View metadata, citation and similar papers at core.ac.uk
brought to you by CORE
provided by Archive of European Integration

CEPS POLICY BRIEF
Thinking ahead for Europe

The Impact of Brexit on the EU Budget: A non-catastrophic event

Jorge Núñez Ferrer and David Rinaldi

No. 347, 7 September 2016

Key Points

Given that the UK is one of the largest economies in the Europe Union – with per capita income above the EU average and therefore a net contributor – there have been concerns that the country's decision to leave the EU could strongly impact the EU budget. On closer scrutiny, however, we find that the impact will be rather small due to the effects of the UK rebate and to the potential contribution the UK would be obliged to make as a condition to obtain access to the internal market. If the UK remains outside the internal market, tariff revenues would make up a considerable share of the 'net loss'. On balance, the financial savings for the UK would be negligible and the impact on member states would be manageable. Also the impact on the classification of regions in EU Cohesion Policy is projected to be minimal and the European Fund for Strategic Investments is not affected by changes in membership.

Policy Recommendations

If or when the UK government triggers Art. 50, it should consider the option of remaining until the end of the current Multiannual Financial Framework and simply stepping out from the next programming period. This would prevent a policy vacuum on regional development and facilitate trade and internal market negotiations.

Despite the manageable impact of Brexit on the EU budget, this is no time for complacency. The budget is exposed to considerable risks from further external shocks and the flexibility instruments have reached their limits. Brexit should be seen as an opportunity to fundamentally rethink the way in which the budget is designed and negotiated.

Jorge Núñez Ferrer is Associate Research Fellow at CEPS; David Rinaldi is Research Fellow at CEPS.

CEPS Policy Briefs present concise, policy-oriented analyses of topical issues in European affairs. Unless otherwise indicated, the views expressed are attributable only to the authors in a personal capacity and not to any institution with which they are associated.

Available for free downloading from the CEPS website (www.ceps.eu) • © CEPS 2016

It is undeniable that the rhetoric surrounding the EU budget has played a relevant role in the Brexit debate. Leave campaigners portrayed the UK net contribution to the EU as a burden and a constraint on national sovereignty. They exclusively focused on direct savings, resorted to incorrect figures, and ignored potential negative impacts of abandoning the EU on regional development,[1] innovation[2] and farm income.[3] In a number of cases, the importance of the UK as "*major*" net contributor was expressed,[4] giving the impression that the exit of the UK from the EU would cause considerable damage to the EU budget. Closer scrutiny, however, does not lead to such a conclusion.

Before turning our attention to these issues, it is worth mentioning the irony that the first post-EU referendum revision of EU budget allocations favours the UK. Exactly one week after the Brexit vote, the European Commission's technical adjustment for the 2017 budgetary allocations translated into an increase of EU funds for the UK.[5] The adjustment of the financial envelope for the UK under the cohesion policy, due to a relative worsening of its GNI, is not substantial,[6] but the UK – after Greece, Italy and Spain – benefits the most among the member states from the revision. What matters, however, is the expected change to the EU budget in the medium to long term and how negotiations concerning the multiannual financial framework (MFF) will be affected.

What changes for the EU budget?

To explain the impact of Brexit in a simplified manner, we look at the 2014 budget.[7] If the UK had to pay its contribution to the EU in full, i.e. approximately €20 billion, the net contribution – and thus the budgetary shortage after Brexit – would amount to over €13.1 billion. This actually equals close to 10% of the EU budget and it would be a rather difficult loss for the member states to absorb. Thanks to Mrs Thatcher, however, and the rebate deal[8] she negotiated in 1984, the UK contribution – and therefore the loss for the EU budget – is much less. It amounts to about €14 billion (including traditional own resources and customs duties), and the net thus is only €7 billion. The complete British exit for the 2014 budget would have reduced internal EU budget expenditures (UK receipts) by €7 billion: nearly €4 billion for agriculture, €1.7 billion for regional policy, €1 billion for competitiveness funding (including €750 million for Horizon 2020) and a few bits and pieces in other policies (see Table 1).

