

# The Current State of Negotiations

*Brexit Business Breakfast  
Friday 12<sup>th</sup> October 2018*

***This seminar series is run in accordance with the “Chatham House Rule”***



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# Economic Update

*The Current State of Negotiations*

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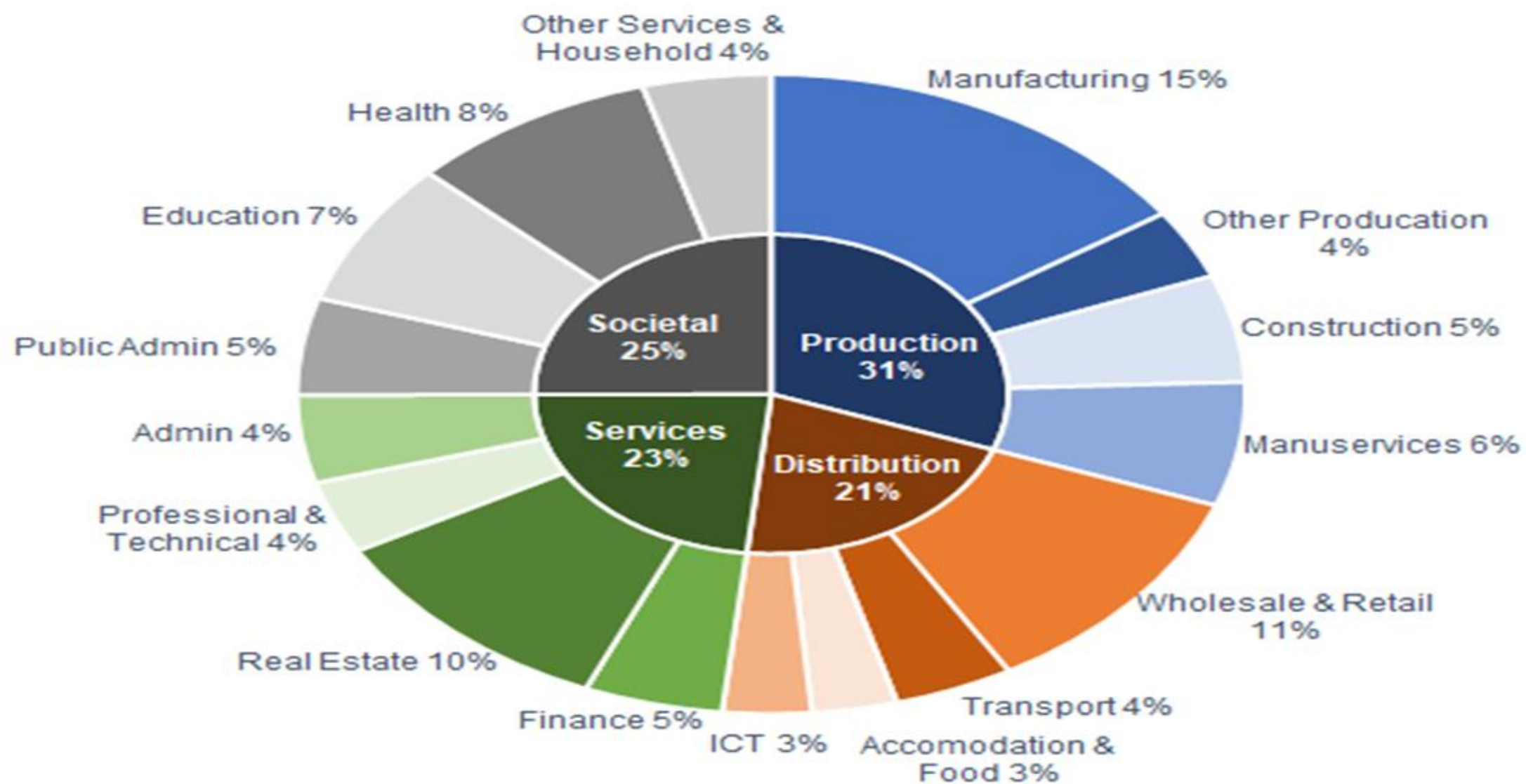


