House of Commons

European Scrutiny Committee

Thirty-fourth Report of Session 2017–19

Documents considered by the Committee on 4 July 2018 including the following recommendations for debate:

EU trade deals: EU-Singapore Free Trade Agreement (FTA) and Investment Protection Agreement (IPA)

Report, together with formal minutes

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Notes

Numbering of documents

Three separate numbering systems are used in this Report for European Union documents:

Numbers in brackets are the Committee's own reference numbers.

Numbers in the form "5467/05" are Council of Ministers reference numbers. This system is also used by UK Government Departments, by the House of Commons Vote Office and for proceedings in the House.

Numbers preceded by the letters COM or SEC or JOIN are Commission reference numbers.

Where only a Committee number is given, this usually indicates that no official text is available and the Government has submitted an "unnumbered Explanatory Memorandum" discussing what is likely to be included in the document or covering an unofficial text.

Abbreviations used in the headnotes and footnotes

AFSJ	Area of Freedom Security and Justice
CFSP	Common Foreign and Security Policy
CSDP	Common Security and Defence Policy
ECA	European Court of Auditors
ECB	European Central Bank
EEAS	European External Action Service
EM	Explanatory Memorandum (submitted by the Government to the Committee)*
EP	European Parliament
EU	European Union
JHA	Justice and Home Affairs
OJ	Official Journal of the European Communities
QMV	Qualified majority voting
SEM	Supplementary Explanatory Memorandum
TEU	Treaty on European Union
TFEU	Treaty on the Functioning of the European Union

Euros

Where figures in euros have been converted to pounds sterling, this is normally at the market rate for the last working day of the previous month.

Further information

Documents recommended by the Committee for debate, together with the times of forthcoming debates (where known), are listed in the European Union Documents list, which is published in the House of Commons Vote Bundle each Monday, and is also available on the parliamentary website. Documents awaiting consideration by the Committee are listed in "Remaining Business": www.parliament.uk/escom. The website also contains the Committee's Reports.

*Explanatory Memoranda (EMs) and letters issued by the Ministers can be downloaded from the Cabinet Office website: http://europeanmemoranda.cabinetoffice.gov.uk/.

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Meeting Summary

The Committee looks at the significance of EU proposals and decides whether to clear the document from scrutiny or withhold clearance and ask questions of the Government. The Committee also has the power to recommend documents for debate.

Summary

EU-Singapore Free Trade Agreement (FTA) and Investment Protection Agreement (IPA)

Negotiations for a trade agreement with Singapore began in 2010 and concluded in October 2014. The agreement was eventually 'split' and presented to the Council as two standalone agreements, in line with the Commission's 'new' approach to negotiating and concluding trade agreements:

- an 'EU-only' FTA, covering areas in which only the EU can act, which is subject to Council and European Parliament approval and is expected to enter into force before the UK leaves the EU on 29 March 2019; and

- a 'mixed' IPA, covering investment protection and dispute settlement provisions, which needs to be ratified by individual Member States and is likely to take several years to come into effect.

These agreements raise significant legal and policy issues for the UK, in particular on the UK's approach to investment protection and dispute resolution after UK exit on 29 March 2019. We recommend the proposals for debate in European Committee B.

Not cleared from scrutiny; recommended for debate in European Committee B; drawn to the attention of the Committee on Exiting the EU, the Foreign Affairs Committee and the International Trade Committee

Data Protection and the Council of Europe

These proposed Council Decisions would authorise EU Member States to sign and ratify a Protocol amending a Council of Europe Convention 108 on personal data protection (the Amending Protocol). The UK ratified the Convention in 1985. Authorisation is needed because the EU cannot yet be a party to the Convention, though it covers an area of (mostly) EU exclusive competence. As the envisaged changes to the Convention will enable international organisations to accede, the EU is likely to become a party to the Convention once the Amending Protocol comes into force (all 51 Parties to the Convention have signed). The EU has also been involved in the negotiations of the Amending Protocol, seeking to ensure the Convention's consistency with internal EU data rules, principally the GDPR. The proposals have been published at short notice and are being rushed to Council. The Government initially thought that they would be considered at a Council meeting of 22 June but we understand from officials that this did not happen but that the UK supported the Decision authorising signature of the Convention at the Council meeting of 26 June. We ask the Minister formally to clarify the position but do not seek to take issue with any override given the Minister's proactive apology and explanation of how matters were expedited beyond the Government's control. However,

we ask the Government a number of other questions about competence, transition and Brexit implications in respect of the Convention once the EU also accedes.
Not cleared from scrutiny; further information requested; drawn to the attention of the Digital, Culture, Media and Sport Committee, the Science and Technology Committee, the Joint Committee on Human Rights and the Exiting the EU Committee

Possible financial implications for the UK of the next Multiannual Financial Framework

We discussed the possible financial implications of the EU's next long-term budget (the Multiannual Financial Framework 2021–27) for the UK, in the context of the Government's desire to stay embedded in various EU programmes and agencies. We also considered the possible financial implications of the Government's 'backstop' proposal for the border with Ireland, and any hypothetical extension of the post-Brexit transition period after December 2020. Overall, we concluded that the financial implications of the EU budget after 2021 cannot yet be quantified but could be substantial.

Not cleared from scrutiny; further information requested; drawn to the attention of the Treasury Committee, the Public Accounts Committee and the Exiting the EU Committee

Motor Insurance Directive

We considered a controversial proposal by the European Commission to extend the insurance requirement under EU law to vehicles that are only used on private land, such as tractors and motor sport vehicles. The UK opposes the proposal but it is unclear what level of support it has for its position among other Member States. We also discussed the implications of Brexit for UK residents who are injured in a traffic accident elsewhere in Europe, as the current system—which allows them to pursue compensation in the UK from an overseas insurer—will fall away when the UK leaves the Single Market.

Not cleared from scrutiny; further information requested; drawn to the attention of the Transport Committee and the Treasury Committee

Documents drawn to the attention of select committees:

('NC' indicates document is 'not cleared' from scrutiny; 'C' indicates document is 'cleared')

Digital, Culture, Media and Sport Committee: Personal data and the Council of Europe Convention [Proposed Decisions (NC)]

Exiting the European Union Committee: Personal data and the Council of Europe Convention [Proposed Decisions (NC)]; EU trade deals: EU-Singapore Free Trade Agreement (FTA) and Investment Protection Agreement (IPA) [Proposed Decisions (NC)]; Long-term EU budget 2021–27: financial implications for the UK after Brexit [Proposed Council Regulations (NC)]

Foreign Affairs Committee: EU trade deals: EU-Singapore Free Trade Agreement (FTA) and Investment Protection Agreement (IPA) [Proposed Decisions (NC)]

Home Affairs Committee: EU approval of the Global Compact on Migration [Proposed Council Decisions (NC)]; Establishing a European network of immigration liaison officers [Proposed Regulation (NC)]

International Development Committee: EU approval of the Global Compact on Migration [Proposed Council Decisions (NC)]

International Trade Committee: EU trade deals: EU-Singapore Free Trade Agreement (FTA) and Investment Protection Agreement (IPA) [Proposed Decisions (NC)]

Joint Committee on Human Rights Committee: Personal data and the Council of Europe Convention [Proposed Decisions (NC)]

Public Accounts Committee: Long-term EU budget 2021–27: financial implications for the UK after Brexit [Proposed Council Regulations (NC)]

Public Administration and Constitutional Affairs Committee: The EU Civil Protection Mechanism: strengthening EU disaster management [Proposed Decision (NC)]

Science and Technology Committee: Personal data and the Council of Europe Convention [Proposed Decisions (NC)]

Transport Committee: Motor Insurance Directive [Proposed Directive (NC)]

Treasury Committee: Motor Insurance Directive [Proposed Directive (NC)]; SEPA: cost of cross-border money transfers [Proposed Regulation Amendment (NC)]; Long-term EU budget 2021–27: financial implications for the UK after Brexit [Proposed Council Regulations (NC)]

1 EU trade deals: EU-Singapore Free Trade Agreement (FTA) and Investment Protection Agreement (IPA)

Committee's assessment	Legally and politically important
Committee's decision	Not cleared from scrutiny; recommended for debate in European Committee B; drawn to the attention of the Committee on Exiting the EU, the Foreign Affairs Committee and the International Trade Committee
Document details	(a) Proposal for a Council Decision on the signing, on behalf of the EU, of the Free Trade Agreement between the EU and Republic of Singapore ; (b) Proposal for a Council Decision on the conclusion of the Free Trade Agreement between the EU and the Republic of Singapore; (c) Proposal for a Council Decision on the signing, on behalf of the EU, of the Investment Protection Agreement between the EU and its Member States, of the one part, and the Republic of Singapore of the other part; (d) Proposal for a Council Decision on the conclusion of the Investment Protection Agreement between the EU and its Member States, of the one part, and the Republic of Singapore of the other part
Legal base	(a) and (b): Articles 91, 100(2), 207 and 218(11) TFEU (in accordance with Opinion 2/15 of the Court of Justice of the EU issued on 16 May 2017), in conjunction with 218(5) (on signing) and 218(6) TFEU (on conclusion) (c) and (d): Article 207 TFEU (in accordance with Opinion 2/15 of the Court of Justice of the EU issued on 16 May 2017), in conjunction with 218(5) (on signing) and 218(6) TFEU (on conclusion)
Department	International Trade
Document Numbers	(a) (39638), 7966/18 + ADDs 1–13; COM(18) 197; (b) (39637), 7967/18 + ADDs 1–13; COM(18) 196; (c) (39635), 7973/18 + ADDs 1–2; COM(18) 195; (d) (39636), 7974/18 + ADDs 1–2; COM(18) 194

Summary and Committee's conclusions

Overview—content and expected timeline

1.1 Negotiations for a trade agreement with Singapore began in 2010 and concluded in October 2014. The agreement was eventually 'split' and presented to the Council as two standalone agreements in April 2018, in line with the Commission's 'new' approach to negotiating and concluding trade agreements:[1]

- an 'EU only'[2] free trade agreement (FTA), covering trade and foreign direct investment (FDI)[3] liberalisation (and excluding non-direct foreign (portfolio)[4] investment and investment dispute mechanisms, as these are elements for which the Member States have competence); and
- a 'mixed'[5] investment protection agreement (IPA) covering protection of direct and indirect foreign investment and establishing a tribunal and appeal system to adjudicate investor-State disputes (Investor Court System (ICS)).

1.2 The separation of 'EU-only' trade agreements from 'mixed' investment protection agreements follows the Court of Justice judgment of 16 May 2017 on the balance of competences between the EU and its Member States in the EU FTA with Singapore.[6]

1.3 An EU-Singapore Political Cooperation Agreement, which sets out the broader political framework in which the bilateral EU-Singapore FTA and IPA will function, is being developed in parallel.

1.4 As the EU-only FTA only requires approval of the Council and European Parliament, and does not require formal ratification by individual Member States, the Commission hopes that the EU-Singapore FTA will avoid the delays recently seen in the implementation of mixed agreements such as the EU-Canada Comprehensive Economic Trade Agreement (CETA), where national or regional parliaments have a direct veto. It is expected to enter into force before UK exit on 29 March 2019.

1.5 As the EU-Singapore IPA is a mixed agreement, it will need to be signed and ratified by both the EU and individual Member States in accordance with their domestic procedures, which could take several years.[7] Once ratified, the IPA will replace the 12 existing bilateral investment agreements between Singapore and EU Member States. The UK is one of 12 EU Member States that has a bilateral investment treaty (BIT) with Singapore.

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1 See Council conclusions on the negotiation and conclusion of EU trade agreements of 22 May 2018, also set out in Annex B of the letter from Greg Hands to Sir William Cash dated 11 June 2018.

2 An 'EU-only' agreement comprises 'exclusive EU' competence provisions, which only the EU can exercise and Member States cannot.

3 FDI involves the investor retaining management control of the investment vehicle (e.g. a subsidiary) in the host state.

4 'Portfolio investment' is any investment that is not FDI (see above).

5 A 'mixed' agreement means that there are parts for which the EU is exercising competence and other parts for which Member States are exercising their competence, and must therefore be entered into by both the EU and its Member States in their own right.

6 See the Minister's summary of the Court of Justice Opinion in his letter of 13 July 2017.

7 In the case of the EU-South Korea Free Trade Agreement (FTA), which is also a mixed agreement, completion of the national ratification process in all EU Member States took over four years (source: http://www.europarl.europa.eu/sides/getAllAnswers.do?reference=P-2016–009651&language=EN) .

The Government's position on the EU-Singapore FTA

1.6 The then Minister of State for Trade Policy (Greg Hands) set out the Government's position on the EU-Singapore FTA in his Explanatory Memorandum of 3 May 2018.

1.7 He listed the following "specific benefits for the UK":

> "a) Immediate duty-free access to the Singaporean market for all products.
>
> "b) Advanced regulatory framework and liberalisation across many services sectors, including financial, legal, healthcare, educational and environmental.
>
> "c) Removal or prevention of a number of many technical barriers to trade and non-tariff measures, such as duplicative testing requirements for motor vehicles and parts, electronics, pharmaceuticals and certain green technologies.
>
> "d) Liberalisation of Singapore government procurement market, including with the fostering of 'green' public tendering.
>
> "e) A high level of protection and enforcement of intellectual property rights.
>
> "f) Secured [geographical indication][8] protection for 'Scotch Whisky'."

1.8 On the implications of the proposed FTA in the wider context of the UK's exit from the EU, the then Minister notes the EU's and UK's "shared aim" for international agreements to which the UK is a party by virtue of EU membership to continue to apply to the UK during the Implementation Period and that "… the EU set out in the draft Withdrawal Agreement that the UK should be treated as a Member State for the purposes of international agreements during the [Implementation Period], including the [EU-Singapore FTA]". He also states that the Government will continue to work with the Singaporean Government "on the shape of [their] future bilateral trade relationships to come into effect after the [Implementation Period], which includes "securing continuity of the [EU-Singapore FTA]".

The Government's position on the EU-Singapore IPA

1.9 The then Minister also sets out the Government's position on the EU-Singapore IPA in his Explanatory Memorandum of 3 May 2018. He notes that the UK has a BIT with Singapore, which would be:

- suspended upon its provisional application; however, "Member States are not expected to seek provisional application" and the Commission is "unlikely to propose provisional application while it awaits the outcome of a Belgian reference to the [CJEU] on the ICS provisions of CETA (Opinion 1/17)"; and

8 The World Intellectual Property Organisation defines a geographical indication (GI) as "a sign used on products that have a specific geographical origin and possess qualities or a reputation that are due to that origin. In order to function as a GI, a sign must identify a product as originating in a given place. In addition, the qualities, characteristics or reputation of the product should be essentially due to the place of origin. Since the qualities depend on the geographical place of production, there is a clear link between the product and its original place of production."

- terminated upon entry into force of the new agreement, but it is "unlikely" that the IPA "will enter into force before the UK leaves the EU".

The Government's position on parliamentary scrutiny of trade deals

1.10 The then Minister also refers to "the implications of the change in architecture for parliamentary involvement in the conclusion of the Japan and Singapore agreements", and offers to work with Parliament "to explore ways to ensure that opportunities for thorough scrutiny remain".

The Committee's conclusions and questions to the Government

1.11 **The Committee notes that the proposed FTA is expected to enter into force before the UK leaves the EU on 29 March 2019, but that the proposed IPA is likely to take several years to ratify and is therefore unlikely to enter into force before 29 March 2019. It is not clear whether or when provisional application of the IPA may be put forward and agreed.**

1.12 **The Committee considers that both proposed agreements—notwithstanding their very different timetables for entering into force—have significant legal and policy implications for the UK, both whilst a member of the EU and after its exit:**

- **first, given their economic significance for the UK and the EU, particularly in terms of potentially securing a wider agreement with the Association of Southeast Asian Nations (ASEAN). The Commission describes the EU-Singapore trade and investment agreements as "an important step towards the EU's ultimate goal of a trade and investment agreement with ASEAN";**[9]
- **second, in terms of the proposed FTA's impact on the continuity of UK trade relations with Singapore after UK exit on 29 March 2019, both during any implementation/transition period and as the basis for a future UK-Singapore trade agreement; and**
- **third, given the need to further consider the potential implications of the proposed IPA for UK investment relations with Singapore after UK exit.**

1.13 **We ask the Government to address the outstanding issues identified below within 10 working days:**

Expected impact on the UK of the EU-Singapore FTA

1.14 **The then Minister states that the Government is preparing its own analysis of the EU-Singapore FTA, which it will "make available to Parliament as soon as possible". We welcome the analysis and ask that the Government:**

- **explains what consultations the Government has undertaken or is undertaking in its assessment of the EU-Singapore FTA's likely impact on the UK a) whilst a member of the EU, b) during any transition/implementation period and c) after 31 December 2020;**

9 European Commission Factsheet, 18 April 2018.

- **sets out whether the Government has combined its consultation with UK stakeholders on this EU-Singapore FTA with any consultations on a potential bilateral FTA with Singapore after the end of any transition/implementation period; and**

- **provides a clear breakdown of how different UK sectors and stakeholders are expected to win or lose from the EU-Singapore FTA.**

Continuity of trade relations with Singapore after UK exit from the EU

1.15 **In view of the Government's stated aim "for international agreements (to which the UK is a party by virtue of EU membership) to continue to apply to the UK as now" (after 29 March 2019), we ask the Government to set out:**

- **whether the UK needs to secure the explicit agreement of third countries in order to secure the benefit of EU bilateral agreements during the transition/ implementation period, notwithstanding the provision in the draft Withdrawal Agreement that the UK is to be treated as a Member State for the purposes of international agreements during the transition/implementation period;**

- **whether Singapore has confirmed that it would be prepared to agree to apply the EU-Singapore FTA to the UK during any transition/implementation period, or whether it would seek any concessions in doing so;**

- **what practical effect there would be if the UK met all EU obligations under the FTA without being able to benefit from it;**

- **whether Singapore has indicated that it would be willing to accept continuity of effect of the FTA beyond the transition/implementation period;**

- **whether the UK will be seeking to negotiate a similar or more ambitious FTA with Singapore bilaterally during any implementation/withdrawal period and if so: a) what concessions Singapore might seek; b) what further access to the Singaporean market the UK is likely to seek; and c) whether the EU-Singapore agreement contains any "most favoured nation" provision[10] which would inhibit Singapore giving the UK more favourable terms than the EU;**

- **whether the Government intends to run negotiations for a future UK-Singapore FTA in parallel to, or after conclusion of, the negotiation of the future UK-EU relationship; and**

- **what consideration it has given to the legal and practical considerations of running future UK-Singapore FTA negotiations in parallel to ongoing discussions over the future UK-EU trade and investment relationship.**

10 A most favoured nation provision requires a party to the agreement (in this case either EU or Singapore) to give to the other party any more favourable terms it accords to another state in any other agreement it enters into, as would happen if Singapore gave the UK more favourable terms than in its agreement with the EU.

Investment protection and dispute resolution after UK exit

Clarification on the timetable for provisional application and/or conclusion of the IPA and the Government's position

1.16 **We note the then Minister's assessment that the IPA is "unlikely" to enter into force "before the UK leaves the EU" and that "[a]greeing to the signature and future conclusion of the [EU-Singapore IPA] at this time does not bring the [EU-Singapore IPA] into force". Furthermore, the then Minister's assessment is that provisional application before UK exit is also unlikely. We ask the Government to:**

- **outline the timetable for potential provisional application of the IPA and its conclusion;**
- **confirm that the UK intends to vote in favour of the Council Decisions on signature and conclusion of the IPA and to set out its reasons for doing so. This should include the Government's position on the contents of the proposed IPA, in particular on the proposed Investment Court System (ICS);**
- **share its analysis on the implications of provisional application and/or conclusion of the proposed IPA taking place during any transition/implementation period, including in relation to 'sunset clauses';[11] and**
- **confirm that the Government has not made any submissions to the CJEU on Opinion 1/17 and to share its analysis on the implications of the CJEU finding that ICS in CETA is incompatible with the EU Treaties.**

Clarification on the Government's future investment policy

1.17 **In February 2017, the then Minister stated that the Government believes "it is important to have investor protection in [EU trade agreements]" but it remains unclear what form this should be in.[12] In October 2017, he stated that the Government's stated ambitions are to support an investment dispute resolution process that is capable of delivering fair dispute outcomes in a transparent manner, to ethical standards, and in a cost-effective manner.[13] With just nine months until the UK's departure from the EU, we ask the Government to set out its intended approach to investment protection and dispute resolution after 29 March 2019. In particular, does the Government:**

- **intend to keep or update the UK's current BIT with Singapore after 29 March 2019 or will it seek to replicate the proposed IPA in its future agreement with Singapore (and therefore replace the current UK-Singapore BIT)? We ask the Government to share its analysis on its intended approach;**
- **intend to negotiate further BITs after EU exit and, if so, with whom?;**

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11 Most BITs contain a "sunset clause", providing for their provisions to continue in effect for a specified period following termination. Sunset clauses mean that a state will remain bound by its treaty obligations for a period of time notwithstanding a decision to terminate. The EU-Singapore IPA sets a time limit for subsequent sunset clause provisions in existing BITs of three years (paragraph 3c of Article 4.12), whereas the UK-Singapore BIT has a 10 year sunset clause (http://investmentpolicyhub.unctad.org/Download/TreatyFile/2261, Article 14.

12 Debate in European Committee B on the EU-Canada Comprehensive Economic and Trade Agreement, 6 February 2017, Hansard Online.

13 Explanatory Memorandum dated 5 October 2017.

- **consider that the UK will be more effective than the EU27 in negotiating new investment protection agreements after EU exit, as EU-negotiated IPAs require ratification by all 27 Member States?; and**
- **intend to negotiate the UK's future trade and investment relationship with Singapore at the same time, under 'one umbrella agreement' or to split the trade and investment protection and dispute elements (as for the EU-Singapore FTA and IPA)? If its preferred approach is an integrated trade and investment agreement, what would form its basis—the current EU-Singapore FTA plus the UK BIT with Singapore or the proposed IPA?**

1.18 **In relation to the Commission's proposed Multilateral Investment Court (MIC), which is intended to replace bilateral ICS included in EU level agreements with the EU's FTA partners, the then Minister of State for Trade states that "[t]he Government will actively participate in those [MIC] negotiations as a member of UNCITRAL. We will assess the detail of this proposal as it develops, and will consider the compatibility of any outcome with the UK's interests".[14] Now that negotiations on MIC have started, what is the Government's assessment of whether any resulting MIC might improve the existing investor-State dispute settlement framework in a cost-effective manner? Furthermore, on exit from the EU, will the UK choose to use the MIC as a forum for investor-state arbitration in its future trade agreements, including with the EU?**

Transparency and scrutiny of trade negotiations

1.19 **We consider that transparency in, and effective public and parliamentary scrutiny of, trade negotiations, both while the UK is a member of the EU and after UK withdrawal (when it is able to operate an independent trade policy) are fundamental to ensuring the democratic accountability of trade deals that the UK intends to become party to.**

1.20 **Whilst the Minister reiterates the Government's position on the importance of continued scrutiny by national parliaments of external trade agreements, the means of achieving this remain unclear.**[15]

1.21 **For the negotiation and conclusion of EU trade and investment deals, we ask the Government to set out:**

- **what steps it is taking or intends to take to ensure that Parliament will be able to engage more effectively in the scrutiny of EU deals—in particularly 'EU-only' agreements—while we remain a Member of the EU (until 29 March 2019) and during any transition or implementation period (scheduled until 31 December 2020); and**
- **how the UK Government intends to 'implement' the Council Conclusions of 22 May 2018, which stress the importance of keeping all interested stakeholders, including national parliaments and civil society, informed of the progress and contents of trade agreements under negotiation.**

14 Letter from Greg Hands to the Committee of 29 November 2017.

15 The Government's command paper, Preparing for our future UK trade policy, published on 9 October 2017, states that the Government will "continue to respect the role of Parliament…in preparing for and giving effect to an independent UK trade policy".

1.22 **For the negotiation and conclusion of new UK trade and investment agreements we ask the Government to explain:**

- **whether Parliament will enjoy an equivalent or better level of transparency with regard to the UK's FTA negotiations after UK exit, for example, by publishing its negotiating mandates for future trade and investment agreements?**

- **how the Government intends to give effect to the statement that "Parliament will have a crucial role to play in the scrutiny and ratification of the UK's future trade deals"?**[16]

1.23 **We recommend these documents for debate in European Committee B for the following reasons:**

- **it would provide the only opportunity for Members to scrutinise the Government's position on the EU-Singapore FTA before it is signed and concluded (as the FTA does not require ratification by individual Member States in accordance with their own domestic procedures);**

- **the reasons for the UK agreeing to the signature and conclusion of the EU-Singapore IPA and its implications for future UK-Singapore investment relations and the UK Government's wider approach to investment protection agreements after 29 March 2019 are unclear and urgently need to be addressed; and**

- **it remains unclear what steps the Government intends to take to ensure transparency in, and effective scrutiny of, a) new EU trade deals that the UK enters into before UK exit (and during any implementation/transition period) and b) future UK trade and investment deals after 29 March 2019.**

1.24 **In the meantime, we retain these documents under scrutiny and draw them to the attention of the Committee on Exiting the EU, the Foreign Affairs Committee and the International Trade Committee.**

Full details of the documents

(a) Proposal for a Council Decision on the signing, on behalf of the EU, of the Free Trade Agreement between the EU and Republic of Singapore: (39638), 7966/18 + ADDs 1–13; COM(18) 197; (b) Proposal for a Council Decision on the conclusion of the Free Trade Agreement between the EU and the Republic of Singapore: (39637), 7967/18 + ADDs 1–13; COM(18) 196; (c) Proposal for a Council Decision on the signing, on behalf of the EU, of the Investment Protection Agreement between the EU and its Member States, of the one part, and the Republic of Singapore of the other part: (39635), 7973/18 + ADDs 1–2; COM(18) 195; (d) Proposal for a Council Decision on the conclusion of the Investment Protection Agreement between the EU and its Member States, of the one part, and the Republic of Singapore of the other part: (39636), 7974/18 + ADDs 1–2; COM(18) 194.