[1] See Bachtler & Begg (2016), Bachtler & Mendez (2016) and Springford et al. (2016).

[2] Hook & Szomszor (2016).

[3] See Van Berkum et al. (2016).

[4] See Irwin (2015).

[5] See European Commission (2016).

[6] According to European Commission (2016), the original EU budget allocated to the UK for the period 2017-20 was €5,488.2 million, and it increased by €50 million to €5,538.2 million, in 2011 prices.

[7] We refer to actual own resources and operating budgetary budget for the year 2014 and not to the latest data available, i.e. 2015, as the latter are influenced by an increase in GNI and an appreciation of the British Pound, which makes 2015 unrepresentative of the average UK contribution to the EU. In 2016 and subsequent years, such levels are unlikely to be reached as the UK own resources will be affected by the current depreciation of the British Pound and by the UK rebate which will be compensating for the relatively high 2015 contributions.

[8] For more information about the impact of the rebate deal on EU Own Resources, see Núñez Ferrer et al. (2016).

Table 1. UK payments, based on the 2014 budget

	Expenditures (€ million)
CAP	3.952
Regional Policy	1.723
Competitiveness Funds	1.023
of which Horizon2020	748
Other	286
of which Security & Citizenship	137
TOTAL EU Expenditure in the UK	**6.985**
	Receipts (€ million)
Traditional Own Resources & Customs	2.731
VAT-based Contribution	2.933
GNI-based Contribution	14.525
UK Rebate	-6.066
Adjustment Justice and Home Affairs	-50
TOTAL UK Contribution to the EU	14.072
NET LOSS for the EU Budget	7.087

Source: Based on European Commission data.

Without taking into account the traditional own resources of the EU, the UK's net contribution, according to the operating budgetary balances used by the European Commission, was only €4.9 billion, representing 0.23% of GNI. If all expenditure is included, such as external action, which is not included in net balance calculations, this reaches 0.3% of GNI, or €6 billion. The overall savings for the UK is thus 0.35% of its GNI, assuming that the UK retains the same customs tariff income.

If, for the sake of simplicity, we simply take the UK out of the picture and imagine that the shortfall is redistributed amongst the – remaining – member states (see Table 2, Scenario A). Under the assumption that the EU decides not to reduce external action expenditure, the "rebates on the UK rebate" enjoyed by Germany, the Netherlands, Austria and Sweden would also disappear.

The biggest impact would be on Germany with an increase in contributions of €2.56 billion (9% increase), followed by France with €1.47 billion (7% increase). Most countries would have seen their contributions increase for the 2014 budget, with some notable exceptions. There are in fact (relatively small) savings for Greece, Bulgaria, Latvia, and interestingly also for the Netherlands. Such impact is the result of the combined effect caused by i) the change in the weight of the different sources (UK VAT and customs contributions impact) and ii) the redistribution caused by the removal of the rebate and associated rebates.

Ultimately, the impact on the EU budget may be less sizable, as the UK will have to negotiate, in the framework of its future relationship with the EU, some contribution to the EU budget and access to the single market. The UK may want to contribute to some selected EU policies, such as Horizon 2020 for instance, for which the UK is *de facto* a leading net

beneficiary. To model this, in a second scenario, we imagine the UK receiving a similar status as Norway does in the EEA, at least for what pertains to its contribution to the EU (Scenario B). If the UK were to contribute to the EU a share of its GDP similar to that of Norway, its contribution would amount to €3.5 billion. The contributions of Norway to EU operations are part of the 'other income' in the EU budget, and thus it is reasonable for the EU to reduce the contributions of the remaining 27 member states proportionally to take this participation into account.