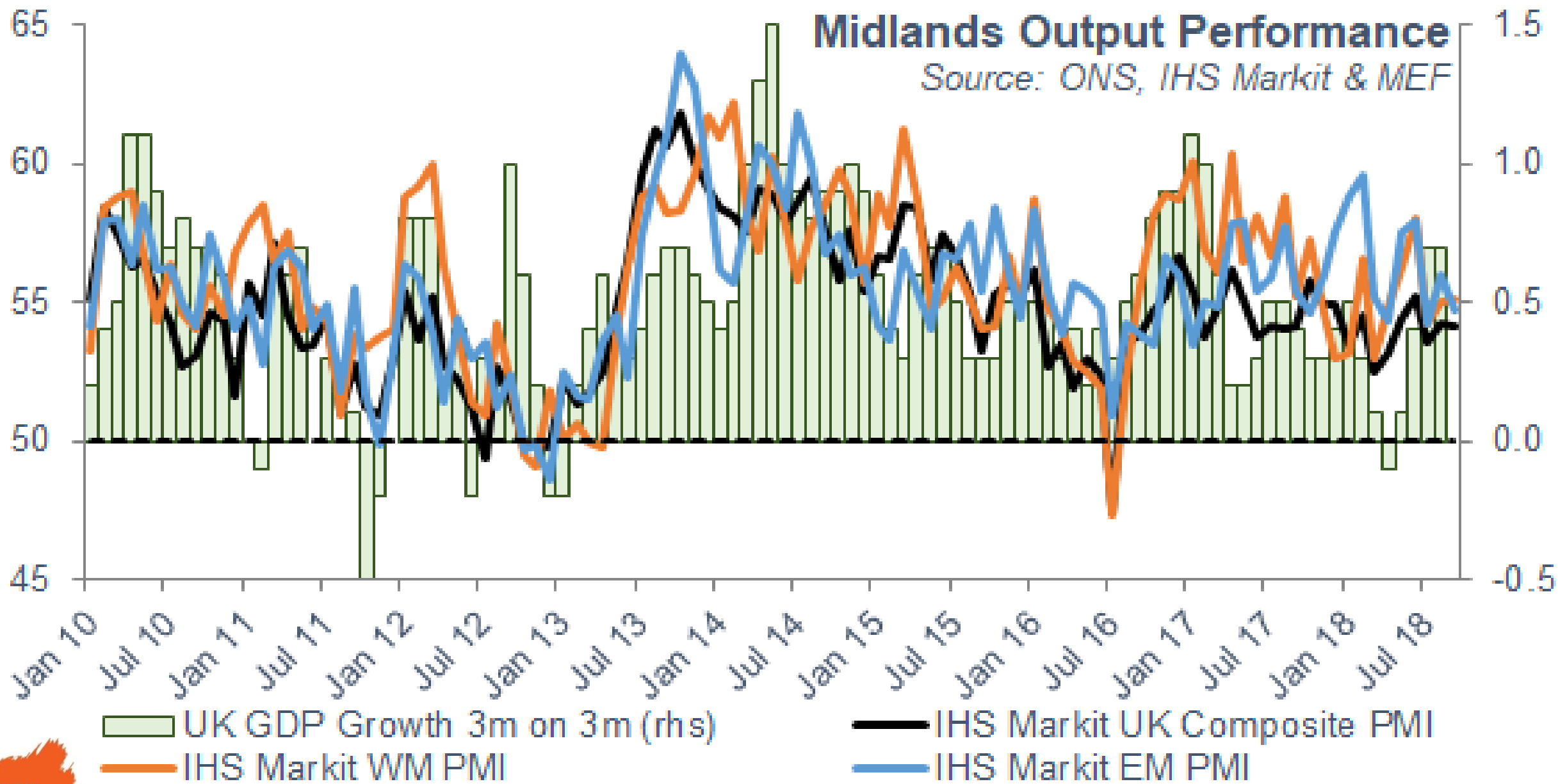
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## Output Structure of WMCA (2016)

