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www.agribusinessintelligence.informa.com

ISBN: 978-1-910962-90-9

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Introduction - The CAP post-Brexit

While not the major preoccupation of European Union lawmakers in the coming years of CAP development, there is little doubt that the UK's departure from the EU in or soon after 2019 (Brexit) will have a profound effect on the direction and nature of future changes. This is for two reasons: the resulting budget constraints and the removal of a major reforming influence on the debate on future line of development.

Withdrawal of the UK from financing of the Brussels budget will leave a hole in funding amounting to more than 10% of the current budget. In the event of the UK having a partnership with the EU similar to that of the EEA/Norway agreement, or a customs union relationship with the EU, it would be still contributing to the EU budget, but on a lesser scale. Whatever the relationship, overall EU budgetary funds would be reduced.

This will place additional pressure on a policy sector which still consumes close to half of the Union's annual expenditure. The moderating pressure of the UK, in alliance with the Netherlands and the Scandinavian member states, has hitherto been a major factor in the development of a less protective and more open agriculture trade policy. What effect will the absence of the UK from the Council of Ministers have on future policy development?

Whatever trading relationship the UK establishes with the EU27, involvement in the internal agriculture policy will form no part of it. However, the eventual agreement will still mean that both sides will seek to maintain close coordination on regulations on animal welfare and food safety standards, as well as commons standards on labelling, packaging etc. There is unlikely to be any major changes in this area.

But it is not only financial pressures which the Commission and member state governments have to consider. In a world where an increasing proportion of the world's trade, and its agricultural trade in particular, takes place within trade agreements of one sort or another, can the EU afford to be less or more protective of its agriculture?

Environmental issues are also likely to be paramount. Is the Union doing enough to protect its rural environment? Is the current commercial agriculture which dominates most of western and central Europe too extractive and too unfavourable to conservation of flora and fauna and the maintenance of adequate water supplies?

Undoubtedly, the CAP has changed fundamentally in the last three decades – from a restrictive, self-sufficiency oriented approach, concerned principally with maximising domestic production, to one concerned with limiting excessive production and encouraging a more market-focused approach, and with greater concentration on environmental factors.

It however still has far to go in eliminating the financial waste still involved in the blanket payment of largely unconditional subsidies. The European Commission maintains in the introduction to its recent consultations on the future development of the CAP[i] that: "Agricultural prices have fallen substantially and market uncertainty has increased, due amongst others to macroeconomic factors, geopolitical tensions, inhibiting a clear long-term planning of the sector".

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The first part of this statement is undoubtedly true: EU farmgate prices are now closer to world prices than they have ever been since the end of World War II. It is however doubtful if world conditions are currently any less uncertain than they have been in previous post-war decades.

The Commission is also right in proclaiming the death of the multilateral approach to agricultural trade agreements. More than 90% of the world's agricultural trade now takes place within regional or plurilateral trade agreements – a change which has largely taken place since 2001. In its own words: "The emphasis of trade negotiations has moved more visibly from multilateral to bilateral deals, requiring a careful balancing of offensive and defensive interests, with due attention paid to certain sensitive sectors."

The Union's commitment to wider international agreements on climate change and environmental issues also puts the process of agricultural policy formation under additional pressures. The Commission points out that the EU has signed up to new international commitments, especially those concerning climate change (through the 21st Conference of Parties, or 'COP 21') and broad aspects of sustainable development (through the UN's Sustainable Development Goals – SDGs), and is also exposed to other geopolitical developments such as new large-scale migration.

In its consultation document, the Commission summarises what should be the major concerns of future policy development[1]. Implicitly acknowledging that the last CAP reform attempt of 2013 did not go far enough, it says that: "Broader challenges related to the balance of support, the economic prospects for agriculture and rural areas, care for the environment (e.g. greening), action over climate change, sustainable and safe food production have to be faced."

In addition, 'emerging opportunities' in the areas of health, trade, the bioeconomy, the circular economy and the digital economy also need to be tackled. It is very doubtful however whether facing up to these challenges will result in any 'simplification' of the agriculture policy as the Commission intends.