16 As stated by the then Minister of State for Trade (Greg Hands) in his letter to the European Scrutiny Committee of 11 June 2018 (p.10, para 3).

Background

Timeline

1.25 Negotiations between the EU and Singapore on this trade deal were launched in 2010 (based on the ASEAN negotiating directives adopted by the Council in 2007, which were then modified in July 2011 to authorise the Commission to open negotiations on investment protection provision within the FTA with Singapore).

1.26 The Commission referred the agreement to the CJEU for an Opinion on competence in 2015, as there was disagreement over whether some of the areas covered by the FTA were Member State, mixed or EU competence. On 16 May 2017, the CJEU issued its opinion (Opinion 2/15), stating that the EU-Singapore FTA also covered shared competences such as investor State dispute settlement and non-direct foreign (portfolio) investment.

1.27 The proposed Decisions on the signature and conclusion of the FTA and IPA were presented to the Council on 18 April 2018.

1.28 The Council Decisions on signature and conclusion of the FTA and IPA are expected to be voted on by the Council on 15 October 2018, ahead of signature at the 12th Asia-Europe Meeting (ASEM) summit which is due to take place on 18–19 October 2018.

Content of the FTA and IPA

1.29 See the Commission's guide to the EU-Singapore FTA and IPA of April 2018 and the then Minister's Explanatory Memoranda of 3 May 2018 on the proposed FTA and IPA, listed above.

The new architecture of EU trade agreements

1.30 On 22 May 2018 Trade Ministers agreed Council Conclusions on the negotiation and conclusion of EU trade deals.

1.31 The Conclusions approve the Commission's plans to propose negotiating directives for EU-only trade deals separately from mixed competence investment agreements "with a view to strengthening the EU's position as a negotiating partner".

1.32 However, Member States stress that, "it is for the Council to decide whether to open negotiations on this basis [… and] it is equally for the Council to decide, on a case-by-case basis, on the splitting of trade agreements". Referring explicitly to the EU's ongoing trade talks with Mercosur, Mexico and Chile, the Conclusions state that those deals "will remain mixed agreements".

1.33 Furthermore, the Council also stresses that national parliaments and civil society must "be kept duly informed" and that the Council will "continue endeavouring to obtain, to the greatest extent possible" a consensus that reflects all Member States' interests.

Continuity of trade relations during the scheduled transition/ implementation period

The draft Withdrawal Agreement of 19 March 2018

1.34 Article 124 of the EU's draft Withdrawal Agreement of 19 March, which has been agreed by the UK (subject to the proviso that "nothing is agreed until everything is agreed") addresses EU external agreements. It provides that:

- The UK may negotiate, sign and ratify agreements with third countries provided that they do not come into effect or apply until after the transition period, unless authorised by the EU; and
- During the transition period the UK shall remain bound by obligations stemming from EU only agreements, EU authorised agreements and mixed EU bilateral agreements.

1.35 A footnote to Article 124 states that "The Union will notify the other parties to these agreements that during the transition period, the United Kingdom is to be treated as a Member State for the purposes of these agreements".

1.36 In the Government's response to the International Trade Committee Report on 'Continuing application of EU trade agreements after Brexit' of 15 May 2018, the Government does not state that third party agreement is necessary:

> "As agreed at March European Council, the EU has stated in the draft Withdrawal Agreement that the UK is to be treated as a Member State for the purposes of international agreements during the Implementation Period.
>
> "It is a process of transition, rather than a new agreement. The EU's notification is expected to cover the UK and all Member States' agreement to this approach.
>
> "In parallel to this, we continue to work bilaterally with partner countries to ensure continuity of effect for our international agreements beyond the Implementation Period.
>
> [...]
>
> "It remains the case that all partner countries are committed to ensuring there is no disruption to our trading relationship. We have a mature relationship with our partner countries, and in discussions cover a range of scenarios to ensure continuity.
>
> "In parallel to arrangements for the Implementation Period, the Government continues the important work with partner countries to ensure continuity of effect of our international agreements beyond the Implementation Period, to avoid any disruption in trade from January 2021 onwards."

Overview of the Investor-State Dispute Settlement (ISDS), Investor Court System (ICS) and Multilateral Investment Court (MIC)

1.37 Following public and political opposition to ISDS provisions in FTAs, given their perceived lack of independence, consistency and transparency, in 2015 the Commission put forward an investor court system (ICS) for each of its new FTAs, beginning with Vietnam and Canada (CETA). The ICS is intended to establish permanent and more independent arbitral mechanisms.

1.38 However, the Commission considers that the ICS fails to deal with the need to maintain consistency of case law and will also become a financial and human resource drain on the EU as the number of individual investment courts established under each new FTA multiplies. In September 2017, the Commission put forward a proposal for the opening of negotiations of a multilateral investment court (MIC)—an international court empowered to hear disputes over investments between investors and States that accept its jurisdiction over their BITs. It would be permanent and independent and consist of a tribunal of first instance and an appeal tribunal. Running costs of the court would be met by the contracting parties, and the Commission estimates that the share apportioned to the EU and Member States would be around €5.4 million (£4.97 million). This compares with the option of maintaining the status quo of ISDS and individual investment courts under each of the EU's new FTAs, which comes to a cost of around €9 million (£8.23 million).

1.39 Further information on, and the differences between, ISDS, ICS and the MIC are set out in the Commission Factsheet of September 2017 on the MIC.

1.40 In his Explanatory Memorandum of 5 October 2017, the then Minister of State for Trade Policy and Minister for London (Greg Hands) indicated the Government's support for "the principle of ensuring investor-state arbitration delivers fair dispute outcomes, is transparent and maintains high ethical standards." He added that the Government will wish to consider whether the proposed MIC "improves the existing investment dispute settlement framework and does so in a cost-effective manner".

Transparency in, and scrutiny of, trade agreements

As a member of the EU (until 29 March 2019) and during any transition/ implementation period

1.41 The Government recognises that the EU's 'new approach' to negotiating and concluding EU trade agreements will have implications for the scrutiny of EU only FTAs by national parliaments:

> "Mixed agreements involving shared competence between the EU and its Member States require ratification by Member States before they can enter into force, whereas EU-only competence agreements do not and enter fully into force following approval and conclusion by the Council and the European Parliament, and ratification by the third-country. In this respect I am aware that concluding FTAs as EU only agreements will have

implications for the involvement of the UK Parliament in concluding EU FTAs, with formal scrutiny ahead of the Council Decisions on signature and conclusion no longer accompanied by a domestic ratification process."[17]

1.42 The Government commits to working with both the European Scrutiny Committee and House of Lords European Scrutiny Committee "to explore ways to ensure that opportunities for thorough scrutiny remain".[18]

Future UK trade and investment agreements

1.43 The Government's command paper, Preparing for our future UK trade policy, published on 9 October 2017, states that the Government will "continue to respect the role of Parliament…in preparing for and giving effect to an independent UK trade policy".

1.44 It remains unclear how parliamentary scrutiny of UK trade negotiations (after 29 March 2019) will function, or what specific undertakings the Government will undertake to ensure a meaningful and transparent scrutiny framework.

Previous Committee Reports

None.

17 Para 4, p.2 of Correspondence from Rt Hon Greg Hands to Sir William Cash (Chairman of the European Scrutiny Committee) dated 2 May 2018 .

18 Para 2, p.3 of Correspondence from Rt Hon Greg Hands to Sir William Cash (Chairman of the European Scrutiny Committee) dated 2 May 2018 .

2 The EU Civil Protection Mechanism: strengthening EU disaster management

Committee's assessment	Legally and politically important
Committee's decision	Not cleared from scrutiny; further information requested; drawn to the attention of the Public Administration and Constitutional Affairs Committee
Document details	Proposed Decision amending Decision No 1313/2013/EU on a Union Civil Protection Mechanism
Legal base	Article 196 TFEU, ordinary legislative procedure, QMV
Department	Cabinet Office
Document Number	(39265), 14884/17, COM(17) 772

Summary and Committee's conclusions

2.1 The EU Civil Protection Mechanism enables Member States to coordinate their response to natural and man-made disasters within and beyond the EU. It was overhauled in 2013 to strengthen the focus on disaster prevention and risk management and enhance the collective operational capacity of the EU and Member States to plan for and respond to disasters. The Emergency Response Coordination Centre is the operational hub of the Mechanism. It is supported by a voluntary pool of resources committed in advance by Member States to respond to emergencies (the European Emergency Response Capacity).

2.2 The EU Civil Protection Mechanism is funded until the end of 2020. A new funding instrument will be needed to continue the Mechanism beyond 2020. The Commission considers that changes need to be made before then to increase the assets available to the Mechanism so that it can respond at times when Member States' own capacities are stretched to their limits. The proposed amending Decision would make "targeted changes" to the EU Civil Protection Mechanism which are intended to address capacity gaps and ensure that the Mechanism is equipped to respond to a range of emergency situations. The Commission proposes a dual system based on "two complementary pillars":

- a European Civil Protection Pool which would operate in a similar way to the existing voluntary pool, but with additional incentives for Member States to "pre-commit" their own disaster response capacities so that these assets are more readily available in an emergency; and

- a new dedicated reserve of EU-acquired and funded response capacities—*rescEU*—which would provide "a last resort capacity" that could be mobilised immediately and (unlike assets provided by Member States) would be under the Commission's operational control.

2.3 Our earlier Reports listed at the end of this chapter provide a detailed overview of the changes proposed by the Commission. When we last considered the proposed Decision in April, we asked the Government for further information on the extent of the EU's competence to act in the field of civil protection (the relevant powers are contained in Article 196 of the Treaty on the Functioning of the European Union—TFEU), as well as the need for and "added value" of a dedicated reserve of EU response capacities (*rescEU*), and the broader policy and Brexit implications of the changes envisaged to the EU Civil Protection Mechanism. In his letter of 17 April 2018, the Minister for Implementation at the Cabinet Office (Oliver Dowden) told us that:

- the Government does not consider that Article 196 TFEU gives the Commission the power to make decisions on the deployment of assets and exercise command and control of assets on the ground;
- whilst there may be a shortage of capability to deal with forest fires, the lack of an Impact Assessment accompanying the Commission's proposal means that the Government "cannot take a view on whether there is a shortfall in capacity at the European level in all of the areas identified" or whether the solution proposed by the Commission is the most cost-effective means of addressing any shortfall;
- the Government's view remains that national governments are primarily responsible for planning to ensure that all natural and man-made risks are managed appropriately—action at EU level should not undermine or be a substitute for Member States' own investment in core civil protection capabilities;
- assets should not be directly owned or operated by the Commission;
- any assistance provided to the European Civil Protection Pool "must be in the spirit of voluntary cooperation" and there should be "no compulsion" to provide assistance or more onerous conditions placed on the withdrawal of assets from the Pool;
- there should be flexibility to co-finance assets provided by Member States which do not form part of the European Civil Protection Pool; and
- the Government sees "clear benefits" in cooperating with the EU on civil protection post-exit, but its position may be affected by any changes made to the current EU Civil Protection Mechanism.

2.4 The Minister indicated that many Member States had expressed similar views to the UK on *rescEU* and the European Civil Protection Pool.

2.5 We questioned whether the distinction the Minister drew between the setting up of *rescEU* (which would, in his view, be in line with Article 196 TFEU) and giving the Commission the power to make decisions on the deployment of *rescEU* assets and exercise command and control over them (which would not) was sustainable. We suggested that if the EU had the power to establish its own autonomous disaster response capability, it would seem to follow that it must also be able to decide when and how to deploy it. We asked the Minister to explain how decisions on the deployment of *rescEU* assets should be taken and who should exercise command and control over them, given that the assets would not be the property of individual Member States. We also requested progress reports on negotiations within the Council and a summary of the Government's position on the changes sought by the European Parliament.

2.6 In his letter of 6 June 2018, the Minister reiterates the Government's position that *rescEU* assets should be owned by the Member State hosting them and that the ultimate decision on their deployment should rest with that State, particularly if its personnel are involved. The European Parliament broadly supports the Commission's proposal, but some MEPs question whether the Commission should own specific civil protection assets, such as field hospitals, and echo concerns voiced by the UK and other Member States about the impact of the proposal on state sovereignty.

2.7 The Minister expects trilogue discussions to begin as soon as the Council agrees its negotiating mandate (officials have indicated that this could be in July). He says that the Government intends to work constructively with the Council Presidency and the Commission to agree "a mutually beneficial and efficient compromise" which is "proportionate, cost-effective and in line with the voluntary and Member State-led principles underpinning the EU Civil Protection Mechanism". The Minister notes that the UK "is amongst several other Member States in arguing that Member States should maintain ownership and deployment of *rescEU* assets" and that financial incentives (such as EU co-financing of transport assistance) should continue to be available to Member States deploying assets through the EU Civil Protection Mechanism, even if these assets have not been pre-committed to the European Civil Protection Pool.

Our Conclusions

2.8 **We are content with the Minister's response, although it is not clear how the compromise being contemplated by the Presidency would make much difference, in practice, to the way in which the current EU Civil Protection Mechanism operates or succeed in filling existing capability gaps. We understand that the Presidency's compromise text may be considered by Coreper later this month and, if agreed, provide the Council's mandate for trilogue negotiations to begin with the European Parliament. We ask the Minister to report back on the outcome of deliberations within Coreper and to explain how any compromise text agreed differs from the Commission's original proposal and addresses the Government's key concerns. Meanwhile, the proposed Decision remains under scrutiny. We draw this chapter to the attention of the Public Administration and Constitutional Affairs Committee.**

Full details of the documents

Proposed Decision amending Decision No 1313/2013/EU on a Union Civil Protection Mechanism: (39265), 14884/17, COM(17) 772.

The Minister's letter of 6 June 2018

Competence to act

2.9 The Minister sets out the Government's position on the limits of the EU's competence under Article 196 TFEU:

> "The Government's view is that whilst the Commission's intent to create *rescEU* is in line with Article 196 TFEU because it supports and

> complements the activities of Member States, decisions on deployment and command and control over assets by the Commission exceeds the limits of the Commission's competence under Article 196 TFEU."

2.10 Responding to our concern that conferring a power on the EU to establish an autonomous disaster response capacity without also conferring a power to decide when and how to use it may not be sustainable, the Minister observes:

> "The Commission's proposal for *rescEU* states that the Commission will 'acquire, rent, lease and/or otherwise contract capacities via Member States to be deployed'. The Commission will then maintain ownership of *rescEU* assets which would be hosted by Member States.
>
> "The UK and other Member States do not support this proposal, and continue to work with the Presidency and the Commission on a pragmatic compromise, which ensures that the outcome is a new level of emergency asset at the European level, ensuring that countries with critical needs can access support during emergencies. The UK is one of a number of Member States that believes this can be achieved with a system in which *rescEU* assets are not only hosted by Member States but ownership of assets is maintained by those Member States hosting the asset. Assets may be acquired, rented or leased via joint procurement with the Commission with clear procurement rules, which set out Member States' ownership. Similarly, in the case of deployment, whilst we support deployment decisions over *rescEU* assets being taken by the Commission in consultation with Member States, the Government is of the view that the ultimate decision should remain with the Member State hosting the *rescEU* asset, particularly where deployment of Member States' personnel is involved."

The European Parliament's position

2.11 The European Parliament's Committee on Environment, Public Health and Food Safety (ENVI) has agreed its position and is "broadly supportive" of the Commission's proposal:

> "MEPs voted for a report which was supportive of the Commission's substantive proposals (creation of *rescEU*; Commission-owned or operated assets; better linkage between prevention/preparedness and response activities), but suggested some amendments in the margins (linkage to the Erasmus programme to establish common training; references to climate change, the importance of risk reduction activity and risk-aware investment, and better communication of EU-funded activity)."

2.12 The Minister adds that "a number of MEPs have expressed scepticism over the Commission's proposal to own specific civil protection assets such as field hospitals and have shared concerns about the potential impact of the proposals on state sovereignty when dealing with natural disasters within their own borders—a concern echoed by the UK and other Member States".

Progress of negotiations within the Council

2.13 The Minister reports "steady progress" in the official-level Working Party on Civil Protection. A majority of Member States (including the UK) broadly supported a compromise text put forward by the Presidency in May but agreed that further work was needed. The compromise addresses the Government's concerns "by ensuring proposals are proportionate, cost-effective and in line with the voluntary and Member State-led principles underpinning the Union Civil Protection Mechanism". He adds:

> "The UK is amongst several other States in arguing that Member States should maintain ownership and deployment of *rescEU* assets and financial incentives (i.e. transport co-financing for deployment of assets) are maintained for both assets pre-committed and not committed to the European Civil Protection Pool."

Previous Committee Reports

Twenty-fifth Report HC 301–xxiv (2017–19), chapter 2 (25 April 2018) and Eleventh Report HC 301–xi (2017–19), chapter 2 (24 January 2018).

3 Personal data and the Council of Europe Convention

Committee's assessment	Legally and politically important
Committee's decision	Not cleared from scrutiny; further information requested; drawn to the attention of the Digital, Culture, Media and Sport Committee, the Science and Technology Committee, the Joint Committee on Human Rights and the Exiting the EU Committee
Document details	(a) Proposal for a Council Decision authorising Member States to sign, in the interests of the EU, the Protocol amending the Council of Europe Convention for the Protection of Individuals with regard to the Automatic Processing of Personal Data (ETS. No 108) ("the Convention"); (b) Proposal for a Council Decision authorising Member States to ratify, in the interests of the EU, the Protocol amending the Convention
Legal base	(a) Article 16 TFEU in conjunction with Article 218(5) TFEU:—; QMV (b) Article 16 TFEU, in conjunction with Article 218(6)(a)(v) TFEU; EP consent; QMV
Department	Digital, Culture, Media and Sport
Document Numbers	(a) (39867), 9765/18, COM (18) 449; (b) (39866), 9766/18, COM (18) 451

Summary and Committee's conclusions

3.1 The EU is not a member nor observer of the Council of Europe as neither status is open to non-States. The 28 EU Member States are members but the EU has been able to accede to certain Council of Europe Treaties[19] where these are open to international organisations.

3.2 Convention 108 of the Council of Europe on the protection of individuals with regard to the automatic processing of personal data came into force in 1981. It was ratified by the UK in 1985. It required acceding States to incorporate data protection measures into national law. For many years, the Convention has been the leading international legal instrument on personal data protection. The 1995 EC Data Protection Directive (which the UK's Data Protection Act 1998 transposed) took Convention 108 as its starting point.

3.3 Work on negotiating a Protocol to amend and modernise the Convention started in 2010. The Commission put forward a negotiating mandate for consideration by EU Member States in 2013. The mandate gave the EU[20] the ability to negotiate on behalf of all EU Member States in areas where it had competence. An Amending Protocol was adopted

19 For a list of Council of Europe Treaties which the EU has either signed or ratified, see this Treaty List as of 20 June 2018.

20 With the Commission as negotiator.

by the Council of Europe on 18 May 2018.[21] The proposed Council Decisions will provide EU authorisation for the Member States to sign and ratify the Amending Protocol. The proposed Decision for ratification also requires the consent of the European Parliament.

3.4 The Amending Protocol will therefore be an example of an EU-authorised agreement. These are entered into by the Member States on behalf of and under the instructions of the EU, because the agreement covers matters of exclusive EU competence but is only open to state parties. Article 124(1) of the EU's draft Withdrawal Agreement of 19 March, which has been agreed by the UK[22] states that during the transition/implementation period, the UK shall remain bound by obligations stemming from such EU authorised agreements.

3.5 The Amending Protocol aims to strengthen data protection as a fundamental right in the Convention; to achieve a balance with other fundamental freedoms (freedom of expression); to address challenges to privacy resulting from the use of new technology; to promote consistency with other legal frameworks such as the General Data Protection Regulation (GDPR)[23] and the Law Enforcement Directive[24] and to enhance the Convention's monitoring mechanisms. Changes would also enable international organisations to be parties.[25] This means that once the Amending Protocol has entered into force after ratification by all existing parties,[26] the EU could itself accede to the new amended Convention.

3.6 The Minister for Digital and the Creative Industries (Margot James) has submitted both an Explanatory Memorandum (EM) and a letter, both dated 19 June.

3.7 Her letter seeks to explain and apologise for short notice of the proposed Council Decisions. These were slated for agreement in the ECOFIN Council meeting of 22 June to enable Member States to sign the Amended Protocol once opened for signing on 25 June. The Minister further explains that negotiation of the Amending Protocol itself had been slow and it was not agreed before May. Due to the late publication of the proposed Council Decisions, the timeline leading up to the signing of the Amending Protocol is "quite short". This was despite pressure from the UK and other Member States for earlier publication of the Council Decisions to allow more time for national and Parliamentary consideration.

21 See the announcement on the128th Session of the Committee of Ministers (Elsinore, Denmark, 17–18 May 2018) Council of Europe website. The final text of the Amending Protocol which revises Convention (CM/Inf (2018)15-final).

22 Subject to the condition that "nothing is agreed until everything is agreed".

23 Regulation (EU) 2016/679 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Protection Regulation).

24 Directive (EU) 2016/680 on the protection of natural persons with regard to the processing of personal data by competent authorities for the purposes of the prevention, investigation, detection or prosecution of criminal offences or the execution of criminal penalties, and on the free movement of such data, and repealing Council Framework Decision 2008/977/JHA.

25 Article 27—Accession by non-member States or international organisations: "After the entry into force of this Convention, the Committee of Ministers of the Council of Europe may, after consulting the Parties to this Convention and obtaining their unanimous agreement, and in light of the opinion prepared by the Convention Committee in accordance with Article 23.e, invite any State not a member of the Council of Europe or an international organisation to accede to this Convention by a decision taken by the majority provided for in Article 20.d of the Statute of the Council of Europe and by the unanimous vote of the representatives of the Contracting States entitled to sit on the Committee of Ministers".

26 Convention 108 is open to all countries in the world and currently has 51 States Parties, namely the 47 Council of Europe Member States plus Uruguay, Mauritius, Senegal and Tunisia (by order of accession, Tunisia becoming a Party on 1 November 2017). Argentina, Burkina Faso, Cape Verde and Morocco have also been invited to accede and Mexico has recently submitted an accession request.

The UK supports the Amending Protocol and intends to become a signatory. Given the short notice she does not seek clearance or a scrutiny waiver but asks for the Committee's understanding that circumstances have been beyond the Government's control.

3.8 In her EM, the Minister makes the following key points:

Competence

- The Commission has only authorised Member States to sign in the interests of the Union "insofar as its provisions fall within Union competence" and does not assert exclusive external competence in relation to the Amending Protocol and Convention. The EU's external competence derives from the fact that the Amending Protocol could affect internal rules on data protection—principally the GDPR and the Law Enforcement Directive.[27]

- The proposed Decisions are therefore to be adopted on the basis that competence is shared and the Amending Protocol will be concluded as a mixed agreement.[28]

- The Convention and Amending Protocol cover certain aspects of data processing such as national security, which fall outside the scope of EU law. The Government considers that the UK retains competence to act in those areas but it was alone in opposing the mandate which was subsequently adopted by QMV.

Policy Implications:

- The UK participated fully in the drafting of the Amended Protocol. It welcomes the increased level of data protection through alignment with the GDPR.

- The new Data Protection Act 2018[29] (the Act) includes a power to make any necessary amendments to comply with the modernised Convention once it is in place. Prior to ratification of the Amending Protocol this power will be used to make any necessary amendments to align those parts of the Act which are outside of the scope of EU law with the Amending Protocol.

Brexit implications

- Convention 108 is specifically referenced in the GDPR[30] as being a key consideration when the Commission is assessing a third country's data protection standards for the purposes of a data adequacy decision. Supporting the modernised Convention would send a strong message of the UK's commitment to high data protection standards, to the Commission and other Member States.

- The Amending Protocol will automatically continue to apply to the UK post exit, assuming UK ratification.

27 See external competence based on Article 3(2) TFEU. As this competence, derived from extensive internal rules, is exclusive, the risk that the EU is exercising any "shared competence"(where either the EU or the Member State can act) is low.

28 A mixed agreement is where both the EU and Member States exercise competence.

29 See Section 183. The Data Protection Act 2018 implements the Law Enforcement Directive and makes changes to UK law to enable the UK to comply with the GDPR.

30 We assume the Minister means Article 45(2)(c) of the GDPR in conjunction with Recital 105, "the third country's accession to the Council of Europe Convention of 28 January 1981 for the Protection of Individuals with regard to the Automatic Processing of Personal Data and its Additional Protocol should be taken into account".