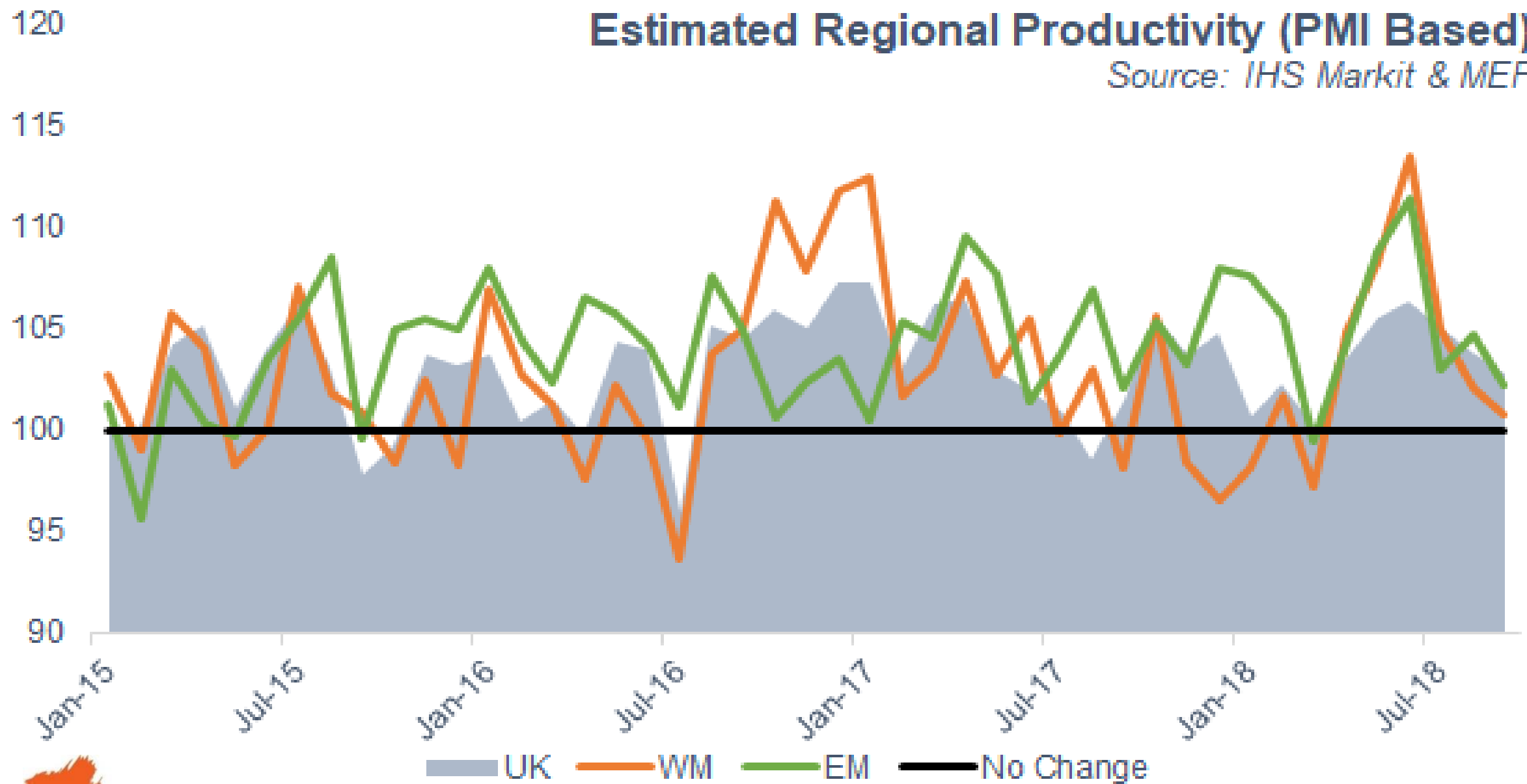
Source: ONS & WMEF





# Estimated Regional Productivity (PMI Based)

Source: IHS Markit & MEF



65

# New Business & Business Outstanding

Source: IHS Markit & WMEF

60

55

50

45

40

Jan-16

Apr-16

Jul-16

Oct-16

Jan-17

Apr-17

Jul-17

Oct-17

Jan-18

Apr-18

Jul-18

UK New

WM Outstanding

UK Outstanding

EM Outstanding

WM New

No Change

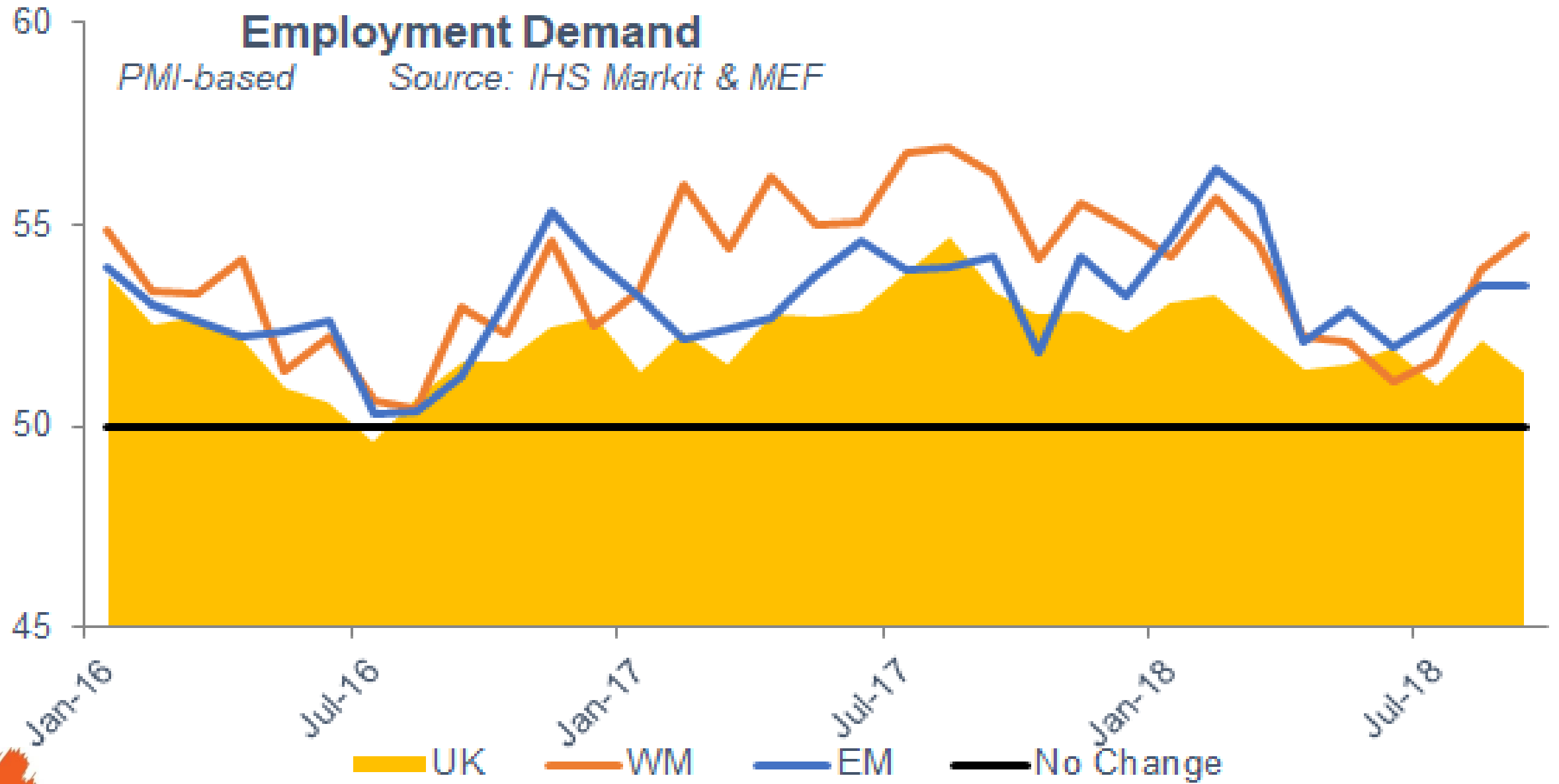
EM New



# Employment Demand

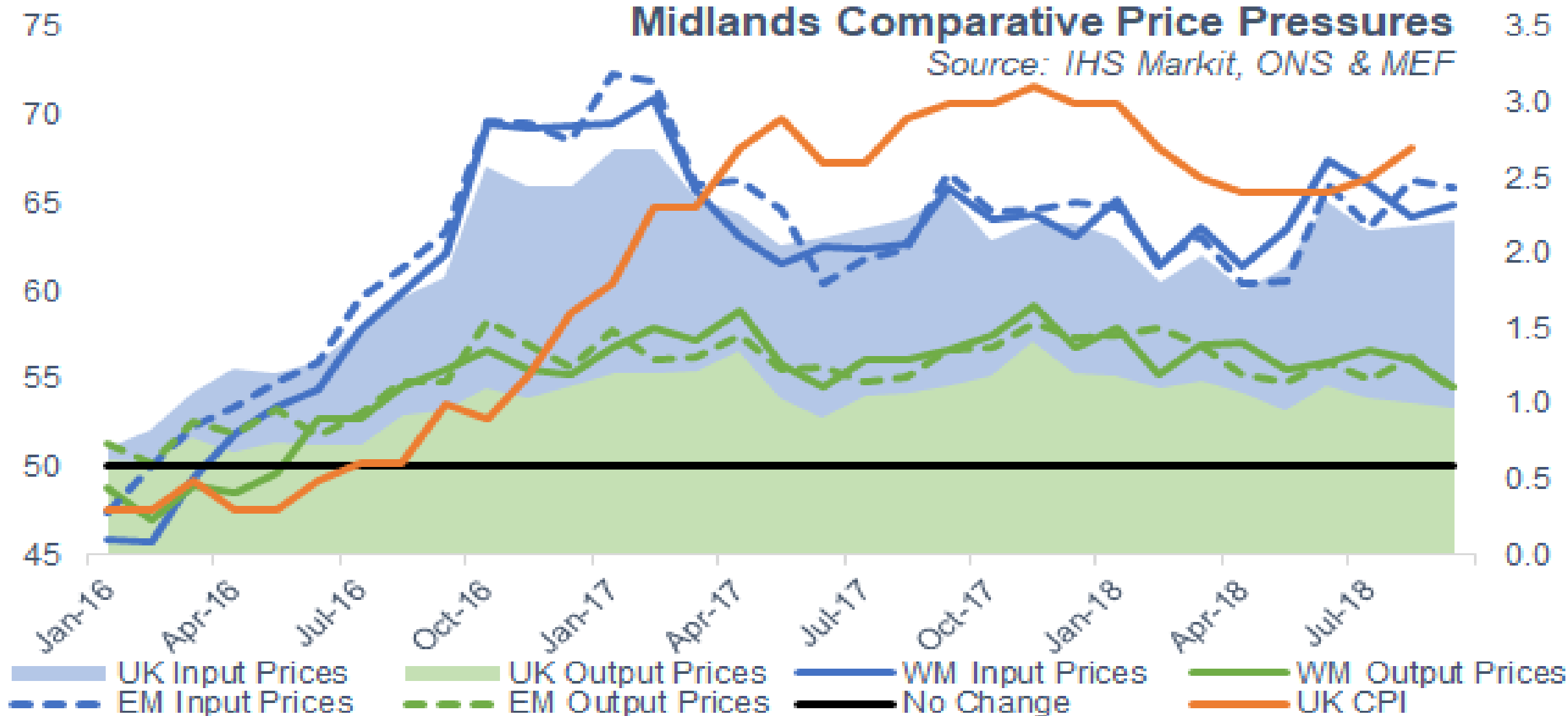
PMI-based

Source: IHS Markit & MEF



# Midlands Comparative Price Pressures

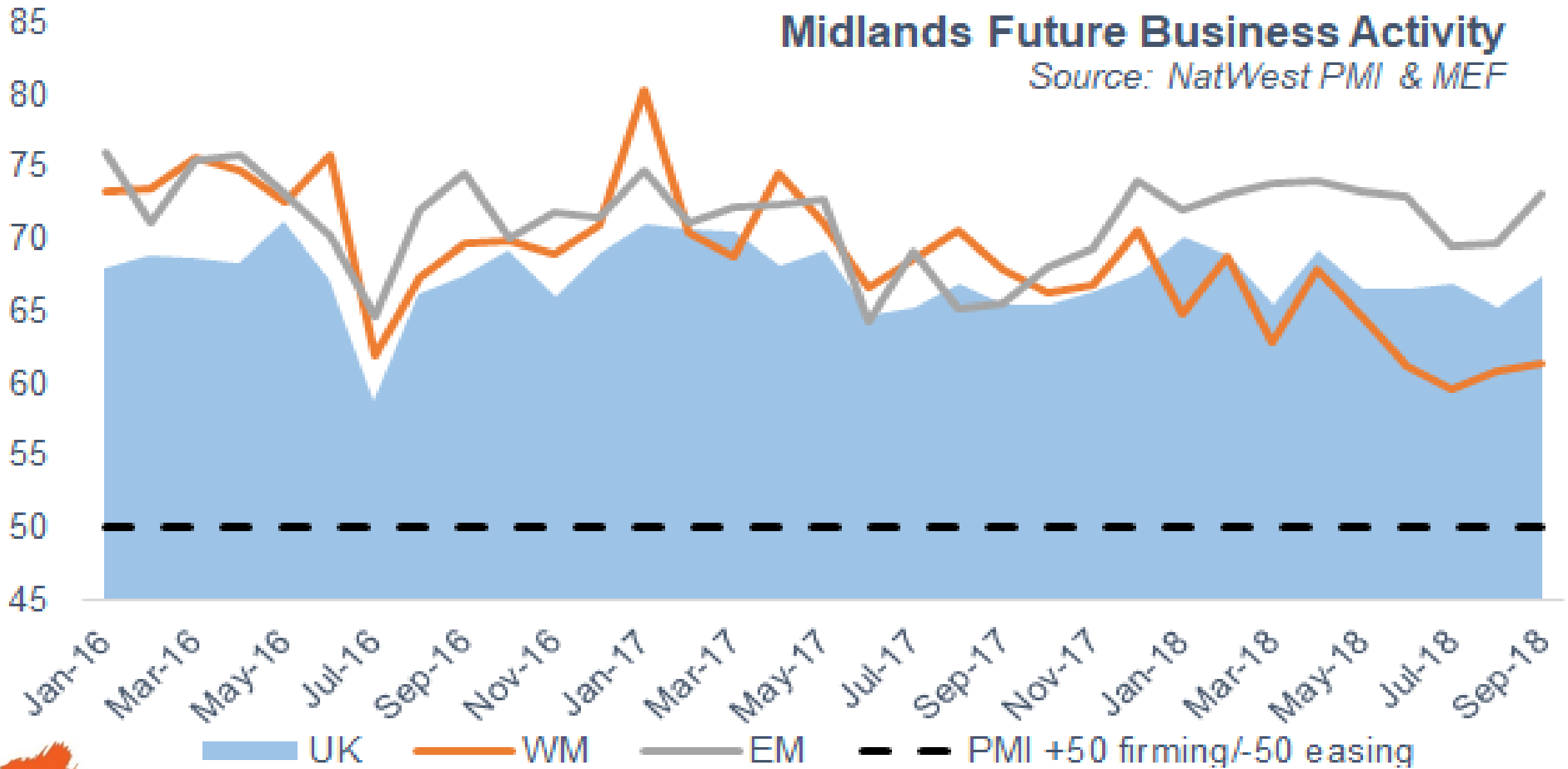
Source: IHS Markit, ONS & MEF

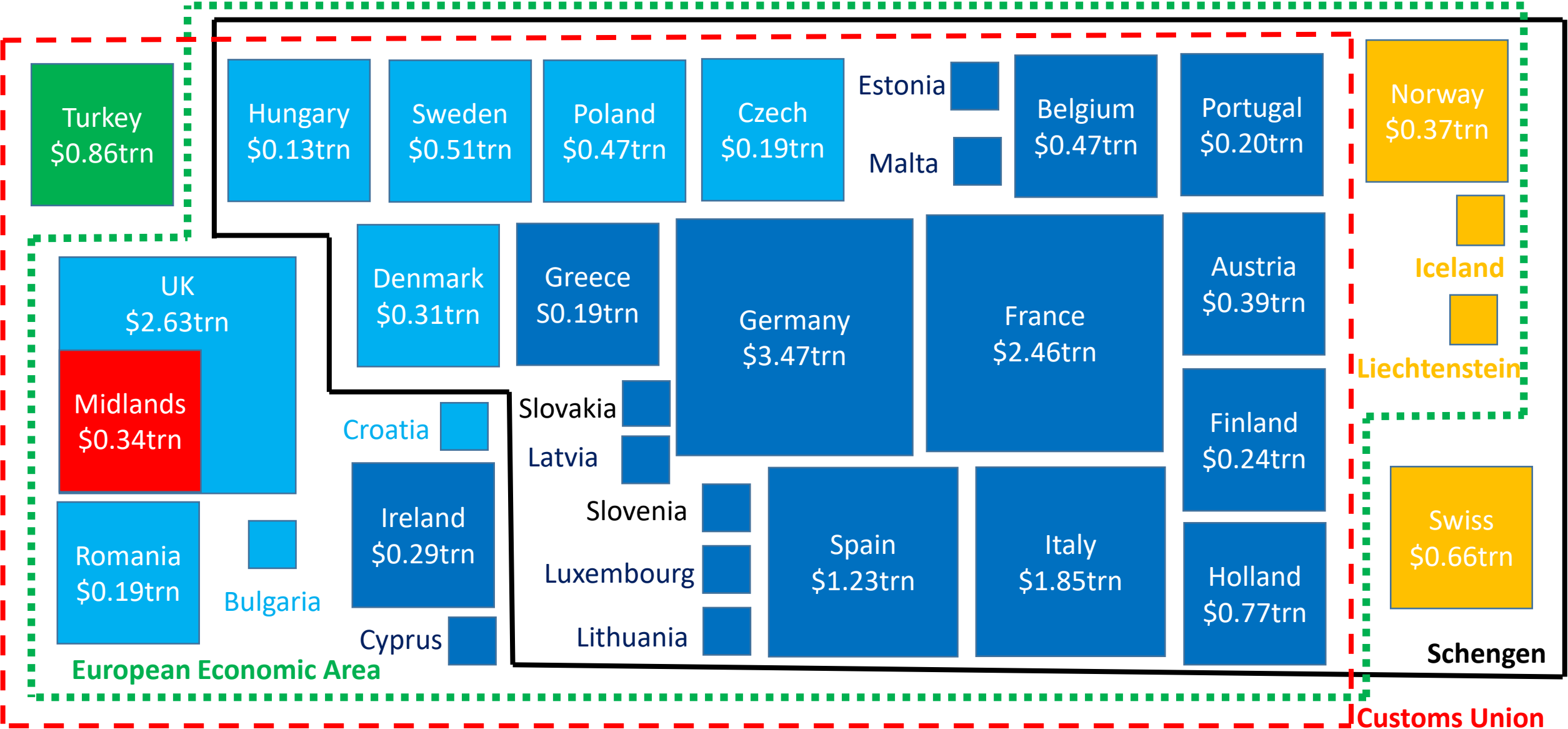




# Midlands Future Business Activity

Source: NatWest PMI & MEF





