

# 2

## The Fiscal Impact of Brexit

One of the main areas where even detractors of Brexit concede that the UK will benefit from withdrawal from the EU, concerns the saving of the annual contributions (sometimes described as the membership fee) paid to that organisation.<sup>1</sup> However, estimates of the potential savings vary considerably.<sup>2</sup> Thus, now that the UK is committed to negotiate its withdrawal from the EU, it is necessary to clarify the likely budgetary savings which will accrue to the UK Treasury.

The calculation of net budgetary contributions to the EU is not quite as straightforward as it might appear, however, for a number of different reasons, including:

1. The composition of the EU budgetary process is itself slightly opaque, due to the way in which budget payments are set, the resources over which the EU lays claim and the fact that contributions depend to a large extent upon the relative national income of member states. Thus, should the UK achieve a higher (lower) growth rate relative to other member states, it will incur higher (lower) demands for contributions to the EU budget than were initially anticipated. Retrospective adjustments are, therefore, common.

2. When considering net payments to the EU budget, studies use different assumptions about the UK rebate, and how this may change over time, and also the range of payments received from the EU. For example, whilst it is relatively easy to justify payments made directly to the UK government, such as structural or rural development fund payments, and, moreover, payments made to farmers as part of the CAP, since these are administered by UK government departments, it is perhaps more difficult to justify the inclusion of funding achieved by private sector organisations (including UK universities) in research and/or training programmes, secured through competitive bidding.
3. The timing of calculating the payments is different when comparing Treasury and EU Commission estimates of net payments, with the result that they often present quite different estimates. Hence, there will be some discrepancy between different studies, depending upon which data sources they have chosen (Browne et al. 2016: 40). To take one example, the IFS typically use figures from the EU Commission, whereas, for this chapter, data has been drawn from HM Treasury.
4. The actual net fiscal savings, from withdrawal from the EU, will depend upon whether the type of trading arrangement, established with the EU, involves an element of fiscal contribution. However, discussion of this final element is postponed until Chap. 9, where the various models of multilateral and preferential trade arrangements are discussed in more detail.

There are two further reasons why estimates of budgetary savings, forecast during the referendum campaign, were problematic, namely: (i) the assumptions that were made relating to the future growth of the EU budget (if any); and, (ii) how potential changes to the composition of that budget were factored into the calculations. The latter, for example, could impact significantly upon the UK if additional low-income countries were to join the EU, with the consequences of regional development funds being redistributed away from poorer UK regions towards these new member states. Or, alternatively, whether those proportions allocated to CAP or research funding expenditure

were to shift over time. Whilst these questions are less relevant for the UK once the withdrawal process has been completed, it is necessary to examine how effectively the different economic studies internalised these factors in their models in order to forecast likely economic consequences arising from Brexit.

For something as apparently clear-cut as UK budgetary contributions to the EU, therefore, estimating the likely fiscal benefit arising from Brexit is a little more complicated than might be expected.

## Composition and Size of the EU Budget

The EU budget has increased, over time, from 0.5% of community Gross national income (GNI) in 1973, to its present 1% level (Browne et al. 2016: 6). It is set by a 5–7-year Multiannual Financial Framework, which was introduced in 1988 to provide a more stable funding platform than had previously applied. For 2014–2020, the budget was set at €960 billion, which implies an average of €137.14 billion per year during this 7-year framework period. This, in turn, equates to 1% of EU Gross National Income. This settlement represents a cash increase over the previous financial period, but a real terms (after inflation) decrease, which represents the first such real terms reduction in the EU budget (HM treasury 2014: 5). Thus, budgetary appropriations declined from the previous 1.12% of GNI (Keep 2015: 3).<sup>3</sup>

In practice, however, it is a little more complicated for two reasons. Firstly, the EU budget fails to include additional elements which are essentially off balance sheet (HMG 2014: 26). These include €36.8 billion worth of allocations to an Emergency Aid Reserve, a European Globalisation Fund, a Solidarity Fund, a Flexibility Instrument and the European Development Fund. If included in the core EU budget, this would represent an increase of 0.04% of total EU GNI, taking the total to 1.17% of EU GNI in 2015.<sup>4</sup> Secondly, the appropriation commitments are increased by what is described as a ‘margin’ of around 0.28% of EU GNI, presumably in order to provide a degree of flexibility to EU expenditures intended to cover a relatively long time period. Hence, the total appropriations (payments made into the EU budget) necessary to

cover this total sum (i.e. core budget + margin) represents 1.23% of EU GNI up until 2020 (see Table 2.1).

Having established the magnitude of EU budgetary expenditures, the contributions can be established for each member state. This primarily derives from what the EU has established as its 'own resources', namely (HM Treasury 2014: 9–10):

- i. Gross National Income (GNI)-based contributions (currently representing approximately 74% of total EU revenue) vary according to the relative affluence of member states. It is calculated that the UK's share of this revenue category was 14.5% in 2014;
- ii. VAT contributions (13% of EU revenue) are based upon a slightly complicated set of assumptions and capped to limit excessive variations. The pertinent point is that the UK's share of contributions to the EU budget under this category was 16% in 2014;
- iii. Customs duties (12% of EU revenue) levied on goods imported from non-member states. It is estimated that the UK contributed 16.1% of the revenue under this category;
- iv. Sugar levies (less than 1% of EU revenue) are charged on the production of sugar;
- v. A small proportion (approximately 1%) of EU revenue lies outside of the 'own resources' and includes contributions from non-EU member states to participate in certain programmes, taxes paid on EU staff salaries, interest on late payments and fines levied upon companies breaching competition law.