Table 2. Simulation changes in gross contributions, using 2014 budget

	Scenario A UK contributions set to zero		Scenario B UK as EEA member	
	€ million	**% change**	**€ million**	**% change**
BE	+191.9	+4.98	+72.0	+1.93
BG	- 4.9	-1.24	-17.1	-4.43
CZ	+74.6	+5.39	+31.6	+2.36
DK	+265.4	+10.71	+186.5	+7.77
DE	+2562.0	+9.03	+1676.4	+6.10
EE	+5.6	+3.05	-0.1	-0.03
IE	+104.4	+6.83	+56.8	+3.84
EL	-59.4	-3.36	-112.6	-6.57
ES	+141.2	+1.39	-172.3	-1.76
FR	+1477.2	+7.02	+827.9	+4.06
HR	+22.7	+5.53	+10.2	+2.57
IT	+791.9	+5.22	+311.1	+2.12
CY	+17.9	+11.13	+13.0	+8.32
LV	-13.5	-5.83	-20.6	-9.20
LT	+12.2	+3.67	+1.7	+0.53
LU	+51.1	+18.05	+42.3	+15.43
HU	+63.9	+6.70	+33.9	+3.67
MT	+8.2	+11.14	+6.0	+8.32
NL	-71.7	-1.13	-269.0	-4.39
AT	+493.0	+15.48	+395.0	+12.80
PL	+207.3	+5.55	+89.3	+2.47
PT	+26.2	+1.58	-24.8	-1.54
RO	+24.3	+1.77	-19.3	-1.45
SI	+30.6	+8.57	+19.7	+5.69
SK	+57.2	+8.38	+35.2	+5.32
FI	+187.0	+9.52	+126.2	+6.63
SE	+421.3	+9.91	+288.7	+0.07

Source: Own calculations based on European Commission data.

Such a hypothesis, in a more realistic vein, entails a loss for the EU budget of approximately €3.4 billion (for the 2014 budget case), and halves the financial benefit for the UK of leaving the EU, an amount that is easily won or lost in a €2 trillion economy by small changes in any government revenue parameter. The result is a rather low impact for member states, and for some member states (BG, EE, EL, ES, LV, NL, PT, RO), the overall impact is actually a reduction in gross contributions.

During the present MMF, the impact of the UK exit will also be reduced by the fact that commitments that have been taken during the membership of the UK will still need to be financed by the UK contribution. This means that some payments will possibly continue until final closure of programmes and decommitments in 2023. Overall, the impact of the UK's exit will be manageable.

Two additional elements point in the direction of a "no-catastrophe" verdict for the EU budget in the aftermath of Brexit. First, a preliminary analysis carried out by the Conference of Peripheral Maritime Regions of Europe (CPMR) highlights that there won't be substantial changes to the geography of convergence regions with the UK out of the picture. Changes would affect marginally only France, Italy, Spain and Bulgaria.[9] Secondly, assuming the European Fund for Strategic Investments (EFSI) is extended, given its market-based design, it is not likely to be affected by changes in membership. However, the UK can be negatively affected, even though EFSI regulations allows for projects in non-EU countries.

The UK's access to EFSI financing will be constrained by the requirement that another member state *must* be involved, de facto making any use of EFSI only possible for cross-border investments.[10] Thus, the impact of Brexit on the UK's use of EU financial instruments and EFSI may affect it, as the country is one of the main beneficiaries.

Ironically, in case the UK were to leave the single market and tariffs were to be imposed on exported products to the EU in line with WTO rules, the tariff revenues going to the EU budget could be potentially important. The value of goods exported to the EU in 2015 hovered around £220 billion, a value at the present exchange rate of €255 billion. Assuming that UK exports to the EU do not fall, just a 2% average tariff would bring as much as €4.6 billion in revenues for the EU budget, after collection fees of the member states (20%). That would make up a considerable share of the 'net loss'. This results in a situation in which the impact on the revenue side remains rather similar whether or not the UK participates in the single market; what changes is the way in which the UK contributes to the EU budget: from government transfers to tariffs on exports. To some extent this reveals the irony of the net balance disputes, which are based on public transfers and ignore the wider aspects of the EU and the single market. British exporters lose from the costs of tariffs, and importers lose from UK tariffs. Costs tend to affect demand, and thus the financial losses from tariff barriers can easily exceed any 'net contribution loss' by a multiple.

