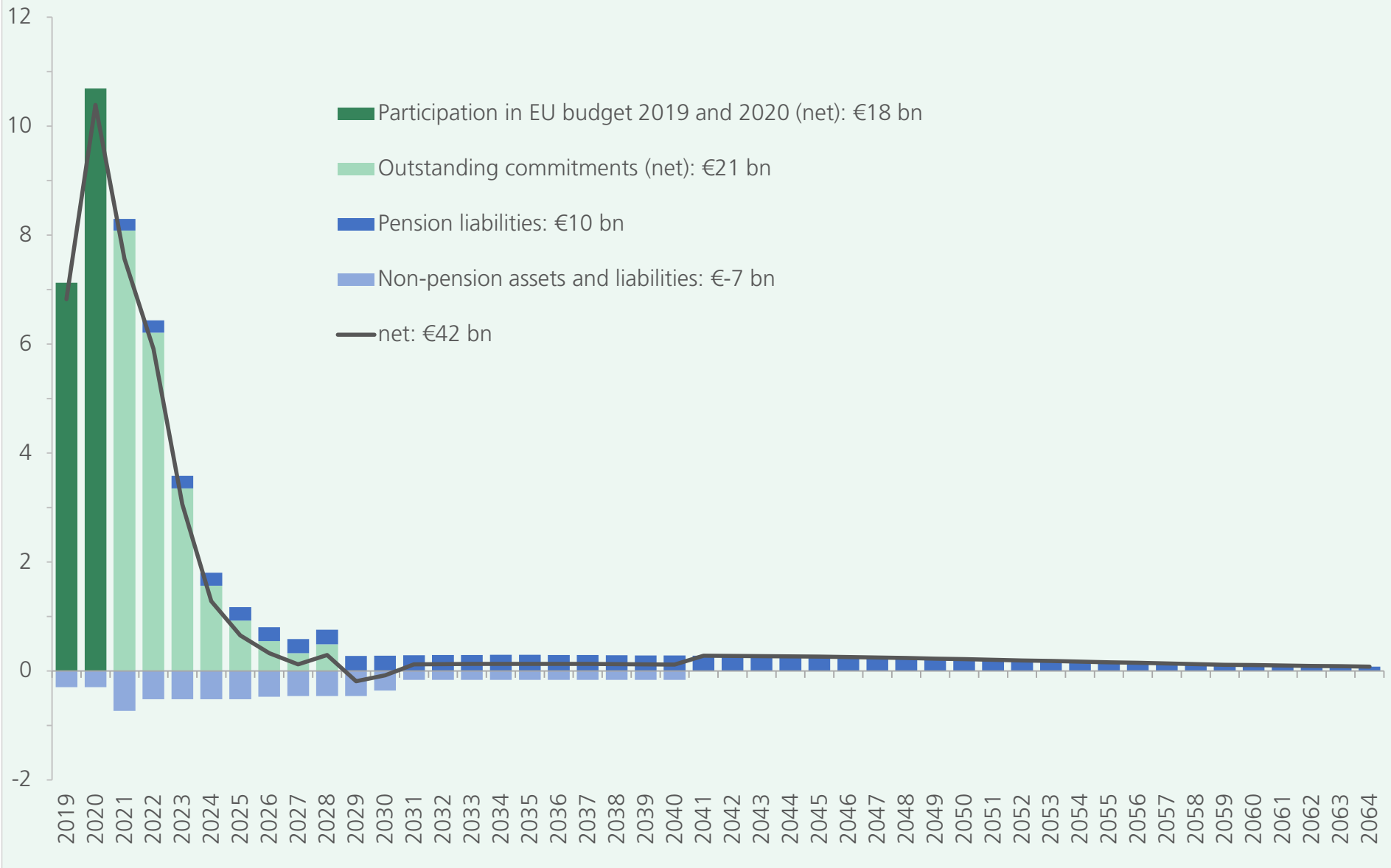
Financial instruments financed by the EU budget: includes instruments created to enhance access to finance for R&I and infrastructure projects. The OBR expects € 0.7 billion to be returned

2020 surplus: this arises from the UK's participation in the EU budget surplus exercise with respect to 2020

source:

OBR. Economic and fiscal outlook - March 2019, supplementary fiscal tables

OBR estimates of UK payments to the EU arising from the financial settlement, € billion



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