Customs duties and sugar levies comprised the initial basis for EU funding, reflecting its early focus upon agricultural production and its establishment of a customs union (described as a 'common market' in UK discourse), later augmented by VAT contributions and, more latterly, the rising importance of revenues calculated according to the relative affluence of member states. The volatility in calculating net payments to the EU budget is largely due to the inherent nature of the 'own resources' system (HM Treasury 2014: 13–14). Moreover,

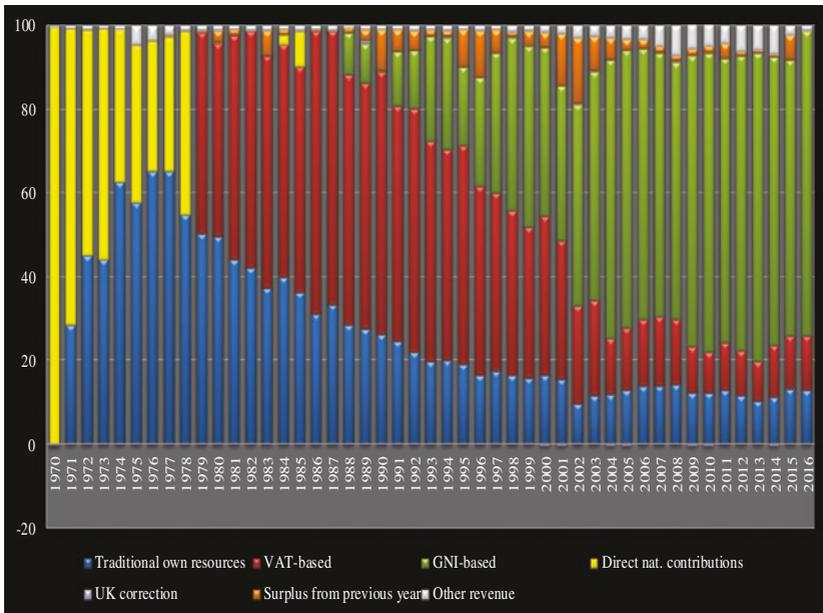
Table 2.1 Multiannual financial framework EU 28 for 2014–2020, adjusted for 2017 (€m, 2017 prices)

Commitment appropriations	2014	2015	2016	2017	2018	2019	2020	Total 2014–2019
1. Smart and inclusive Growth	52 756	77 986	69 304	73 512	76 420	79 924	83 661	513 563
1a. Competitiveness for growth and jobs	16 560	17 666	18 467	19 925	21 239	23 082	25 191	142 130
1b. Economic, social and territorial cohesion	36 196	60 320	50 837	53 587	55 181	56 842	58 470	371 433
2. Sustainable growth: Natural resources	49 857	64 692	64 262	60 191	60 267	60 344	60 421	420 034
of which Market-related expenditure and direct payments	43 779	44 190	43 951	44 146	44 163	44 241	44 264	308 734
3. Security and citizenship	1 737	2 456	2 546	2 578	2 656	2 801	2 951	17 725
4. Global Europe	8 335	8 749	9 143	9 432	9 825	10 268	10 510	66 262
5. Administration of which administrative expenditure of the institution	8 721	9 076	9 483	9 918	10 346	10 786	11 254	69 584
	7 056	7 351	7 679	8 007	8 360	8 700	9 071	56 224
6. Compensation appropriations	29	0	0	0	0	0	0	29
Total commitment as a percentage of GNI (%)	121 435	162 959	154 738	155 631	159 514	164 123	168 797	1 087 197
Total payment as a percentage of GNI (%)	0.90	1.17	1.05	1.04	1.04	1.04	1.03	1.04
Total payment appropriations as a percentage of GNI (%)	135 762	140 719	144 685	142 906	149 713	154 286	157 358	1 025 429
Margin available (%)	1.01	1.02	0.98	0.95	0.97	0.97	0.96	0.98
Own Resources Ceiling as a percentage of GNI (%)	0.22	0.21	0.25	0.28	0.26	0.26	0.27	0.25
	1.23	1.23	1.23	1.23	1.23	1.23	1.23	1.23

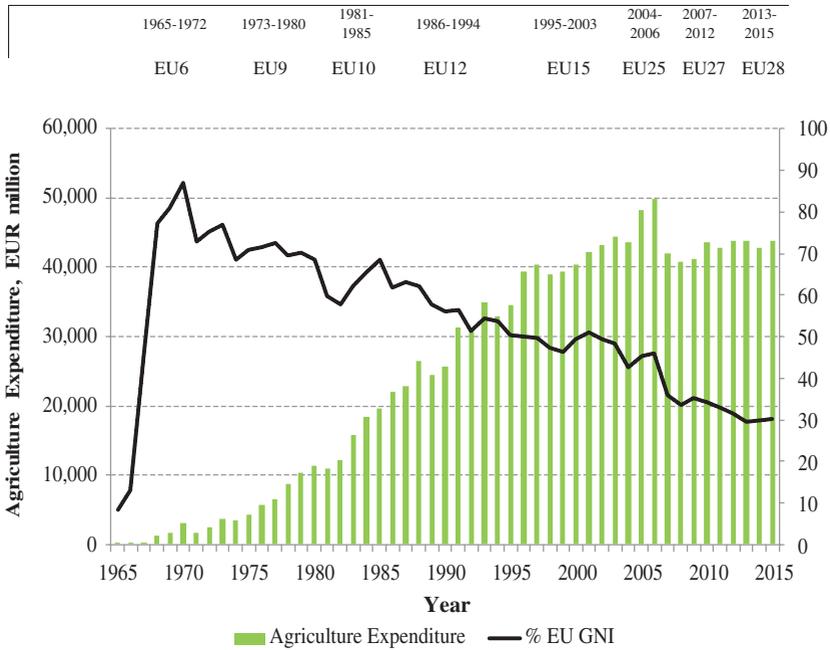
Source: Europa EU (2016)