External critics of the CAP regard the continuing payment of direct subsidies to farmers under Pillar 1 of the support policy as a major flaw and a serious obstacle to acceptance of reform by the farming sector. The fact that these subsidies account for over 70% of CAP expenditure and nearly 30% of the entire EU budget make them a prime target for future reforms.

To quote the recent RISE report on the future of the CAP[ii]: "The introduction of these direct payments and their later decoupling from production were important steps in the evolution of the CAP but the impression that they offered farmers a permanent entitlement to such support was a mistake. These payments are ineffective, inefficient and inequitable. They do not serve well the purpose of income support of those most needy, nor do they serve food security, efficiency of resource use, nor the delivery of rural environmental services and

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[1] Quote : "*Against this background, as part of its working programme for 2017, the Commission will take forward work and consult widely on simplification and modernisation of the CAP to maximise its contribution to the Commission's ten priorities and to the Sustainable Development Goals (SDGs). This will focus on specific policy priorities for the future, taking into account the opinion of the REFIT Platform and without prejudice to the next Multiannual Financial Framework. The starting point must be will be a well-founded assessment of the performance of the current policy.*"

moving to a more productive and sustainable agriculture. The conclusion is that they should be systematically reduced and resources switched to provide targeted assistance, including transitional adjustment assistance".

The RISE report summarises well the essential problem of current European agriculture policy: "Despite a generously funded, but badly targeted, agricultural policy and a relatively protective border regime of tariffs and tariff rate quotas, for all but the most efficient and the largest farmers, the wafer-thin margins on agricultural commodity production have left them earnings extremely low returns on capital invested and often with low and highly variable incomes from farming. Farmers therefore operate under intense economic pressures and are subject to much criticism about their environmental performance, and the lavish nature of the CAP".

To most critics of the CAP the direct subsidies are the main flaw in the system and need to be phased out, certainly in their present form. Most importantly, the aims of reform should be to concentrate on better land management, with farm income being protected by risk management measures replacing blanket income subsidies.

It remains to be seen whether the EU27 avoids the development of a more introverted approach to EU agriculture policy development with more protection, greater emphasis on EU self-sufficiency and more restricted spending on structure and environmental policies? It is also possible – but by no means guaranteed - that a budget squeeze will have a beneficial effect on development of future European agricultural policy.

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[i] "Modernising and simplifying the CAP: Summary of the results of the public consultation." European Commission – DG AGRI Brussels, 7 July 2017

[ii] Buckwell, A. et al. 2017. CAP – Thinking Out of the Box: Further modernisation of the CAP – why, what and how? RISE Foundation, Brussels

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Chapter One: The impact of Brexit on the EU budget

Any accurate picture of the impact of Brexit on the future of the EU budget depends upon which form of Brexit is most likely to be applied. Versions range from complete withdrawal from the EU Single Market and Customs Union, to some form of conditional access to either the Internal Market or the Customs Union. In the former case, the calculation is relatively simple: a net loss to Brussels funding of €8-10 billion per annum. The other alternatives would involve some continuing contribution to the common budget. The degree of continuing UK involvement in the EU system would determine the amount.

Considerable concern has been raised in Brussels and some member states that UK withdrawal – particularly in the case of a hard Brexit – would create a serious problem for the EU budget. But other analysts believe that the costs and benefits would to a great extent balance themselves out and result in only a small problem.

A recent CEPS report[i], for example, points out 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”.

The timing of Brexit is crucial for assessing its budgetary impact. The UK is currently scheduled to leave the EU in March 2019 – 21 months before the end of the EU’s current 2014-2020 Multiannual Financial Framework (MFF) period. Brexit would thus mean a loss for the 2020 EU annual budget equivalent to the UK’s total or partial yearly net contribution, which in recent years has amounted to around €10bn a year. The actual size of the loss will depend on the outcome of Brexit negotiations.