3.9 **Given the short notice of the potential agreement of these proposed Council Decisions, we were unable to consider them in time for any clearance or scrutiny waiver before the Council meeting of 26 June (not the 22 June as the Minister expected) at which we understand the UK supported the proposed Decision authorising signature of the Convention.[31] We further understand from officials that the European Parliament is not expected to give its consent to the proposed Council Decision authorising Member States to ratify the Amending Protocol until the Autumn.**

3.10 **We therefore ask the Minister to write to us to:**

- **confirm our current understanding, informed by officials, that the proposed Council Decision on signing was due to be considered at a Council of 26 June and if so, how the UK voted;**
- **clarify that the proposed Council Decision authorising Member States to ratify is being postponed until the Autumn to tie in with the necessary consent of the European Parliament being obtained, meaning that Member States are unlikely to be able to sign the Convention until then.**

3.11 **In the event that the Minister formally confirms that the UK did override scrutiny on 26 June in respect of the proposed Council Decision for signature, we are unlikely to take exception given the Minister's advance explanation and the fact that the Convention is aligned with the GDPR which already applies to the UK. But we ask the Minister to keep us informed of progress towards the adoption of the Council Decision for ratification and the eventual signing of the Convention by the UK. We ask that any request for clearance or scrutiny waiver be made with plenty of notice.**

3.12 **We also ask the Minister to respond to the following questions:**

- **We note the UK's position that EU competence in the data protection field does not extend to national security. Did the UK attempt to gain any recognition in the texts of the proposed Council Decisions or lay a minute statement to this effect?**
- **It is our understanding that** Council Rules of Procedure[32] **require 16 days' notice of items being placed on the agenda. If this notice has not been given, then unanimity is required for the Council to proceed to consider the item.[33] Could you please confirm that these rules were followed in relation to the expected consideration of the proposed Decisions at the JHA Council meeting of 26 June?**

31 We note from the agenda that is it only the proposed Council Decision on signing that is due to be considered at the General Affairs Council of 26 June.

32 Article 3(1) of the Council Rules of Procedure provide: "The provisional agenda shall contain the items in respect of which a request for inclusion on the agenda, together with any documents relating thereto, has been received by the General Secretariat from a member of the Council or from the Commission at least 16 days before the beginning of that meeting". Article 7 then provides "The agenda shall be adopted by the Council at the beginning of each meeting. The inclusion in the agenda of an item other than those appearing on the provisional agenda shall require unanimity in the Council".

33 Article 3(7) of Rules of Procedure provides "The agenda shall be adopted by the Council at the beginning of each meeting. The inclusion in the agenda of an item other than those appearing on the provisional agenda shall require unanimity in the Council".

- **We tend to agree with the Minister's understanding that the Amending Protocol and Convention will continue to apply to the UK "post exit" (by which we assume she means after 29 March 2019): during the proposed transition/implementation period and after. To what extent, if at all, does the Minister consider that the position might change if the EU becomes a party to the Convention itself, as is expected? Does the Minister consider that the legal position in relation to mixed multilateral agreements, where the EU and the Member States in their own right are both parties to a multilateral agreement is clearly addressed in the draft Withdrawal Agreement?**

- **We also understand when the Minister says that continued adherence to the Convention would be helpful in securing a data-sharing arrangement with the EU, such as an adequacy decision. Will continued adherence to the Convention indirectly keep the UK aligned with EU data protection rules given that the EU may be an influential future party to the Convention? Does the Minister consider that the Convention could also assist in securing data-sharing arrangements necessary for trading with non-EU third countries, as part of future trading arrangements?**

3.13 **In the meantime, we retain these documents under scrutiny. We draw this chapter and these documents to the attention of the Digital, Culture, Media and Sport Committee, the Science and Technology Committee, the Joint Committee on Human Rights and the Exiting the EU Committee.**

Full details of the documents:

(a) Proposal for a Council Decision authorising Member States to sign, in the interest of the EU, the Protocol amending the Council of Europe Convention for the Protection of Individuals with regard to the Automatic Processing of Personal Data (ETS. No 108): (39867), 9765/18, COM(18) 449; (b) Proposal for a Council Decision authorising Member States to ratify, in the interest of the European Union, the Protocol amending the Council of Europe Convention for the Protection of Individuals with regard to the Automatic Processing of Personal Data (ETS.No.108): (39866), 9766/18, COM(18) 451.

Previous Committee Reports

None.

4 Motor Insurance Directive

Committee's assessment	Legally and politically important
Committee's decision	Not cleared from scrutiny; further information requested; drawn to the attention of the Transport Committee and the Treasury Committee
Document details	Proposal for a Motor Insurance Directive amending Directive 2009/103/EC
Legal base	Article 114 TFEU; ordinary legislative procedure; QMV
Department	Transport
Document Number	(39804), 9365/18 + ADDs 1–2, COM(18) 336

Summary and Committee's conclusions

4.1 Forty-eight countries in Europe and North Africa participate in the international 'Green Card' system, a certificate proving valid motor insurance when crossing the borders of participating countries. It also allows the victim of a motor accident caused by a visiting vehicle from another participating country to pursue their claim for compensation domestically, via the Insurers' Bureau[34] of the country where the accident occurred, without having to pursue a claim in the country where the vehicle that caused the accident is registered.[35] Moreover, the claim would be settled according to the legislation of the country where the accident occurred.

4.2 Within the European Economic Area, of which the UK is part by virtue of its EU membership, the Motor Insurance Directive (MID) builds on the Green Card system (see paragraphs 4.20 to 4.25 below), notably by:

- Establishing a mandatory insurance requirement for motor vehicles, and setting minimum level of third party liability insurance coverage for drivers to protect victims of accidents, including mandatory cover of material damage (in addition to personal injury);
- Requiring Member States to establish a compensation body for victims of motor accidents where the vehicle is uninsured or untraceable;
- Allowing for border controls on motor insurance (which are compulsory under the 'Green Card' scheme) to be abolished, because the Member States have agreed that, if an uninsured vehicle from their country causes an accident in another participating country,[36] its national Insurers' Bureau will pay the victims compensation instead; and

34 The Insurers' Bureau is a consortium of all domestic insurers which issue motor insurance.
35 For example, a vehicle from Ukraine causing an accident in Poland would allow the victim in Poland to lodge their claim for compensation from the driver's *Ukrainian* insurer with the *Polish* Insurers' Bureau, who would then liaise with its Ukrainian counterpart.
36 Switzerland, Serbia and Andorra—the so-called 'Section III' states—have made a similar commitment, and as such vehicles from those countries can be driven freely throughout EEA without needing to show a 'Green Card' at the border.

- Establishing a unique scheme for 'visiting victims', where someone is the victim of a motor accident when visiting another 'Green Card' country (but only where the victim and the responsible vehicle are from the EEA). The scheme allows the injured party to pursue their compensation claim against the driver's insurer in their home country, without having to deal with a foreign insurer or legal system.

4.3 In May 2018, the European Commission tabled a proposal for significant amendments to the Motor Insurance Directive, which would mark the first substantial changes to the legislation since 2005. The Commission based its proposal on an evaluation of the legislation, as well as a series of judgements by the European Court of Justice about the types of vehicles and situations where the compulsory insurance requirement applies. Notably the proposal would codify the *Vnuk* judgement, under which even vehicles used on private land, such as tractors and motor sports vehicles, must have a valid insurance policy. By extension, each Member State's national Insurers' Bureau would be liable to pay compensation if such a vehicle was involved in an accident but was uninsured.

4.4 The other elements of the proposal relate to the use of claims histories when purchasing insurance; protection of victims where a driver's insurer goes insolvent; the equalisation of minimum cover levels across all EU countries; and a framework for national authorities to check the validity of the insurance of vehicles entering their territory using technology such as ANPR. We have set out the substance of the Commission proposal in some detail in "Background" below.

4.5 The Minister for Transport (Jesse Norman) submitted an Explanatory Memorandum on the proposal on 20 June 2018.

4.6 The Government appears broadly supportive of the changes the Commission has proposed, with the notable exception of the codification of the *Vnuk* judgement. Extending the scope of the mandatory insurance requirement to vehicles used only on private land, the Minister says, raises the possibility that motorised children's toys and ride-on lawnmowers could require insurance. The UK's position is that vehicles not driven on public roads should not be regulated at EU-level, since they "very rarely cross into another Member State's territory". The Government estimates that the proposed change would cumulatively increase insurance premiums in the UK by £2 billion per year, of which almost half—£800 million—would be to account for "additional fraudulent claims on private land". This, the Minister says, translates into an average increase in individual premiums of nearly £50 per annum. The European Commission's impact assessment for its proposal acknowledged these estimates, but added that these "calculations [were] based on internal figures and models that the Commission was not able to verify in detail".[37] It also appears some other Member States, including France, already apply the insurance requirement to vehicles on private land.[38]

4.7 With respect to the implications of Brexit for the UK's participation in the systems for cooperation between national insurers' bureaux, the Minister's Memorandum notes that the UK is in the process of obtaining so-called 'Section III' status under the Green Card system. Once formally approved by the European Commission, this means that UK

37 Commission Impact Assessment SWD(2018) 247, p. 156.

38 According to Insurance Europe, in 2016 average premiums in France were €184 (£162) per year, significantly lower than some other EU countries such as Italy (€403; £354); the Czech Republic (€388; £341) and Belgium (€308; £271). The figures publishes do not include the UK, making further comparisons difficult.

drivers—when entering an EEA country from the UK or another EEA Member State—will not need to prove the validity of their insurance on entry. The same already applies to non-EEA countries Serbia, Switzerland and Andorra. However, after the UK leaves the Single Market, UK residents will no longer benefit from the 'visiting victims' scheme, the simplified process for claiming compensation if they are the *victim* of a motor accident when visiting an EEA country (see paragraphs 4.59 to 4.62 below).

4.8 **We thank the Minister for his helpful and detailed Explanatory Memorandum on the latest proposed changes to the Motor Insurance Directive. The Government is clearly concerned that, if the new Directive takes effect while the UK is still under an obligation to apply EU law (e.g. before the scheduled end of the transitional period on 31 December 2020) the changes to the statutory scope of the insurance obligation could push up car insurance premiums significantly. The European Commission has not been receptive to the Government's arguments about the need to narrow the scope of the Directive instead. We note that the Department for Transport consulted on the implications of the Court's case law for the UK in late 2016, but that no further legislative or regulatory action appears to have been taken since.**[39]

4.9 **The full implications of any changes to the Motor Insurance Directive for the UK, including the proposed codification of the *Vnuk* judgement, are not yet known. This will depend, firstly, on the outcome of the legislative negotiations between the European Parliament and the Member States. Secondly, the direct or indirect legal implications for the UK specifically will depend on the nature of its relationship with the EU when the changes to the Directive formally take effect, and neither of these variables is yet known with any certainty. In particular, we do not yet know if the new legislation might take effect before the end of the proposed post-Brexit transitional period.**[40]

4.10 **The proposal also provides a timely reason to assess the broader implications of the UK's exit from the EU for the impact of the MID on UK drivers, insurers and victims of motor accidents. The Government's 2013 'Balance of Competences' review judged the impact of the Motor Insurance Directive for the UK to be "highly beneficial",[41] but its overall effects are not easily replicated from outside the Single Market.**

4.11 **In particular, while the Government has made good progress in securing continued access of UK drivers to the European Economic Area without the need to carry a 'Green Card' and undergo border controls to check for valid insurance, it is unclear whether it also wants to secure a continuation of the existing 'visiting victims' provisions which at the moment apply only to EEA residents. This is a reciprocal system, meaning that the mere fact of 'retaining' the Directive in UK law under the EU (Withdrawal) Bill will not make any practical difference in the absence of a binding agreement with the other participating countries.**

4.12 **We note in this respect that the Motor Insurers' Bureau has said that "if the [visiting victims] scheme cannot be maintained or replicated, victims may have no**

39 https://www.gov.uk/government/consultations/motor-insurance-consideration-of-the-vnuk-judgment.

40 During the transitional arrangement, scheduled to last until 31 December 2020, the UK would remain obliged to apply EU legislation—including new EU law. The legal framework for the transition is dependent on wider agreement with the EU on the substance of the Withdrawal Agreement.

41 See https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/278733/consultation-response-balance-competences-uk-eu.pdf, p. 408.

choice but to pursue their claim in a foreign country in an unfamiliar language" which would "clearly [be] a backwards step for victims and would be an unwelcome change".[42] The Bar Council has made a similar recommendation, warning that the UK leaving the 'visiting victims' system could lead to "£100s of millions of expenditure on treatment costs, social care and benefits"[43] because UK residents would forgo seeking compensation for overseas accidents and rely on domestic public services instead.

4.13 **However, it is not clear if the UK would have to continue applying the Motor Insurance Directive in full in return for an international agreement with the EU to extend the 'visiting victims' scheme to the UK post-Brexit. The extension of the system to the EFTA-EEA states Norway, Iceland and Liechtenstein has required them to transpose the Directive into their national legislation in full, and they will be expected to do the same for any future changes to the Directive (including, if agreed, the codification of the *Vnuk* judgement).[44]**

4.14 **In view of the potential impact of the Commission proposal, and the wider ramifications of the UK leaving the system for cross-border resolution of compensation claims created by the Motor Insurance Directive, we retain the proposed legislation under scrutiny. We also ask the Minister to write to us to clarify the following points:**

- **How many other Member States support the UK in opposing the codification of the *Vnuk* judgement, and would they constitute a blocking minority? What is the Government's assessment of the Commission's claim that some Member States, including France, already apply the "insurance requirement to private land without public access" but "the average French premiums are far from being the highest in the EU"?**

- **What action does the Government believe needs to be taken in any event to ensure UK compliance with the *Vnuk* judgement and related case law, even without codification of Court's findings (and presuming the narrower scope as proposed by the UK is not adopted)?[45]**

- **When is the Government expecting the European Commission to sign off on the UK's status as a 'Section III' state to allow for the continued post-Brexit access of UK drivers to the European Economic Area without needing to prove the validity of their insurance at the border? In particular, can this happen before the UK formally leaves the EU, or is there a risk of a gap at the point of the UK's exit on 29 March 2019 if there is no Withdrawal Agreement?**

- **Is it the Government's intention to negotiate an agreement with the EU that maintains the 'visiting victims' provisions of the Motor Insurance Directive for UK nationals visiting the EEA and vice versa?**

- **If so, what assessment has it made of the legal requirements this may impose on the UK in terms of continued adherence to all or parts of the Motor Insurance Directive (including any of the amendments now under**

42 See https://mib.org.uk/mib-insight/what-does-brexit-mean-for-cross-border-motor-travel-and-victim-protection/.

43 See https://www.barcouncil.org.uk/media/557763/paper_11_traffic_accidents.pdf.

44 See EEA Joint Committee Decision 117/2011 of 21 October 2011.

45 The Minister's Explanatory Memorandum explains that the proposal on the scope of the MID would require changes to at least seven UK legal instruments, including the Road Traffic Act 1988.

consideration)? In particular, could it require the UK to continue to apply the compulsory insurance requirement in line with the *Vnuk* judgement if the Commission proposal to codify this case law is accepted by the Member States and the European Parliament?

- **If the Government is not seeking continued participation in the 'visiting victims' scheme, what assessment has it made of the potential costs to the public purse if UK residents involved in a traffic accident in the European Economic Area come to rely to a greater extent on publicly-funded services in the UK because they fail to pursue a claim for compensation overseas? In particular, what is the average annual value of reimbursements obtained by the Motor Insurance Bureau for claims by UK residents for accidents elsewhere in the EEA under article 24(2) of the Directive, and how much does the MIB pay out to Compensation Bodies of other Member States?**

4.15 **Given that the new Motor Insurance Directive may apply in the UK (whether during transposition or, potentially, as a part of the wider future partnership with the EU), we are drawing the Commission proposal to the attention of the Transport and Treasury Committees. We also ask the Minister to keep us informed of developments in the Member States' deliberations on the proposal, especially with respect to the elements identified by the Government as problematic. In the meantime, we retain the proposed Directive under scrutiny.**

4.16 **We also note that 'Section III' status may resolve most issues related to border controls for private vehicles travelling between the UK and the EU after Brexit (although UK drivers' licences will also no longer be automatically recognised throughout the EU). However, the British haulage industry will face far more substantial difficulties because, as a commercial activity, they are currently covered by free movement and cabotage provisions of the Single Market which will cease to apply when the UK becomes a 'third country'. The European Commission** summarised **these consequences in a Stakeholder Notice in January 2018, but they are outside the scope of this Report. We understand the Transport Committee is currently considering these issues as part of its inquiry into "**Freight and Brexit**".**

Full details of the documents

Proposal for a Motor Insurance Directive amending Directive 2009/103/EC: (39804), 9365/18 + ADDs 1–2, COM(18) 336.

Background

4.17 Under the 2009 Motor Insurance Directive, anyone who holds a compulsory car insurance policy in a European Economic Area (EEA) country is covered to drive throughout the entire EEA.[46]

4.18 The foundations of EU motor insurance legislation lie in the International Green Card System. The Green Card is an international certificate of third party liability insurance that makes it possible for travellers to drive across national borders within Europe without

46 The current Motor Insurance Directive was incorporated into the EEA Agreement by means of Joint Committee Decision 117/2011.

having to buy supplementary insurance for each country they visit. The system is run by a Council of national bureaux (COB), and was set up in 1949 under the auspices of the United Nations Economic Commission for Europe (UNECE). Under the system as originally established, drivers have to show their Green Card when entering a different country (therefore requiring systematic border controls on entering traffic).

4.19 If a car from one 'Green Card' country causes an accident while in another, the national 'bureau' of the country where the accident took place (which brings together all companies issuing motor insurance) handles and settles any insurance claims (the cost of which it recovers from the bureau of the country where responsible vehicle is registered). This basic system only offers protection where an accident involves a car from another 'Green Card' country, and held valid insurance. It does not apply when the vehicle involved in the accident is uninsured, or where the *victim* is visiting another 'Green Card' country and is involved in a car accident there.

The EU's Motor Insurance Directive

4.20 Within the EU, and by extension the wider European Economic Area, the 'Green Card' system has been developed much further to allow for the abolition of border controls for motor insurance and to increase protection for victims. Since 1972, five Motor Insurance Directives have sought to improve the ability of EU residents to use their cars elsewhere in the Union and to improve the protection of victims of traffic accidents.[47] The first Directive requires all vehicles to be covered by a motor third party liability (MTPL) insurance policy and abolished systematic border controls to check the insurance of vehicles with plates from another EU Member States (while allowing "random checks").[48]

4.21 Since then, successive Directives have led to significant changes. For example, between 1983 and 2005 new EU legislation introduced minimum amounts of cover for car insurance policies, including for material damage in addition to personal injury; the establishment of national guarantee funds in each Member State to compensate victims of traffic accidents if a driver is uninsured or cannot be traced; a requirement for insurers to offer policies that are valid throughout the entire EU; the ability for drivers to request a claims history statement to use when applying for motor insurance with a new provider; and clearer conditions under which Member States could carry out border checks for insurance.[49]

4.22 The Motor Insurance Directives also offers protection for EEA residents who are the victim of a traffic accident in any 'Green Card' country other than where they live ('visiting

47 See Council Directive 72/166/EEC; Council Directive 84/5/EEC; Council Directive 90/232/EEC; Directive 2000/26/EC; and Directive 2005/14/EC.

48 The drafting of the Directive had caused divergent interpretations across Member States. Some performed random checks on all vehicles entering from another Member State (irrespective of whether they had licence plates issued by another Member State or a 'third country'), whereas others applied them only to cars with 'third country' licence plates.

49 The Directive does not regulate issues of civil liability and the calculation of compensation awards, or optional (comprehensive) cover for physical injury of the driver, material damage to vehicles or vehicle theft. Those matters are decided by individual EU countries. See for more information this factsheet issued by the UK Bar Council.

victims') and where the accident involves a vehicle registered in an EEA country.[50] Under articles 20 to 26 of the Directive, someone who is involved in a car accident where those conditions are met can claim compensation in their home country, meaning they do not have to deal with a foreign legal system. It enables victims to return home and then pursue a claim via a local representative of the foreign insurer of the driver who caused the accident, or via the 'Compensation Body' (the MIB in the UK). If the accident took place in an EEA country and the vehicle is unidentified or uninsured, the victim can also get compensation from the national bureau in the EEA country where they live (which then recoups any pay-out from the bureau of the country where the vehicle was registered or of the country where the accident took place).

4.23 In practice therefore, for motor accidents that take place anywhere in the European Economic Area, the victim can pursue their claim for compensation in their Member State of residence. For example, a UK tourist to France injured by a vehicle insured in Italy could seek compensation via the Italian insurers' representative in the UK. If it has not appointed one, the victim could turn to the UK's Motor Insurance Bureau, which would pay out any valid claims and then have this money reimbursed by its Italian counterpart. This system is seen as an important piece of consumer protection as it obviates the need (in the above example) for the UK tourist to seek compensation via the French Insurers' Bureau, which would be necessary under the 'Green Card' system, or from the Italian insurer directly.[51]

4.24 There are also three so-called 'Section III' States[52] (Switzerland, Serbia and Andorra). These countries, while outside the European Economic Area, have agreed to pay compensation for traffic accidents caused by a car normally registered in their territory, even if the vehicle in question is not insured (referred to as 'deemed insurance cover'), mirroring the requirements on EEA countries under the Motor Insurance Directive. As a result, vehicles from these three countries can travel freely between each other's territories and EEA countries, without the driver needing to carry the Green Card when crossing borders: the number plates of vehicles from these countries are presumed to be the proof of insurance. Given the UK's decision to leave the EU, the Department for Transport announced in May 2018 that the Government had provisionally secured status for the UK as a 'Section III' State pending formal approval by the European Commission.

4.25 However, the 'visiting victim' provisions do not apply for residents of countries outside the European Economic Area, including the 'Section III' States. As such, by way of example, at present a UK resident injured by a Swiss-insured vehicle in France would have to seek compensation via the French Insurers' Bureau, as the reimbursement scheme for visiting victims do not apply between the national bureaux of the UK and Switzerland. We

50 These first three Directives built on the system of "green cards", which had been introduced to facilitate the settlement of claims in accidents caused by a motorist in a Member State other than that in which the vehicle is normally based. This system ensures the payment of compensation to victims of accidents caused by visiting vehicles through a private-sector network of Green Card Bureaux set up by the insurers and established in all the Member States. However, an important gap still remained: because the original aim was to eliminate border controls on insurance, the "green card" system did not make any provision for victims of road traffic accidents when visiting another country (a so-called 'visiting victim'). This gap was filled by the fourth Motor Insurance Directive, which also provides for a mechanism for settling claims in respect of such accidents.

51 The Motor Insurance Directive's 'visiting victim' provisions also apply if the accident took place in a non-EEA 'Green Card' country like Switzerland, but only if both the victim and the vehicle involved were registered to different EEA countries.

52 This refers to Section III of the Council of Bureaux' internal regulations.

have assessed the implications of Brexit for the UK's approach to motor vehicle insurance, including for UK visitors to other European countries, in more detail in paragraphs 4.59 to 4.62 below.

Proposal to update the Motor Insurance Directive

4.26 In May 2018, the European Commission published a legislative proposal to amend the Motor Insurance Directive. This proposal built on three different developments: the Commission's own evaluation of the functioning of the 2005 Directive; the Consumer Financial Services Action Plan; and a series of judgments by the European Court of Justice (CJEU) on the scope of the Directive. All in all, the Commission proposal would affect the Directive in the following areas:

- The **scope of the compulsory insurance requirement and the compensation guarantee offered by national guarantee bodies**, in the light of a series of Court of Justice judgements that extended the Directive to also cover vehicles only or mostly used on private land such as tractors and motor sports vehicles;
- Protection for victims of traffic accidents in case of the **insolvency of insurer** of the driver causing the accident, or when the insurer does not respond to a claim for compensation;
- Establishing a framework for the use of **checks and controls to verify the validity of insurance** of vehicles entering one EU Member State from another;
- The use of **claims histories** when purchasing motor insurance, and preventing discrimination based on nationality when setting insurance premiums; and
- The equalisation of **minimum cover requirements** for motor insurance across all Member States.

4.27 The main findings or implications of these are set out below, followed by a description of the amendments the Commission has proposed to update the Directive in light thereof, alongside the Government's position as articulated in the Explanatory Memorandum submitted by the Minister for Transport (Jesse Norman) on 20 June 2018.

Court of Justice interpretation of the Motor Insurance Directive

4.28 One of the most controversial aspects of the Motor Insurance Directive is its scope, following a number of judgments of the Court of Justice of the European Union about which vehicles are subject to the mandatory insurance requirement under article 3 of the Directive. The implications of the Court's caselaw in this area are set out in some detail in the European Commission's impact assessment.[53]

4.29 In particular, the 2014 *Vnuk* judgement[54] clarified the scope of the insurance obligation for drivers as covering "any activities consistent with the 'normal function' of a vehicle, regardless of the location where the vehicle is used". This judgement made

53 Commission document SWD(2018) 247, p. 110.

54 Judgement in case C-162/13, *Vnuk*. The Vnuk judgment concerned an accident involving a tractor on a farm in Slovenia. Specifically, Mr Vnuk, an employee of the farm was knocked off a ladder by a trailer attached to a tractor that was reversing across the farmyard.

headlines in the UK at the time, because the Court's interpretation extended the need for motor insurance to vehicles used only on private property, as well as vehicles not primarily designed for use in traffic like tractors or motor sport vehicles.[55] The Court subsequently clarified further that "normal function of a vehicle" refers to use its for transport, not any other use the vehicle may have such as ploughing or powering pumps (the *Rodrigues de Andrade* judgement),[56] but confirmed that the characteristics of the terrain (i.e. public or private land) where an accident occurs are irrelevant to whether the Directive applies (the *Torreiro* judgement).[57]

4.30 As a result of this case law, the compulsory insurance of motor vehicles under the Directive applies to accidents involving a vehicle "regardless of the characteristics of the property or terrain on which the accident occurred", as long as the vehicle was being used as a mode of transport at the time. By extension, if an *uninsured* vehicle within those parameters is involved in an accident on private land, the national guarantee fund—the Motor Insurers' Bureau in the UK—would have to meet any subsequent claim for compensation. As the MIB is funded by companies that issue motor insurance, any increased calls on the Bureau could have the effect of pushing up their contributions and, as a result, drivers' insurance premiums. The Department for Transport consulted on the implications of the Court's judgements for the UK in late 2016, but does not appear to have determined what action needed to be taken to ensure compliance with *Vnuk*.[58]

4.31 At EU-level, a number of Member States—including the UK—have asked the Commission to amend the MID to ensure it applies only to vehicles when used on publicly accessible land (and thereby obviating the Court's interpretation of the Directive as currently written). The Government estimated that accepting the Court's interpretation would result in additional premium costs for the UK totalling £1.83 billion (although this was based on the UK's unlimited cover for personal injury, not the minimum amounts of cover required by the Directive).[59] The Government also sought a specific exemption from the Directive for vehicles used in motor sports, because the "normal function"—as defined by the Court—would also apply to cars or bikes competing in a race and therefore make them subject to the insurance requirement. The Association of British Insurers (ABI) had estimated that including such vehicles in the scope of the Motor Insurers' Bureau would "lead to [an] increase of premiums of 10 per cent".[60]

4.32 However, the European Commission's proposed amendments to the Motor Insurance Directive comprehensively reject the UK's preferred approach with respect to both the overall scope and the exemption for motor sport vehicles. Instead, the Commission has proposed to codify the Court's jurisprudence by inserting a new definition of "use of a vehicle".[61] This would have the effect of making the extension of the Directive to vehicles used on private land a statutory requirement. The Commission's reasoning for rejecting the UK proposal is that narrowing the scope of the Directive to accidents on publicly

55 The definition of a 'motor vehicle' under the Directive is already wide, covering "any motor vehicle intended for travel on land and propelled by mechanical power, but not running on rails".