the complexity inherent in the ‘own resources’ approach therefore partly reflects the historical development of the EU and the difficulty in securing a more streamlined approach, when this would inherently involve individual nations who benefit from any changes and others who are required to make larger contributions as a result. The evolution and significance of each source of EU revenue are illustrated in Fig. 2.1.

In terms of EU expenditure, the initial dominance of the Common Agricultural Policy (CAP), which can be noted in the Fig. 2.2, has been reduced somewhat due to the dramatic expansion of cohesion and structural funds to promote regional development across all member



**Fig. 2.1** Structure of EU financing, 1958–2015. *Sources* For 1970–2008: European Commission (2009). Financial Report EU budget 2008. Publication and accompanying dataset. Last accessed 15 August 2016. For 2009–2014: European Commission (2015). Financial Report EU budget 2014. Publication and accompanying dataset. Last accessed 15 August 2016. For 2015–2016: European Commission (2016). Definitive Adoption (EU, Euratom) 2016/150 of the European Union’s general budget for the financial year 2016. Last accessed 15 Aug 2016



**Fig. 2.2** Agriculture expenditure as part of the EU GNI, 1965–2015 (€m). *Sources* Author-collated data from various reports on CAP expenditure (European Commission, DG Agriculture and Rural Development, Financial Reports 2008 and 2013–2015)

states. Thus, in the current budgetary framework, 47% of total spending commitments relate to regional policy, 39% for CAP and sustainable development, with the balance incorporating administration (6%), external policy (6%) and issues relating to migration, public health, consumer protection, culture and youth policy (2%) (Keep 2015: 6–7).

### Financial Management and Fraud

One issue which typically arises, when considering the EU budget, concerns accusations of financial mismanagement and/or fraud. This criticism derives from the annual reports produced by the European Court of Auditors (ECA), which assess the financial management of the EU’s finances. In its opinion, the latest set of accounts to be assessed, in

2012, were found to be legal and regular, but that 4.8% of EU expenditure was subject to ‘material error’—in essence, this means that spending did not conform to the rules established to guide EU expenditure. Data collected through monitoring sampling, undertaken across different categories of EU expenditure, indicate that errors were not confined to specific sectors, with agricultural support estimated to have a material error of perhaps 3.8% of total expenditure, rural development 7.9%, regional policy, energy and transport 6.8%, employment and social affairs 3.2%, external relations 3.3%, and research 3.9%.

The auditors emphasise that these findings do not necessarily equate to fraud, and nor do they necessarily imply that almost 5% of the total EU budget was wasted. Indeed, there is some evidence for this equivocation, as there were 1194 cases of suspected fraud reported in 2012, compared to 12,137 cases of non-fraudulent error noted in the same year (HM Treasury 2014: 27). Moreover, in mitigation, it has to be more difficult dealing with the complexity inherent in management a series of programmes across a large number of nations, each at different levels of development, and with different previous approaches to the administration and monitoring of public expenditure programmes. Indeed, the ECA themselves recognise this difficulty in setting an error ceiling of 2% as acceptable for EU spending programmes—a rate that would be difficult to justify in public spending programmes within a single nation (HMG 2014: 30). Nevertheless, the failure to meet even this generous target, together with the estimated irregularities and errors catalogued by the ECA, certainly create cause for concern about deficiencies in eligibility assessment and compliance monitoring which require corrective action. Consequently, for the nineteenth consecutive year, the ECA provided only partial assurance as to the accuracy of the EU’s accounts (HM Treasury 2014: 21–24).

## UK Contributions to the EU Budget

The UK has been an almost continuous net contributor to the EU’s budget; the one exception being in 1975 (see Table 2.2).

The UK is currently the second largest net contributor to the EU, after Germany, but only the third largest when these payments are averaged per capita (per person) (see Table 2.3 and Fig. 2.3).

Table 2.2 UK net contributions to the EU/EC Budget (£m), 1973–2020

	Gross contribution	Negotiated refunds	Rebate	Total contribution (after rebate and refunds)	Public sector receipts	Net contribution—(Gross contribution—rebate and refunds—public sector receipts)	GDP, chained volume measures, seasonally adjusted (£m)	Net contribution as % GDP
1973	181			181	79	102	781,583	0.013
1974	181			181	150	31	762,257	0.004
1975	342			342	398	-56	750,912	-0.007
1976	463			463	296	167	772,852	0.022
1977	737			737	368	369	791,889	0.047
1978	1348			1348	526	822	825,111	0.100
1979	1606			1606	659	947	855,933	0.111
1980	1767	98		1669	963	706	838,462	0.084
1981	2174	693		1481	1084	397	831,931	0.048
1982	2863	1019		1844	1238	606	848,700	0.071
1983	2976	807		2169	1522	647	884,520	0.073
1984	3204	528		2676	2020	656	904,639	0.073
1985	3940	61	166	3713	1905	1808	942,519	0.192
1986	4493		1701	2792	2220	572	972,239	0.059
1987	5202		1153	4049	2328	1721	1,024,346	0.168
1988	5138		1594	3544	2182	1362	1,083,629	0.126
1989	5585		1154	4431	2116	2315	1,111,618	0.208
1990	6355		1697	4658	2183	2475	1,119,587	0.221
1991	5807		2497	3309	2765	544	1,107,059	0.049
1992	6738		1881	4857	2827	2030	1,111,043	0.183