CEPS suggests that the negotiations between the UK and the EU27 may persuade the UK to effectively remain an EU member state until the end of 2020. It would thus detach itself from paying into the EU budget as from January 2021, thereby avoiding the need to rush into a cumbersome set-up of domestic regional development grants, securing the sustainability of EU-funded projects and preventing a policy vacuum. The parallel negotiations that the UK could face, covering access to the internal market for goods, services and capital and trade deals with third countries, would also be a good reason to avoid difficult negotiations to exit during the current programming period.

Militating against this approach, however, would be the domestic political pressure on the UK government to ‘deliver’ on Brexit, and the inevitable opposition from anti-EU voices in the UK to the idea of remaining a member state for longer than the two years stipulated in Article 50 of the EU Treaty.

The UK could face domestic pressure to stop all payments immediately after exiting the Union or even before, but the likelihood of this happening is very small. The likely response from the EU27 would be to stop transfers to UK beneficiaries (regions, farmers, researchers). Since a unilateral UK decision to stop payments would be interpreted as an aggressive move in Brexit negotiations, and would worsen the UK’s ability to obtain gains on more important issues, it is unlikely. What is more likely is that the EU27 and the UK would reach an agreement

in which the UK commits to honouring part of the commitments taken under the current MFF in exchange for a progressive phase-out of EU transfers to the UK.

1.1 Calculating the UK's budget contribution

As with all EU member states, the UK's gross contribution to the EU Budget is based on a percentage of its VAT receipts and of its gross national income, plus some customs duties and levies on sugar production. This is the system used to calculate all member states' EU budget contributions and, by and large, has the effect that the larger the country in economic terms, the greater its payment.

The last of the elements of the calculation, sugar duties, is the only remnant of the original 'own resources', based on agricultural levies and customs duties which were responsible for the original imbalance in UK budgetary contributions, whereby the UK paid substantially more into the EU budget than it received. This was the major bone of contention between London and Brussels throughout the 1970s and 80s, and it culminated in the struggle for Prime Minister Margaret Thatcher's 'claim for a rebate for excessive contributions arising from the operation of the CAP. Due to the outcome of this negotiation, uniquely among the Member States, the UK has benefitted from a rebate ('abatement') on its EU Budget contributions ever since 1985.

This is calculated according to a formula which, in essence, traditionally meant that the UK's net contribution was reduced by 66% relative to what it would be without the abatement. However, certain elements from the budget are now excluded from the deduction, including EU overseas aid, and, from 2009, non-agricultural expenditure in new Member States. This contribution to the reconstruction of the ex-communist countries, the effect of which was phased in up to 2011, largely accounts for a sharp increase, more latterly, in the UK's net contribution. This increase was to provide a major plank in the platform of the 'Leave' campaign during the UK's 2016 EU referendum.

The UK's net contribution to the EU Budget in 2014 was estimated at £9.8 billion, up from £3.3 billion in 2008 and £7.4 billion in 2010. It is forecast to fluctuate between £8.0 billion and £9.9 billion a year between 2014/15 and 2019/20.

1.2 Budget impact of UK leaving the EU

On this basis, withdrawal of UK payments would represent a reduction in net contribution of around 12% of the current EU28 total. This reduction implies that the EU27 would either have to increase their own overall contributions to the EU budget by the same amounts, in order to keep spending at current levels, or cut spending to adapt to a reduced income flow.

