BREXIT and its Consequences

Analysis, Position and Reform Proposals
Europe – Making it fit for the Future

Taxpayers Association of Europe (TAE)
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Process and BREXIT - Deadline

Article 50 of the EU Treaty of Lisbon regulates the process of leaving the European Union. First, the British government has to formally notify Brussels of their intention before the negotiations about an exit begin. The hard BREXIT has been decided by the British House of Commons and everything indicates that it also passes the House of Lords. If Scotland will accept that still remains open. According to Prime Minister, Theresa May, the **formal notification** shall take place by **end of March 2017** at the latest. Then the hourglass starts running, for the **exit negotiations have to be completed within a two year period.** If not, Great Britain would exit Europe automatically and possibly in an uncontrolled fashion.

BREXIT – Consequences for Great Britain

The consequences accompanying a hard BREXIT have been quite differently assessed over the past months. On one hand the damage to be compensated for the EU institutions has to be considered, for the British government has signed obligations even beyond the year 2019; on the other hand the damage to the economy and the people has to be assessed as well. A hard BREXIT also means the loss of right to stay for citizens of the Union. And finally, the BREXIT also has purely political consequences. That is the question which is probably the easiest to answer, since Great Britain is generally known as "difficult" partner within the EU. Many member states will not be unhappy about the exit due to the almost notorious blockade policy of the Kingdom. On the other hand, the BREXIT should not become example for others.

The damage in Great Britain for the economy and the people is already becoming apparent. Europe is by far the most important trade partner of Great Britain. More than 40 percent of the British exports of goods and services go into the EU states.

Marcus Theuerer has summed it up for the Federal Agency for Civic Education. (Also see **http://www.bpb.de/internationales/europa/BREXIT/229517/moegliche-folgen-des-BREXIT**):

The uncertainty about Great Britain's future in the EU already has concrete economic consequences for the British. For example in the exchange market, for which short-term risks are decisive. In the exchange market the British Pound has significantly depreciated against the Euro and the Dollar since last autumn. Imported goods have become more expensive for British consumers. But others see the weak Pound as a chance: Since British goods are less expensive on the international markets, it could promote exports.

At the same time companies hesitate to hire new employees and put off investment decisions. Economic experts expect that the British economy, which in the past years has still substantially grown, has nearly stagnated since spring 2016. In a recently published study, the Organisation for Economic Cooperation and Development (OECD) points out that the economic growth in Great Britain is already declining.

More than one-third of the entire wholesale business in the financial sector of the EU has thus far been transacted in Great Britain, and therefore more than in Germany, France and Italy together. On the European domestic market not only goods, but also financial services "made in Britain" are traded "on a large scale".

Therefore, the damage for the London bankers inflicted by the BREXIT is obvious.

The Damage for the EU States

But the EU states also are in danger of suffering due to Great Britain's exit, for more than half of the exports to Great Britain come from the EU zone. This is the reason why e.g. the German automobile industry is afraid of the BREXIT: For Audi, BMW and Mercedes the British thus far have been some of the best customers. But customs barriers could burden business after the BREXIT.

Especially for BMW Great Britain is one of the most important production sites. The Bavarians manufacture the popular compact car "Mini" in Oxford, England, a car that over the last one-and-a-half decades has become a German-British bestseller. If the British drop out of the internal market it would not necessarily be the end of the "Mini", but would pose a large challenge to the intricate pan-European supply chain of the manufacturer.

Tax Implications not yet Foreseeable

If Great Britain does not join e.g. the European Economic Area (EEA) after its exit from the EU, and thus does not conclude separate economic treaties with the EU or individual member states, Great Britain would take on the status of a "normal" third country.

In this case existing EU directives would no longer be applicable. One of the consequences would be that e.g. payment of dividends and interests within a group of companies would no longer be exempt from tax at source in Germany, or that cross-border restructuring would no longer be carried out tax neutral. Furthermore, the qualification of Great Britain as Non-EU/EEA country could result in fiscal relief contained in national tax laws no longer being applicable. This would e.g. lead to the move of a natural person from Germany to Great Britain, giving up German residency, immediately falling under exit taxation. German enterprises would have to fear tax disadvantages in refunds of contributions. Also, there is a trade tax intercorporate privilege in pay-outs of GB corporations. The Foreign Tax Act substance evaluation is not applicable to UK controlled-foreign-corporation incomes.

(Also see: **http://www.roedl.de/themen/entrepreneur/2016-12/uk-brexit-2017-steuer-aenderungen)**.