(continued)

Table 2.2 (continued)

	Gross contri- bution	Negotiated refunds	Rebate	Total contri- bution (after rebate and refunds)	Public sec- tor receipts	Net contribu- tion (Gross contribution— rebate and refunds— public sector receipts)	GDP, chained volume measures, seasonally adjusted (£m)	Net contri- bution as % GDP
1993	7985		2539	5446	3291	2155	1,138,897	0.189
1994	7189		1726	5463	3253	2211	1,183,144	0.187
1995	8889		1207	7682	3665	4017	1,212,798	0.331
1996	9133		2412	6721	4373	2348	1,243,709	0.189
1997	7991		1733	6258	4661	1597	1,282,602	0.125
1998	10,090		1378	8712	4115	4597	1,323,527	0.347
1999	10,287		3171	7117	3479	3638	1,366,983	0.266
2000	10,517		2085	8433	4241	4192	1,418,176	0.296
2001	9379		4560	4819	3430	1389	1,456,837	0.095
2002	9439		3099	6340	3201	3139	1,491,761	0.210
2003	10,966		3559	7407	3728	3679	1,543,468	0.238
2004	10,895		3593	7302	4294	3008	1,582,486	0.190
2005	12,567		3656	8911	5329	3582	1,629,519	0.220
2006	12,426		3569	8857	4948	3909	1,670,306	0.234
2007	12,456		3523	8933	4332	4601	1,712,996	0.269
2008	12,653		4862	7791	4497	3294	1,702,252	0.194
2009	14,129		5392	8737	4401	4336	1,628,583	0.266
2010	15,197		3047	12,150	4768	7382	1,659,772	0.445
2011	15,357		3143	12,214	4132	8082	1,684,820	0.480
2012	15,746		3110	12,636	4169	8467	1,706,942	0.496

(continued)

Table 2.2 (continued)

	Gross contribution	Negotiated refunds	Rebate	Total contribution (after rebate and refunds)	Public sector receipts	Net contribution (Gross contribution—rebate and refunds—public sector receipts)	GDP, chained volume measures, seasonally adjusted (£m)	Net contribution as % GDP
2013	18,135		3674	14,461	3996	10,465	1,739,563	0.602
2014	18,777		4416	14,361	4576	9785	1,792,976	0.546
2015 <sup>a</sup>	17,779		4861	12,918	4445	8473	1,833,233	0.462
2016 <sup>b</sup>	20,500		4800	15,700	4500	11,200		
2017 <sup>b</sup>	18,000		6100	11,900	4600	7300		
2018 <sup>b</sup>	18,600		4400	14,100	4800	9400		
2019 <sup>b</sup>	19,800		4700	15,000	5200	9800		
2020 <sup>b</sup>	20,300		5100	15,200	5400	9800		

Sources HM Treasury (2016), ONS, UK National Accounts (2016)

Note <sup>a</sup>2015 are estimates, <sup>b</sup>figures for 2016–2020 are forecasts rounded to the nearest £100 million

Table 2.3 EU budgetary balances by member state (€m), 2013–2015

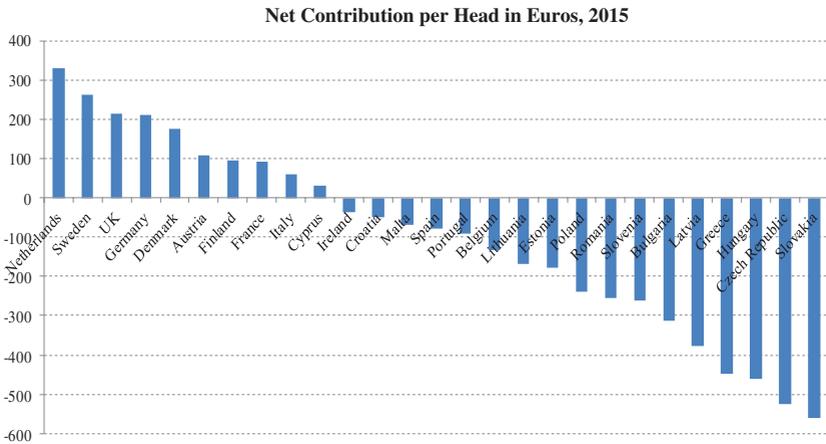
	Expenditure					Contributions					Net contributions		Net contribution per head (in €), 2015
	2013	2014	2015	2013	2014	2015	2013	2014	2015	2013	2014	2015	
Netherlands	2264	2014	2359	6552	8373	7947	4288	6358	5588	331			
Sweden	1661	1691	1468	4211	4294	4019	2550	2603	2552	262			
UK	6308	6985	7458	17,068	14,072	21,409	10,760	7088	13,952	215			
Germany	13,056	11,484	11,013	29,376	29,143	28,125	16,320	17,659	17,112	211			
Denmark	1435	1512	1529	2899	2508	2521	1465	996	993	175			
Austria	1862	1573	1787	3191	2870	2726	1329	1297	939	109			
Finland	1497	1062	1330	2159	1904	1854	662	842	524	96			
France	14,239	13,479	14,468	23,292	20,968	20,606	9052	7489	6138	92			
Italy	12,554	10,695	12,338	17,168	15,889	15,920	4614	5193	3582	59			
Cyprus	227	273	203	185	161	230	-42	-112	27	32			
Ireland	1874	1563	2009	1731	1651	1839	-143	87	-169	-37			
Croatia	290	584	605	238	430	397	-52	-155	-207	-49			
Malta	174	255	134	86	76	104	-87	-179	-30	-70			
Spain	13,752	11,539	13,696	11,369	11,111	10,089	-2383	-428	-3606	-78			
Portugal	6163	4943	2595	1793	1748	1646	-4370	-3195	-949	-91			
Belgium	7209	7044	6952	5291	5233	5471	-1919	-1812	-1481	-132			
Lithuania	1881	1886	877	405	385	390	-1476	-1501	-488	-167			
Estonia	973	668	443	212	200	210	-761	-467	-233	-177			
Poland	16,179	17,436	13,358	4214	3955	4236	-11,965	-13,481	-9121	-240			
Romania	5561	5944	6538	1474	1459	1446	-4086	-4485	-5092	-256			
Slovenia	814	1142	940	426	385	403	-388	-758	-537	-260			
Bulgaria	1977	2255	2730	478	461	484	-1499	-1795	-2246	-312			
Latvia	1063	1062	982	269	270	236	-794	-792	-746	-376			