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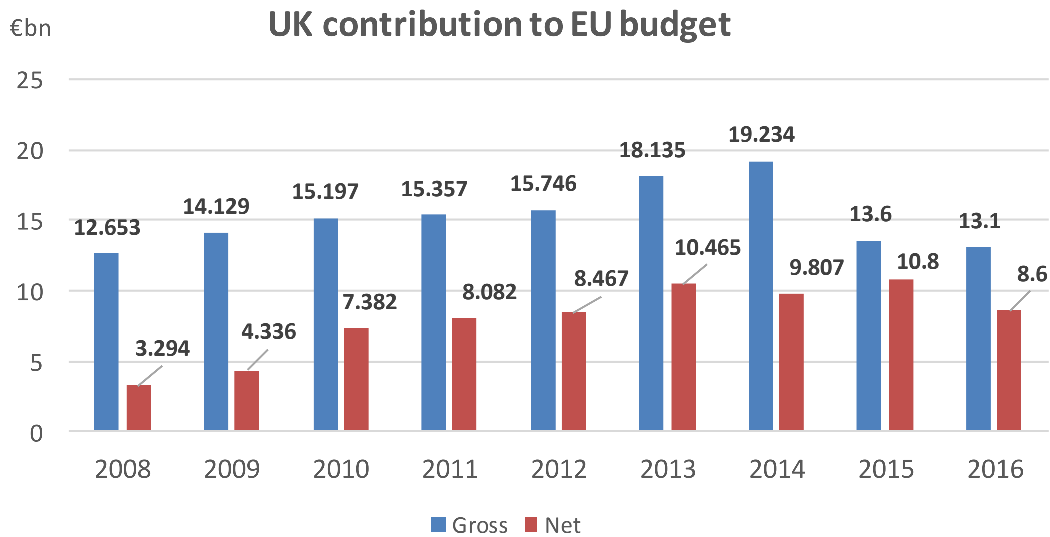
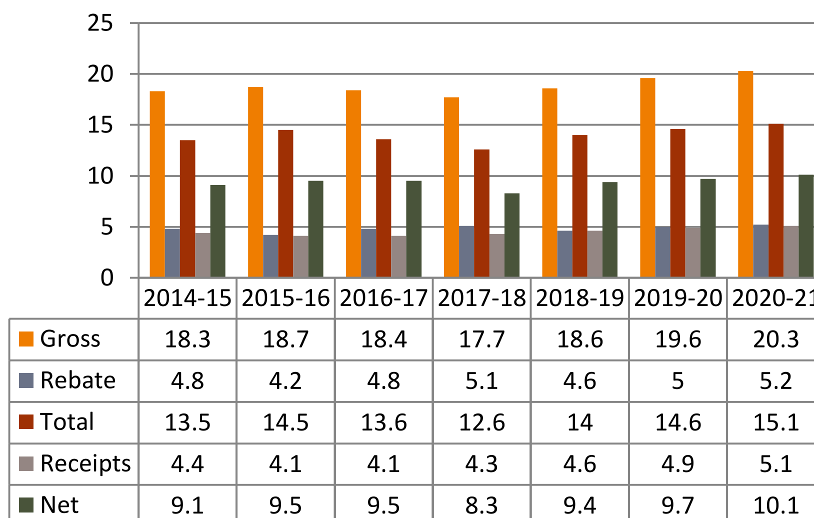


Figure 1: UK contribution to EU Budget

The UK's gains from the EU budget are mainly in the agriculture and rural policy areas. Contributions to the support of UK agriculture under Pillar One of the CAP and taken from the European Agricultural Guarantee Fund (EAGF) in 2014 were €3.12 billion. This total has increased steadily in recent years from €2.5 billion in 2008.

In addition, the UK draws €703 million from the European Agricultural Fund for Rural Development (EAFRD) under Pillar Two of the CAP, plus €337 million from the regional development fund (ERDF).

The UK net contribution could have been expected to continue to rise as a consequence of increasing EU expenditure and static or declining payments to the UK for agricultural support. The UK's net contribution to the EU budget is estimated by the UK Office of Budget Responsibility as likely to have risen by 11% over the seven-year budgetary period to 2020-21 from £9.1 billion to £10.1 billion. This is the figure reached after deduction of the rebate and Brussels' contributions to UK-EU policies.



