Brexit: the exit bill

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Contents:
1. Introduction
2. The EU’s position
3. The UK’s position
4. What is the legal position of the settlement?
# Contents

Summary .................................................. 3

1. Introduction ........................................... 4

2. The EU’s position ....................................... 6
   - Why is the UK expected to make a settlement? 6
   - What should the settlement cover? ............... 7
   - Which parts of the EU Budget are to be included? 7
   - What sources should be used? ................. 8
   - How should the UK’s share be calculated? .... 8
   - What about areas outside of the EU’s Budget? . 9
   - Will there be a one off payment? ............... 9

3. The UK’s position ..................................... 10
   - Theresa May’s letter triggering Article 50 .... 10
   - 2017 Conservative Manifesto ...................... 10
   - Parliamentary statement: July 2017 .......... 10
   - Comments from Ministers ....................... 10

4. What is the legal position of the settlement? .... 12
Summary

When the UK leaves the EU it is expected to make a contribution towards the EU’s outstanding financial commitments. The media have labelled this as an ‘exit bill’ or ‘divorce bill’, the EU see it as a matter of ‘settling the accounts’. The issue will be discussed in the first phase of Brexit negotiations, under the title of the ‘single financial settlement’ (the settlement).

Making sufficient progress in negotiations on the settlement is a prerequisite to moving negotiations onto areas of the future EU-UK relationship, such as trade arrangements.

The EU set out its position on the settlement ahead of negotiations. So far the UK has made no formal response to the EU’s position.

The EU’s position

The EU’s position is built on the principle that the UK should honour its share of all the financial commitments made by the EU while the UK was a member. On the same basis, the EU says that the UK should be able to participate in EU funding programmes – such as agricultural funding – until the programmes close, which in most cases is 2020.

The EU expects the settlement to include:

- the UK’s participation in the EU budget
- the termination of the UK’s membership of institutions such as the European Investment Bank and the European Central Bank
- the UK’s participation in specific EU funds and facilities that don’t come under the EU budget, such as the facility for Refugees in Turkey.

Most of the EU’s outstanding financial commitments arise from the EU Budget. The EU expect the settlement to include 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 up to 2020. The EU’s liabilities and contingent liabilities should also be shared by the UK, according to the EU.

The EU’s accounts do not apportion the outstanding financial commitments to Member States. The EU proposes that the UK should share them in proportion to its share of total contributions to the EU Budget over 2014-2018.

The EU also proposes that the UK should cover the costs of Brexit – such as the cost of moving EU agencies from the UK – and that the UK’s shareholdings in the European Investment Bank and European Central Bank should be returned.

The EU would like a profile of payments to be established to spread the payments. This will mean that the UK will not pay in one go.

The UK’s position

The UK has made no formal response to the EU’s position. However, the UK Government has recognised that the UK has financial obligations to the EU, and vice-versa, and that they need to be resolved. Ministers have said that they don’t expect the UK’s payment to be as large as some of the figures reported by the media.

Estimates of the net payment reported in the media have ranged from €6 billion to €75 billion. The range of estimates highlights the fact that almost every element of the settlement is subject to interpretation and negotiation.
1. Introduction

When the UK leaves the EU it is expected to make a contribution towards the EU’s outstanding financial commitments. The media have labelled this as an ‘exit bill’ or ‘divorce bill’, the EU see it as a matter of ‘settling the accounts’.

The payment is being discussed in the first phase of Brexit negotiations under the heading of the ‘single financial settlement’ (the settlement). During the first phase of negotiations the UK and EU aim to establish what the settlement includes and how the UK’s share should be calculated.

Box 1: Brexit negotiations

The first phase

The first phase of negotiations largely focus on disentangling the UK from the EU. Besides reaching agreement on the settlement, other objectives for the first phase of negotiations include reaching agreements on citizens’ rights, “other separation issues” and the Irish border.

Moving onto the next phase: making ‘sufficient progress’

The EU has said that Brexit negotiations will only move onto discussing the EU-UK future relationship, including areas such as trade, once ‘sufficient progress’ has been made on the first phase of negotiations. This means progress must be made on the settlement before negotiations can move on. It is not clear what the EU means by ‘sufficient progress’, other than that it will be for the EU27 leaders to decide and not for the UK.

Further information on the negotiations are available in the Library briefing Brexit: the talks begin.

The EU has set out its position on what should be included in the settlement and how the UK’s share should be calculated. Michel Barnier, the European Commission’s Chief Negotiator, says the settlement is about ‘settling the accounts’, not a punishment or ‘Brexit bill’.

The UK Government has not provided any significant detail. However, it has recognised that the UK has financial obligations to the EU, and vice-versa, and that they need to be resolved. David Davis MP, Secretary of State for Exiting the European Union, has said that the UK will obey its legal obligations, but rejected speculation of the UK making a large payment to the EU.