(continued)

Table 2.3 (continued)

	Expenditure						Contributions						Net contributions		Net contribution per head (in €), 2015
	2013	2014	2015	2013	2014	2015	2013	2014	2015	2013	2014	2015	2014	2015	
Greece	7215	7095	6210	1906	1950	1343	1343	1950	1343	1343	1950	1343	-5145	-4867	-448
Hungary	5910	6620	5629	1011	996	1074	1074	996	1074	996	1074	996	-5624	4556	-462
Czech Republic	4893	4377	7075	1617	1507	1542	1542	1507	1542	1507	1542	1507	-2871	-5532	-525
Slovakia	2026	1669	3735	799	720	697	697	720	697	720	697	720	-949	-3038	-560
Luxembourg	1598	1714	1649	322	246	367	367	246	367	246	367	246	-1468	-1283	-2278
Total	126,349	134,656	128,565	129,430	139,744	132,961	132,961	139,744	132,961	139,744	132,961	132,961			

Source: European Commission, interactive graph on EU expenditure and revenue, Available at: [http://ec.europa.eu/budget/figures/interactive/index\\_en.cfm](http://ec.europa.eu/budget/figures/interactive/index_en.cfm) Eurostat (population data). Notes: Negative net contribution denotes a member state being a net recipient



**Fig. 2.3** EU member states net contribution to EU budget (in €), 2015. Source European Commission, interactive graph on EU expenditure and revenue, Available at: [http://ec.europa.eu/budget/figures/interactive/index\\_en.cfm](http://ec.europa.eu/budget/figures/interactive/index_en.cfm) Eurostat (population data)

## Gross Contributions

One of the more controversial statements, made by the *Vote Leave* campaign in the recent referendum, concerned the claim, painted on the side of its campaign bus, which stated:

We send the EU £350 million a week – let’s fund the NHS instead.

Critics of this claim have taken issue with two elements of this statement. Firstly, the apparent pledge that this £350 million would be spent on the National Health Service (NHS), albeit that leading members of the campaign stated that this was ‘an aspiration’ rather than a firm promise.<sup>5</sup> Certainly, the *Vote Leave* website makes the claim that the UK’s EU contributions are of a sufficient magnitude to construct a ‘new, fully-staffed NHS hospital every week’.<sup>6</sup> However, one problem faced by campaigners in a referendum is that, with a few exceptions

such as the role played by Prime Minister Cameron in the *Remain* campaign, they do not control executive office and, therefore, cannot make firm commitments to future government action. Thus, it is difficult to criticise the *Vote Leave* campaign for highlighting the magnitude of budgetary transfers to the EU by comparing them to the cost of an NHS hospital, which appears to be factually accurate, even though certain voters might (and, indeed, were probably intended to) have inferred from this that the campaign was making a spending commitment for a future post-referendum government, which it was incapable of doing.

Secondly, the statement is criticised for using the word ‘send’,<sup>7</sup> given that gross contributions to the EU are not actually dispatched until the UK’s rebate is deducted, which would give a figure of £275 million per week (Emmerson et al. 2016: 1). The *Vote Leave* website carried a more accurate, although less ‘headline grabbing’ description of the £350 million figure as representing the gross cost of EU membership.<sup>8</sup> This statement is accurate but has also been found to be ‘misleading’ by the UK Statistics Authority, given the failure to mention rebate deductions and on the basis that gross figures were being discussed in terms that they implied net payments.<sup>9</sup>