	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Gross	18.3	18.7	18.4	17.7	18.6	19.6	20.3
Rebate	4.8	4.2	4.8	5.1	4.6	5	5.2
Total	13.5	14.5	13.6	12.6	14	14.6	15.1
Receipts	4.4	4.1	4.1	4.3	4.6	4.9	5.1
Net	9.1	9.5	9.5	8.3	9.4	9.7	10.1

Figure 2: Projected UK contributions to EU budget

Due to the rebate deal, the UK contribution – and therefore the loss for the EU budget resulting from Brexit – is much less than it would have been. It amounts to about €14 billion (including traditional own resources and customs duties), and thus the net figure is only €7 billion. Had the UK left exited on the basis of the 2014 budget, it would have reduced internal EU budget expenditures in the UK by some €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 smaller amounts on other policies.

It is reasonable to consider the actual own resources and operating budgetary budget on the basis of the year 2014 and not to the latest data available, i.e. 2015, because the latter is influenced by an increase in GNI and an appreciation of sterling. These factors make 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 sterling and by the UK rebate which will be compensating for the relatively high 2015 contributions.

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.

1.3 'Hard' and 'soft' Brexit impacts

The Delors Institute[ii] has made calculations on the basis of the UK operating within the EU system as Norway currently does in the EEA. 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.

Such a relationship would reduce the loss for the EU budget to approximately €3.4 billion (2014 budget basis), thus halving the financial benefit for the UK of leaving the EU. This would result in a rather low impact for member states, and for some member states (BG, EE, EL, ES, LV, NL, PT, RO), the overall impact would actually be a reduction in gross contributions. During the present MFF, the impact of UK exit would 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 are likely to continue until final UK detachment in 2023.

Ironically, in the case of a so-called 'hard Brexit' with the UK leaving the single market and operating on WTO trade rules and maintaining its current trade levels with EU, there would be a substantial UK contribution to EU funds through the tariffs which would be imposed on products exported to the EU in line with WTO rules and schedules.

The tariff revenues going to the EU budget could be potentially significant. The value of goods exported to the EU in 2015 was around £220 billion, valued at the present exchange rate at around €255 billion. On the assumption that UK exports to the EU were to remain at present levels, just a 2% average tariff would bring as much as €4.6 billion to the EU budget, after collection fees of 20% deducted by the member states. This would reduce the 'net loss' to approximately €5.5 billion.

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However, the costs of trade disruption have to be taken into account at the member state level. The Delors Institute points out that EU Member States “would be likely to see their national budgets shrink because trade barriers would disrupt production networks and ultimately reduce economic growth”.

Significantly, this results in a situation in which the impact on EU revenue remains rather similar, whether or not the UK participates in the single market; what changes is the radical way in which the UK contributes to the EU budget, from budgetary transfers to tariffs on exports. The so called ‘Brussels burden’ is shifted from the UK taxpayer to exporting traders. Costs tend to affect demand, and thus the financial losses from tariff barriers can easily exceed any ‘net contribution loss’.

A Brexit before the end of 2020 would force the EU27 to revise the current MFF in order to adjust it to the total or partial loss of the UK’s contribution. Such a revision could become hotly contested, even more so as the MFF regulation does not provide exact guidelines for adjustment. Furthermore, the changes to the MFF may have important implications for later negotiations. In the event of no agreement on adjustment of the 2020 annual budget, the levels of spending corresponding to the 2019 budget would be maintained and the gap would be automatically filled through an increase in national contributions.

1.4 Challenges for post-2020 MFF

Apart from the immediate effect, Brexit will have a significant impact on the size, composition and financing of the post-2020 MFF. These structural changes are potentially more important for the EU. The main impacts are likely to be:

- The exit of the UK and the corresponding decrease in the EU’s Gross National Income (GNI) may entail a significant decrease of the EU budget in absolute terms, if the EU Council maintains its position for a budget no higher than 1% of EU GNI;
- The end of the UK rebate will automatically trigger the elimination of the so-called “rebates of the rebate” currently enjoyed by Austria, Germany, the Netherlands and Sweden, and may eventually lead to more substantive changes in the system of own resources;
- Brexit will change the dynamics of budget negotiations in the EU Council. Not only will the removal of the UK’s net contribution alter other Member States’ net contributions, but the exit of one of the most vociferous net payers may affect the internal dynamics within the coalition of net contributors.