56 Judgement in case C-514/16, *Rodrigues de Andrade*.

57 Judgement in case C-334/16, *Torreiro*.

58 See https://www.gov.uk/government/consultations/motor-insurance-consideration-of-the-vnuk-judgment.

59 Commission document SWD(2018) 247, p. 62.

60 See Commission Impact Assessment SWD(2018) 247, p. 63.

61 This definition, drawn from the three Court judgements, would read: "Use of a vehicle" means "any use of such vehicle, intended normally to serve as a means of transport, that is consistent with the normal function of that vehicle, irrespective of the vehicle's characteristics and irrespective of the terrain on which the motor vehicle is used and of whether it is stationary or in motion".

accessible land only would be a "lower level of protection of victims" and therefore go against its objective "to ensure a high level of protection for victims of motor vehicle accidents". It says restricting the insurance obligation as proposed by the Government means "there would not be compulsory insurance requirements where accidents occur on private driveways, holiday resorts, secured areas of airports, roads on golf courses, any clubs' private terrains, or farms".

4.33 The Commission also did not accept the UK's argument that the broader scope of the insurance obligation would necessarily lead to increases in premiums, noting the figures used by the UK Government to calculate the costs were not shared with the Commission (and it was therefore "not able to verify [them] in detail"). It also adds in its Impact Assessment that premiums in countries where the insurance requirement *already* applies to private land are not among the EU's highest, and similarly that in Finland—where the insurance requirement already applies to motor sports—has not caused any problems.

4.34 In his Explanatory Memorandum, the Minister reiterates the Government's opposition to the Court's interpretation of the Directive and, consequently, the Commission's proposal to codify it as statute:

> "The Government believes that it should be for individual Member States to set laws for insuring the use of vehicles on private land as these vehicles were rarely cross into another Member State's territory. […] Examples of types of vehicle potentially in scope of the Directive's Article 1 definition include e-bikes, ride-on lawnmowers and motorised children's toys. Many of these will never be in close proximity of members of the public and/or travel at low speeds and therefore pose minimal risk of causing an accident or injury."

4.35 Accordingly, the Minister says the Government will explore the possibility of instead limiting the statutory scope of the insurance requirement to vehicles used on publicly-accessible land during the legislative negotiations. The extent to which it has support among other Member States for such a change is unclear.

Insolvency of the responsible insurer or lack of a reasoned reply to an insurance claim

4.36 The second amendment to the Motor Insurance Directive put forward by the Commission concerns the provision of compensation to victims where the driver's insurer has gone insolvent.

4.37 At present, the Directive requires each Member State to establish a compensation body (the Motor Insurance Bureau in the UK) to compensate victims of accidents caused by uninsured or unidentified vehicles. However, at present these bodies do not have to meet costs arising from claims where the driver has insurance, but their insurer has gone insolvent. This means that, if the law of the country where the driver is insured does not provide for any specific protection scheme in such an eventuality, victims of accidents caused by a vehicle insured with an insolvent insurer may be left without compensation.[62]

62 The Commission has recorded eight cases of insolvency of motor vehicle insurers in the EEA between 1998 and 2007, resulting in approximately 11,500 claims against policyholders of those insurers after their insolvency for a total value of is approximately €180 million. However, it explains that this is "certainly an underestimation of the total problem, as for 3 out of [the] 8 insolvencies information on claims is not available".

4.38 The Commission has now proposed a requirement for each EU country to appoint a body with the task of providing compensation for material damage or personal injuries caused by a vehicle insured by an insolvent insurer.[63] In such circumstances, the national guarantee fund of the country where the victim lives would provide compensation, but claim this back from their counterpart in the Member State where the insolvent insurer was established. The same would apply where a claimant has not received a reasoned reply from the liable party's insurer within three months of submitting an insurance claim. The procedural obligations of the compensation bodies would be defined by the Commission through Delegated Acts.

4.39 The Minister's Explanatory Memorandum explains that, in the UK, the Financial Services Compensation Scheme (FSCS) already covers the full cost of third party motor insurance claims where the liable party's UK-based insurer is insolvent. It adds that "the Commission proposal should create certainty for claimants and speed up the time taken to determine and pay agreed claims", and the reimbursement of the costs by the Member State of the insurer "creates a useful incentive for [Member States] to put in place robust prudential regulation safeguards to avoid insurers in their jurisdiction from becoming insolvent". The Government is, however, considering whether the procedural obligations should be laid down in Implementing rather than Delegating Acts (the latter being subject to a veto by the European Parliament whereas the former are not).

Claims history

4.40 The third element of the Commission proposal to amend the Directive relates to drivers' ability to request, and use, a claims history when purchasing a new insurance policy.

4.41 Since the 2005 iteration of the Directive, drivers have the right to request from their insurer a claims history statement for the past five years. In theory, this would assist drivers in securing an insurance policy (especially if they move to another Member State). However, there is no legal requirement for insurers to take the claims histories issued under the Directive into account when calculating premiums, and the Commission's evaluation found that they are often ignored or have their authenticity questioned.

4.42 To facilitate the use of the claims history statement, the Commission proposes to create a harmonised template which would be used throughout the EU (thereby making it easier to verify their authenticity). It has also suggested requiring all Member States to ensure, in law, that insurers cannot increase premiums for drivers based on their nationality or their previous Member State of residence. To facilitate compliance, insurers would be under an obligation to publish their policies with respect to use of claims histories issued under the Directive when calculating premiums.

4.43 The Government does not oppose the thrust of this element of the proposal, but the Minister has expressed a number of concerns that would need to be addressed in the legislative process. Notably, the Directive should allow for current UK practice where an insurance policy is driver-specific (whereas in most other EU countries it is vehicle-specific), and the Minister questions whether publication of insurers' policy with respect to use of claims histories would actually assist Member States in determining whether the

63 The body would also have to provide compensation if the insurer, even though not insolvent, has not provided a victim with a response to their claim within three months.

non-discrimination obligation was being observed in practice. The Government is also considering whether it is appropriate for the format of the claims history to be determined through an Implementing Act, as proposed by the Commission.

Ensuring the validity of insurance of foreign vehicles

4.44 The fourth area of focus in the Commission proposal is tackling uninsured driving. According to the Association of European Vehicle and Driver Registration Authorities (EREG), the cost of accidents caused by uninsured vehicles to the national guarantee funds across the EU in 2011 alone was €870 million (£766 million). While the Motor Insurance Directive contains a general requirement for Member States to take "all appropriate measures" to ensure that vehicles in their territory are covered by insurance, it prohibits systematic checks of insurance of vehicles bearing plates from another country (including those where the vehicle does not need to be stopped). The reasoning behind this was that systematic checks, especially at borders, would hinder the free movement of vehicles within the Single Market.

4.45 However, given advances in automatic number plate recognition (ANPR), the Commission now proposes that Member States should be allowed to carry out such insurance verification controls on foreign vehicles entering their territory "if the checks form part of a general system of checks (…), are not discriminatory, do not require stopping the vehicle and are necessary and proportionate to achieve the end pursued". Any transfers of personal data to verify the validity of insurance on a vehicle from another EU country would have to be in line with the General Data Protection Regulation.

4.46 The Government supports this element of the proposal, as the Minister notes that it would "allow, but not require, the UK to use ANPR […] checks to detect uninsured vehicles entering the UK, as the policy already do for UK-registered vehicles being driven on UK roads".

Minimum amounts of insurance cover

4.47 Article 9 of the current Motor Insurance Directive established minimum obligatory amounts of cover up to which compensation must be provided under a motor third party liability policy issued within the EU.[64] These are subject to five-yearly adjustments to account for inflation (meaning they are currently set at €1.22 million (£1.07 million) per victim for personal injury, and the same overall limit for any claim relating to property damage). The UK has set limits well above these minimum limits, requiring unlimited cover in motor insurance policies for cases of personal injury, and a £1.26 million minimum cover for property damage.

4.48 However, due to transitional arrangements agreed in 2005 (when the minimum cover was introduced), 13 Member States can still apply lower minimum amounts than the floors laid down in the Directive. While the transitional period itself expired in 2012,

64 The substance of this Article differs between the English and French language versions of the Directive. It sets the minimum amount for personal injuries at 1 million EUR per victim and 5 million EUR per claim in its English version. In the French version, the provision refers either to a "victim" or an "accident" ('sinistre'). It could be argued that the English version refers in both cases to the same thing, because the terms "victim" and "claim" could be interpreted as being related to a single person, rather than to the whole of the accident. As a consequence, there might be different levels of protection for victims of motor accidents depending on where they occur.

the reference dates for the five-yearly adjustment are different for those countries that benefitted from the transition (meaning they are having to increase their minimum cover amounts at a different rate than the other Member States).

4.49 The Commission now proposes to eliminate this discrepancy by effectively uprating the minimum cover in those Member States where lower amounts can still be applied to the same level as applies in the other Member States:

- for personal injuries: minimum cover of €6.07 million (£5.32 million)[65] per accident, irrespective of the number of victims, or €1.22 million per victim (with Member States free to choose either minimum within their domestic legal framework); and

- for damages to property, minimum cover of €1.22 million per claim irrespective of the number of victims.

4.50 Given the UK's higher limits, this change would have no appreciable domestic impact.[66]

Our assessment

4.51 The Motor Insurance Directive is of great importance to many Britons as it underpins their obligations as drivers, as well as to insurers which must comply with the requirements of the Directive when issuing policies and handling claims for compensation involving motor accidents in both the UK and elsewhere in Europe where either the responsible or injured party is a UK resident. It also provides an important safety net for British victims of traffic accidents, both in the UK and when visiting other countries in the European Economic Area, where the most far-reaching consumer protections apply.

4.52 While the Government appears broadly supportive of the Commission proposals with respect to insurer insolvency, claims history, ANPR checks and minimum cover, the Minister has expressed some serious concerns about the Commission proposal to codify the European Court of Justice case law on the scope of the Directive to include vehicles used only on private land. This, he says, raises the absurd and presumably unintended possibility that motorised children's toys and ride-on lawnmowers could require motor insurance.

4.53 The Minister also argues that vehicles used only on private land, including agricultural and motor sports vehicles, would in any event rarely cross national borders. As such, the Government believes that any regulation of their insurance requirements should be left to individual Member States. While this is undoubtedly true for most vehicles in England, Wales and Scotland, the situation near intra-EU borders—including between Northern Ireland and Ireland[67]—may well be different.[68]

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65 Currency exchange rate €1 = £0.87680 Or £1 = €1.14051 as at 31 May 2018.

66 The Commission impact assessment shows the biggest changes in minimum cover (and therefore, potentially, for insurance premiums) would occur in Member States in Southern and Eastern Europe.

67 The Minister's Explanatory Memorandum explicitly notes that the Government "will continue to have discussions on future motor insurance arrangements on the island of Ireland".

68 Consistent application of the 'visiting victims' scheme also relies on a uniform EU-wide understanding across all Member States of which vehicles are covered by the mandatory insurance requirement and, by extension, the backstop protection of national compensation bodies if someone is injured by an uninsured (or unidentified) vehicle.

4.54 It is unclear how many other Member States share the UK's reservations about the codification of the *Vnuk* judgement, and consequently whether a blocking minority exists within the Council to force removal of that proposed amendment to the Directive. We note that both Germany and Ireland, but not the UK, intervened in the *Vnuk* case to argue that the insurance obligation "relates only to situations involving road use". As the new legislation requires a Qualified Majority Vote (QMV) in the Council, the UK currently has substantial influence over the legislative process. However, in light of its decision to leave the EU, it will cease to do so when the UK loses its voting rights at the end of the two-year Article 50 period on 29 March 2019. Nevertheless, under the terms of the proposed post-Brexit transitional arrangement, the UK would continue to apply EU law—including new legislation—as if it were still a Member State.

4.55 The consequences of any codification of the *Vnuk* judgement for UK insurers and drivers are therefore still unclear, because the precise impact of any changes to the Motor Insurance Directive under domestic law depend on three factors:

- The substance of the Directive once agreed between the European Parliament and the Member States in the Council, which could be very different from the text of the Commission proposal (and may not include the codified *Vnuk* definition of "normal use");
- The date by which the new Directive must be transposed into the domestic law of Member States, which depends on the speed with which it is adopted by the EU institutions and published in the Official Journal; and
- The precise nature of the UK's relationship with EU law on that 'transposition date', and in particular whether it falls within the post-Brexit transitional period when the UK would still be applying EU law.

4.56 The Committee will keep any developments in the legislative progress under review to inform its assessment of the implications of the proposed Motor Insurance Directive for the UK.

Implications of Brexit

4.57 The UK's decision to leave the EU will also have other ramifications for drivers, insurers and injured parties which currently have rights and/or obligations derived from the Motor Insurance Directive. Most importantly, the UK's departure from the Single Market means that, by default, the UK would revert to being part only of the basic 'Green Card' system. That means UK drivers would have to prove they hold valid insurance when entering any other participating country, including Ireland and France.

4.58 To avoid this, as we noted above, the Government has worked to secure 'Section III' status for the UK. While this still requires formal approval by the European Commission, this means the UK drivers will join their counterparts Switzerland, Serbia and Andorra in being able to cross national borders within the European Economic Area without having to have their insurance checked. We have asked the Minister to clarify when the Government expects formal Commission approval of the UK's 'Section III' status, and whether this would be ready to take effect on 30 March 2019 if the UK exits the EU without a deal (and the UK automatically loses its status as a participating country under the Motor Insurance Directive).

4.59 In any event, the 'Section III' status will not keep in place the protections for UK victims of a motor accident when it occurs overseas in an EEA Member State. In legal terms, the 'visiting victim' provisions of the MID apply only to:

- accidents which occur in any country participating in the Green Card System (which would include the UK), but *only* where the victim resides in an EEA Member State (which UK residents will not) and the accident arose from the use of a vehicle normally based in another EEA Member State; or

- accidents which occur in when the resident of an EEA Member State visits another EEA country and is injured by an unidentified vehicle.

4.60 As the Government has ruled out the UK staying in the European Economic Area and the Single Market, neither of those scenarios could apply to UK residents who are injured while travelling in an EEA country.[69] The Motor Insurers' Bureau has said:

> "This ['visiting victims'] scheme is European born and will almost certainly face Brexit ramifications. (…) If the scheme cannot be maintained or replicated, victims may have no choice but to pursue their claim in a foreign country in an unfamiliar language. This is clearly a backwards step for victims and would be an unwelcome change.
>
> Whilst the UK may decide to keep national law compliant with the EU Directive in this respect, the obstacle is the fact that all other Member States will have to agree, as the scheme is based on reciprocal agreements and provisions in national laws. Without the EU Motor Insurance Directives, there is nothing binding the UK to the other countries and as such it will be necessary to explore ways to coming to agreements about the provision of local representatives for insurers and also assistance for victims and reimbursement arrangements."

4.61 The Bar Council has warned that an end to the 'visiting victims' protection for UK residents involved in accidents overseas could end up as a significant cost to the public purse, because victims would be less likely to pursue an insurance claim (as this would involve dealing with a foreign insurer through the systems and courts of a foreign country) and therefore require more assistance from publicly-funded services in the UK as a result.

4.62 It is unclear from the Minister's Explanatory Memorandum if the Government intends to negotiate an arrangement effectively extending the 'visiting victim' and other consumer provisions of the MID to the UK by means of an international agreement with the EU; and if so what the implications of that would be in terms of continued adherence to the terms of the Directive. In particular, because there is no precedent for such an agreement (even with the 'Section III' states) it is unclear to us if any such international agreement would

69 EEA residents involved in a motor accident in the UK caused (if caused by an EEA-registered vehicle) would have recourse to pursue a claim domestically, but not if the vehicle was UK-registered.

require the UK to respect the *Vnuk* judgement and any resulting codification of its case law into the Directive (if accepted by a qualified majority of the remaining Member States, see paragraphs 4.28 to 4.35 above).

4.63 Given that the new Directive may apply in the UK (whether during transposition or, potentially, as a part of the wider future partnership with the EU), we have asked the Minister to keep us informed of developments in the Member States' deliberations on the proposal, especially with respect to the elements identified by the Government as problematic.

Previous Committee Reports

None, as this is a new legislative proposal.

The European Scrutiny Committee last considered the 2005 amendment to the Motor Insurance Directive on 5 November 2003. See Thirty-Sixth Report HC 63–xxxvi (2002–03), chapter 12 (5 November 2003).

5 SEPA: cost of cross-border money transfers

Committee's assessment	Politically important
Committee's decision	Not cleared from scrutiny; further information requested; drawn to the attention of the Treasury Committee
Document details	Proposal for a Regulation amending Regulation (EC) No 924/2009 as regards certain charges on cross-border payments in the Union and currency conversion charges
Legal base	Article 114 TFEU; ordinary legislative procedure, QMV
Department	Treasury
Document Number	(39616), 7844/18 + ADDs 1–2, COM(18) 163

Summary and Committee's conclusions

5.1 Within the European Economic Area (EEA), electronic payments in euros are governed by the standardised rules and technical specifications of the Single Euro Payments Area (SEPA). While the practical implementation of SEPA is largely in the hands of the European banking and payment industry via the European Payments Council (EPC), the legal framework that underpins it is laid down in EU law.

5.2 While EU's SEPA regulations have brought down the cost of cross-border payments in euro within the single currency area specifically,[70] the rules also require payment services providers (PSPs) in any EEA country—including those *outside* of the Eurozone—to price domestic and cross-border transfers in euros the same. However, the benefits of the restrictions on charges for cross-border payments have been limited in eight EU Member States, including the UK, that do not use the euro.[71] This is because PSPs in those countries can price these transactions as they would a domestic transfer in euros, which are obviously not common and usually more expensive than a domestic transfer in the local currency. This is despite the fact that PSPs in all EEA countries, irrespective of their domestic currency, also have access to the technical payments infrastructure used within the Eurozone to keep the costs of euro-denominated transfers low.

5.3 To bring the costs of euro payments down for consumers and businesses in Member States that do not use the single currency locally, the European Commission in April 2018 proposed a change to the legal framework underpinning SEPA.[72] The new Regulation would require the nine non-Eurozone Member States to ensure that PSPs in their territory equalise fees for sending or receiving a payment in euros with those for domestic transfers in their national currency. That means, for example, that the UK—while covered by the Regulation under the terms of its EU membership or any post-exit

70 Overall, SEPA has lead to a significant reduction in the cost of transferring money within the single currency area for businesses and consumers: while sending €100 between Eurozone countries cost nearly €20 in 2011, it is virtually free of charge now. See Commission Impact Assessment SWD(2018) 84, p. 85.

71 Sweden has made use of a voluntary opt-in under Regulation 2009/924, under which it has by force of law equalised the pricing of domestic and cross-border transactions in Swedish krona. The Commission impact assessment for its new proposal does not refer to the EFTA-EEA countries.

72 See Commission document COM(2018) 163.

transitional arrangement—will have to ensure that British banks treat an incoming or outgoing payment in euros as if it were in sterling[73] (which, all other things being equal, would significantly reduce or altogether eliminate the fee charged for such transfers, card payments or cash withdrawals). The European Commission estimates the annual EU-wide benefit to consumers and businesses would amount to €900 million (£793 million) at the expense of payment services providers.

5.4 In parallel, the Commission also proposed new transparency requirements for intra-EU currency conversions (i.e. where consumers are offered different options for currency conversion when making a card payment or cash withdrawal in a Member State that uses a different currency than their home country). As proposed, the new requirements would apply irrespective of whether the transaction is already denominated in the currency of the customer's payment card—so-called dynamic currency conversion—or takes place in the currency of the country of transaction.[74] These rules would be given force of law via a future Delegated Act of the Commission, which in turn would be based on new detailed technical standards to be developed by the European Banking Authority (EBA) in the coming years. Before the new transparency requirements were to take effect in 2022, a maximum currency conversion charge would apply as an interim measure.

5.5 The Economic Secretary to the Treasury (John Glen) submitted an Explanatory Memorandum in April 2018 setting out the Government's position on the proposal. In it, he notes the UK is "broadly supportive" of the new Regulation because it would "make financial services more affordable". As regards the implications of the UK's withdrawal from the EU, and the Government's policy of leaving the Single Market and therefore the effects of the EU's directly-applicable SEPA framework, he stated only that "the applicability of the proposed Regulation will depend on the future relationship" with the EU.

5.6 The European Scrutiny Committee first considered the proposal at its meeting on 6 June 2018, and concluded that the price cap on receiving or sending euros in the UK was likely to apply because the new SEPA Regulation is expected to take effect in early 2019. This will either be before the UK formally leaves the EU or, if the Withdrawal Agreement is ratified, during the post-Brexit transitional arrangement when the UK will continue applying EU law and stay in the Single Market (and therefore also the Single Euro Payments Area).

5.7 The situation after the transition is less straightforward. A large number of British banks make use of the UK's membership of SEPA to offer euro-denominated direct debits and credit transfers under the SEPA legal framework and payments infrastructure.[75] To

73 The proposal would not affect cross-border credit transfers denominated in sterling or other non-euro currencies such as US dollars or Swiss francs (for reasons set out in the Committee's Report of 6 June 2018).

74 When making a card payment abroad (i.e. making a cash withdrawal at ATMs and card payments at a point of sale) in a different currency than their 'home' currency, a payment service user faces two possibilities: Dynamic currency conversion (DCC), where consumer knows the final amount to pay in their own currency at the moment of payment or withdrawal; or on-network conversion, where the consumer pays in the local currency and the conversion to the consumer's home currency happens later and the consumer does not know the full cost of the transaction in their 'home' currency until after the transaction is completed.

75 UK banks also make use of the pan-EU payments clearing systems Target2 and EURO1, but will by default lose their ability to do so as and when the UK becomes a "third country" outside of the European Economic Area. TARGET2 is an inter-bank payments system for euros operated by the Eurosystem (the European Central Bank and the Central Banks of the Eurozone countries. EURO1 is "the only private sector large-value payment system for single same-day euro transactions at a pan-European level. The EURO1 system processes transactions of high priority and urgency, and primarily of large amount, both at a domestic and at a cross-border level". It is overseen by the European Central Bank.

preserve this access for its banking sector, the UK would need to negotiate a new Swiss-style arrangement with the EU and the European Payments Council on continued membership of SEPA.[76] That would require continued adherence—referred to as "functional equivalence"—to several pieces of EU payments legislation as they evolve,[77] but without the UK's current influence and vote over future amendments to those laws in the Council of the EU or the European Parliament.

5.8 In light of this, we retained the proposal under scrutiny, and asked the Economic Secretary to estimate the likely benefits of the measure for UK consumers and businesses and to clarify the Government's intentions with respect to SEPA membership after Brexit. In particular, we inquired whether the price cap for receiving or sending euros would be kept in place domestically—the logical consequence of converting the proposed Regulation into UK law under the forthcoming EU (Withdrawal) Act 2018[78]—even if UK banks lost access to SEPA's payment clearing and settlement infrastructure that allows euro-denominated payments to be processed fast and at virtually zero cost.

5.9 The Minister provided an update on the new SEPA Regulation by letter of 22 June 2018. He notes that:

- Using trade in goods and services between the UK and the EU as a proxy, the Government estimates that savings from the proposal to UK businesses and consumers who send or receive euros will amount to €74 million (£65 million) per year;[79]

- With respect to the UK's place in the Single Euro Payments Area after it leaves the Single Market, the Minister refers to a position paper on Brexit published by the European Payments Council on 30 May 2018 which outlines the possibility of continued full UK participation in SEPA provided it fulfils the "functional equivalence" 'third country' access criteria (i.e. continued application of EU payment services legislation, including any future changes).[80] The Minister's letter stops short of actually specifying whether the UK will pursue this option in its free trade agreement with the EU; and

- The Government's 'no deal' planning for the UK's exit from the EU includes "consideration of aspects such as third-country access criteria for SEPA", and efforts to "bring the relevant pieces of EU legislation into domestic law to ensure that the UK has a functioning financial services regulatory regime" when the two-year Article 50 period expires on 29 March 2019.

76 Switzerland is part of SEPA, the only member that is neither in the Single Market nor a user of the euro as its domestic currency.

77 For example, SEPA membership requires implementation of parts of the second Payment Services Directive, the Funds Transfer Regulation, the Capital Requirements Directive, the SEPA Regulation and the Anti-Money Laundering Directive.

