BREXiT UNIT

UK should attach conditions to any 'divorce bill'

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The UK government is said to be ready to make an 'improved' offer on the financial settlement with the EU, also known as the Brexit 'divorce bill'. At one extreme, some argue that the UK should pay **whatever** the EU asks. At the other, some insist that the UK should pay **nothing** at all – or even claim a refund. In the middle ground, it may well be worth paying **something** to secure a better deal.

The government's latest offer is reportedly worth around €45bn (£40bn). This would be a huge sum, but still less than 2% of UK GDP, or three years of the UK's annual contributions to the EU. Viewed as a one-off payment with benefits lasting many decades, this could be a small price to pay.

But whatever the exact number, the more important question is what, if anything, the UK would be getting in return. The UK could guarantee to pay something now - perhaps €30bn (£27bn) to cover bills until the end of 2020 and a contribution for officials' pensions. This may be 'sufficient progress' to allow the next stage of talks to begin. However, any further payments should then depend on the outcome of these negotiations.

This can't be left to the lawyers

The 'divorce bill' is the amount of money that the UK is expected to pay to settle its share of the financial obligations accumulated by the EU while the UK was a member. It should therefore be separate from any costs that might arise after Brexit as the result of new agreements, such as continued participation in EU research and education programmes, or Norway-style payments in return for tariff-free access to the Single Market. In any event, countries are not usually expected to pay a fee just to start trade talks.

Because the 'divorce bill' only covers the past relationship, some have argued that the UK should just pay up. On this view, it is simply a matter of honouring existing obligations, and the question of getting something in return should not arise.

However, this doesn't actually get us very far. For a start, the UK would be on strong legal ground if it simply decided to stop contributing to the EU budget after March 2019. This is based on the argument that Article 50 will end all Treaty obligations at this point, including financial obligations, unless there is some agreement to the contrary. Indeed, the UK should receive some money back, including the €3.5bn (£3.1bn) in capital that it has contributed to the European Investment Bank (EIB).

Nor is it necessary to take this hard-line view. Even if is accepted that the UK does owe something, there is no certainty about what the sums should be. This cannot just be left to the lawyers, or the accountants.

- The Brexit 'divorce bill' is supposed to settle existing obligations, rather than cover the cost of any future agreements. Some therefore argue that it is simply a matter of honouring past debts and the UK should just pay up.
- The problem with this approach is that there is no legal certainty over what it owed.
- Even ignoring the argument that the UK can walk away under the terms of Article 50, the amounts depend on a wide range of assumptions – almost all of which are open to debate.
- This means that the divorce bill is something that needs to be negotiated. It is therefore right to ask what the UK might be getting in return for paying more than it has already offered – and attach conditions.

Remember that some EU officials suggested a bill as high as €100bn (£89bn) earlier in the negotiations. That figure was always ridiculous, as it assumed that the UK would have to pay its full share of all the EU's gross liabilities (with no allowance for assets) and a large chunk on top for the contingent liabilities of the EIB. So the money is clearly something that has to be negotiated, unless you are willing to argue that the UK should just pay whatever the EU asks. (Good luck with that…).

On the other hand, the option of walking away without paying a penny is off the table, for now at least. The UK has already said it will look past the strict legal position and honour commitments made during the period of membership. This is presumably because this is seen as 'the right thing to do' but also to secure a better deal in negotiations over the future relationship. In particular, the Prime Minister said in her Florence speech, '*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 'current budget plan' here refers to the EU's Multiannual Financial Framework (MMF), which runs from 2014 to 2020. In effect, the UK has therefore already offered to pay an amount equivalent to its expected annual contributions between March 2019 and the end of 2020. These numbers are not yet fixed. UK sources have suggested a figure of around £20bn, but this is at the low end, and the EU will be thinking in euros anyway. However, the total on this basis would be unlikely to exceed €25bn (£22.5bn at current exchange rates), net of the UK's rebate and EU spending in the UK.

- The Prime Minister has effectively offered to cover any shortfall until the end of the current EU budget period in 2020. It is likely that the UK will need to pay something extra for the pensions of EU officials too.
- But the EU is also demanding large contributions to spending that could take place long after 2020 (and might not happen at all). Instead, the EU should be cutting back to reflect the departure of its second biggest net contributor.
- That said, a sizeable payment could still be good value for money if it secures a better deal on the future relationship. And it should soon be offset by the accumulated savings on the UK's annual payments to the EU budget. Viewed this way, even a figure north of £40bn could be a fair price to pay.

However, the EU is still expecting the UK to make a further large contribution, perhaps another €25bn, towards spending that has already been agreed in principle but could take place well after 2020, including long-term commitments known as the 'reste à liquider' (RAL). The EU is also reported to be asking for €10bn towards the pensions of EU officials. This implies a total bill of around €60bn (£54bn), even before considering the EIB.

A revised UK offer of €45bn (£40bn) would therefore fall well short of the EU's demands. The EIB issue should at least be relatively easy to resolve. The EIB is reluctant to repay the UK's capital until the loans this money is helping to back actually mature. But the sums are small and mostly invested in worthwhile projects (some in the UK itself) that make a reasonable return. It would certainly make more sense for the UK to leave its capital with the EIB than to make large contingency payments now against the possibility that some borrowers might default.

The case for making a clean break appears to be stronger in respect of pensions. Unfortunately, the EU's estimate of the liabilities here is highly sensitive to the assumptions made, particularly the choice of discount rate. One solution might be for the UK to continue contributing towards the pensions of all EU officials every year, as it does now. That would be hard to explain to the British public. Another might be for the UK to take full responsibility for the EU pensions of the relatively small number of UK nationals, but not the rest. That would probably be unacceptable to Brussels. It therefore seems likely that the UK will end up making an additional one-off payment for pensions too.

However, even if £40bn were enough for the EU, many would ask why the UK should stump up anything at all. This is a political judgement that can perhaps only be made by the people in the room. In favour, £40bn (or more) might be a fair price to pay in return for a 'good deal' with economic benefits potentially lasting many decades. Looked at this way, £40bn could be thought of as a one-off payment equivalent to only a few billion each year (and much better value than HS2!). What's more, since the 'divorce bill' is money that the UK would have to pay anyway if it had remained a member, it would be wrong to regard it as an additional cost of Brexit.

Against this, what would the British taxpayer be getting in return, especially if the default position is that the UK could walk away without paying a penny and 'no deal' would not be the disaster many fear? At the very least it seems reasonable to expect the EU to agree to fast-track talks on a comprehensive trade deal, including an explicit agreement on a time-limited transition period where trade remains as frictionless as possible. The UK could then make some of the money conditional on the success of these talks – perhaps anything more than the €30bn (£27bn) or so required to cover the period until the end of 2020 and something for pensions.

This might just about be acceptable to the British public too. But I don't envy the job of those trying to sell it.

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