The Delors Institute has made calculations on the post-2020 budgetary situation in the EU, on the basis of four assumptions:

- That there are no British national contributions to the EU budget (VAT- and GNI-based), nor is any revenue deriving from TOR (Traditional Own Resources) collected in the UK;
- That there is no EU expenditure in the UK;
- That the ‘rebates on the UK rebate’ will automatically disappear with the end of the UK rebate. The other corrections (reduced VAT call rate, lump-sum corrections) are extended beyond 2020;
- That effects from inflation and exchange rate fluctuations are not taken into account.

On the basis of these assumptions, the EU would have to cope with an overall yearly net revenue loss of €10 billion, or approximately €70 billion over the course of a seven-year MFF period. The EU would save some money as it would have to spend around €7 billion less per year on projects in the UK. But at the same time, it would collect €3 billion less from its Traditional Own Resources (TOR), and would lose €14 billion in direct contributions from the UK government.

Overall If the EU maintained its budget at the current level and used the money currently spent in the UK on other projects, the gap would amount to €17 billion per year, or €119 billion over the course of an MFF.

These are the broad figures arising from a so-called 'hard' Brexit. A situation where the UK still had involvement in the EU system, meanwhile, would inevitably mean that the UK would have to make some payment into the common budget. The real cost to the budget could then be smaller.

If the UK maintained access to some EU initiatives and programmes under a scheme of less than total withdrawal from the internal market and customs union, then it would be likely to keep paying into the EU budget at a reduced level.

Comparison with the case of Norway could give some idea of the likely level. Norway currently pays around 0.25% of its GDP per year through various mechanisms for its partial integration into the European trade and other arrangements. For the UK, this would result in a gross contribution of €5.9 billion per year, according to the Delors Institute.

The Institute sees three ways for the EU to adapt to the €10 billion revenue shortfall. It can:

i. compensate for the shortfall by raising Member State contributions

ii. cut spending

iii. combine spending cuts and increased contributions.

1.5 Four possible scenarios

Basically, therefore, there are likely to be four main scenarios.

1.5.1 Maintaining the level of spending for the remaining EU27 at a constant level

If the EU27 agree to reduce the size of the current MFF only by the amount of EU transfers to the UK, they would need to raise €10 billion in additional revenue. Raising income from increased contributions from Traditional Own Resources and the VAT resource would be difficult, because it would require a reform of the Own Resources Decision. This can only be changed by unanimity, and would need to be ratified by all national parliaments – something which is unlikely to be achieved.

In view of the tight Brexit schedule, therefore, it seems more likely that the Commission would increase national GNI-based contributions instead. It could do so by simply raising the uniform call rate on GNI. Clearly, all Member States would have to pay significantly more, but the burden is likely to be unevenly distributed.

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The countries likely to incur the largest proportionate increases would be those currently benefitting from rebates on the UK rebate. The Netherland's annual contribution would rise by as much as 16.5% (or €760 million), while Germany would pay the highest additional amount in absolute terms (€3.5 bn). The non-rebate countries would see contributions rise by 5-8%, with France being most affected in absolute terms in this group (€1.5 bn). All contributions would increase substantially, while the largest net contributors in particular would be hit hardest. This scenario would therefore be politically very difficult. The introduction of additional rebates could alleviate the problem, but would run counter to years of efforts to simplify the EU's financing. In relative terms, the budget would increase to 1.16% of GNI.

An alternative approach would be to maintain the current EU28 spending level and redirect the money that the UK receives from the EU budget to other areas. The gap in this case would amount to €17 billion per year. If filled via higher contributions, this would lead to increases by as large as 20-25% for the rebate countries and 11-15% for non-rebate countries. In relative terms, the budget would increase to 1.22% of GNI, very close to the 1.23% ceiling fixed in the Own Resources Decision.