78 The European Union (Withdrawal) Bill is still awaiting Royal Assent at the time of writing.

79 The actual proportion of payments in euro sent to or from the UK is difficult to establish because many UK banks route such transactions via subsidiaries in other EU countries. As a result, central statistics on those payments cannot distinguish between Euro payments routed through another Member State, and Euro payments which originate from that Member State.

80 European Payments Council, "Position paper on Brexit and UK PSPs' participation in SEPA schemes" (30 May 2018). The paper also notes that, absent a UK-EU agreement on 'functional equivalence', UK PSPs could themselves apply for participation in SEPA schemes. However, that still requires a large degree of UK adherence to EU payments legislation for transactions in euro.

5.10 The Minister also explained that the proposal was "making rapid progress" in negotiations in the Council. This has resulted in broad agreement on the text of the Regulation, which in the view of the EU's national governments should:

- Maintain the price cap for cross-border transfers in euros sent to or received in EU Member States that do not use the single currency;
- Narrow the scope of the new transparency requirements for currency conversion (when a consumer pays by card or uses an ATM in a Member State that uses a different currency, for example using a UK debit card in France) to dynamic currency conversion only. This means the new rules would not apply where the consumer opts to pay in the local currency, and their bank converts the payment into the consumer's home currency at a later stage;[81]
- Provide more detail on these transparency requirements in the Regulation itself, rather than leaving these to be defined by the European Banking Authority and the European Commission via a Delegated Act; and
- Remove the proposed interim price cap on currency conversion charges that would apply until the transparency requirements take effect.

5.11 A revised legal text based on the above changes is due to be adopted by the EU Member States' permanent representatives (COREPER) in July 2018, to serve as the Austrian Presidency's mandate for negotiations with the European Parliament.[82] The UK is expected to support the amended proposal. The Parliament's Economic & Monetary Affairs Committee (ECON) has not yet announced when it is likely to vote on the SEPA proposal, meaning it is unclear if the changes proposed by the Council are likely to be reflected in the final Regulation. Similarly, pending the Parliament's consideration of the proposal, the timetable for formal adoption of the Regulation (and consequently the timing of its entry into force) is not yet clear.

5.12 **We thank the Minister for his latest update on the SEPA proposals. Given the rapid progress being made in consideration of the proposed Regulation on pricing and transparency of cross-border currency conversions involving the euro, it appears likely the new measures would take effect either before the UK's exit from the EU or—pending ratification of the Withdrawal Agreement—the subsequent transitional period.**

5.13 **However, we are disappointed—but not surprised—that the Minister's letter provides little new information on the Government's actual planning for its post-Brexit relationship to the Single Euro Payments Area.**

5.14 **While referring to the European Payments Council position paper, which outlined the requirements for continued UK membership of SEPA as a 'third country',**

81 This narrowing of the scope of the transparency requirements is in line with the Commission's own Consumer Financial Services Action Plan, which also did not foresee extending them to on-network currency conversion charges.

82 The House of Commons scrutiny reserve does not apply to decisions taken by COREPER. As the mandate for negotiations will not be subject to a formal vote of approval by Ministers (a so-called 'general approach'), there is no scrutiny waiver involved to allow the Government to support the mandate. However, the scrutiny reserve will apply when the final Regulation goes before the Council for adoption following trilogue negotiations with the European Parliament.

the Minister stops short of actually committing to this route. This is, presumably, because of the difficulty of reconciling the Chancellor's recent dismissal of the use of 'equivalence' to preserve some measure of cross-border UK access to the Single Market for financial services[83] with the SEPA membership requirement of proving 'functional equivalence' with EU payment services legislation.

5.15 **We have not seen a realistic proposition from the Government that would retain UK membership of SEPA without meeting the existing requirements that apply to third countries. The Minister's letter refers to 'no deal' planning with respect to "third country access criteria for SEPA", but this seems to be a contradiction in terms: SEPA is a reciprocal system that functions by virtue of an international agreement underpinned by EU law; clearly, in a 'no deal' scenario, such an agreement between the UK and the EU—or between UK PSPs and the European Payments Council—does not exist. As a result, the default assumption must be that British banks will lose access to SEPA's payment settlement and clearing infrastructure when the UK leaves the Single Market (either on 29 March 2019 or at the end of the subsequent transitional period) until an agreement to the contrary is reached. The precise impact of an exit from SEPA on receiving or sending euro-denominated payments in the UK is unclear, but it is likely to result in such transactions becoming costlier for PSPs, and therefore for their customers.**[84]

5.16 **Similarly, while the Minister refers to the retention of EU financial services legislation in UK domestic law after Brexit, he did not answer our question about the impact of retaining in UK law the proposed Regulation capping fees for cross-border transactions involving the euro. We remain of the view that the proposed Regulation, if retained in substance unchanged under the forthcoming EU Withdrawal Act,[85] appears to require UK banks to offer euro transactions at the same price as sterling transactions. This effectively implies offering those payments at a loss if banks did not have continued access to the SEPA infrastructure that currently make cross-border euro-denominated transactions cheap and easy to process.**[86]

5.17 **We hope the Government's upcoming White Paper on Brexit will provide further information on its proposals in the financial services area, including SEPA. If it does not we will press the Treasury further on this matter in the coming months. Given that the European Parliament is yet to establish its position on the proposal, we retain the draft Regulation under scrutiny and draw these latest developments to the attention of the Treasury Committee.**

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83 Mansion House speech by the Chancellor (21 June 2018): "The view of the Commission and some Member States is that the only possible route for future financial services access is through the EU's existing, off the shelf, equivalence arrangements. I don't agree with that. [...] It is piecemeal, unilateral and unpredictable. And therefore does not provide the stability that a well-regulated market requires."

84 For example, Barclays noted in October 2017 that "reduced UK access to EU payment schemes and infrastructure (SEPA, Target2) could increase transaction costs for cross-border payments".

85 The European Union (Withdrawal) Bill is still awaiting Royal Assent at the time of writing.

86 The other alternative would be for banks to make domestic transfers in sterling more expensive to soften the financial impact of having to offer euro-denominated transactions at the same price.

Full details of the documents

Proposal for a Regulation amending Regulation (EC) No 924/2009 as regards certain charges on cross-border payments in the Union and currency conversion charges: (39616), 7844/18 + ADDs 1–2, COM(18) 163.

Previous Committee Reports

See (39616), 7844/18 + ADDs 1–2, COM(18) 163: Thirtieth Report HC 301–xxix (2017–19), chapter 13 (6 June 2018).

6 Long-term EU budget 2021–27: possible financial implications for the UK after Brexit

Committee's assessment	Politically important
Committee's decision	Not cleared from scrutiny; further information requested; drawn to the attention of the Exiting the EU Committee, the Treasury Committee and the Public Accounts Committee
Document details	(a) Proposal for a Council Regulation laying down the multiannual financial framework for the years 2021 to 2027; (b) Proposal for a Council Decision on the system of Own Resources of the European Union; (c) Proposal for a Council Regulation laying down implementing measures for the system of Own Resources of the European Union; (d) Proposal for a Council Regulation amending Regulation (EEC, Euratom) No 1553/89 on the definitive uniform arrangements for the collection of own resources accruing from value added tax; (e) Proposal for a Council Regulation on the methods and procedure for making available the Own Resources based on the Common Consolidated Corporate Tax Base, on the European Union Emissions Trading System and on Plastic packaging waste that is not recycled, and on the measures to meet cash requirements
Legal base	(a) Article 312 TFEU; unanimity; (b) Article 311 TFEU; unanimity and national ratification; (c) Article 311 TFEU; QMV; (d)-(e) Article 322(2) TFEU; QMV
Department	Treasury
Document Numbers	(a) (39683), 8354/18, COM(18) 322; (b) (39686), 8357/18, COM(18) 325; (c) (39688), 8359/18, COM(18) 327; (d) (39839), 8360/18, COM(18) 328; (e) (39687), 8358/18, COM(18) 326

Summary and Committee's conclusions

6.1 The issue of contributions to the EU budget was one of the key topics in the referendum that led to the UK's decision to leave the European Union.

6.2 Following the Government's triggering of Article 50 TEU, the UK and the European Commission provisionally agreed a Brexit financial settlement in December 2017. This stipulated that the UK would pay into the EU budget as if it were still a Member State from March 2019 until 31 December 2020, and contribute afterwards towards the Union's existing financial commitments that remain outstanding on that day.[87] For that same period, there would be a transitional arrangement that effectively keeps the UK in the

87 The main outstanding expenditure towards which the UK would contribute after 2020 is the reste à liquider (RAL), spending commitments which haven't been paid yet, and liabilities such as staff pensions.

Customs Union and the Single Market—and therefore bound by EU law—to provide more time for the negotiation and implementation of a new UK-EU free trade agreement. It should be noted that these financial commitments on the UK beyond 29 March 2019 are not presently legally binding; they rely entirely on future ratification of the UK's Withdrawal Agreement under Article 50.

6.3 In May 2018, the European Commission presented its proposal for the EU's next long-term budget, the Multiannual Financial Framework or MFF, for the period 2021–27. It proposes cumulative EU spending commitments over that period totalling €1.134 trillion (approximately £1 trillion),[88] which is only 5 per cent less than expenditure during the current 2014–2020 budgetary period despite the UK's decision to leave the EU. Under the proposal, which takes the form of a Regulation, EU spending on scientific research, border management, foreign affairs and defence would increase, by reducing agricultural subsidies and cohesion funding for low-income regions in the EU (the two largest areas of the EU budget).

6.4 In parallel, the Commission has also proposed a new legal framework governing the Member States' contributions to the EU budget, the so-called Own Resources Decision (ORD). In addition to increasing the proportion of customs duties collected that Member States must pass to the EU from 80 to 90 per cent, the new ORD would also create three new types of contributions by Member States to the EU budget (based on the corporation tax paid by large companies, revenues from auctions of greenhouse gas allowances, and volumes of unrecycled plastic waste). It would also abolish the UK rebate in light of our withdrawal from the EU. We have set out the substance of both the expenditure and revenue side of the proposed MFF in more detail in "Background" below.

6.5 While the UK remains a Member State, the Government has a veto over both the MFF Regulation and the Own Resources Decision, and the latter must also be approved by Act of Parliament under the European Union Act 2011. However, in light of the UK's decision to leave the EU and the terms of the subsequent financial settlement (see above), the Chief Secretary to the Treasury (Elizabeth Truss) told us in January 2018 that the new MFF would be "not relevant to the UK", because it "is envisaged to play no part" in that long-term budget.

6.6 The Minister submitted an Explanatory Memorandum on the detailed MFF proposals, with some delay, on 18 June 2018. This strikes a slightly different tone, noting that "negotiations on the next Multiannual Financial Framework are primarily a matter for the 27 remaining Member States" but acknowledging that "there are a number of areas where it will be in the UK's and Europe's mutual interest to work together on issues relating to the design of the next Framework and its policies and programmes". That includes, the Minister says, the UK "continuing to take part in those specific [EU] policies and programmes which are greatly to the UK and the EU's joint advantage". With respect to the proposals on how the EU budget will be funded from 2021 onwards, the Explanatory Memorandum says these give rise to "limited policy issues" for the UK because "changes to the Own Resources Decision or MFF Regulation which are adopted on or after the date of entry into force of the draft Withdrawal Agreement, shall not apply to the UK in so far as those amendments have an impact on the UK's financial obligations under the financial settlement" (see paragraph 6.82 in "Background" below).

88 The MFF proposal contains payment appropriations totaling €1.104 trillion.

6.7 As we have previously stated,[89] we agree that the next MFF is likely to have some financial impact on the UK, the size and scope of which it is difficult to establish at present. We do not accept that it is clear at this stage that the implications of the MFF and the Own Resources Decision are limited to the extent of the UK's participation in specific EU programmes as a 'third country', given the continued uncertainty about the transitional period after Brexit and the precise scope of the 'backstop' to keep the Northern Ireland border free of customs and regulatory infrastructure in all circumstances.

UK participation in EU programmes and agencies as a 'third country'

6.8 Firstly, as the Chief Secretary rightly notes, the Government has already announced it will seek to stay involved in various EU programmes and agencies[90] following Brexit, such as the 2021–27 Framework Programme for Research and the European Defence Fund.[91] Where it can reach agreement with the EU on such participation as a 'third country' (which will be especially difficult for any of the regulatory agencies that form part of the institutional architecture of the Single Market),[92] it will also necessarily involve a financial contribution. The Government accepts this, but has said repeatedly that such payments should give the UK a "suitable level of influence".[93]

6.9 In practice, should the UK obtain participation as a 'third country', its financial contribution is likely to be linked to the specific costs of the agency or programme to the EU budget and the UK's economic size relative to the EU's: therefore, the spending limits in the new MFF, once translated into specific financial allocations in the EU's annual budgets from 2021 to 2027, will have a direct effect on what the UK contribution might be. In addition, in response to Brexit, the European Commission called for a new 'automatic correction' mechanism to any British contributions to specific EU programmes so that the UK cannot become a net beneficiary of the EU budget. Our initial assessment indicates there could be a potential gross UK contribution for participation in EU programmes of approximately £4 billion per year (see paragraphs 6.65 to 6.67).

A partial extension of the transition via the Irish Backstop

6.10 Secondly, the Government has proposed that the 'backstop' for Northern Ireland—the fall-back option it agreed with the EU in December 2017 to keep the border with Ireland free of customs and regulatory infrastructure through 'full alignment' with the necessary EU rules—should be given effect by keeping the UK as a whole in a 'temporary customs arrangement' with the EU *beyond* the end of the post-Brexit transitional period for a "time-limited" (but unspecified) period. Its proposal goes much further than the

89 See for example our letter to the Chief Secretary to the Treasury of 22 February 2018.

90 In her Mansion House speech in March 2018, the Prime Minister said the UK wanted to obtain 'associate membership' of the European Chemicals Agency, the European Medicines Agency, and the European Aviation Safety Authority.

91 The Commission proposal for the European Defence Fund reserves participation to EU and EFTA-EEA states only.

92 The Prime Minister has said the UK wants to remain an 'associate' member of the European Chemicals Agency (ECHA), the European Medicines Agency (EMA) and the European Aviation Safety Authority (EASA).

93 See for example the Prime Minister's speech of 21 May 2018: "*In return [for a financial contribution] we would look to maintain a suitable level of influence in line with that contribution and the benefits we bring*"; the Government's May 2018 paper on the UK-EU Security Partnership: "*For the UK to make a contribution to an EU programme or instrument, it would need to play an appropriate role in the relevant decision-making mechanisms*"; or the letter by Universities Minister Sam Gyimah to Sir William Cash dated 23 April 2018: "*The programme allows associated countries a suitable degree of influence, in recognition of the benefits they bring to the programme, and in line with their financial contributions*".

EU's customs union with Turkey, the only precedent, because the arrangement would require the (continued) "elimination of tariffs, quotas, rules of origin and customs processes including declarations on all UK-EU trade".[94] The Government also recognised at the same time that an absence of border controls would further necessitate discussions on (alignment with) EU rules on Value Added Tax, excise and regulatory matters such as product standards.

6.11 Any such *ad hoc* extension of the customs-related elements of the transitional arrangement beyond December 2020 for the UK as a whole (rather than, as the EU proposed, for Northern Ireland specifically) could—in addition to facing substantial political and legal hurdles[95]—involve a financial contribution by the UK towards the EU's expenditure under the 2021–27 MFF. The exact scope of any such financial mechanism would depend on the substance of the backstop (and in particular whether the customs proposals will be followed by any measures to keep the UK aligned on EU regulatory matters affecting goods as well). In addition, unrelated to the backstop, the Government would also still want to secure uninterrupted participation in 'flanking' measures such as the EU's Framework Programme for Research as described above.

6.12 Under such a hypothetical scenario, where border controls were not necessary on any trade in goods between the UK and the EU until a new free trade agreement was in place, the EU might ask the UK to negotiate a financial mechanism covering various different aspects of its continued participation in EU structures. It would of course be up to the Government whether to accept such a proposition or not. Given the state of the negotiations this is necessarily speculative, but such a mechanism *could* include the following elements for reasons set out in more detail in "Background" below:

- A payment towards the cost of the EU agencies relating to goods in which the UK would still be a participant, including the European Medicines Agency and the European Chemicals Agency;[96]
- Depending on the extent to which the UK remained bound by the EU's rules on customs, a revenue sharing mechanism for customs duties, under which the UK could have to transfer at least some of the duties collected on imports at UK ports to the EU budget (Member States of the EU have to allocate 80 per cent of duties collected on imports entering the Customs Union, set to increase to 90 per cent from 2021);[97]

94 The EU-Turkey arrangement has not eliminated tariffs and quotas on all goods (as unprocessed agricultural goods are excepted); it does not remove the need for customs (or regulatory) controls at its border with Bulgaria and Greece; and nor does it obviate the need for VAT and excise controls on goods entering the EU from Turkey. Turkey also does not have any significant role in the EU's trade negotiations with third countries, even though it must adjust its tariff barriers when the EU negotiates trade liberalisation with other countries.

95 For example, the EU has previously said the 'full alignment' backstop—effectively extending the Customs Union, single VAT area and Single Market for goods—is available only to Northern Ireland, not the UK as a whole. That raises the question that an extension of parts of the transition for the UK as a whole could not be negotiated in time for inclusion in the Withdrawal Agreement, necessitating further negotiations with the EU during the transitional period on a new treaty. This agreement would require fresh votes in the Council and the European Parliament, and possibly the EU's national parliaments.

96 Other EU agencies which play a role in the Single Market for goods are the European Food Safety Authority and the Community Plant Variety Office.

97 The European Commission already indicated that as a possibility under its own 'backstop' proposal, where only Northern Ireland would stay in the Customs Union. The backstop as envisaged by the Government may also lead the EU to ask for an agreement on the level of subsidies for farmers. No developed country outside the Common Agricultural Policy has complete tariff-free access to the EU market for agricultural goods.

- The establishment of an economic assistance programme for the EU's low-income Member States along the lines of the EEA and Norway Grants or Switzerland's "Enlargement Contribution", although under the existing precedents such funding is managed bilaterally by the contributing countries and not paid into the EU budget; and
- A contribution towards UK participation in the EU programmes in which the UK wants uninterrupted involvement from the day the transitional period ends, including the Framework Programme for Research and the European Defence Fund (see above).

6.13 In addition, the Government has yet to announce whether it wants to stay in the EU Emissions Trading System after the end of the transitional period. If it does so, the UK might be affected by the Commission proposal to transfer part of the public revenues of emissions auctions to the EU budget (see paragraphs 6.39 to 6.41). There are also of course costs associated with the domestic replication of expenditure in the UK currently handled by the EU, such as agricultural subsidies or regional development funding. We consider those are more appropriately matters for the other Select Committees to consider.

6.14 We also considered the hypothetical possibility of a longer 'full' transitional period (i.e. on the terms laid down in the draft Withdrawal Agreement, but lasting beyond 31 December 2020).[98] This was the Government's own position as recently as March 2018, when it stated that the transition should last "around two years" (i.e. until the middle of 2021, and therefore into the next MFF period), and was recently referred to again by the Secretary of State for International Trade.[99] Our analysis of the possible financial implications of this scenario are set out in more detail in paragraphs 6.70 to 6.84 below.

6.15 In summary, if the Withdrawal Agreement were ratified—given none of its provisions, even those agreed at negotiators' level, are currently legally-binding—*and* the transitional arrangement it contains were to last into 2021, the UK would likely have to negotiate a specific exclusion from the MFF Regulation and Own Resources Decision to avoid the UK becoming a contributor to the EU budget above and beyond the financial settlement agreed in December 2017. This is also what the Chancellor told us earlier this year, when he explained that "if there were a question about extending the implementation period" that "would be on the basis of a negotiated arrangement about any financial implications of that. It would not be by way of the UK's adhering to and participating in the next MFF".[100]

Conclusions

6.16 **The uncertainty around the UK's future economic and security partnership with the EU means it is impossible to determine the exact financial implications of the next Multiannual Financial Framework for the UK.**

98 As noted, beyond 31 December 2020 the UK would still pay towards EU financial obligations that arose before that date but remained outstanding. Those contributions will decrease over time.

99 The Secretary of State (Liam Fox) told Sky News on 24 June 2018 that he "would be prepared to accept an extension to the Brexit transition period". In late May 2018, the Times had already reported that "Britain will ask for a customs and regulatory alignment implementation period from 2021 to at least 2023 to avoid the need for infrastructure or checks on the border".

100 Oral evidence by the Chancellor of the Exchequer, Q187 (5 March 2018).

6.17 **Under any scenario where the UK remains involved in EU programmes or agencies as a 'third country', a financial contribution will be required which will be linked to the EU's own budget in that area (and therefore to the expenditure limits for different policy areas to be established by means of the MFF). We are disappointed that the Minister's Explanatory Memorandum fails to provide any meaningful information about the Government's proposals for a funding mechanism for the EU programmes and agencies in which the UK wants to participate as part of the new UK-EU partnership. Using the EU's normal methodology for 'third country' contributions to the specific Programmes, the gross UK contribution could run into billions of pounds annually.**

6.18 **Moreover, the Government's high-level proposals for the new economic partnership with the EU envisage a trade agreement which ultimately obviates the need for any border controls on goods moving between the UK and the EU. That is also the objective of its recent outline for the customs-related aspects of the Irish 'backstop'. In all likelihood, any economic relationship with the EU which is that close is likely to lead to additional requests for financial contributions to the EU (which the Government would, of course, be free to refuse). For example, under the 'temporary customs arrangements' the Cabinet Office put forward in June, the UK may have to transfer a share of the customs duties it collects to the EU (potentially under the terms of new EU budgetary legislation, the Own Resources Decision, over which the Government and Parliament will lose their veto[101] on 29 March next year). It is also clear from the EU's economic relations with Switzerland, Iceland and Norway that close integration into even a part of the Single Market is usually accompanied by a request for financial contribution towards the economic development of the EU's lower-income Member States (although such funding is not paid to the EU, but managed by the contributing and recipient countries bilaterally). We have taken note of the Government's position that "any final decision on [Cohesion Fund] participation [after 2020] will be taken as part of the discussions on the Future Economic Partnership with the EU".[102]**

6.19 **In light of our concerns about the lack of clarity as to the financial implications of both the future partnership and the proposed UK-wide backstop, we have written to the Chief Secretary to the Treasury with a number of additional questions about the Government's approach on the MFF negotiations. In the absence of further detail about the Government's position on the cost to the UK taxpayer of its proposals on continued UK involvement in certain areas of EU activity, we will—as a matter of prudence—scrutinise the MFF proposals as having a significant (but unknown) financial impact on the UK taxpayer. As such, we retain the proposed MFF Regulation and the proposals for the EU's Own Resources under scrutiny, and draw them to the attention of the Exiting the EU, Public Accounts and Treasury Committees.**

6.20 **We now rescind our earlier recommendation for a debate on the 2018 EU budget given that our previous considerations on the Brexit financial settlement have been overtaken by events, but we will consider whether the MFF proposal requires a debate in the House based on any further developments in the negotiations on the UK's future partnership with the EU and the Government's upcoming Brexit White Paper.**

101 Under the Treaties, the Own Resources Decision requires the unanimous approval of the Member States in the Council and "approved by the Member States in accordance with their respective constitutional requirements". In the UK, under the European Union Act 2011, this requires an Act of Parliament.

102 Explanatory Memorandum submitted by the Department for Business, Energy & Industrial Strategy on the European Commission's 2021–2027 Cohesion Fund proposals (13 June 2018).

Full details of the documents

(a) Proposal for a COUNCIL REGULATION laying down the multiannual financial framework for the years 2021 to 2027: (39683), 8354/18, COM(18) 322; (b) Proposal for a Council Decision on the system of Own Resources of the European Union: (39686), 8357/18, COM(18) 325; (c) Proposal for a Council Regulation laying down implementing measures for the system of Own Resources of the European Union: (39688), 8359/18, COM(18) 327; (d) Proposal for a Council Regulation amending Regulation (EEC, Euratom) No 1553/89 on the definitive uniform arrangements for the collection of own resources accruing from value added tax: (39839), 8360/18, COM(18) 328; (e) Proposal for a Council Regulation on the methods and procedure for making available the Own Resources based on the Common Consolidated Corporate Tax Base, on the European Union Emissions Trading System and on Plastic packaging waste that is not recycled, and on the measures to meet cash requirements: (39687), 8358/18, COM(18) 326.

Background

6.21 On 2 May 2018, the European Commission presented its proposal for the next long-term EU budget (the 'Multiannual Financial Framework' or MFF) for the 2021–27 period.

6.22 By means of a Regulation, the MFF will establish the cumulative spending limits for spending in broad areas of policy from the annual EU budgets from 2021 to 2027 (e.g. the heading "Single Market and Innovation", which includes the Framework Programme for Research, or the heading "Migration and Border Management", from which the EU's Border & Coast Guard Agency is funded). Specific multi-annual funding allocations for specific programmes, including the Common Agricultural Policy, will be established in programme-specific Regulations to be negotiated in parallel to the overall MFF limits. The Commission has begun publishing those detailed proposals, which we will scrutinise separately in the coming months to assess their implications for the UK.

6.23 The MFF Regulation (and therefore the overall spending limits by which the EU is bound) is subject to the veto of each EU Member State, and requires a vote of approval in the European Parliament.[103]

EU expenditure from 2021 to 2027: The substance of the proposed MFF

6.24 Although the UK's exit from the EU results in the loss of one of the largest net contributors to the EU budget, the European Commission proposal would nevertheless establish an overall spending limit of €1.134 trillion (£978 billion) over the 2021–27 period, down only slightly from the €1.137 trillion (£975 billion) in the 2014–2020 period (adjusted for inflation).[104] As a result, the Commission says the new MFF would be "comparable to the size of the current Financial Framework" but as a share of the EU's Gross National Income (GNI) it would increase from 1 to 1.11 per cent.