# EU & European Complexity



GDP Current US\$ 2016 Source: EU, IMF, Bloomberg & WMEF  
GDP other economies less than US\$100 billion

EU-Euro Area

EU-Own Currency

EFTA

EU Associate Member

## Birmingham Export Position (2016)

*Source: UNCTAD, HMRC, OECD & WMEF*

	World	UK	West Midlands	Birmingham
Value of EU Exports (£m)	3,414,200	139,975	12,871	1,657
EU Exports % of GVA		8.01	10.17	6.44
% of Total EU Imports	100.00	4.10	0.38	0.05
Value of Non-EU Exports		147,905	16,862	2,489
Non-EU Exports % of GVA		8.46	13.32	9.68

## Impact of WTO Trading Regime on WM Merchandise Exports to the EU

*Source: WTO, HMRC & WMEF*

	Total WM-EU Exports 2017 (£'000)	WMEF Estimated Impact		
		Average	Minimum	Maximum
<b>Exports</b>	14,697,974	584,451	33,315	1,943,745
<b>Implied Tariff Levels</b>		4.0	0.2	13.2

*Assumes tariff level equivalent to export compression, no policy accommodation to offset impact of WTO regime, no increased EU import demand and exchange rate stability*

## International Engagement Expenditure

*Source: PESA, DFID, MoD & MEF*

	2016/17 (£m)	% of Public Expenditure	% of GDP
<b>Total Notional International Engagement Expenditure</b>	<b>53,833</b>	<b>7.58</b>	<b>2.75</b>
<b>Defence</b>	<b>35,866</b>	<b>5.05</b>	<b>1.83</b>
<b>Single Intelligence Account</b>	<b>2,514</b>	<b>0.35</b>	<b>0.13</b>
<b>Foreign &amp; Commonwealth Office</b>	<b>2,048</b>	<b>0.29</b>	<b>0.10</b>
<b>Department for Exiting EU</b>	<b>24</b>	<b>0.00</b>	<b>0.00</b>
<b>Department of International Trade</b>	<b>0</b>	<b>0.00</b>	<b>0.00</b>
<b>Overseas Development Assistance</b>	<b>13,381</b>	<b>1.88</b>	<b>0.68</b>

Memo Note: ODA equivalent to 0.7% of GNI

Total defence related spending equal to 2% of GDP

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# Centre for Brexit Studies, BCU

The Brexit – the U.K.'s Divorce Bill - Too much?

Visiting Professor John Clancy

12<sup>th</sup> October 2018

# What the UK will pay after leaving the EU on 29 March 2019

December 2017 Treasury Estimate:

**£35-39 Billion**

March 2018 Office for Budget Responsibility:

**£37.1 Billion**

(with around 75 per cent falling due within five-years)

“We continue to make the fiscally neutral assumption that any reductions in transfers to the EU after factoring in this settlement are recycled into other spending.”