Difficult Prognosis on Costs and Follow-Up Costs for GB

There are many prognoses regarding the question of how expensive the EU exit might get for the British – and the range is quite large, for the economic effects also depend on the future relationship of Great Britain with the EU, which is anything but sure.

From today's perspective it is to be expected that Great Britain will close trade treaties with its most important trade partners in order to prevent negative consequences as outlined under the topic "Trade Implications not Yet Foreseeable" (page 2). In the first instance there needs to be a bilateral trade agreement with the EU in representation of the 27 member states, subsequently with the other countries in the EEA, as well as all other important trade partners in the perspective of Great Britain. But it is unclear how fast Great Britain can actually close bilateral trade agreements and what costs are looming if there are no bilateral trade agreements after the BREXIT. Even if a lot of agreements can be developed simultaneously, it remains to be expected that it will require many years to rebuild the current contract status. This also will have financial consequences for Great Britain.

Among economists the negative prognoses are clearly in the majority. In the worst case, 950,000 jobs would be destroyed in Great Britain until the end of the decade, the employers' confederation estimates. The economic costs of the BREXIT could reach up to 100 billion Pound (about 130 billion Euro). There are even gloomier predictions: An analysis by the Bertelsmann Foundation together with the Munich-based Ifo Institute came to the conclusion that the BREXIT could cost the British up to 300 billion Euro in prosperity in the long run. A study by the London School of Economics and Political Science (LSE) predicts that the British are threatened by a similarly hard set-back as after the world financial crisis of 2008/2009.

The OECD as well views the BREXIT in a negative light: Depending on the scenario the BREXIT could cost every British household between 1,500 and 5,000 Pound (1,900 to 6,500 Euro) in the future.

Costs for the EU Institutions and Direct Costs for GB Caused by the EU

In contrast, the quantification of costs for the EU institutions due to the exit seems to be easier, for most of the items are indisputable claims for budget items that the British co-signed for.

The amount payable by Great Britain in the context of the BREXIT comprises promises of payment by the British not yet paid that have to be fulfilled until 2019 (period 2014-2019). This pertains to liabilities towards the Cohesion Fund (e.g. the Structural and Regional Funds). To be more exact, it pertains to projects that the British have expressly approved. But there are other legally binding liabilities of general nature that were incurred for investments after 2019. Ignored in this is the co-called British rebate (6 billion Euro).

Due to the liabilities named above, Great Britain can hardly shirk responsibility for paying the costs for the British officials, whereby primarily pension liabilities are the subject. Here it is of consequence that the EU institutions have not created a Pension Fund. About 3.8 % if the officials are British. For this costs of 7.7 billion Euro are projected. Additionally, a balance of 29.2 billion Euro is still payable until 2018.

For the Cohesion Fund at least 13.7 billion Euro become payable for the period of 2019-2020; hereunder for the Cohesion Fund for Agriculture and Fish additionally at least 3.7 billion Euro for the period 2019-2020.

For the Copernicus – Program there are 0.4 billion Euro to be paid. For the “Connecting Europe Facility”, which is to further the connection of Europe on the digital level, there are at least 1.2 billion euro payable.

The European Structural and Investment Funds (ESI Funds) and the European Fund for Strategic Investments (EFSI) also demand fulfilment of contract. The share for the British in this amount to at least 1.9 billion Euro.

Additionally, there are payments due to the European Development Fund and its fiduciary funds in the amount of 1.7 billion Euro.

An absolutely crucial issue though will be the assessment and consideration of existing assets of the EU.

Estimates by the Centre for European Reform assume costs of up to 73 billion Euro for the BREXIT. This estimate is based on a maximum contribution of Great Britain to the EU budget and minimal payments out of it.

Even if Great Britain is contractually obligated, disputes about the amount of payments still to be made and the assessments of assets are to be expected. Even the liabilities towards the Pension Fund have not been accepted by Great Britain.

EU chief negotiator, Michel Barnier, therefore in precaution assesses **the BREXIT costs for Great Britain at 60 billion Euros** based on a medial and realistic scenario.

This amount must not necessarily be paid out at once, but can be paid off over the course of several years.

On the following page you can find Great Britain’s liabilities according to the study “The €60 billion Brexit bill: How to disentangle Britain from the EU budget” by the Centre for European Reform set out in tabular form.