103 The UK does not, in practice, have a veto anymore, as the MFF Regulation is likely to be adopted after the Government loses its seat on the Council on 29 March 2019.

104 European Parliament Research Note (http://www.europarl.europa.eu/RegData/etudes/BRIE/2018/621864/EPRS_BRI(2018)621864_EN.pdf).

6.25 In terms of funding for specific policy areas, the Commission has proposed splitting the previous five main 'headings' of the EU budget into seven, with indicative funding allocations over the seven-year period as shown in the table below.

Table 1: MFF 2021–27 (Source: European Commission)

MFF heading	Proposed 2021–27 MFF limit	In £	Share of total MFF	Increase (real, %) compared to the 2014–20 MFF at EU-27[105]
1. Single Market, Innovation & Digital	€166 bn	£146 bn	14.7%	+43%
2. Cohesion and Values	€392 bn	£345 bn	34.5%	+1%
3. Natural Resources and Environment, including the CAP	€337 bn	£296 bn	29.7%	-16%
4. Migration and Border Management	€31 bn	£27 bn	2.7%	+210%
5. Security and Defence	€24 bn	£21 bn	2.1%	
6. Neighbourhood and the World[106]	€109 bn	£96 bn	9.6%	+14%
7. Administration	€76 bn	£67 bn	6.7%	+7%
Total	€1.134 trillion	£998 bn	100.00%	+5%

6.26 As described by the Chief Secretary to the Treasury in her Explanatory Memorandum on the MFF proposal, even though the overall size of the long-term EU budget would be reduced, the allocations between different policy areas have shifted considerably. The Commission has proposed substantial increases for innovation (including research), border management and security, and external relations. These would be financed by cuts real-term to agricultural subsidies and cohesion funding.[107] Nevertheless, agricultural payments and cohesion policy funding would still account for just over half of all EU expenditure. The Committee is assessing the Commission's funding allocations for individual programmes within the above headings in more detail, and on a case-by-case basis, as part of its scrutiny work in the coming months.

6.27 In response to concerns about the deterioration in respect for the rule of law in several EU Member States, the Commission has also tabled a proposal for a new mechanism allowing it to suspend EU budget payments to countries where the sound management of EU money cannot be guaranteed. We have considered this 'rule of law proposal' in a separate chapter of this Report.

105 The Commission removed the UK's share of EU funding under the 2014–2020 EU budget to calculate the percentage increase compared to the proposed 2021–2027 MFF.

106 For comparison purposes this heading also includes the European Development Fund for development assistance to the ACP countries, even though the Fund is currently 'off-budget' and therefore not part of the 2014–2020 MFF.

107 Cohesion Policy is delivered through three main funds, the European Fund for Regional Development, the European Social Fund and the Cohesion Fund.

6.28 Given the proposed overall increase in the MFF as a percentage of the EU's economic size compared to the current long-term budget, combined with the UK's exit from the EU, the pattern of contributions by the remaining Member States would also change. This resulted in a clear divergence of positions between the net contributors and net beneficiaries of the EU budget at the General Affairs Council meeting on 14 May 2018, exposing fault lines between the countries which want to maintain current levels of expenditure and those who are reluctant to increase their national contributions to make up for the Brexit shortfall. Since then, 6 Member States have already stated their opposition to the proposed cuts to the Common Agricultural Policy. The European Parliament made some initial recommendations for the long-term budget in March 2018,[108] and also began formally considering the Commission proposal in mid-May.

The EU's system of own resources: how the MFF would be funded

6.29 In parallel to its proposal to establish the EU's spending limits for 2021–27, the Commission has also published draft legislation—the so-called Own Resources Decision—on how the EU budget would be funded during that period. Like the MFF Regulation, the Own Resources Decision must be agreed unanimously by all Member States. In addition, as it provides for the transfer of money from national Governments to the EU, it requires 'approval' at national level in each Member State of the Union before it can take effect.[109] In the UK, under section 7 of the European Union Act 2011, the Government cannot permit an Own Resources Decision to be adopted by the Council unless it is authorised to do so by Act of Parliament.[110]

6.30 The current Own Resources Decision was adopted in 2014 to coincide with the start of the present MFF.[111] Under its provisions, which have in substance remained mostly the same since the 1980s,[112] the revenue which funds the EU budget consists primarily of its so-called Own Resources.[113] This category of revenue can be sub-divided into:

- **Traditional Own Resources** (TOR), which refers to all customs duties and sugar levies collected by the Member States on imports from outside the EU; these are passed on to the European Commission, minus a 20 per cent collection cost which is retained by the Member State of import. TOR are a substantial contribution to the EU budget: in 2015, the EU's revenue from customs duties was €18.6 billion (£16.6 billion), or 12.7 per cent of its total income. The UK's annual contribution from customs duties amounted to €3.15 billion (£2.77 billion);[114]

108 http://www.europarl.europa.eu/sides/getDoc.do?type=TA&language=EN&reference=P8-TA-2018–0075.

109 See article 311 TFEU.

110 Parliament granted its consent for the current Own Resources Decision by means of the European Union (Finance) Act 2015. The European Union Act 2011 also prevents the Government from abstaining on a vote, as that would effectively allow the legislation to be adopted by the other Member States and make it binding on the UK.

111 See Council Decision 2014/335.

112 The Government noted that the 2014 Own Resources Decision "sees very little change to the system in place for the 2007 to 2013 MFF; there will be no new Own Resource, no EU-wide taxes, and no change to the UK abatement". The Commission itself has stated that "the last substantial, qualitative change in the Own Resources system dates back to the 1980s" when GNI-based REVENUE SOURCE was introduced to underpin the increase of expenditure related to implementing the Single Market and the enlargement to new Member States.

113 The 'other resources' of the EU typically amount to less than 5 per cent of its annual revenue. These include for example the taxation of the salaries of EU civil servants, payments by 'third countries' for participation in EU programmes, and penalty payments imposed on Member States or businesses by the EU.

114 http://www.europarl.europa.eu/external/html/budgetataglance/default_en.html#united_kingdom.

- The **VAT-based contribution**, which in essence requires each Member State to pass on a proportion (0.3 per cent for the UK) of its harmonised Value Added Tax base (i.e. the value of all supplies consumed which are subject to VAT) to the EU. The VAT base is calculated using a number of statistical compensations to 'neutralise' the effects of the different VAT rates used by Member States.[115] In 2015, it represented 11.9 per cent (€17 billion) of the EU's revenues; and

- The **Gross National Income (GNI) -based contribution**, which acts as a balancing mechanism and requires the Member States to fill the shortfall between the income delivered by the TOR and VAT revenue sources and the EU's expenditure (as agreed by the Member States and the European Parliament) in any given year by making a direct contribution to the EU budget.[116] Over time, the VAT and TOR revenue streams have become too small to fund the budget. As a result the GNI-based contribution is now the largest source of revenue for the EU: it has increased from covering 10 per cent of the EU budget following its introduction in 1988 to approximately 70 per cent as of 2018 (amounting to €103 billion).

6.31 The Own Resources Decision is also the basis for the UK's budgetary rebate, which effectively gives the Government a veto over its abolition while the UK remains an EU Member State: since any changes require unanimity in the Council, the Government could block any new Own Resources Decision that sought to repeal or modify the abatement, and as a result the existing ORD, including its provisions on the rebate, would remain in effect.

The Commission proposals for new system of own resources

6.32 In a policy paper accompanying the 2018 MFF proposals, the European Commission argues that the revenue side of the EU budget should be reformed to decrease its reliance on the GNI-based contribution:

> "[The] predominant role of the Gross National Income-based contribution fosters the common perception that EU revenues just reflect the Member States' capacity to pay and is hence used to justify the focus on net balances and the existence of corrections. The predominant weight of national contributions on overall EU financing fuels the expectation that the EU returns a 'fair share' of its spending to each Member State, in proportion to their contributions. This in turn has been identified as one element hampering a more consequential reform of the expenditure side in line with a collective logic of European added value."[117]

115 Under the current system, the Value Added Tax bases of all Member States are harmonised in accordance with EU rules. This requires numerous corrections and compensations as well as the calculation of a weighted average rate. These bases are then capped at 50% of the Gross National Income base in order to address the regressive aspects of the VAT -based resource. Finally, a uniform rate of 0.3 per cent is levied on each Member State's harmonised Value Added Tax base, with the exception of Germany, the Netherlands and Sweden which have a reduced call rate.

116 In practice, after the amount which remains to be covered after the TOR and VAT-based resources are accounted for is calculated, it is split into national contributions resulting from the application of a uniform call rate to the Member States' Gross National Income. On average, the call rate has been at 0.6% over the past two decades, although it has risen to 0.7% over 2012–16.

117 Commission document SWD(2018) 172.

6.33 The Commission therefore also tabled a legislative proposal for reform of the system of Own Resources which would:

- Increase the proportion of customs duties collected by Member States that are passed to the EU budget, by reducing the collection costs from 20 to 10 per cent (increasing the annual revenue from the Traditional Own Resources from €23 billion to €26 billion);[118] and

- Simplify the calculation of each country's VAT-based contribution by modifying the statistical adaptations made to strip out the effects of different Member States' VAT rates, which the Commission says "are cumbersome and generate onerous administrative work while their material impact has been at a consistently very low level for many years". Under the reformed system, the 'call rate'—which could not exceed 2 per cent—would be applied to each Member State's standard-rated taxable base (presumed to be 45 per cent of all supplies consumed).[119]

6.34 Crucially however, the Commission also tabled a separate proposal to introduce three new types of own resources to decrease the EU budget's reliance on the GNI-based contribution, to "establish the principle that future revenues arising directly from EU policies should flow to the EU budget".[120] These new resources would be:

- a **share of the Member States' Common Consolidated Corporate Tax Base**;

- a **share of the national revenue generated by auctions under the EU's Emissions Trading System**; and

- a national contribution that is proportional to a Member State's amount of **non-recycled plastic packaging waste**.

6.35 As new types of own resources, these proposals are likely to face considerable opposition from the Member States and the likelihood that they will all be created is very low. Overall, the Commission proposes to set the Own Resources ceiling—the theoretical amount of total contributions made by Member States towards payments from the EU budget in any one year, at 1.29% of the Union's GNI (up from 1.23% currently).[121] The Chief Secretary's Memorandum on the Own Resources Decision states only that "limited policy issues arise" because the UK's financial obligations under the draft Withdrawal Agreement only run until December 2020 and cannot be retrospectively altered by a new ORD (see paragraphs 6.80 to 6.84 below). Nevertheless, given our concerns that the UK payments to the EU after 1 January 2021 may be affected by the new Own Resources Decision depending on policy decisions yet to be made by the Government (see the section on "Potential financial implications for the UK of the 2021–27 MFF"), we have described the new proposed Own Resources individually in more detail.

118 €1 = £0.88605 or £1 = €1.12860 as at 29 June 2018.

119 For example, the UK's VAT receipts in 2017–18 amounted to £125.3 billion with a standard rate of 20%. Under the new calculation method, the UK's standard-rated taxable base would have been £281.9 billion (£125.3 billion × 45% / 20%). With a call rate of 1 per cent, that would have required a contribution to the EU budget of £2.8 billion. The UK's actual VAT-based contribution in 2017 was £3 billion.

120 Commission document COM(2018) 326.

121 These figures also include the European Development Fund, which is currently 'off budget' and therefore not included in the Own Resources ceiling of the MFF.

CCCTB own resource

6.36 In 2016, the European Commission re-launched its proposal for a Common Consolidated Corporate Tax Base (CCCTB), which would allow companies with operations in more than one EU country to comply with a single EU-wide set of rules for calculating their taxable income and file one tax return for the entire Union. These consolidated taxable profits would then be shared between the Member States in which the company is active, at the applicable national rate. This apportionment would use a formula to determine what proportion of profits were generated in a specific Member State.[122] The Government opposes the proposal, and the House of Commons issued a Reasoned Opinion against the legislation, arguing it breached the subsidiarity principle.

6.37 Although the CCCTB proposals remain to be agreed between the Member States, the Commission has now suggested linking the corporate tax raised through the new system to the EU budget. The new corporate tax-base contribution would be calculated by applying a 'call rate' on the value of the taxable profits of those companies for which the CCCTB would be compulsory, as apportioned to each Member State.[123] The Commission estimates, based on 2012 data, that a 'call rate' between 1 and 6 per cent would yield revenue for the EU budget of between €4 billion and €23 billion annually.[124]

6.38 The use of the CCCTB as a basis for an 'Own Resource' for the EU budget would require the legislative framework establishing the harmonised EU-wide method of its calculation and consolidation to be in place. At present, it seems unlikely that it will be in place by 1 January 2021, when the new Own Resources Decision would take effect. However, we note that negotiations within the Council on the common rules for the calculation of corporate tax remain live as of summer 2018, with EU Finance Ministers engaging in a high-level policy debate at the ECOFIN Council meeting on 22 June.[125] Under the terms of the post-Brexit transitional arrangement, the UK would be required to apply new EU legislation on corporate taxation if it took effect before the end of the transition.

ETS own resource

6.39 The Emissions Trading System is one of the main instruments to reduce greenhouse gas emissions in the EU. It sets a cap on the total amount of greenhouse gases that can

122 The CCCTB proposal consists of two separate Directives: one to legislate for the introduction of the 'common' tax base (i.e. the rules for calculating the corporate tax base), and a supplementary proposal for the 'consolidation' element (i.e. allowing for EU-wide profits to be filed as a single tax return, with taxation redistributed to the relevant Member States).

123 The Commission has propo sed that the use of the CCCTB would be compulsory for cross-border groups with revenues exceeding €750 million (£658 million) annually. Taxable profits of companies outside the mandatory scope of the CCCTB Directive (i.e. those of companies below the size threshold or outside the other criteria) would be excluded for the purposes of calculating the contribution to the EU budget.

124 According to the Commission, the total corporate tax base in the EU-27 (i.e. minus the UK) was estimated at nearly €380 billion in 2012.

125 The Franco-German 'Meseberg Declaration' of 19 June 2018 also contains a commitment to "put in place actual tax convergence between France and Germany regarding corporate tax". Including a "common position on the Commission proposal for a directive establishing a Common Corporate Tax Base" which Paris and Berlin "will promote it jointly in order to support and accelerate the European project to harmonise the corporate tax base in Europe".

be emitted by the sectors covered. Companies buy emission allowances to cover their activities (although some industries receive them for free on a transitional basis).[126] Most of the auctioned allowances are used by the energy sector.

6.40 The Commission has proposed that Member States should pass a share of the revenues generated by their ETS auctions to the EU budget. This new contribution would be calculated using 90 per cent of the allowances distributed to all Member States for auctioning (excluding aviation emissions and the special allowances for the less-developed EU countries).[127] However, it would cover the allowances which lower-income EU countries are allowed to use at their discretion to provide to their electricity generation sector for free (so that the new Own Resources Decision would not provide these countries with a perverse incentive to increase the share of free allowances to reduce contributions to the EU budget).[128]

6.41 The auctioning of allowances generated €21.3 billion of revenue for the EU's Member States from 2013 to 2017 (although that figure includes UK auctions). The Commission estimates that annual average revenue for the EU budget of this new contribution could vary between €1.2 billion and €3 billion, depending on the carbon price and auction volumes. As the Government is yet to announce whether it will seek to remain a full member of the EU ETS even after Brexit,[129] it is not clear what this new 'Own Resource'—if agreed by the remaining Member States—would have for the UK.[130] The Chief Secretary's Explanatory Memorandum is silent on this issue.

Plastic waste own resource

6.42 In January 2018, the European Commission adopted an EU Plastics Strategy which set out the EU's policy options for increasing recycling rates of plastic waste and reducing its leakage into the environment.[131] In spring 2018, the Council and Parliament also adopted a new Directive which sets an EU-wide recycling target of 55 per cent for plastic packaging waste by 2030.[132]

6.43 To further incentivise Member States to reduce plastic waste while also generating revenue for the EU budget, the Commission has now proposed to require each EU country

126 Under the ETS Directive, the EU's manufacturing industry receives a substantial share of its allowances for free, although the proportion will decrease from 80% in 2013 to 30% in 2020. The energy sector in some Member States also receives some of its emission allowances for free to modernise their infrastructure. Airlines continue to receive the large majority of their allowances for free in the period 2013–2020.

127 The Commission notes that the 10 per cent of allowances which are redistributed "for the purposes of solidarity, growth and interconnections" will be excluded from the calculations, as will the 2 per cent of allowances sold to finance the ETS Modernisation Fund (which will investment in modernising the power sector and wider energy systems and boosting energy efficiency in 10 poorer EU Member States).

128 Currently, 10 Member States have the possibility to allocate up to 40 per cent of their allowances for free. The UK is not covered by this optional scheme. For the purposes of the Own Resource, the hypothetical revenue arising from these allowances will be calculated using their market value.

129 See oral evidence by Energy Minister Claire Perry MP to the House of Lords EU Select Committee (21 March 2018). The Minister did not rule out the UK seeking to stay part of the EU ETS until the end of Phase 4 (which runs from 2021 to 2030).

130 The UK could also seek to establish its own ETS and 'link' it to the EU's version. For example, under the terms of the EU-Switzerland Agreement, emission allowances that can be used for compliance under the EU ETS are recognised for compliance under the Swiss system and vice versa. See our Report of 21 February 2018 for more information on the Agreement, and the implications in the context of the UK's exit from the EU.

131 See for more information on the EU Plastics Strategy our Report of [date].

132 See for more information on the amendment to Directive 94/62/EC on packaging and packaging waste our Report of 2 May 2018.

to make a contribution proportional to the quantity of plastic waste in their territory that is not recycled (using data on recycling rates that EU law already requires Member States to gather and report).[133] In practice, the contribution would consist of a yet-to-be-determined 'call rate'—up to a maximum of €1 (£0.87)—multiplied by the kilogrammes of non-recycled plastic packaging waste in each Member State.

6.44 According to the Commission, the EU (minus the UK) generated 13.6 million tonnes of plastic packaging waste in 2015, of which 40 per cent was recycled.[134] As that would impose the new levy on just over 8 million tonnes of unrecycled waste, revenues from this Own Resource would range between €4 and €8 billion (£3.5 to £7 billion) per year (depending on the 'call rate' applied, which in this example would range from €0.50 to €1 per kilogramme).

The EU's revenue under the Commission proposal

6.45 The projected amounts of revenue generated under the new system of Own Resources as proposed by the Commission are shown in the table below. As can be seen, despite the UK's exit the revenue from customs duties would remain roughly constant by increasing the total proportion passed to the EU budget. Conversely, the GNI-based contribution would be reduced substantially by increasing yield from the VAT-based own resource and by means of the new 'own resources'.

Estimated evolution of the structure of EU financing

	Budget 2018		Estimated Average 2021-2027	
	EUR billion	% of total revenue	EUR billion	% of total revenue
Traditional Own Resources	**23**	**15,8 %**	**26**	**15 %**
Existing national contributions of which	**120**	**82,9 %**	**128**	**72 %**
(Reformed) Value Added Tax-based Own Resource	*17*	*11,9 %*	*25*	*14 %*
Gross National Income-based Own Resource	*103*	*71,0 %*	*103*	*58 %*
New Own Resources of which	**-**		**22**	**12 %**
Own Resource based on the Common Consolidated Corporate Tax Base	-	-	12	6 %
EU Emissions Trading System-based Own Resource	-	-	3	2 %
Plastic packaging waste-based Own Resource	-	-	7	4 %
Total Own Resources	**143**	**98,7 %**	**176**	**99 %**
Revenue other than Own Resources	2	1,3 %	**2**	**1 %**
Total Revenue	**145**	**100,0 %**	**178**	**100 %**

Figure 1: Projected EU revenue 2021–27 (source: European Commission)

133 The recent amendment to the Packaging and Packaging Waste Directive will establish more precise "rules according to which Member States should report what is effectively recycled and prepared for re-use and can be counted towards the attainment of the targets". The Commission notes, however, that "the data should be further improved, in particular for some Member States and as regards recycled plastics packaging".

134 ICF Consulting Services Ltd (2018), Plastics: Reuse, Recycling and Marine Litter", a study prepared for the European Commission (not yet published).

Abolition of the UK rebate and other 'budgetary corrections'

6.46 Since 1984, the UK has enjoyed a 'correction' to its contributions into the EU budget to reflect the imbalance between payments into the budget and its receipt of EU agricultural subsidies (and given that the UK, at that point, had a lower per capita income than the European Community average).[135] This is popularly called the UK rebate.

6.47 The UK rebate in turn spawned other rebates and corrections. In particular, since 2002 Austria, Germany, the Netherlands and Sweden have benefited from a reduction in their contribution towards the UK rebate. In addition, reflecting their position as net contributors, Germany, the Netherlands and Sweden currently enjoy a reduced 'call rate' for their VAT-based contribution, and Austria, the Netherlands, Sweden and Denmark also receive a lump-sum reduction to Gross National Income-based contributions.

6.48 The Commission argues that Brexit offers an opportunity to "render the EU budget more coherent and streamlined" because it renders "the rebates and other correction mechanisms obsolete". It has proposed to remove all the 'correction mechanisms' referred to above, including the UK rebate in view of its exit from the EU. However, to "avoid a significant and sudden increase in the contributions" of the other Member States which have rebates, they would receive lump sum reductions to their GNI-based contribution (which would be gradually phased out by 2025).

Potential financial implications for the UK of the 2021–27 MFF

6.49 As a Member State, the UK is a net contributor to the EU budget. From 2014 to 2016, the UK's average annual share of gross contributions to the budget was just over €17 billion (£15 billion), while its average share of EU expenditure received over the same period amounted to approximately €7 billion (£6 billion) per annum.

6.50 The Office for Budget Responsibility have forecast that the UK's contribution to the 2014–20 Multiannual Financial Framework, including the Brexit financial settlement under which the UK will remain a contributor on its current terms as a Member State until the end of 2020, will amount to 12.4 per cent of all EU spending commitments (marginally lower than the 12.7 per cent estimate previously used by the Treasury). Under the terms of the draft Withdrawal Agreement, if eventually ratified to make it legally-binding, the UK would also pay for a share of the EU's expenditure commitments still outstanding after December 2020. This means it would contribute towards the 'payment appropriations' of the EU annual budget even under the new MFF, but those yearly amounts would decrease over time.[136] However, if the transitional period ends on 31 December 2020, the UK would not be legally required to pay towards any *new* spending commitments made under the proposed 2021–27 financial framework.

6.51 Had the UK remained a Member State, with a contributing share of 12.4 per cent, it could have been expected to pay approximately £126 billion towards the 2021–27 MFF

135 That year, the European Council at the Fontainebleau European Summit concluded that "any Member State sustaining a budgetary burden which is excessive in relation to its relative prosperity may benefit from a correction at the appropriate time".

136 The European Commission notes: "Potential additional contributions by the United Kingdom honouring its obligations assumed as an EU Member State that have to be paid beyond 2020 could reduce the financing needs to be covered by Own Resources, particularly at the beginning of the next Multiannual Financial Framework. However, such contributions cannot be factored in with certainty as long as no withdrawal agreement has been signed with the United Kingdom."

expenditure ceilings proposed by the Commission. However, irrespective of the UK's scheduled withdrawal from the EU, there are two scenarios under which the next MFF and its specific funding programmes remain important for the UK:

- Firstly, even under the new post-Brexit partnership, the Government has already said the UK will seek continued participation in specific EU funding programmes and agencies in the long-term. The UK's contribution in return for participation, where acceptable to the EU-27, will be linked to the EU's own planned expenditure under the new MFF, so that the British payment is at least proportional to what the remaining Member States are putting in;

- Secondly, it is not yet clear that the UK will actually fully be a 'third country' vis-à-vis the EU when the MFF starts on 1 January 2021. The Government has already announced that it wants the entire UK to stay part of a 'customs arrangement' which eliminates all tariffs and customs controls until an alternative customs agreement is agreed which obviates the need for customs controls on UK-EU trade in goods, particularly across the Irish border. It says it 'expects' this arrangement to end by December 2021 at the latest, but has not introduced an actual sunset clause to that effect. Any continued participation of the UK in all or parts of the Customs Union and the Single Market for goods could require a specific financial contribution in addition to the aforementioned payments for involvement in specific EU programmes.

6.52 We have described the political and financial implications for the UK of both of these scenarios in more detail below.

UK contributions to the EU as a 'third country'

6.53 The first aspect of the 2021–27 MFF's significance for the UK after Brexit lies in the Government's stated desire to continue the UK's participation in specific programmes and agencies funded by the EU budget.

6.54 Certain EU funding instruments with a strong cross-border or collaborative element are open to participation by 'third countries', in return for a financial contribution and acceptance of the legal framework for the programme as established by the European Parliament and the Council. Formalised cooperation typically requires a specific legal agreement with the EU to be in place, for example the EU-Ukraine Agreement on scientific cooperation or the EU-Switzerland agreement on Swiss participation in the ITER nuclear energy project. As part of its post-Brexit planning, the Government has already expressed an interest in seeking such participation in the 2021–27 successors to current iterations of some specific programmes:

- The Framework Programme for Research (FP9 or 'Horizon Europe');[137]

- The Euratom Research & Training Programme for nuclear energy,[138] including the ITER research programme for nuclear fusion;[139]

137 On 21 May 2018, the Prime Minister explicitly stated the Government was seeking formal association of the UK to the 2021–2027 Framework Programme for Research and the Euratom Research & Training Programme.