# OBR Assumptions

- The UK leaves the EU in April 2019 – two years after Article 50 was invoked.
- Any reduction in expenditure transfers to EU institutions – after factoring in the cost of the financial settlement – would be recycled fully into extra spending. This assumption is fiscally neutral.
- There are no changes to the structure or membership of tax systems for which there are common EU rules (such as VAT and the EU emissions trading scheme or the customs duties that are deemed to be collected on behalf of the EU).

# EU & UK Government joint report 8/12/17

Report on phase one of negotiations under Article 50:

“nothing is agreed until  
everything is agreed”

“also agreed by the UK on the condition of an overall  
agreement under Article 50 on the UK’s withdrawal.”

# Treasury € Forecast

Between **€40 Billion** and **€45 Billion**

equivalent to

**£35 Billion** and **£39 Billion**

at the then prevailing exchange  
rate of €1.13 per pound.

# OBR March 2018 Estimates

**€41.4 Billion or £37.1 Billion**

**€28 Billion** falling due

between 2019-20 and 2022-23

“the UK will not be required to incur expenditures earlier than would be the case had it remained a Member State unless agreed by both sides”

# Some assumptions

UK participation in EU annual budgets to 2020:

“The UK will continue to contribute to, and participate in, the implementation of the Union annual budgets for the years 2019 and 2020 as if it had remained in the Union.” - Joint Report

Gross contributions after the UK's rebate and the amount retained to notionally meet the cost of collecting customs duties are set to total

**€38 Billion**

across 2019 and 2020.

# Net: Deduct Public Sector Receipts

OBR: after subtracting public sector receipts from the EU  
– for example, funding under the Common Agricultural Policy –  
net contributions from the public sector across 2019 to 2020

amount to

**€25.5 Billion**

# Net: Deduct Private Sector Receipts

OBR: after subtracting private sector receipts from the EU

– for example, EU-funded research at UK universities –

the overall net flow from the UK to the EU

amounts to

**€21.5 Billion**

# OBR Table

Table B.1: Total UK contributions to the EU if we remained a member

	€ billion							
	Outturn	Estimate	Forecast					
	2016	2017	2018	2019	2020	2021	2022	2023
GNI based contribution (a)	17.5	12.6	14.9	17.7	17.9	17.5	17.1	16.9
VAT payments to the EU (b)	3.6	3.3	3.4	3.4	3.4	3.5	3.6	3.7
Traditional own resources (c)	3.8	4.0	3.9	3.8	3.8	3.8	3.8	3.8
<b>Notional contribution (d)=(a+b+c)</b>	<b>24.9</b>	<b>19.8</b>	<b>22.1</b>	<b>24.9</b>	<b>25.1</b>	<b>24.8</b>	<b>24.5</b>	<b>24.3</b>
TOR collection costs (e)	-0.4	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8
UK abatement (f)	-6.7	-5.1	-4.8	-4.7	-5.4	-5.3	-5.2	-5.2
<b>Gross contribution (g)=(d+e+f)</b>	<b>17.8</b>	<b>13.8</b>	<b>16.5</b>	<b>19.4</b>	<b>19.0</b>	<b>18.8</b>	<b>18.5</b>	<b>18.4</b>
Public sector receipts from the EU (h)	-4.3	-5.6	-5.6	-6.3	-6.6	-6.6	-6.6	-6.7
<b>Public sector net contribution (i)=(g+h)</b>	<b>13.5</b>	<b>8.3</b>	<b>10.9</b>	<b>13.0</b>	<b>12.4</b>	<b>12.2</b>	<b>11.9</b>	<b>11.7</b>
Private sector receipts from the EU (j)	-2.8	-1.7	-1.7	-2.0	-2.0	-2.0	-2.0	-2.0
<b>UK total net contribution (k)=(i+j)</b>	<b>10.7</b>	<b>6.5</b>	<b>9.2</b>	<b>11.1</b>	<b>10.4</b>	<b>10.1</b>	<b>9.8</b>	<b>9.7</b>



# Apportionment in 2019

UK currently set to leave the EU on 29 March 2019,  
in calendar year 2019, so:

there will be one quarter  
in which we make contributions as a Member State

and three quarters  
when those contributions are made under the terms of the financial settlement

**€3.0 Billion**  
of net contributions to the EU that year are treated as normal Member State contributions and  
**€8.1Billion**  
as part of the financial settlement

# Reste à liquider (RAL)

EU Multiannual Financial Framework (MFF)  
to 2020

Joint Report: “The UK will contribute its share of the financing of the budgetary commitments outstanding at 31 December 2020”

# OBR: RAL Estimate €256.4 Billion

Table B.2: Post-2020 RAL after decommitments

	€ billion
<b>2016 Commission estimate</b>	<b>254.2</b>
Under-implementation adjustment	+14.3
Increases in commitments pre-2020	+0.5
Lower expected commitments	+6.1
Decommitment rate adjustment	-18.7
<b>Post-2020 RAL</b>	<b>256.4</b>