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1 European Commission, Terms of Reference for the Article 50 Treaty on European Union negotiations, 19 June 2017
2 The Council of the European Union, Negotiating directives for Article 50 negotiations, 22 May 2017, para 19
3 European Commission, Position paper transmitted to the UK: essential principles on the financial settlement, 12 June 2017
4 UK’s financial obligations to EU will be ‘incontestable’, says Barnier, The Guardian, 3 May 2017
5 HC Deb.13 July 2017:c15-16WS
6 ‘David Davis rejects claim of €100bn Brexit divorce bill’, The Guardian, 3 May 2017; Committee on Exiting the European Union Oral evidence: The UK’s negotiating objectives for its withdrawal from the EU, HC 1072, Q1411; “Brexit divorce bill will
Box 2: How much might the settlement be?

The European Commission’s chief negotiator, Michel Barnier, has reportedly put the payment at close to €60 billion. The estimated size of the settlement depends on what financial commitments, liabilities and assets are included and how these are shared. For example, the Centre for European Reform – a broadly pro-EU think tank – has produced estimates that range from €24 billion to €73 billion. Estimates of the net payment from the Institute of Chartered Accountants in England and Wales (ICAEW) range from €6 billion to €36 billion. The FT has calculated net payments of up to €75 billion. Most of these estimates were made before the EU published its position on the settlement.

The range of estimates highlights the fact that almost every element of the potential payment is subject to interpretation. Ultimately any payment will be determined in Brexit negotiations. Negotiations will determine which financial commitments, liabilities, and assets, are to be shared, and how they are shared. The number of years that the payment will be paid over will also be agreed in negotiations.

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 would pay to do so:

- There may be specific European programmes in which we might want to participate and if so, it will be reasonable that we make a contribution.

Non-EU members already participate in some of these 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 Library briefing The UK’s contribution to the EU Budget goes into further details about future participation in Commission programmes. This briefing also discusses how the UK contributes to the EU Budget, and the funding the UK receives from the budget.

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7 House of Lords European Union Committee, Brexit and the EU budget, 4 March 2017, HL Paper 125, page 3
8 Centre for European Reform, The €60 billion Brexit bill: How to disentangle Britain from the EU budget, February 2017, page 10
9 ICAEW, Analysing the EU Exit Charge, May 2017
10 ‘Brussels hoists gross Brexit ‘bill’ to €100bn’, FT, 3 May 2017 and ‘Brexit number crunch: the final bill the EU could accept’, FT, 16 June 2017
11 Conservative Manifesto 2017, page 36
2. The EU’s position

The European Commission has produced a paper setting out the EU’s position on the settlement.\(^\text{12}\) The position paper fleshes out ideas put forward earlier in the Council’s negotiating directives.\(^\text{13}\)

**Why is the UK expected to make a settlement?**

The EU says 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 3) and committed to funding them by agreeing revenue raising measures (see Box 4), and the EU believes these commitments should be met.

On the same basis, the EU says that the UK should continue to benefit from EU funding programmes until the programmes close. This means that the UK would continue to receive funding in areas such as economic development, agriculture and research and innovation until the current funding period, 2014 – 2020, ends. Continued participation would require the UK to obey the EU’s legal rules for the programmes.

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**Box 3: EU spending plans: multiannual financial frameworks**

The EU plans its spending over seven-year periods through the Multiannual Financial Framework (MFF).\(^\text{14}\) 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 (2011 prices). This spending is equivalent to around 1% of the Gross National Income (GNI) of the whole EU.\(^\text{15}\)

Further details are available in the Library briefing *A guide to the EU budget*.

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**Box 4: 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 (as measured by GNI).

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*.

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\(^{13}\) The Council of the European Union, *Negotiating directives for Article 50 negotiations*, 22 May 2017

\(^{14}\) The MFF must cover a period of at least five years.
What should the settlement cover?
Broadly speaking the EU wants the settlement to include:

- the UK’s participation in the EU Budget
- 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 seventy bodies and funds to be included in the settlement. This list may be updated before the day of withdrawal.

Which parts of the EU Budget are to be included?
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 expects the UK to contribute to, along with a short description of each.

1. **EU budget outstanding commitments (reste à liquider)**
The EU, in their annual budgets, 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). At the end of 2016, the EU’s total accumulated RAL is €239 billion.

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 seventy programmes whose spending has been agreed through regulations – the EU says that it expects the UK’s settlement to cover a share of the outstanding spending of these programmes.

3. **Liabilities which are not balanced by corresponding assets**
Liabilities are, generally speaking, obligations to pay for something. The EU’s position paper says the settlement should include EU liabilities

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16 From the French for ‘yet to be paid’.
17 European Commission, Consolidated accounts of the European Union and Financial Statement Discussion and Analysis
recorded in the EU’s accounts which are not balanced by corresponding assets, such as pensions and other employee benefits.\textsuperscript{19}

The EU’s position paper does not mention assets – apart from saying that the liabilities to be included in the settlement should be those without corresponding assets. If the UK is required to contribute to the EU’s liabilities, the UK Government may say that they should also benefit from a share of the EU’s assets. The EU’s assets include buildings, equipment and financial investments.

The EU has larger liabilities than assets, so if these are shared it is probable that the UK would make a payment to the EU rather than receive one from the EU.\textsuperscript{20} However, this depends on precisely what it shared.