138 Speech by the Universities Minister (Sam Gyimah) on 28 May 2018.

139 See the Committee's Report of 10 January 2018.

- The Galileo and Copernicus satellite-based navigation and observation programmes;[140]
- The European Defence Fund for research into, and the development of, military technology;[141] and
- The EU's funding instruments for development assistance in Eastern Europe, Africa, Asia, the Caribbean and the Pacific, including the successor to the current European Development Fund.[142]

6.55 The European Commission proposal for the 2021–27 MFF also cautiously assumes that some form of UK 'third country' contribution will take place after Brexit, noting that "external contributions, notably from the United Kingdom, may alleviate the strain on Own Resources" (i.e. the size of the remaining Member States' contributions to the EU budget).[143]

Conditions for and restrictions on UK participation in EU programmes as a 'third country'

6.56 The extent to which the current iterations of any relevant EU programmes allow for full participation by 'third countries' varies. For example, while the Framework Programme for Research contains a mechanism for 'association' by non-EU countries which is widely used, third country participation is not foreseen for the European Development Fund or most of the European Defence Fund. Even during the post-Brexit transition, when the UK remains a full budgetary contributor, the EU can already exclude the UK from certain "sensitive" programmes—including parts of the Galileo satellite navigation project and the European Defence Fund.[144]

6.57 The European Council, in its March 2018 Guidelines on the "future framework", was clear that any UK participation of this kind would be based on the conditions and restrictions established by the EU as regards 'third country' involvement generally:

> "Regarding certain Union programmes, e.g. in the fields of research and innovation and of education and culture, any participation of the UK should be subject to the relevant conditions for the participation of third countries to be established in the corresponding programmes."[145]

6.58 As all EU funding programmes need to be re-established with a new legal framework at the start of each MFF, it is not yet possible to say what the exact conditions for UK participation as a 'third country' from 2021 onwards would be for the programmes in

140 HM Government, "Technical note on UK participation in Galileo" (May 2018).
141 See the Committee's Report of 9 May 2018.
142 The Government's May 2018 policy paper on the 'Framework for the UK-EU Security Partnership' said it wants to "explore a mechanism that allows for future UK-EU cooperation in specific geographic and thematic areas, where it is in our mutual interests. For the UK to make a contribution to an EU programme or instrument, it would need to play an appropriate role in the relevant decision-making mechanisms. UK entities would be eligible to deliver EU programmes and receive funding".
143 Commission document SWD(2018) 172.
144 This exclusion of the UK from 'sensitive' EU programmes can be triggered at the EU's discretion under Article 122(7) of the draft Withdrawal Agreement, to which the Government has already agreed. That effectively implies the Government would be making financial contributions towards EU programmes where UK entities would not be eligible to receive any funding back.
145 European Council Guidelines on Article 50 (23 March 2018).

which the Government is seeking continued involvement (see paragraph 6.56 above). The programme-specific requirements or restrictions on non-EU involvement will be determined by the Regulations that underpin them (as agreed between the EU Member States and the European Parliament). For the 2021–27 MFF, those discussions will take place in the coming months and years.

6.59 While the UK will be able to participate in the Council's negotiations on the next MFF and the legal frameworks for individual EU funding programmes while it remains a Member State, it is likely to lose its voting rights before any of the proposals are formally agreed between the Council and the European Parliament.[146] It will therefore be paramount that the Government secures the best possible 'third country' mechanisms in the draft Regulations for Programmes where UK participation is desirable, and this will be an area of focus for the Committee as it scrutinises the programme-specific proposals in the coming months.

The UK's financial contribution to EU programmes as a 'third country'

6.60 One of the biggest questions about UK involvement in EU programmes as a 'third country' will be the requisite financial contribution once it is no longer paying into the EU budget as a Member State, and the formal levels of participation and of influence this brings in return.[147] As the Chief Secretary notes in her Explanatory Memorandum, for "any UK participation in policies and programmes in the next MFF", the Government would "expect to make an ongoing contribution to cover our fair share of the costs involved and the exact terms would be subject to negotiation". However, she makes no attempt to set out the UK's proposals for the calculation of that contribution.

6.61 Instead, we are left to examine existing precedent. Where EU programmes make provision for participation by non-Member States, the 'third countries' in question typically make an annual financial contribution which is calculated based on the EU's own budget for the programme for any given financial year and the third country's share of the total GDP of the EU plus the country itself (the so-called 'proportionality factor', which for the UK currently stands at approximately 16 per cent).[148] This underpins, for example, the mechanism agreed by Norway and Switzerland with the EU to allow for the full participation their researchers in the Framework Programme for Research.[149] In practice therefore, the contribution a third country makes is decided largely for them by the EU, as it is the main variable is the contributions the Member States themselves are expected to make as part of the annual EU budget.

146 The European Commission's ambition is for the MFF Regulation to be adopted prior to the European elections in May 2019.

147 In a pure 'third country' scenario, where the UK voluntarily seeks case-by-case participation in EU programmes, the Own Resources Decision would not be relevant as the UK would not pay into the EU budget as a Member State or be bound by EU budgetary legislation.

148 By way of example, under the financial mechanism as it applies to (for example) Norway, where the UK's share of the GDP of the EU-27 and the UK combined is 16 per cent and the EU's budget for programme Y in year X is €100 million, the UK's contribution would be €16 million (taking the total budget for programme Y to €116 million that year). The exact calculation can vary: for example [Switzerland and ITER?].

149 This EU-third country financial mechanism in advance as part of a wider agreement: it does not allow for the associated countries to negotiate their contribution year-by-year, based for example on the amount of funding they received back from a specific EU programme to which they contributed. There is no rebate, as the UK enjoys at present as a Member State.

6.62 In terms of influence over the strategic direction or priorities of EU funding programmes, 'association' buys the governments of third countries only limited formal leverage. While their representatives can typically attend the technical committees where EU Member States have to approve work programmes (and sometimes individual funding decisions) put forward by the European Commission, they act as observers only and have no voting rights. The position of the UK Government is that it is willing to make "appropriate" financial contributions to specific EU programmes, but that this should in turn come with a "suitable level of influence" for the UK.[150] It has so far refused to define either what "appropriate" means in this context (for example, whether the 'GDP approach' as outlined in paragraph 6.63 would be acceptable), or specify what it believes a "suitable" degree of influence would look like in practice (for example, whether that condition is met by being granted the same observer status on the relevant technical committees as other 'third countries'). As noted, the Treasury's Explanatory Memorandum on the next MFF provides no further clarity about the Government's thinking in this regard.

6.63 Moreover, the issue of Brexit will also politicise the question of any UK participation and the size of its expected financial contribution. For example, the Commission has proposed what is, in effect, a UK-specific financial contribution mechanism for participation in the next Framework Programme for Research (FP9 or 'Horizon Europe'). Under its proposal, the UK's payments would be subject to an "automatic correction of any significant imbalance compared to the amount that entities established in the [UK] receive through participation in the Programme": in other words, the UK would have to pay more into the Programme than it does at present to ensure it does not remain a net beneficiary when it becomes a 'third country'.[151] Several of the Commission proposals for funding programmes under the 2021–27 MFF, including FP9, Creative Europe and Erasmus+, also explicitly state that the UK, as a third country, cannot have an agreement which "confer[s] a decisional power", presumably voting rights, within the committees that oversee the European Commission's management of those programmes.

6.64 If the other Member States and the European Parliament accept these proposed parameters, it will severely constrain the Government's room for manoeuvre in negotiating participation agreements. Whether the EU institutions will seek to modify those provisions to facilitate full participation of the UK in specific programmes in return for a balanced financial contribution will be a major test of the Government's strength in the negotiations on the future UK-EU partnership.

The potential cost of UK participation as a 'third country'

6.65 Given the uncertainties about which programmes the UK will actually participate in once it is fully a 'third country' vis-à-vis the EU, and the substance of the financial mechanisms to underpin such involvement (which may differ on a case-by-case basis), it is impossible to estimate *a priori* the total annual cost to the UK taxpayer of programme-specific participation. However, by way of example, under the 'GDP approach' used to

150 See for example the Prime Minister's speech of 21 May 2018: "*In return [for a financial contribution] we would look to maintain a suitable level of influence in line with that contribution and the benefits we bring*"; the Government's May 2018 paper on the UK-EU Security Partnership: "*For the UK to make a contribution to an EU programme or instrument, it would need to play an appropriate role in the relevant decision-making mechanisms*"; or the letter by Universities Minister Sam Gyimah to Sir William Cash dated 23 April 2018: "*The programme allows associated countries a suitable degree of influence, in recognition of the benefits they bring to the programme, and in line with their financial contributions*".

151 The Horizon.

calculate Norway and Switzerland's participation in the Framework Programme for Research (FP8), the UK's annual gross contribution to FP9 *alone* could be €2.3 billion (£2 billion) annually.[152]

6.66 If we assumed for the sake of argument that the UK could obtain participation in all six programmes in which the Government has expressed an interest, using the same calculation of the potential UK contribution based on its GDP and the proposed budget for the 2021–27 period in the Commission's MFF proposal, we could arrive at an estimate of a gross annual contribution of approximately £4 billion, as shown in the table below.

6.67 These estimates are necessarily extremely provisional: in reality, the overall *net* UK contribution would be different because the EU's own budget for these Programmes might be different (lower) than proposed by the Commission; the financial mechanism agreed with the EU might use a different methodology to calculate the UK's contribution (for example, we do not know how the 'automatic correction' could operate in practice to balance the UK's contributions and receipts);[153] there would be funding flowing back from these Programmes to the UK; and it is unclear if the Government could secure full participation in all these areas of EU activity as a 'third country' (or, conversely, if there are other EU programmes not listed here in which it also wants to participate). It also excludes the possibility of any additional direct UK assistance to the EU's low-income Member States as described in paragraph 6.70 below.

Table 2: Potential gross UK contribution to select EU programmes, 2021–27

Programme	Proposed average annual EU budget 2021–27	Option for 'association' by third countries	Potential gross annual UK contribution if participation permitted [154]	Potential gross annual UK contribution in £
Framework Programme for Research (FP9)	€14 bn	Yes	€2.2 bn[155]	£1.9 bn
Euratom Research Programme	€343 mn	Yes	€55 mn	£48 mn

152 The Commission has proposed a total budget for Horizon Europe over the 2021–2027 period of €100 billion. As the UK's share of the cumulative GDP of the EU-27 and the UK is 16 per cent, that would amount to a total contribution over that period of €16 billion or €2.3 billion per annum, taking the total budget for the Programme to €116 billion (notwithstanding similar contributions from other 'third countries'). The UK's contributions for participation in specific EU programmes as a 'third country' will not benefit from its current rebate.

153 For example, a different financial mechanism could be in place under the Framework Programme for Research (where the Commission has proposed linking the UK contribution to its status as a net beneficiary while it was a Member State), or if the Member States do not accept the Commission proposal to merge the off-budget European Development Fund with the Neighbourhood & Development Cooperation Instruments, which would potentially allow the UK to contribute only to a sub-set of the EU's development instruments and therefore lower its contributions.

154 Calculated using a 16 per cent proportionality factor combined with the provisional average EU budget for each programme in the 2021–2027 period.

155 For FP9, the European Commission has proposed an ad hoc financial mechanism for the UK that relies on the UK's receipts from the current Framework Programme for Research as it is currently net beneficiary from the Programme. If that proposal is accepted by the European Parliament and the Member States, and the UK still wants to associate, its contribution may therefore be higher.

156 Switzerland has an 'association' agreement for the EU's satellite navigation programme (i.e. Galileo), which nevertheless does not provide the same access to the Programme as an EU Member State. However, there is no precedent for something similar for the Copernicus earth observation programme.

ITER nuclear fusion project	€867 mn	Yes	€139 mn	£121 mn
EU Space Programme (Galileo & Copernicus)	€229 mn	Partial[156]	€37 mn	£32 mn
European Defence Fund	€1.86 bn	Unclear, possibly for EEA countries only[157]	€297 mn	£260 mn
Neighbourhood, Development & International Cooperation Instrument	€12.8 bn	Unclear[158]	€2 bn	£1.79 bn
Total per annum	**€30 bn**	**-**	**€4.8 bn**	**£4.2 bn**

Other financial aspects of the future UK-EU partnership

6.68 Beyond programme-specific participation there are also other elements of the future UK-EU economic relationship that could entail a financial contribution from the UK to the EU budget.

- The Government has stated explicitly that it is looking to retain **participation in various EU regulatory agencies**, including the European Aviation Safety Agency (EASA), the European Medicines Agency (EMA) and the European Chemicals Agency (ECHA), as part of the new trade agreement with the EU.[159] While there are substantial political and legal obstacles if the UK wanted these bodies to continue fulfilling their current regulatory roles vis-à-vis UK entities (notably continued application of the relevant EU legislation without a say over any future changes),[160] such participation would also event involve a modest

157 The European Commission proposal for the European Defence Fund 2021–2027 is open to EU Member States and the EFTA-EEA countries Iceland, Liechtenstein and Norway only (though this can be changed by the European Parliament and the Council over the course of the legislative procedure). The pilot project for part of the European Defence Fund, the Preparatory Action for Defence Research (PARD) is open to Norway via the EEA Agreement. However, it has reportedly not received any funding from it despite making a contribution. The other element of the Fund for the 2018–2020 period, the Defence Industrial Development Programme, does not currently contain any formal mechanism for full 'third country' participation.

158 The NDIC Instrument is the first time the EU's various development assistance instruments would be merged into a single funding programme. It would also mark the first time the European Development Fund, which finances assistance to the ACP countries and Member States' overseas territories, would be fully 'budgetised'. If the EDF remained 'off-budget' as it is at present, UK participation in that particular programme might be easier as it is constituted by separate treaty, meaning there are fewer limits to participation by a non-EU country (especially in terms of participation in decision-making and governance structures). See for more information our Report of 16 May 2018, in particular paras. 4.16 to 4.20.

159 Speech by Prime Minister Theresa May (2 March 2018): "We will also want to explore with the EU, the terms on which the UK could remain part of EU agencies such as those that are critical for the chemicals, medicines and aerospace industries: the European Medicines Agency, the European Chemicals Agency, and the European Aviation Safety Agency."

160 These regulatory agencies are part of the core institutional framework for the Single Market, which the Government has committed to leaving. While EASA offers the opportunity for non-EU countries to remain covered by its functions (in return for continued UK application of EU aviation legislation), ECHA and EMA do not foresee this possibility for countries outside of the Single Market. Continued use of their regulatory roles would also necessitate the UK remain bound by the EU's legislation on chemicals and pharmaceuticals.

financial contribution to cover a share of the Agencies' running costs.[161] The same applies broadly to **EU agencies in the field of Justice & Home Affairs**, where the Government is also seeking a continued role for the UK even as a 'third country'; and

- Depending on the depth of the new trade partnership, the EU could also request the UK establish an **assistance programme for the Union's lower-income Member States**, similar to the EEA and Norway Grants (the €1.5 billion funding mechanism Norway, Iceland and Liechtenstein established for tthe 2014–2021 period as a condition of their participation in the Single Market under the EEA Agreement) or Switzerland's £1 billion "Enlargement Contribution". Both these programmes are aimed at the economic development of the EU's lower-income Member States, and in particular the countries that have joined the EU since 2004.[162] Although a similar scheme would represent a cost to the UK exchequer, it would not necessarily involve any direct payments into the EU budget (the EEA, Norwegian and Swiss programmes are managed by their respective national governments).

6.69 We have written to the Chief Secretary to the Treasury to request further information about each of these elements of the future partnership, and their financial implications.

Financial implications of continued participation by the UK in the Single Market or Customs Union beyond December 2020

6.70 The second potential scenario under which the next MFF would still be relevant for the UK (and more so, in terms of the likely financial cost) is related to the length of any post-Brexit arrangements that effectively keep the UK in (parts of) the Customs Union or Single Market beyond the scheduled end of the transition on 31 December 2020.[163] In such an eventuality, we consider it likely the UK would be asked to make a continued financial contribution commensurate in some way with its participation in EU structures. As we have stated, it would of course be up to the Government to refuse any such proposition if it did not feel it offered sufficient benefits for the UK in return.

6.71 In January 2018 the Treasury told us that the post-2020 Multiannual Financial Framework is "not relevant to the UK" because "the UK is envisaged to play no part".[164] After setting out our concerns about the financial implications of extending all or part of the transition beyond December 2020 in writing in February,[165] the Committee raised this matter with the Chancellor directly when he gave evidence to us in March. He told us:

> "We are clear that if there were a question about extending the implementation period beyond the end of the MFF, that could not be by

161 In 2018, ECHA, EMA and EASA will receive funding from the EU budget totalling €84.4 million (£74 million). While the UK's payments would therefore be fairly limited, it would still need to be negotiated with the EU before these new arrangements could take effect.

162 Switzerland and the EU are currently in discussions about the future of the former's Enlargement Contribution, which Switzerland proposes should amount to approximately £1 billion over a ten-year period.

163 For the purposes of this Report, we have presumed that the Withdrawal Agreement, including the transitional arrangement, takes effect on 29 March 2019 as planned. The European Commission has published a series of 'Brexit preparedness notices' with sectoral information on the implications for both UK and EU businesses of the UK becoming a 'third country'.

164 Explanatory Memorandum submitted by HM Treasury (29 January 2018).

165 Letter from Sir William Cash to Elizabeth Truss (21 February 2018).

> way of Britain's participating in the next MFF. That would create all sorts of potential problems and, conceivably, long-tail liabilities, which we would not be prepared to take on. If we were to entertain that possibility (…) of an extension into the next MFF, that would be on the basis of a negotiated arrangement about any financial implications of that. It would not be by way of the UK's adhering to and participating in the next MFF."[166]

6.72 If the Government was of the view that more time was needed to prepare the entirety of the UK's new economic partnership with the EU as a 'third country', including the necessary regulatory and customs infrastructure, it could also theoretically seek an extension to the 'full' transition period on the terms already agreed. For example, the UK's proposed legal text for the transitional period, published in March 2018, stated:

> "The UK believes the Period's duration should be determined simply by how long it will take to prepare and implement the new processes and new systems that will underpin the future partnership. The UK agrees this points to a period of around two years [from March 2019], but wishes to discuss with the EU the assessment that supports its proposed end date."[167]

6.73 The Prime Minister and the Secretary of State for Exiting the EU have also repeatedly referred to a transitional period lasting "around two years" from March 2019, i.e. until mid-2021. The Secretary of State for International Trade also recently said he could countenance a transition lasting longer than currently scheduled.[168] However, in addition to facing substantial political and legal hurdles (not least by keeping the UK subject to an increasing volume of EU legislation over which it had no say), such an extension of the transition could also have a significant financial cost.

6.74 Under the terms of the transitional arrangement and the accompanying financial settlement as set out in the March 2018 draft Withdrawal Agreement, the UK would pay into the EU budget until the end of 2020 as if it were still a Member State. Thereafter, it would remain liable for a share of outstanding expenditure commitments undertaken by the EU under the 2014–2020 MFF. In return, the UK would remain eligible for participation in almost all[169] EU funding programmes on current terms (that is to say, as if it were still Member State). As part of the broader transitional arrangement, it would also remain part of the Customs Union and the Single Market to delay the imposition of the trade barriers that the UK becoming a 'third country' vis-à-vis the EU will impose by default while negotiations continue on a free trade agreement that, it is the Government's ambition, will also have the effect of obviating the need for border controls. We reiterate that these financial commitments remain, at present, political only; they are not legally binding on the UK until the Withdrawal Agreement is ratified by both Parliament and the EU.

166 Oral evidence by the Chancellor of the Exchequer, Q187 (5 March 2018).

167 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/682894/Draft_Text_for_Discussion_-_Implementation_Period__1_.pdf.

168 The Secretary of State (Liam Fox) told Sky News on 24 June 2018 that he "would be prepared to accept an extension to the Brexit transition period". In late May 2018, the Times had already reported that "Britain will ask for a customs and regulatory alignment implementation period from 2021 to at least 2023 to avoid the need for infrastructure or checks on the border".

169 Controversially, UK companies were not allowed to bid for new contracts for the EU's Galileo satellite programme even if the transition takes effect in March 2019. It is unclear whether a similar exception will apply to the European Defence Industrial Development Programme.

6.75 If the Agreement is ratified and the transition were to be extended beyond December 2020 for any reason, the European Council's April 2017 guidelines for the Brexit negotiations, which are binding on the European Commission in its negotiations with the Government, are unequivocal about the conditions:

> "To the extent necessary and legally possible, the negotiations may also seek to determine transitional arrangements which are in the interest of the Union and, as appropriate, to provide for bridges towards the foreseeable framework for the future relationship in the light of the progress made. Any such transitional arrangements must be clearly defined, limited in time, and subject to effective enforcement mechanisms.
>
> Should a time-limited prolongation of Union *acquis* be considered, this would require existing Union regulatory, budgetary, supervisory, judiciary and enforcement instruments and structures to apply."

6.76 As a result, the current proposal for a transitional arrangement (i.e. until end 2020) rests entirely on the "time-limited prolongation of the Union *acquis*", which in turn relies—*inter alia*—on the application of the EU's 'budgetary instruments'. This includes the Multiannual Financial Framework, the mechanism for funding the EU budget (the Own Resources Decision) and the EU's annual budgets. A straightforward reading of the EU's position is therefore that for the duration of the transition, whatever its length, the UK would remain a contributor to the EU budget as if it were still a Member State. Any extension would therefore include additional contributions to the EU above and beyond the December 2017 financial settlement.

6.77 We first raised concerns about the possible financial implications of Government's continued ambiguity about the length of the transition in our Report on the 2018 annual EU budget.[170] In the event of an extension, the UK would—from 1 January 2021 until the end of the transition—have to make payments towards the new Multiannual Financial Framework, potentially under the terms of a new Own Resources Decision[171] (although the precise impact of the latter on any further UK contributions is unclear because of certain provisions of the Withdrawal Agreement which prevent retroactive changes that affect the UK's overall financial contribution, see paragraphs 6.80 to 6.83 below). The Government will have lost its veto over both of those pieces of legislation before they are due to take effect.

6.78 Therefore, an extension of the transition on current terms could have the following financial implications:

- The UK would have to contribute towards EU spending which it did not approve, within expenditure ceilings over which it had no say. In 2021, based on the Commission's proposed payment appropriations for that year of €150 billion, a UK share of 12.7 per cent (its estimated present share of contributions as a Member State) would imply a gross UK contribution of €19 billion (£16.6 billion);

170 See the Committee's Report of 19 December 2017.

171 Article 122 of the draft Withdrawal Agreement stipulates that "Union law shall be applicable to and in the United Kingdom during the transition period", and that "during the transition period, any reference to Member States in the Union law (…) shall be understood as including the United Kingdom". Article 2 defines "Union law" as including "the acts adopted by the institutions (…) of the Union", therefore including the Own Resources Decision and the MFF Regulation.

- Not only would the UK be contributing substantial sums of money without having been able to veto the EU's overall spending limits, it would also have no substantial say over *how* the money is spent: the legal frameworks for specific programmes under the next MFF will be decided without the UK. Similarly, the Government would not have voting rights over the EU's detailed annual budgets or on the programme-specific technical committees where funding priorities and financial management are discussed by the Member States;

- Article 122 of the draft Withdrawal Agreement allows the EU to exclude the UK from participation in "sensitive" programmes even during the transition. This is the case, controversially, for tendering for the most sensitive contracts under the Galileo satellite programme and potentially for specific projects under the European Defence Fund. If such exclusions are pushed through by the EU, a prolonged transition would imply the Government making further contributions to EU programmes where UK entities had no realistic prospect of benefitting from that centralised pool of funding; and

- There would also most likely be a lower return for the UK in terms of receipts until there was clarity about the UK's long-term participation in EU instruments like the Framework Programme for Research, and most likely no rebate on the UK contribution (even though a pure transition would also imply the UK remained part of the post-2020 Common Agricultural Policy, in the form to be agreed by the European Parliament and the EU-27, until the end of the transition).[172]

The UK rebate during an extended transition

6.79 In addition to the general financial implications of an extended transition, there is some uncertainty about whether the terms of the Withdrawal Agreement as currently drafted would prevent the UK from facing any additional financial obligations, and stop the EU from abolishing the UK rebate on any of the Government's contributions from 1 January 2021 onwards (i.e. on any UK contributions not covered by the financial settlement agreed late last year, which only runs until 31 December 2020).

6.80 Article 128(2) of the Withdrawal Agreement states:

> "By way of derogation from Part Four [on the transitional arrangement],[173] amendments to Council Regulation 1311/2013 [the current MFF Regulation] or Council Decision 2014/335/EU [the current Own Resources Decision], adopted on or after the date of entry into force of this Agreement shall not apply to the United Kingdom in so far as those amendments have an impact on the United Kingdom's financial obligations."

6.81 The clear purpose of this provision is to ensure that, from the start of the transitional period until the end of the current Multiannual Financial Framework in December 2020,

172 The European Commission tabled its proposals for reform of the Common Agricultural Policy in June 2018. If agreed by the European Parliament and the EU-27, they would take affect at the same time as the new MFF, i.e. on 1 January 2021.

173 Part Four of the Withdrawal Agreement contains the transitional arrangement, i.e. the continued applicability of all EU law to the UK as it did while it was a Member State.

the UK rebate cannot be abolished.[174] The 'correction' would therefore be applied to the Government's contributions in 2019 and 2020 as it did before the UK ceased being a Member State. More generally, any changes to the EU's system of Own Resources that would alter the UK's contributions after it formally exits the EU would not apply.