OBR: UK's financing share of RAL = 12.4%

**€31.7 Billion** gross payment from the UK

OBR estimate of UK receipts = **€11.5 Billion**

resulting in a net RAL payment of

**€20.2 Billion (£18.2 Billion)**

OBR assumes that the RAL is paid out on a declining path over an 8-year period from 2021 to 2028

# Other assets/liabilities

- Fines and 'recoverables': **+€1.1 Billion**
- European Investment Bank (EIB): **+€3.5 Billion** (12 Annual £300M instalments from 2019)
- European Fund for Strategic Investments (EFSI): **+€1.0 Billion**
- Guarantee Fund for External Actions (GFEA): **+€0.3 Billion**
- Financial instruments financed by the EU budget: **+€0.7 Billion**
- European Central Bank (ECB): **+€0.1**
- 2020 cash surplus: **+€0.2**

# Total Payment due for Assets/Liabilities

Payment from EU to UK:

**+€6.8Billion**  
**(+£6.0 Billion)**

# The final bill

- Budget Payments: **€21.5 Billion**
  - Reste à liquider: **€20.2 Billion**
  - Assets/Liabilities: **-€6.8 Billion**
- €34.9 Billion (£31 Billion)**

But what about the Pension Fund?

OBR says Pension Fund and Sickness  
Scheme at liability figure of

**€76.7 Billion**

Implying UK share of

**€9.5 Billion (£8.4 Billion)**



# Still not worked out?

Has NAO or OBR or Treasury done the figures yet?

- OBR says “In conjunction with the NAO we expect to refine this
- estimate in our future work.”
- Relies on one Eurostat report from 2016.
- The figure will be reset following publication of the 2018 EU accounts.
- Do we know what the 2018 accounts are likely to say?

# Old figure?

## Figure 9

HM Treasury's estimate of the EU's balance sheet assets and liabilities as at 31 December 2020

**Pension and other employee benefit liability is reduced by investment and budgetary reflows**

Balance sheet item	HM Treasury's estimate of value in EU's accounts in 2020 (€bn)	Description
Pension and employee benefits	76.1	Forecast liability in December 2020 of the defined benefit pension scheme for EU officials and the post-employment sickness benefits scheme.

# EU Accounts 2017

*Annual accounts of the European Union 2017*

## LIABILITIES

### 2.9. PENSION AND OTHER EMPLOYEE BENEFITS

Net employee benefit scheme liability

	Pension Scheme of European Officials	Other retirement benefit schemes	Joint Sickness Insurance Scheme	31.12.2017 Total	EUR millions 31.12.2016 Total
<i>Defined Benefit Obligation</i>	63 951	1 854	7 756	73 560	67 664
<i>Plan assets</i>	N/A	(137)	(301)	(438)	(432)
<b>Net liability</b>	<b>63 951</b>	<b>1 717</b>	<b>7 455</b>	<b>73 122</b>	<b>67 231</b>

# The Liability Trail EU Pension Scheme

	Liability
2017	€ 73.122
2016	€ 67.231
2015	€ 64.242
2014	€ 59.053
2013	€ 46.818
2012	€ 42.503

# The Discount Rates and Inflation game

	Liability	Nominal Discount Rate	Inflation	Real Discount Rate
2017	€ 73.122	1.9%	1.5%	0.4%
2016	€ 67.231	1.7%	1.4%	0.3%
2015	€ 64.242	2.0%	1.4%	0.6%
2014	€ 59.053	2.0%	1.3%	0.7%
2013	€ 46.818	3.7%	1.9%	1.9%
2012	€ 42.503	3.6%	2.0%	1.6%

# The Name's Bond – Euro Bond

- The ECB's whatever it takes QE Bond buying spree from 2015 in particular removed a functioning Bond market in Eurozone Commercial and Sovereign Bonds
- Bond yields fell through floor
- Discount rates collapsed in response
- No policy response or communication between ECB and EU Commission
- Deliberate Eurozone policy to get inflation back to 2% level
- Real effective discount rates went next to zero – exponential effects on Pension Fund liabilities

# 2018 Discount Rate

- Inflation Rate in the EU running at 2.1% August/September 2018
- Which discount rate will the EU Commission use?
- And will the real discount rate for calculation of the accounts go negative?
- What has the EU Commission told the UK the liability figure is likely to be, and why?
- Should there be an insistence of a retrospective floor on discount rates for the purposes of the divorce bill?
- Should it revert to pre ECB QE rate? Should it be 5%?

## Withdrawal Agreement Provisions

- Keep paying in about 46 chunks
- Elect to pay in 5



# The Subscription Argument

- Is it a Reste à liquider – type obligation or not? Over how long?
- Isn't it an annual subscription in the accounts?
- If we're pretending it's a Fund – then actuarial assessment is needed now as to how previous annual pension payments from UK to EU were distributed. Are we due a rebate for earlier payments into the notional fund?
- Or is it just our 12.4% every year of the EU annual pensions bill?
- Should we have been paying into the pensions of EU officials who completed service before we joined in 1973?
- Do we actually cease to have an obligation to the EU after either March 2019 or January 2021?

The €10 Billion question?

**Can we have our money back?**