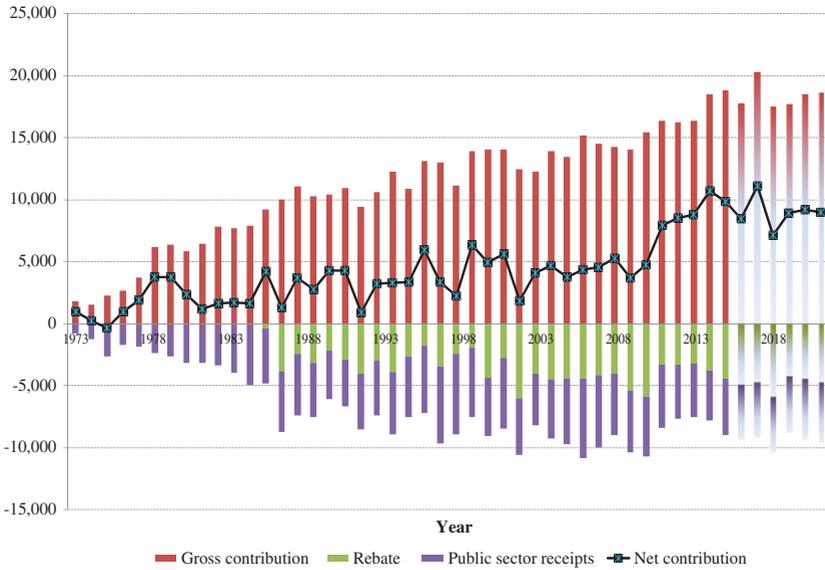
A second headline, during the referendum campaign, has been criticised on similar grounds, namely the claim that the UK contribution to the EU budget has exceeded half a trillion pounds over the period of UK membership.<sup>10</sup> This study re-calculated those figures given in Table 2.3, by inflating values to transfer historical fiscal transfers into 2014 prices, and then aggregating all adjusted contributions. Once again, this calculation is accurate but is not particularly helpful, because it ignores the rebate, which, when the calculations are repeated to include the rebate, over-state the gross contributions after rebate by £108.9 billion at 2014 prices, or around 29% of the reported total (Begg 2016: 46–47). The resultant figure of £375.1 billion (i.e. £484bn–£108.9bn) is still a very large number, but it does not make such attractive headlines.

## The UK Rebate

One early acknowledgement of distributional concerns raised by the ‘own resource’ system resulted in the adjustment of the UK’s net contributions paid into the EU budget by means of a correction or abatement—normally described as a ‘rebate’. Given that the UK had a relatively efficient and small agricultural sector, and that CAP expenditures were a majority of EU spending at the time of its accession to the EU, the UK received relatively small expenditures from the EU budget. At the same time, as a trading nation, the UK’s share of customs duties and VAT receipts were disproportionately large, thereby requiring a disproportionately high contribution to the EU budget. In 1984, the UK was the third-poorest EU member state, in terms of GNI per capita, and yet making the second largest net contribution to the EU budget (HMG 2014: 15). Unsurprisingly, this led to political tensions within the EU, and the rebate was negotiated to provide an *ex post facto* adjustment to reduce net contributions to a more equitable position.

The initial 1985 rebate lowered UK contributions by 66%, yet more recent increases in various elements of the EU budget that are excluded from this deduction have reduced its scope, thus significantly increasing UK net payments (Webb et al. 2015: 11–12). The rebate is calculated by subtracting the UK’s percentage share of expenditure from the UK’s percentage share of VAT contributions, then multiplying this by 0.66 and finally multiplying this sum by the total amount of EU expenditure.<sup>11</sup> This rebate is valuable to the UK (see Fig. 2.4), amounting to £4.9 billion in 2014 and signifying that the UK’s net contribution would have been just under 50% larger had the rebate not been applied (see Table 2.4).

It should be noted that the UK is not the only member state to benefit from a budgetary correction mechanism. For example, Austria, Denmark, Germany, the Netherlands and Sweden are all net contributors to the EU budget who receive one or more forms of contribution adjustments, to prevent what might otherwise be termed an ‘excessive’ budgetary burden (HMG 2014: 27; Business for Britain 2015: 369–370). Thus, the UK is certainly not unique in the EU for having



**Fig. 2.4** UK contributions to and receipts from the EU budget real terms (£m at 2015 prices), 1973–2020. Sources HM Treasury (2016), ONS, UK National Accounts (2016). Note 2015 are estimates, figures for 2016–2020 are forecasts rounded to the nearest £100 million

**Table 2.4** Percentage of UK rebate lost due to 2005 changes

Year	Actual size of UK rebate in nominal prices (€m)	Value of UK rebate had 2005 changes not been made in nominal prices (€m)	Lost value of the UK rebate (%)
2008	6114	6416	4.7
2009	6057	7407	18.2
2010	3553	5670	37.3
2011	3623	5978	39.4
2012	3835	6726	43.0
2013	4073 (est)	7480 (est)	45.5

Source Lewis (2014: 4)

what are regarded as disproportionate and inequitable funding burdens ameliorated. Despite this fact, the UK abatement has been subject to periodic criticism from the Commission and other member states (Business for Britain 2015: 182; Capital Economics 2016: 28).

Given that this is a fiscal matter, any decision to remove or reform the rebate would require unanimity in the Council of Ministers, and thus the UK, whilst a member of the EU, would have a veto over proposals to reform or remove the rebate. Yet, this is by itself no guarantee that a UK government, seeking other concessions, might bargain away part of the rebate. Indeed, this is precisely what happened in December 2005, when the UK conceded certain exemptions from the rebate in an attempt to negotiate a substantial fall in CAP expenditure. These exemptions included EU overseas aid and non-agricultural expenditure in the post-2004 new member states, and the effect was to significantly reduce the value of the rebate (Keep 2015: 15; Webb et al. 2015: 9; Begg 2016: 44). Unfortunately, CAP expenditure was not reduced as a quid pro quo, thus reinforcing the importance of securing formal agreements rather than less distinct ‘understandings’ in international negotiations (Business for Britain 2015: 182).<sup>12</sup> The budgetary impact, arising from this reduction in the effectiveness of the rebate, is illustrated in Table 2.4.