An Overview of BREXIT Costs

	EU end 2018 € billions	UK share (12%) € billions	UK share (15%) € billions
LIABILITIES			
Pension liabilities	63.8	7.7	9.6
Reste à liquider (RAL) end 2018	241.0	29.2	36.2
ESI Funds Cohesion: Outstanding allocation 2019-20	113.0	13.7	17.0
ESI Funds Rural/Fish: Outstanding allocations 2019-20	30.4	3.7	4.6
Copernicus	2.9	0.4	0.4
Connecting Europe Facility	10.1	1.2	1.5
EFSI Capital	16.0	1.9	2.4
European Development Fund and Trust Funds	-	1.7	1.7
TOTAL	**€477.2**	**€59.6**	**€73.3**
CONTINGENT LIABILITIES			
Guarantees/Provisions	23.1	2.8	3.5
EU loans	56.1	6.8	8.4
TOTAL	**€559.7**	**€69.1**	**€85.2**
OFFSET PAYMENTS: UK RECEIPTS			
Assets	22.5	2.7	3.4
UK rebate for 2018 (approx)	-	6.0	6.0
Receipts for UK projects (approx)	9.0	9.0	9.0

METHOD 1: Maximum liabilities, includes contingent liabilities paid upfront, excludes rebate			
UK share of liabilities	-	59.6	73.3
Contingent liabilities (UK share upfront)	-	9.6	11.9
UK receipts	-	11.7	12.4
NET TOTAL		**€57.4**	**€72.8**

METHOD 2: Maximum liabilities, excludes contingent liabilities and rebate			
UK share of liabilities	-	59.6	73.3
UK receipts	-	11.7	12.4
NET TOTAL		**€47.9**	**€60.9**

METHOD 3: Excludes 2019-20 allocations, maximum receipts			
UK share of liabilities	-	42.2	51.8
UK receipts including rebate	-	17.7	18.4
NET TOTAL		**€24.5**	**€33.4**

*ESI (European Structure and Investment)

**EFSI (European Funds for Strategic Investment)

Source: *The €60 billion Brexit bill: How to disentangle Britain from the EU budget*, Centre for European Reform, Feb. 2017.

Position of the TAE

Great Britain will definitely leave the EU. How Scotland and Northern Ireland will act is still open.

From the perspective of the European taxpayers it must be demanded that there shall no longer by any so-called “cherry picking” by Great Britain. It is inacceptable to want to participate in EU programs on one hand and on the other hand not to pay into the EU pot, and it would deliver completely wrong incentives for other EU countries.

The EU must rigorously pursue its interests. It is Great Britain seeking to “divorce” the EU not the other way around. Nevertheless, the highest amount of fairness is called for, because Great Britain was and still is one of the most important trade partners of the EU countries, still belongs to Europe, and thus should remain partner on a par with the EU.

But Great Britain also has to contribute its fair share for a clean separation from the EU, and to fulfil its commitments and payment obligations thus far entered into.

Great Britain has committed itself to proportional take-over of costs in numerous ballots in the Council as well as the Parliament. The European taxpayers in the remaining 27 member states therefore have a right to fulfilment. But Great Britain has already announced that it will not stick to its commitments in the case of failure to reach an agreement, and to act like a non-member by 2019 at the latest.

If Great Britain against expectation should not fulfil the agreement it has voted on itself, it is the opinion of the Taxpayers Association of Europe (TAE) that the EU should also consider economic sanctions for the protection of the remaining 27 member states. For Great Britain not fulfilling the legally indisputable demands named above would be a clear breach of law, but would currently not be enforceable. Therefore respective sanctions would be necessary in this case in order to force Great Britain to fulfil the contract. This stance should be clearly communicated in order to move Great Britain in the direction of a fair solution and separation from the EU from the beginning.

Europe Must not Be Responsible Alone and For Everything
Understanding the Lesson and Drawing Consequences

The BREXIT does not come as a surprise. For years there have been signs that the EU is losing acceptance in its member countries. The European institutions have simply neglected to take the growing discontent of the people with the bureaucracy in Brussels serious. This discontent could be owed to the democratic deficit regarding to decisions made in Brussels, or to the often one-sided and negative reporting of the media about Brussels. Ultimately, the question of responsibility is no longer important. The crucial matter is the result that we are now faced with in the EU; a pile of broken fragments that needs to be put together anew.

After the BREXIT vote a lot was screamed about; reforms were wholeheartedly announced, more public accessibility etc., all along the lines of: “We have understood.” Now, roughly nine months after the decision in Great Britain, it seems as if things simply continued as before, “business as usual” so to say. In the interest of the EU this must not be the case, as it only helps the right-wing and left-wing populists and the enemies of the EU.