1.5.2 Spending cuts

The EU could, to some extent avoid the struggle to increase national contributions through cutting spending. However, €10 billion a year represents a large cut compared to what the EU spends on its most popular projects. This becomes especially clear when looking at those programmes that are widely perceived as providing real added-value at European level. The sum of €10 billion roughly equals:

- the entire budget for European foreign policy ("Global Europe"), plus the budget heading "Security and Citizenship", which includes a wide variety of topics, such as EU action on immigration, consumer protection, and culture, or
- the entire EU research framework ("Horizon 2020") plus the Fund for Asylum, Migration and Integration, or
- all EU spending on competitiveness and growth without Horizon 2020, including popular initiatives such as Erasmus+ and spending on large infrastructure programmes, plus all spending on Security and Citizenship, or
- a 20% cut in the EU's funds for cohesion policy (Structural and Cohesion Funds), or
- a 20% cut in the budget of the CAP.

Although such spending cuts would be distributed over several programme areas, there can be no doubt that they would be painful. They would make it necessary to restructure the budget completely, or find innovative ways to reduce the size of the largest budget headings.

Even after such deep cuts, the relative size of the EU budget would rise slightly, from 1.02% to 1.08% of EU GNI. The increase reflects the fact that the UK contributes more to EU GNI than to the EU budget. Maintaining the current ratio of 1.02% would require spending cuts amounting to more than €23 billion per year. However more likely is that in order to keep Member State contributions stable in absolute terms, Brussels would only go as far as the €10 billion cut.

1.5.3 A combination of increased contributions and budget cuts

A compromise could consist of simultaneous budget cuts and contribution increases that make up for the remaining shortfall. The budgetary implications for most countries would be limited. However, the distribution of the additional burden would be even more unequal than demonstrated by other alternatives, because the expiration of rebates would play a larger role in relative terms. If, for example, the budget was cut by only €5 billion, the relative size of the EU budget would rise to 1.12% of GNI.

1.5.4 No agreement

If the EU27 fail to reach an agreement at the end of 2020, Article 312.4 of the Treaty on the Functioning of the European Union (TFEU) stipulates that "the ceilings and other provisions in place for the final year of the expiring MFF shall be extended until such time as that act is adopted". In practice, this means that the level of spending for 2020 would be maintained until an agreement on the MFF is reached. Whether this benefits net contributors or net recipients depends on the timing of Brexit.

In the event of UK leaving in 2019 or 2020, the spending levels for 2020 would be much lower than today, as the current MFF would have to be revised. Since the corresponding regulation only states that the MFF should be adjusted 'accordingly' in case of Treaty change, there is ample room for interpretation. The choices would be:

i. Spending lowered by 17%, the UK's share in EU GNI;

ii. Spending lowered by €17 billion, the UK's gross contribution to the budget;

iii. Spending lowered by €10 billion, the UK's net contribution;

iv. Spending level maintained.

The decision has to be unanimous, and practicality would force it to be taken while the current MFF is still in force. If the UK quits in 2021 or later, the levels of spending for 2020 would be roughly as projected today.

In summary therefore, withdrawal of the UK from its current relationship with the EU would lead to some loss of revenue to the common budget. The extent of that reduction would clearly depend on the UK's actual future relationship. Whatever happened, the change would force the EU27 to re-order its budgetary arrangements. The choices open to the member states would be principally between cutting expenditure or increasing contributions to the budget by the member states – principally by those who are already major contributors. Such budgetary reorganisation could be a major stimulant of policy reform – particularly in the area of agriculture policy. What some may regard as a welcome stimulant to CAP reform could be cuts in funding of the agriculture policy of as much as 20%.

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[i] "The Impact of Brexit on the EU Budget: A non-catastrophic event." Jorge Núñez Ferrer and David Rinaldi. No. 347, 7 September 2016 Centre for European Policy Studies

[ii] "Brexit and the EU Budget: Threat or Opportunity?" Jörg Haas, Research Fellow, and Eulalia Rubio, Senior Research Fellow, Jacques Delors Institut – Berlin

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