## Net Contributions

One issue raised, during the referendum campaign, is whether it is more appropriate to use gross contributions to the EU budget rather than net figures—i.e. after all deductions. This is an interesting question to consider, because the answer partly depends upon circumstances. In regular conversation, if an individual is asked about their income, they will most likely reply giving their gross income, rather than what they actually receive into their bank accounts after tax. Nor will it be very likely that they will think to add back into the calculation of their income what they might receive in tax credits or social security benefits, and even less the net benefit they might personally receive through the provision of those public services which their tax payments help to fund,

less any additional fees or charges involved in utilising these public services. The more complex net income calculation may provide the more accurate answer, but it is unlikely to be the one given, even if the individual concerned was an economics professor! Nevertheless, given that the issue under consideration is a matter of public policy, then it would seem reasonable that the net contribution figure is the one that should be preferred for giving a more useful understanding of the budgetary impact of EU membership upon the UK. Certainly, when seeking to estimate any likely budgetary savings from Brexit, the net figure is the more useful.

Utilising official figures from Table 2.2, and as illustrated in Fig. 2.4, the current UK net contribution to the EU budget is around £10 billion per annum. This figure relates to total contributions transferred to the EU by the UK government after the rebate has been deducted and after taking account of the receipts received back *by the public sector* from the EU for participation in various programmes, such as the CAP or regional development funding. It does not, however, include a further amount received by the private sector, in the UK, relating to their participation in EU programmes. These most notably include research funding won by UK universities, through a competitive process, from the Horizon 2020 research programme, and the Erasmus student mobility scheme. The Treasury estimates that, in 2013, these payments to private organisations totalled in the region of £1.4 billion (HM Treasury 2015: 14). If this is subtracted from the net public sector receipts, it gives a final net financial impact upon the UK economy from the EU budget of around £8.6 billion per year. This latter figure does not give an estimate of fiscal savings for the UK government arising from Brexit, however, but rather it begins to consider impacts upon the UK economy beyond the confines of national public expenditure.

The range of different estimates of UK contributions to the EU budget, therefore, range from around £19.2 billion gross payments, to £10 billion net contributions for the UK government and public sector, and around £8.6 billion for both public and private sectors. Each of these figures can be used for certain circumstances.

The gross figure is useful if the intent was to indicate what potential future transfers might be required if the UK rebate were eliminated by

future reform of EU finances, or, alternatively, if considering whether any divergence between the efficiency of nationally, as opposed to supra-nationally, determined forms of expenditure may affect the economic impact experienced by the UK economy (Congdon 2014: 19–22). For example, if it were proven that UK expenditure was more (or less) effective than EU expenditure, then there would be an argument to deflate (or inflate) the anticipated economic impact accordingly, rather than simply focus on aggregate receipts and net budgetary contributions. However, in the absence of robust evidence on this point, it would be unwise to seek to manipulate fiscal estimates due to suspicions as to their effectiveness.

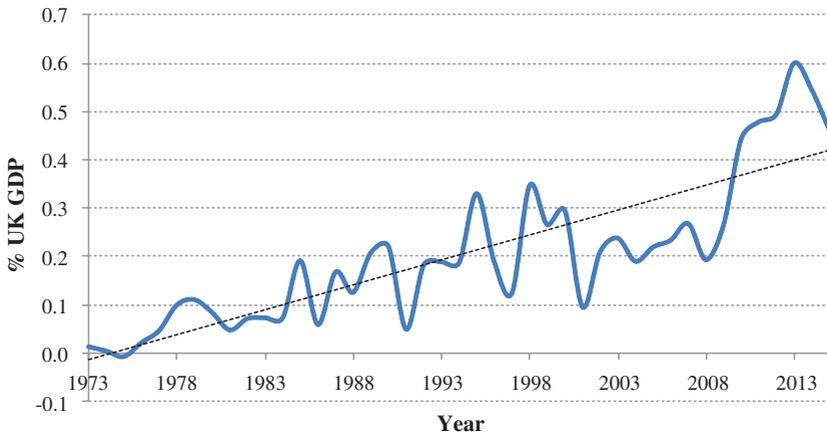
The net contribution estimate would, however, be preferable particularly when seeking to estimate the impact of withdrawal from the EU upon the UK economy. In this circumstance, the most accurate estimate of the fiscal savings to government following Brexit, *ceteris paribus*, would be a value around £10 billion per annum, representing around 0.53% of UK GDP, which is the figure that most studies tend to use in their calculations (e.g. HM Treasury 2015: 14; Ottaviano et al. 2014: 2; Dhingra et al. 2015: 3; Capital Economics 2016: 3).

## The Uncertainty of Future Budgetary Developments

The estimates produced, above, do not, however, take into account possible future developments which may impact upon the level of potential budgetary savings. These may include:

- a. future growth of the EU budget and consequent increase in UK fiscal contributions;
- b. the macroeconomic impact arising from Brexit and consequences for the national budget;
- c. which model of trade relationship the UK negotiates with the EU following Brexit.