As long as Brussels discusses more about questions like the introduction of EU taxes or communitarisation of unemployment benefits, and seizes more and more competencies, instead of finally approaching institutional reforms, not much will change about the existing discontent. The same holds true for the demand of liability of EU countries for the debts of another EU country. The discussion of tax harmonisation is also not suitable to calm Europe, for only tax competition is the guarantee for low taxes.

Fair tax competition is of course important and needs to be guaranteed, but it would be equally important to ensure a more efficient use of funds on EU level.

If wasting of tax funds on the European level is made so easy, because not even a European prosecutor is able to bring charges against the squanderer, most likely the European official, because so far he or she does not have the power to do so, and he or she thus de facto does not exist, this is incompatible with the expectations of the people.

Therefore, before a change in EU revenues is even remotely considered in spite of the BREXIT, EU spending and EU responsibilities need to be put to the test.

The elections in France are coming up now. Therefore, Europe more than ever need reforms as e.g. have been suggested by the European Taxpayers Association since 2001.

The democratic deficit is met with harsh criticism. Of the 28 Ministers in the Council of Ministers, deciding about the weal and woe of Europe, most of the time only one's own minster is known. This also holds true for the group chairman in the European Parliament. The representatives in the EU Parliament are not elected directly, but their position on the party list and the result of the election decides who enters the European Parliament.

Brussels therefore should take the interest of the taxpayers much more into account and should create more proximity than is the case today.

More Power to the National Parliaments in Europe
Daring to Have More Subsidiarity

One has to take the people along again and win back the trust in the EU. More national sovereignty also is part of that.

In the interest of Europe's future the responsibilities of the EU need to be redefined. Subsidiarity and deregulation are paramount in this. The same holds true for the definition of European values and the defence thereof.

But the EU countries as well are called upon. Matters that are able to be managed regionally and nationally should first be managed autonomously. Matters that really can only be resolved in the European level, like a European foreign and security policy or a European immigration policy, must finally be pushed ahead. More Europe where it is necessary, less Europe in points where it is possible. For the EU is much too valuable in spite of all the criticism placed upon it in order to endanger thus European peace and prosperity project.

One thing conceivable is the rights of the national parliaments regarding EU matters being strengthened. Prerequisite for this would be that the European Treaties needed to be adjusted accordingly. But the European Treaties have constitutional level throughout and can only be changed unanimously.

The stronger and more direct influence of national parliaments, e.g. with a blocking minority, would be suitable for creating a bit more proximity to the people. In any case, it could halt the discussions that only irritate and frighten the people in time.

Nevertheless, it would be important to keep the EU voting based on qualified majority according to today's status in order to ensure that a minority of members cannot enforce EU decisions against the majority of the EU population.

Thus, it is important to find the right balance and as fast as possible in order to forestall further exit debates.

Europe is not the problem, but the solution! Unity in diversity, as the founding fathers of the EU formulated it.

Problem Areas and Fields of Action (A-Z)

EU Budget/ EU Funding Policy

- Auditing of proper and complete levying of EU revenues
- Capping of EU subsidies
- Change of promotional practice, e.g. subsidised loans for large-scale projects
- Comprehensive performance audit
- Consistent implementation of and adherence to the principle of subsidiarity: Member states as the ones responsible for the distribution of EU-subsidies while at the same time introducing controlling systems
- Creation of an independent subsidy council
- Definition of objectives/ efficiency directives
- Elimination of subsidy programs the distort competition
- Elimination of the subsidy spiral, no multiple subsidisation
- Harsher penalties for subsidy fraud
- Implementation of a control system
- Promoting structural adjustment, accelerate structural change
- Public registration of subsidy recipients including reason for award
- Re-organise EU budget
  - Reform of EU finances
  - Efficiency audit and in-depth audit
  - Make budget more flexible Budget
  - Cap
- Strengthening of the rights of the EU prosecutor/ EU attorney-general
- Subject promotion instead of object promotion
- Temporal limit and degression of subsidies
- Transparency
- Utilisation of savings effects, e.g. through standardisation

EU Institutions

- Downsizing of EU institutions
  Moving away from the principle "one country, one representative" (e.g. in the Commission or the Court of Auditors). Guaranteeing more national representatives, not more efficiency.
- Strengthening of national participation
- Strengthening of the European Parliament
- Strengthening the legal framework conditions of the European Court of Auditors and of OLAF. This also includes the accompanying auditing instead of the current practice of auditing ex-post, as well as the intensified auditing of proper and complete levying of EU revenues.

Further Policy Areas

- Bureaucracy reduction
- Common European foreign and domestic policy
- Common European immigration policy
- Deregulation
- Maintain tax competition
- No EU tax
- Subsidiarity

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