---

[9] Three regions in France, plus Umbria and Sardinia in Italy would pass from Transition to More Developed Region status. Alicante's region and one region in Bulgaria would pass from Low Developed Region (LDR) to Transition. Interestingly, that would be the first Bulgarian region getting out of LDR status.

[10] See Art. 8 of EFSI Regulations. Projects can involve Enlargement, EU Neighbourhood, EEA, EFTA and OCTs (overseas countries and territories).

What changes to expect in the MFF negotiations?

Since the negotiations over the UK's exit from the EU will last at least two years, and given that the UK government does not seem inclined to trigger Art. 50 with any urgency, membership and participation to the budget may well be binding till 2019. With the MFF ending in 2020, it would seem relatively logical for the UK to seek to avoid exit negotiations to the current MFF and simply step out from the next programming period. Thus, the UK could be free from the obligation to contribute to the EU budget as of January 2021,[11] thereby avoiding the need to rush into a cumbersome set-up of domestic regional development grants securing the sustainability of EU-funded projects[12] and preventing a policy vacuum (Bachtler & Mendez, 2016). The rather complex array of negotiations that the UK would face, covering access to the internal market for goods, services and capital and trade deals with third countries, may also serve as a compelling reason to avoid difficult negotiations to exit the current programming period.

However, rationality does not seem to have played an important role in the politics of Brexit and there might be a demand for a prompt end to UK contributions to the EU. The negotiations might be negatively affected by yearly budget disputes. The likelihood of an accumulation of the 'RAL'[13] may lead to additional budgetary requirements. Other difficulties may also create budgetary demands, which would affect the negotiations and put the UK negotiators into a confrontational mode for domestic political reasons. This could lead to less than constructive negotiations.

But this is hardly the time for complacency

Despite the manageable impact of Brexit, the EU should not sit on a false sense of security, ignoring the level of risks facing the EU budget and the impact of further mismanagement of possible crisis developments: enduring migration problems, climatic disasters, new financial crisis, etc. The financial, economic, debt and migration crises have already stretched the EU budget close to its limit and practically exhausted the existing 'flexibility' instruments. There is little doubt that the entire architecture of the EU budget is in need of deep revision.

Enderlein (2016) stresses that Brexit offers an opportunity to substantially revise EU budget arrangements, including modification of the 7-year framework, development of true own resources and a clearer and more efficient division of powers between the European Commission and the member states. The mid-term review of the MMF expected by the end of 2016 is not likely to bring substantial changes to either account for Brexit or longer-term budgetary revisions. However, the review could propose a methodology to reassess the role of the EU budget in collaboration with the member states, potentially also bringing in participation by national parliaments. These proposals are also reflected in the independent report (Núñez Ferrer et al., 2016) to the High Level Group on Own Resources, chaired by

[11] As mentioned earlier, bills for EU-funded projects in the framework of the programming period 2014-20 can become due for payment up until 2023.

[12] Following Bachtler & Begg (2016), the EU can hardly agree on a setting where the UK stops payments to the EU budget and still receives funding for EU-backed projects. If the UK wants to end its EU budget contributions, any EU-funded project in Great Britain would either stop being sponsored or must be funded wholly by the UK Government.

[13] French acronym for "*reste à liquider*", it identifies outstanding commitments to the EU budget. Already in normal circumstances, the multiannual structure of the EU budget programming entails a rising profile of payments towards the end of the MFF; in addition, the economic and public debt crisis at the beginning of the financial framework caused a postponement of several payments, resulting in a particularly low level of payments during the first half of the programming period.

Mario Monti, which proposes a reform process based on milestones, e.g. reaching a certain reform in the expenditures before triggering a new resource. A different process of iterative negotiations and a process of reforms and adaptation could be envisaged, rather than adopting a single, big overarching proposal by the European Commission. The world has changed, and so too have the ways of working and communicating; it is time to fundamentally rethink the way the budget is designed and negotiated.

References

Bachtler, J. and I. Begg (2016), "Cohesion and Cohesion Policy in the UK: What might Brexit entail?", Policy Brief prepared for the initiative on the UK in a Changing Europe, based at King's College London and funded by the Economic and Social Research Council (ESRC).