\textbf{(4) Contingent liabilities}

Contingent liabilities are potential liabilities that may occur depending on the outcome of an uncertain event in the future. The EU believes that the UK should contribute towards the contingent liabilities in the EU’s accounts.

\begin{quote}
\textbf{Box 5: Example of a contingent liability in the EU budget The European Financial Stabilisation}

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 uses the EU budget as a guarantee to borrow money on financial markets, which it then subsequently lends to countries who require the funding.

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.
\end{quote}

\textbf{(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.

\textbf{What sources should be used?}

The EU proposes 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.

\textbf{How should the UK’s share be calculated?}

The above sources only show totals for the EU – they don’t provide shares for each Member States. A way to calculate the UK’s share needs to be established in negotiations.

\textsuperscript{19} Further examples are provided on page 3 of the Single Financial Settlement position paper.

\textsuperscript{20} European Court of Auditors, Annual Reports concerning the financial year 2015, 13 October 2016, para 1.5
The EU proposes that the UK’s share of financial commitments should be based on the proportion of total contributions to the EU Budget that were from the UK over 2014-2018. The UK’s rebate would be included when determining the UK’s share of contributions to the EU Budget. In recent years the UK’s share has been around 13%.  

The EU thinks that the UK’s payments shall be established and paid in euros.

**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 propose 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 proposes that the UK’s capital in the EIB be paid back once all the EIB’s outstanding loans, at the time of UK withdrawal, have concluded.

**European Central Bank (ECB)**

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

**Other areas outside of the EU Budget**

In most other cases – such as for the European Development Fund – the EU proposes that the UK meets its outstanding commitments.

**Will 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 says 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.”

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

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22 European Commission, Essential Principles on Financial Settlement, 12 June 2017, pages 4 - 5
3. The UK’s position

The UK has made no formal response to the EU’s position paper and has not yet set out its view in any detail. However, the UK Government has recognised that the UK has financial obligations to the EU, and vice-versa, and that they need to be resolved.

Theresa May’s letter triggering Article 50

On 29 March 2017, Prime Minister Theresa May’s letter to Donald Tusk triggering Article 50 said 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”.23 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 the letter:

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.24

Parliamentary statement: July 2017

David Davis MP, Secretary of State for Exiting the European Union, went a little further than the letter and 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.25

Comments from Ministers

Prior to his July 2017 statement David Davis MP said that the UK will obey its legal obligations, but rejected speculation of the UK making a large payment to the EU.26

Boris Johnson MP, Secretary of State for Foreign Affairs, has said that some of the estimates in the media of the size of the payment “seem to

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23 Prime Minister’s letter to Donald Tusk triggering Article 50, 29 March 2017, page 4
24 The Conservative and Unionist Party Manifesto 2017, page 36
25 HC Deb. 13 July 2017: c15-16WS
26 ‘David Davis rejects claim of €100bn Brexit divorce bill’, The Guardian, 3 May 2017; Committee on Exiting the European Union Oral evidence: The UK’s negotiating objectives for its withdrawal from the EU, HC 1072, Q1411; "Brexit divorce bill will be 'nothing like' tens of billions of pounds, David Davis says", The Independent, 27 March 2017
me to be extortionate, and I think that to “go whistle” is an entirely appropriate expression.” Michel Barnier, the European Commission’s Chief Negotiator, responded to Mr Johnson’s comments saying that he could not hear whistling but ‘a clock ticking’, referring to the two year deadline for Article 50 negotiations.

27  HC Deb. 11 July 2017:c139
28  Press conference by Michel Barnier, the European Commission’s Chief Negotiator on the state of play of Article 50 negotiations with the United Kingdom, 12 July 2017
4. What is the legal position of the settlement?

There is some debate over whether the UK would be legally liable for any of the EU’s outstanding financial commitments once it left the EU. A Lords Committee recently considered the issue and found that the most persuasive argument was that the UK would not be legally liable. However, the same committee also concluded that if the UK were to simply leave without making any payments the economic and political consequences could be ‘profound’:

On the basis of the legal opinions we have considered we conclude that, as a matter of EU law, Article 50 TEU [the Treaty on the European Union] allows the UK to leave the EU without being liable for outstanding financial obligations under the EU budget and related financial instruments, unless a withdrawal agreement is concluded which resolves this issue.

Individual EU Member States may seek to bring a case against the UK for the payments of outstanding liabilities under principles of public international law, but international law is slow to litigate and hard to enforce. In addition, it is questionable whether an international court or tribunal could have jurisdiction.

However, the political and economic consequences of the UK leaving the EU without responding to claims under the EU budget are likely to be profound. If the UK wants a preferential trading relationship with EU, including a transitional arrangement, the EU partners may well demand a financial contribution post-Brexit.29

The Lords Committee received conflicting evidence about the legal position and its conclusion was based on what it felt was the most persuasive argument.30 Since the Committee published its report some have questioned the conclusion reached on the legal position of the UK’s financial obligations.31

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29 House of Lords European Union Committee, *Brexit and the EU budget*, 4 March 2017, HL Paper 125, paras 135 - 137
30 ibid, paras 98 - 160
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