For the first factor, it can be noted that the historical development of UK budgetary contributions has been variable, but following



**Fig. 2.5** UK net contributions to the EU budget (% of UK GDP), 1973–2015. Sources HM Treasury (2016), ONS, UK National Accounts (2016)

a steadily increasing trend (see Fig. 2.5). There are many causes to this phenomenon, including: (i) the natural growth in a budget fixed at a certain percentage of EU GDP; (ii) UK growth rates being faster than the EU average over recent years, partly because of problems with the Eurozone economies, and therefore the UK has to pay an increasing share of EU expenditure; (iii) the EU budget as a whole being expanded over time, from 0.5% of EU GDP in the 1970s to a little over 1% of GDP today; and (iv) the UK rebate being eroded through negotiating exemptions as a means to leverage additional change within the organisation. There is every expectation that the EU budget will increase further during the next budgetary period. This may arise out of the need to provide further support to the single currency (MacDougall 1977: 20; HMG 2014: 37–38) or to enable the EU to provide a sufficient fiscal stimulus in future economic crises (Begg 2016: 41). Whatever the reason, were this to occur before the UK formally completed the Brexit procedure, it would further exacerbate the UK's budgetary transfers to the EU and, therefore, fiscal savings post-Brexit would be larger than predicted.

A second factor concerns the impact of Brexit upon the UK economy and consequent affect upon the national government's fiscal

position. The range of economic studies, produced over the past two decades, have put forward a range of predicted effects, ranging from large economic benefits to equally large economic costs, with the majority of the studies suggesting a more moderate impact of between plus or minus 2–3% of UK GDP (see Table 1.8). The most recent commentary on the likely impact of Brexit, produced by the Bank of England in its August 2016 inflation report, infers a slowing of UK growth by perhaps around 2.5% from what was previously forecast, despite active monetary policy measures (Bank of England 2016a, b). It may be questionable as to what proportion of this predicted economic slowdown is due to the uncertainty centring upon Brexit or whether the previous forecast was too optimistic. Nevertheless, *if* this proves to be accurate, and given the Office for Budget Responsibility rule of thumb that as little as a 0.8% permanent reduction in the level of output would be sufficient to eliminate Brexit's £10 billion budgetary saving, then the net fiscal impact may be negative (Capital Economics 2016: 29; Emmerson et al. 2016: 2).

The final factor concerns the future trade relationship that the UK negotiates with the EU, and whether this includes an element of financial contribution towards EU programmes. Around half of the preferential trade options, available to the UK and discussed in more detail in Chap. 9, would involve varying degrees of fiscal transfers to the EU (see Table 2.5). The closest forms of trade relationship would be likely to carry the most significant fiscal costs, whereas the more independent and less intimate the relationship, the less of a fiscal burden

**Table 2.5** Estimated fiscal impact from different future trading relationships with the EU

	Gross		Net		UK net	
	£m	% GDP	£m	% GDP	£bn	% GDP
Norway—EEA	620	0.76	310	0.38	4.4	0.22
Turkey—Customs Union	n/a	n/a	n/a	n/a	3 <sup>a</sup>	0.14 <sup>a</sup>
Swiss—Bilateral	420	0.13	410	0.13	2.1	0.09
South Korea—FTA	0	0	0	0	0	0
Greenland—WTO	0	0	0	0	0	0
Hong Kong—Unilateral	0	0	0	0	0	0
Free Trade						

<sup>a</sup>Author estimate

may be required, if, indeed, any contribution is necessitated at all. Consequently, any financial contribution necessitated by the eventual model selected by the UK will have to be subtracted from the potential net £10 billion in UK budgetary savings in order to reach the final budgetary saving once any trade arrangement is operational. Thus, should the UK participate in the EEA on the same terms as Norway, the overall net savings to the UK from Brexit might be as low as £5.6 billion, whereas if the UK negotiated a Free Trade Agreement (FTA) on a similar basis to the deal offered to Canada, there would be no fiscal cost involved, and therefore the final budgetary saving for the UK would remain at around £10 billion.

## Notes

1. This is not the only area where savings could occur, as the UK government would no longer have to contribute towards the cost of representation in the EU, and, although there would still be the need for trade and diplomatic missions following withdrawal, this is unlikely to incur a similar magnitude of expenditure.
2. The EU's own calculations of the net budgetary balance with the UK can be found via [http://ec.europa.eu/budget/financialreport/2014/lib/financial\\_report\\_2014\\_en.pdf](http://ec.europa.eu/budget/financialreport/2014/lib/financial_report_2014_en.pdf). This estimate records around half of the net contribution that the UK makes to the EU budget as calculated by the ONS or the HM Treasury. The ONS explains some of the reasons for differences in calculation via <http://visual.ons.gov.uk/uk-perspectives-2016-the-uk-contribution-to-the-eu-budget/>. The Treasury and Office for Budgetary Responsibility (OBR) estimates are to be found via [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/483344/EU\\_finances\\_2015\\_final\\_web\\_09122015.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/483344/EU_finances_2015_final_web_09122015.pdf).
3. [http://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/ecofin/139831.pdf](http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/139831.pdf).
4. *Op cit.*
5. <http://www.independent.co.uk/news/uk/politics/brexit-350-million-a-week-extra-for-the-nhs-only-an-aspiration-says-vote-leave-campaigner-chris-a7105246.html>.
6. [http://www.voteleavetakecontrol.org/briefing\\_cost](http://www.voteleavetakecontrol.org/briefing_cost).

7. <http://www.theguardian.com/politics/reality-check/2016/may/23/does-the-eu-really-cost-the-uk-350m-a-week>.
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Relationship with the EU

Whyman, P.; Petrescu, A.I.

2017, XXV, 384 p. 58 illus., 56 illus. in color., Softcover

ISBN: 978-3-319-58282-5