Bachtler, J. and C. Mendez (2016), "Brexit, EU Cohesion Policy and Regional Development in the UK", European Policies Research Centre, University of Strathclyde, Glasgow.

Boulanger, P. and G. Philippidis (2015), "The end of a romance? A note on the quantitative impacts of a 'Brexit' from the EU", *Journal of Agricultural Economics*, 66(3): 832–842.

Dhingra, S., O. Gianmarco, T. Sampson and J. Van Reenen (2016), "The impact of Brexit on foreign investment in the UK", Centre for Economic Performance, London.

Enderlein, H. (2016), "What should happen? What is likely to happen? Notes on Brexit", Policy Paper, Jacques Delors Institute – Berlin, 30 June.

European Commission (2016), Technical adjustment of the financial framework for 2017 in line with movements in GNI and adjustment of cohesion policy envelopes, COM(2016) 311 final, 30.06.2016.

Hook, D. and M. Szomszor (2016), "Examining Implications of Brexit for the UK Research Base – An analysis of the UK's competitive research funding", Digital Research Reports, May.

Irwin, G. (2015), "BREXIT: the impact on the UK and the EU", Global Counsel, London, June.

Matthews, A. (2016), "The 2016 mid-term review of the Multi-annual Financial Framework", CAP Reform.eu.

Nuñez Ferrer, J., J. Le Cacheaux, G. Benedetto and M. Saunier (2016), Study on the Potential and Limitations of Reforming the Financing of EU Budget, Background Study for the High Level Group on Own Resources.

Springford, J., P. McCann, B. Los and M. Thissen (2016), "Brexiting yourself in the foot: why Britain's Eurosceptic regions have most to lose from EU withdrawal", Insight, Centre for European Reform, London.

Woolford, J. (2016), "What a difference a decade can make: cohesion policy and Brexit", paper prepared for the initiative on the UK in a Changing Europe, based at King's College London and funded by the Economic and Social Research Council (ESRC).

Van Berkum, S., R. Jongeneel, H. Vrolijk, M. Van Leeuwen and J. Jager (2016), "Implications of a UK exit from the EU for British agriculture", LEI Report 2016-046b (study for the National Farmers' Union (NFU), Warwickshire, UK), LEI-Wageningen UR, The Hague.

ABOUT CEPS

Founded in Brussels in 1983, CEPS is widely recognised as the most experienced and authoritative think tank operating in the European Union today. CEPS acts as a leading forum for debate on EU affairs, distinguished by its strong in-house research capacity and complemented by an extensive network of partner institutes throughout the world.

Goals

- Carry out state-of-the-art policy research leading to innovative solutions to the challenges facing Europe today
- Maintain the highest standards of academic excellence and unqualified independence
- Act as a forum for discussion among all stakeholders in the European policy process
- Provide a regular flow of authoritative publications offering policy analysis and recommendations

Assets

- Multidisciplinary, multinational & multicultural research team of knowledgeable analysts
- Participation in several research networks, comprising other highly reputable research institutes from throughout Europe, to complement and consolidate CEPS' research expertise and to extend its outreach
- An extensive membership base of some 132 Corporate Members and 118 Institutional Members, which provide expertise and practical experience and act as a sounding board for the feasibility of CEPS policy proposals

Programme Structure

In-house Research Programmes

Economic and Finance
Regulation
Rights
Europe in the World
Energy and Climate Change
Institutions

Independent Research Institutes managed by CEPS

European Capital Markets Institute (ECMI)
European Credit Research Institute (ECRI)
Energy Climate House (ECH)

Research Networks organised by CEPS

European Climate Platform (ECP)
European Network of Economic Policy Research Institutes (ENEPRI)
European Policy Institutes Network (EPIN)

CEPS, Place du Congrès 1, B-1000 Brussels, Belgium
Tel: 32 (0)2 229 39 11 • www.ceps.eu • VAT: BE 0424.123.986