6.82 However, whether those safeguards would continue to apply should the transition still be in effect from 1 January 2021 onwards is unclear. It should be borne in mind that Article 128 of the Withdrawal Agreement, and the legal text for the financial settlement as a whole, were drawn up based on the UK's participation in the EU's budget—as a contributor and a recipient—until the end of the current MFF on 31 December 2020. It seems unlikely that the EU-27 would agree to an extension to the transition on the currently-agreed terms, but allow Article 128 to effectively exempt the UK from having to contribute fully to the programmes and agencies of which it would still be a beneficiary. In particular, they would be likely to insist the UK also contribute under the terms of the new Own Resources Decision, which would after all also govern the EU-27's contributions to the EU budget from January 2021.

6.83 Therefore, any extension of the transition on its current terms could also lead the EU to require changes to the parameters of the financial settlement to make it reflect the extended length of the UK's transitional participation within the EU's structures. That could involve continued payments into the EU budget above and beyond the contributions agreed as part of the financial settlement, and potentially with no rebate on the contributions from 1 January 2021.

6.84 The prospect of paying into the EU budget beyond 2020 for new expenditure commitments undertaken on the basis of a Multiannual Financial Framework over which the UK had no say would clearly be highly problematic, especially as the Council will be losing, in the UK Government, one of the EU's main proponents of a restrictive budgetary approach.[175] We therefore welcome the Chancellor's comments that any extension would be conditional on the UK not being bound by the 2021–27 MFF Regulation.

The financial implications of the Government proposal for the Northern Ireland 'backstop'

6.85 One scenario that effectively involves an extension of certain elements of the transitional arrangement beyond 31 December 2020 is now official Government policy. It results from the Cabinet Office's position on the 'backstop' to keep the border with Ireland free from any 'hard' infrastructure when Northern Ireland and Ireland cease to be jointly part of the shared European customs and regulatory territories.

6.86 Back in December 2017, the Government and the European Commission agreed that the objective of avoiding regulatory and customs infrastructure on the Irish border would, "in the absence of agreed solutions", be achieved through continued "full alignment" by the UK[176] with EU rules that would make such controls unnecessary. The European Commission's legal text for the 'backstop' was published in February 2018. It would require Northern Ireland to continue applying EU rules on goods, including product standards,

174 At present, the UK has an effective veto over the abolition of the rebate. From the start of the transition, it will lose that veto, hence the need for the rebate to protected in the Withdrawal Agreement.

175 In 2013, the UK Government secured the [first] real-terms reduction in the MFF compared to the previous budgetary period.

176 The EU interpretation of this was that such alignment would apply to Northern Ireland only.

VAT, customs and excise, with border checks by joint UK-EU teams taking place on goods entering Northern Ireland from the rest of the UK. This interpretation of the Joint Report was, rightly, immediately rejected by the Government.

6.87 In June 2018, the Government proposed its own partial interpretation of this 'backstop' that would involve the *entire UK* effectively staying in most of the Customs Union (but with limited ability to negotiate free trade agreements separate from the Common Commercial Policy). The backstop would, if necessary, operate beyond 31 December 2020 for a "time-limited" period, which the Government "expects" would end by December 2021.[177] Under its terms, the UK would continue to apply the Common External Tariff, and unspecified parts of the EU's VAT and excise rules, in return for the "elimination of tariffs, quotas, rules of origin and customs processes including declarations on all UK-EU trade". The Government also wants to keep the benefits of existing and future EU free trade agreements with 'third countries' which are in effect at the same time as the backstop, and a mechanism for the "UK national interest [to be] represented in future FTA negotiations affecting the UK" and an "ability to continue to help develop the rules that govern [EU] trade and customs policy". The matter of continued regulatory alignment or cooperation affecting trade in goods is apparently to be covered by a separate Government proposal in the future.[178]

6.88 Even as proposed, the 'customs arrangement' goes much further than the EU-Turkey Customs Union, the only precedent for such a close level of alignment with the EU on customs matters by a non-Member State of similar economic size.[179] The EU-Turkey arrangement has not eliminated tariffs and quotas on all goods (as unprocessed agricultural goods are excepted); it does not remove the need for customs (or regulatory) controls at its border with Bulgaria and Greece; and nor does it obviate the need for VAT and excise controls on goods entering the EU from Turkey. Turkey also does not have any significant role in the EU's trade negotiations with third countries, even though it must adjust its tariff barriers when the EU negotiates trade liberalisation with other countries.

6.89 However, while such a partial extension of the transition by means of the backstop may be preferable from the Government's perspective compared to the original Commission proposal, it is not currently provided for in the Withdrawal Agreement.[180] This means there are only a few months left to negotiate such an arrangement in all its details, and the EU's Chief Negotiator has already rejected the substance of the Government's proposal.[181] In any event, as the Chancellor recognised, this interpretation of the backstop (especially if it, ultimately, retained the free circulation of goods between the UK and the EU without any border controls) could still raise the question of a UK financial contribution.

177 The Government's technical note of 7 June 2018 does not refer to the need for regulatory alignment in areas such as sanitary and phytosanitary controls or other product standard-related regulations.

178 If the UK were to leave the Common Agricultural Policy on 1 January 2021 it is unclear how it could remain in the Single Market for agricultural goods without facing tariff barriers.

179 Monaco and San Marino, which are sovereign, are also part of the EU's customs territory, but by virtue of their small size and economic dependence on France and Italy respectively.

180 The latest public version of the Withdrawal Agreement was published by the Government and the European Commission on 19 March 2018.

181 If the Government considered (the possibility of) an extension necessary, but was unwilling to agree to a prolongation on the same terms that are to apply until the end of 2020 (i.e. full application of EU law and contributions into the EU budget), we do not see how the mechanism could be included in the Withdrawal Agreement. Consequently, the UK would have to negotiate a new treaty with the EU at some point between March 2019 and December 2020, with the EU needing to act on a different legal basis and the possibility that any 'partial' extension could ultimately be blocked by the remaining Member States (or their national parliaments), or the European Parliament.

6.90 In particular, if a UK-wide backstop were acceptable to the EU, we consider it possible that the EU could request a financial mechanism to cover:

- The **transfer of a share of customs duties the UK collects to the EU budget** if it continued to apply the Common External Tariff and engage in tariff-free trade with the EU. As noted in paragraph 6.32, the Customs Union functions as one of the EU's "Own Resources", and Member States must allocate 80 per cent of customs duties to the EU budget (which is due to rise to 90 per cent under the new Own Resources Decision from 1 January 2021, see paragraph 6.35 above).[182] The specifics of the revenue sharing mechanism, if the EU insisted on it, would have to be negotiated with the Government;[183]

- Payments to cover the **UK's continued use of the EU institutions and agencies** (for example the European Chemicals Agency, the European Food Safety Authority and the European Medicines Agency) and the use of EU-wide systems such as the VAT Information Exchange System (VIES), the TRACES system for tracking animals, and the Excise Movement & Control System for excisable goods;[184]

- The continued free circulation of agricultural goods between the EU and the UK (i.e. tariff and quota-free and without official controls at the border) could require **continued UK adherence to the limits on agricultural subsidies under the Common Agricultural Policy** (CAP), even if this money was managed by the UK and not sent directly to the EU budget. We note in this respect that there is no example of a developed country which is outside the CAP and Common Fisheries Policy (CFP) but enjoys tariff-free access to the EU market for agricultural and fisheries goods, and that the Commission proposal for the backstop would require Northern Ireland to apply "provisions of Union law on the production and marketing of agricultural and fisheries products";[185]

- As set out in paragraph 6.62 and onwards, the UK would have to agree the mechanism for its **contribution to the specific EU programmes under the next Multiannual Financial Framework in which it wants to participate** from the moment they become operational on 1 January 2021, notably the Framework Programme for Research (FP9); and

182 We do not consider it likely that any customs duties passed to the EU by HM Revenue & Customs under this scheme would offset the costs charged to the Government for UK participation in EU agencies and programmes, because the EU would argue that it would receive those revenues even in the absence of the UK's continued position within the Customs Union (in which case they would be collected by the Member State of import, rather than the UK).

183 The same would apply in the case of the Government's 'Customs Partnership', where the UK would apply EU customs rules and tariffs on goods entering the UK but destined for the EU. However, under this system there would be additional complications as the Own Resources would need to be calculated based on the proportion of goods destined for the EU only, and not all goods entering the UK as is the case while it is in the Customs Union. Moreover, it is unclear if the TOR contribution would be calculated based on the EU's tariff as it applies to the third country from which the goods are imported, or the tariff that applies to goods imported from the UK.

184 The negotiations would also have to touch on the implications of the UK's exit from the Common Agricultural Policy for the access of UK agricultural goods to the EU market.

185 Developing countries have full or partial tariff- and quota-free access to the EU market for agricultural goods under the Generalised System of Preferences and the 'Everything But Arms' programme.

- As noted above, the EU could also request the UK establish an **assistance programme for the Union's less economically-developed Member States**, similar to the EEA and Norway Grants (the funding mechanism Norway, Iceland and Liechtenstein were required to establish as a *quid pro quo* of their participation in the Single Market under the EEA Agreement).[186] These grant programmes mirror the EU's cohesion funding for economic development of certain EU Member States in Southern and Eastern Europe.[187] Similarly Switzerland, which has more limited but still intensive integration into the Single Market for goods, also implemented a £1 billion development scheme for the EU's post-2004 accession countries (which is currently the subject of negotiations on a potential £1 billion renewal for the next decade).

6.91 With respect to the 'temporary customs arrangements' as part of the Irish backstop in particular, the fact that the UK would still effectively function as a point of entry into the EU for customs purposes, without any further customs controls when goods move from the UK to the EU, also implies HM Revenue & Customs could continue to transfer the lion's share of customs duties collected (on imports destined for the EU) to the Union budget. If this was not the case, the EU would be deprived of a significant portion of its Traditional Own Resources (see paragraph 6.32 above), which would in turn require taxpayers in other Member States to compensate for this shortfall. We do not consider it likely that any customs duties passed to the EU by HM Revenue & Customs under this scheme would offset the costs charged to the Government for UK participation in EU agencies and programmes, because the EU would argue that it would receive those revenues even in the absence of the UK's continued position within the Customs Union (in which case they would be collected by the Member State of import, rather than the UK).

6.92 Clearly, a financial mechanism—even if it had to cover only a few of the elements described above—would not be straightforward to negotiate. With the time that is left before the Withdrawal Agreement must be finalised and submitted for ratification, it seems highly improbable that it could be accomplished as part of the Article 50 discussions. Therefore, the financial implications of the UK-wide 'backstop' which the Government appears to envisage would most likely have to be negotiated during the transitional period itself (and contained in a new UK-EU treaty, which could then face a veto either in the UK, the European Parliament and—possibly—in any of the EU's 27 national parliaments). However, that in itself appears impossible because the EU has said the ratification of the Withdrawal Agreement is conditional on an agreement on the 'backstop'.

6.93 In light of unresolved questions we have raised in this Report, we have written to the Chief Secretary to the Treasury to request clarification of the Government's intentions with respect to the potential financial implications of the Irish backstop and its proposals for a financial mechanism for participation in specific EU programmes.

Previous Committee Reports

None.

186 http://www.efta.int/EEA/news/Signature-agreements-Financial-Mechanisms-period-2014–2021–327391.

187 For the 2014–2020 period, the EEA and Norway Grants combined amount to €2.8 billion (£2.5 billion). However, the UK scheme would have to reflect the extent to which it remained part of the Single Market and its larger economic size.

7 Rule of law: suspension of payments from the EU budget

Committee's assessment	Politically important
Committee's decision	Not cleared from scrutiny; further information requested
Document details	Proposal for a Regulation of the European Parliament and of the Council on the protection of the Union's budget in case of generalised deficiencies as regards the rule of law in the Member States
Legal base	Article 322(1)(a) TFEU and Article 106a TAEC; ordinary legislative procedure; QMV
Department	Treasury
Document Number	(39685), 8356/18, COM(18) 324

Summary and Committee's conclusions

7.1 In recent years, concerns have grown about respect for the rule of law and the independence of the judiciary in several EU Member States. Romania and Bulgaria, which joined the EU in 2007, remain subject to increased EU oversight of their judicial and political systems under the Cooperation and Verification Mechanism because of concerns over judicial and political corruption in those countries.

7.2 More recently, a dispute between the European Commission and the Polish Government about the latter's controversial judicial reforms[188] culminated in a decision by the Commission, in December 2017, to activate the EU Treaty's Article 7 process for the first time. This procedure can, ultimately, lead to the suspension of a Member State's voting rights in the Council if the other Member States believe there is a "serious and persistent breach" of the "values of respect for human dignity, freedom, democracy, equality, the rule of law and respect for human rights". In addition, the European Parliament's Civil Liberties Committee is considering a resolution calling on the Commission to initiate a second Article 7 process against Hungary in light of controversial electoral and political reforms there.[189] This resolution is expected to be considered by the Parliament's Plenary, which has the power to start the process independently of the European Commission, in September 2018.

7.3 These Member States all have in common that the EU is a major source of funding used for their public investment programmes, especially through the European Structural and Investment Funds that provide financial support for the Union's lower-income

188 Following the 2015 General Election, the new Polish Government introduced legislation regarding the composition and procedures of Poland's Constitutional Tribunal which judges whether legislation complies with the Polish Constitution. In Spring 2017 the Polish Government proposed further legislation aimed at judicial reform: to change the selection process for membership of the Polish judicial appointments body, the National Judicial Council; to give the Justice Minister the ability to dismiss Court Presidents who have the task of supervising judges' work, allocating cases and organising courts; and to terminate the tenure of all Supreme Court judges, unless decided by the Justice Minister that they could stay in office.

189 There have also been press reports about the use of EU funding for projects from which friends and family of Hungarian Government politicians stand to benefit.

regions. For example, in 2015, Poland was the largest net beneficiary of EU funding with net receipts of €9.6 billion (£8.4 billion).[190] Moreover, in Poland, Hungary, Romania and Bulgaria the share of public investment accounted for by funding from the EU budget exceeds 40 per cent.

7.4 In light of concerns about the rule of law as described above, the European Commission—as part of its wider package of proposals on the EU's 2021–27 Multiannual Financial Framework (MFF)—in May 2018 proposed a Regulation on "on the protection of the Union's budget in case of generalised deficiencies as regards the rule of law in the Member States". In essence, where the Commission believes that there is a threat to the rule of law in an EU country which poses a risk to the "sound financial management or the protection of the financial interests of the Union", it would be able to suspend or even terminate an agreement for EU funding where a 'government entity' in the Member State in question is the recipient. Risks to the EU budget could, for example, relate to fraudulent use of EU money; improper public procurement exercises; or a lack of effective and independent judicial oversight of the government entities that manage EU budgetary allocations.

7.5 The procedure for establishing a "generalised deficiency" which could lead to a suspension of payments from the EU budget, as proposed by the Commission, would be as follows:

- The European Commission informs the Member State in question that it believes such a deficiency exists, who in turn will have at least one month to formally reply;
- If the Commission is still of the view that the rule of law is not functioning properly to the detriment of the EU budget, it can propose an Implementing Act (a type of EU statutory instrument) with to take any "appropriate measures" to protect the EU's finances;
- The Member States in the Council would be able to block the Commission's proposal for safeguard measures within one month, if there is a qualified majority of Member States in favour of doing so. Alternatively, the Council can adopt amendments to the Commission proposal by qualified majority.[191] Decisions to invoke safeguard measures would be lifted or amended using the same procedure.

7.6 Under the terms of the draft Regulation therefore, suspension of payments would be largely at the Commission's discretion. A change to, or veto of, its proposed measures could be only be taken by a large majority of Member States; if no sufficient majority exists, the Commission's Implementing Act suspending payments would automatically take effect. However, the procedures and safeguards as described above will now be subject to discussions among the Member States and in the European Parliament, which must jointly adopt the Regulation under the ordinary legislative procedure.

7.7 Within the Council in particular, the proposal is likely to elicit strong opposition (in particular from those Member States who feel they could become subject to the measures

190 €1 = £0.88605 or £1 = €1.12860 as at 29 June 2018.

191 If the Council opts for amending the Commission proposal, the legal act would take the form of a Council Decision, not an Implementing Act. There is no formal role for the European Parliament in this procedure.

proposed by the Commission). The effect of any suspension of payments from the EU would be commensurately larger in Member States which are net recipients of funding from the EU budget (as all four of the countries mentioned above are). However, the Regulation can be adopted with the support of only a qualified majority of Member States.

7.8 The Chief Secretary to the Treasury (Elizabeth Truss) submitted an Explanatory Memorandum on the proposal with some delay on 18 June. It does not attempt any assessment of the merits, or lack thereof, of the proposed Regulation.

7.9 **The proposal for a Regulation on the rule of law and the EU budget should be seen against the wider political canvass of concerns of deteriorating judicial independence and civil society in some EU Member States. As a result, there is likely to be significant opposition to the Commission proposal from some quarters of the Council and the European Parliament. The position of the UK remains unclear, although in any event it is unlikely the Regulation would be subject to a vote in the Council before the Government is due to lose its institutional representation within the EU on 29 March 2019.**

7.10 **The implications for the UK are likely to be minimal given its exit from the EU[192] and the independence of its judiciary. However, given the unprecedented nature of what the Commission has proposed, we ask the Minister to keep us informed of developments on the negotiations on this proposal (including the possibility that it may be subject to a blocking minority within the Council), and in the mean time we retain the Regulation under scrutiny.**

Full details of the documents

Proposal for a Regulation of the European Parliament and of the Council on the protection of the Union's budget in case of generalised deficiencies as regards the rule of law in the Member States: (39685), 8356/18, COM(18) 324.

Previous Committee Reports

None.

192 Under Part Four of the draft UK Withdrawal Agreement the transitional period is due to end on 31 December 2020. However, the Government has stated that the new UK-EU customs and regulatory arrangements will not be ready by that date, and the Government's official position remains that the transition should last "around two years" after the end of the Article 50 period on 29 March 2019.

8 EU approval of the Global Compact on Migration

Committee's assessment	Legally and politically important
Committee's decision	(a) Cleared from scrutiny (b) Not cleared from scrutiny; further information requested; drawn to the attention of the Home Affairs and the International Development Committees
Document details	(a) Proposal for a Council Decision authorising the Commission to approve, on behalf of the Union, the Global Compact for Safe, Orderly and Regular Migration in the field of development cooperation (b) Proposal for a Council Decision authorising the Commission to approve, on behalf of the Union, the Global Compact for Safe, Orderly and Regular Migration in the area of immigration policy
Legal base	(a) Article 16 TEU and Article 209 TFEU, QMV (b) Article 16 TEU and Article 79 TFEU, QMV
Department	Home Office
Document Numbers	(a) (39583), 7400/18 + ADD 1, COM(18) 167 (b) (39584), 7391/18 + ADD 1, COM(18) 168

Summary and Committee's conclusions

8.1 In its latest Global Trends report, the United Nations Refugee Agency estimates that 68.5 million individuals were forcibly displaced worldwide as a result of persecution, conflict, or generalised violence by the end of 2017, a new "record high" and an increase of 2.9 million on the previous year.[193] The vast majority (85%) are hosted by developing regions. In September 2016 the United Nations General Assembly adopted the New York Declaration for Refugees and Migrants which recognises that large-scale movements of refugees and migrants are "global phenomena that call for global approaches and global solutions". The Declaration sets out a process for international negotiations which will culminate in the adoption of a Global Compact for Safe, Orderly and Regular Migration ("the Global Compact on Migration") in December 2018 establishing "a framework for comprehensive international cooperation on migrants and human mobility".[194]

8.2 A first draft of the Global Compact was published in February followed by a revised draft ("zero draft plus") in March and intergovernmental negotiations are underway to agree the final text.[195] The European Commission has proposed two Council Decisions

193 See UNHCR Global Trends Forced Displacement in 2017.

194 See the text of the New York Declaration for Refugees and Migrants agreed on 19 September 2016.

195 The latest version of the text—"zero draft plus"—is attached to the proposed Council Decisions (see ADD 1).

(published on 21 March) which would give it the authority to approve the Global Compact on behalf of the EU at the intergovernmental conference in December. The first proposed Decision—document (a)—would cover the development policy elements of the Global Compact. The second proposed Decision—document (b)—would cover the immigration policy elements. Two Decisions are needed as the UK's Title V (justice and home affairs) opt-in applies to document (b) dealing with immigration, meaning that the UK is not bound to participate in the second Council Decision unless it chooses to opt in but will be bound by the first Decision if it is adopted.

8.3 The European Commission considers that the Council can give the authorisation it seeks to approve the Global Compact on Migration under the powers conferred by Article 16 of the Treaty on European Union (TEU) which provide that the Council shall exercise "policy-making and coordinating functions". It says it is seeking authorisation so far in advance of the intergovernmental conference in December because it believes that the EU's influence can be exercised most decisively during the early stages of negotiation on a final text. It undertakes to cooperate closely with Member States and revert to the Council if the final text of the Global Compact on Migration diverges substantially from the latest draft text.

8.4 In her Explanatory Memorandum of 11 April 2018, the Immigration Minister (Caroline Nokes) told us that there was some uncertainty as to the procedures that the Commission should follow to obtain the Council's authorisation to approve the Global Compact on Migration and some doubt whether the proposed Council Decisions would be put to the vote. The Commission considered that the usual procedures for negotiating, signing and concluding international agreements or establishing the EU's position in an international body (set out in Article 218 TFEU) were not appropriate in this case as the Global Compact would not create any legal obligations under domestic or international law.[196] It had therefore cited Article 16 TEU as the procedural legal base for both proposals, relying on Court of Justice case law to support its position.[197] The Minister noted that this was "the first time the Commission has taken this approach in using Article 16 TEU" and that the Government was considering its position.[198] She added that, even if the Government decided not to opt into document (b), the UK would still be bound by document (a) dealing with the development cooperation elements of the Global Compact and so would be able to attend and influence EU coordination meetings within the United Nations and negotiate as part of the EU block.[199] She set out the factors that would inform the Government's opt-in decision but indicated that a decision *not* to opt into document (b) was unlikely to have a negative political impact. The UK would, in any event, remain free to sign the Global Compact on Migration in its national capacity as the EU only has observer status within the United Nations

8.5 In our Report chapter agreed on 25 April, we asked the Minister to:

- inform us of the date on which the three-month deadline for opting into document (b) would expire;

196 See p.3 of the Commission's explanatory memorandum accompanying both proposed Council Decisions.
197 See *Council v. Commission*, Case C-660/13.
198 See para 7 (i) of the Minister's Explanatory Memorandum.
199 The EU has observer status within the United Nations General Assembly and can present common positions agreed on behalf of the EU and EU Member States.

- explain on what basis the European Commission had "already assumed" that the UK would not opt in;[200]
- clarify the Government's position on the use of Article 16 TEU to obtain the Council's authorisation to approve the Global Compact (a non-binding agreement);
- explain how far in advance that authorisation should be sought, given the possibility that the content of the Global Compact on Migration might change during negotiations;[201] and
- indicate what options (other than Article 16 TEU) were available to give the Commission the authorisation it sought.

8.6 We noted that development cooperation and migration were areas of shared competence in which both the EU and Member States were entitled to act and asked the Minister to explain:

- whether there were elements of the Global Compact on Migration for which the EU had acquired exclusive competence, meaning that the EU alone must act;
- whether all elements of the Global Compact were matters of shared competence; and
- if competence was shared, what need or justification there was for separate EU approval of the Global Compact.

8.7 In her letter of 31 May 2018, the Minister tells us that the three month opt-in deadline will expire on 23 July. The Commission had envisaged securing the Council's agreement to adopt the proposed Decisions before the April round of negotiations within the UN began, meaning that the UK would not have had time to complete its domestic processes for reaching an opt-in decision. The Commission had therefore concluded that the UK would not opt into document (b). During discussions in COREPER at the end of March, Member States raised concerns about authorising the EU (through the Commission) to approve the Global Compact when it was still under negotiation. The proposals were not taken to the Council for approval, but nor were they formally withdrawn by the Commission. As a result, the Minister confirms that "the UK still has a JHA opt-in decision to take".

8.8 The Minister agrees with the Commission that the usual procedural legal base for establishing the EU's position within an international body (Article 218(9) TFEU) cannot be used for the negotiation of non-legally binding instruments. She considers that "Article 16 TEU could potentially be an appropriate legal base in this case" and that its use would be consistent with Court of Justice case law,[202] but adds that the Commission should only seek authorisation to approve the Global Compact on Migration on behalf of the EU "when there is a final or near-final version of the text, likely in late June".

8.9 Finally, the Minister considers that the Global Compact "contains a mixture of Union and Member State competence" and that the purpose of the proposed Council

200 See para 14 of the Minister's Explanatory Memorandum.

201 See para 43 of the Court's ruling in *Council v. Commission*, Case C-660/13.

202 See *Council v. Commission*, Case C-660/13.

Decisions is "to allow the EU to speak with a single voice during negotiations in the UN, adding weight to Member States' existing coordination of their negotiating positions". The Minister adds:

> "We do not consider it necessary for there to be a legal basis for this co-ordination, and agree with other Member States that it would be inappropriate to authorise the EU to approve the GCM at this stage in negotiations, but agree that it remains helpful for EU Member States to continue to adopt a co-ordinated approach, in so far as possible, to negotiations in the UN."

8.10 The Minister invites us to clear the proposed Council Decisions from scrutiny.

Our Conclusions

8.11 **We are content to clear from scrutiny the proposed Council Decision on the development policy elements of the Global Compact on Migration—document (a)—as the authorisation given to the Commission to approve these elements of the Global Compact would not encroach on Member States' competence to act in the area of development cooperation.**[203]

8.12 **We are not willing to clear from scrutiny the proposed Council Decision on the immigration policy elements of the Global Compact—document (b)—for two reasons. First, the Minister confirms that "the UK still has a Justice and Home Affairs opt-in decision to take" but does not tell us whether the Government intends to opt in. We ask her to provide this information, and the reasons underlying the Government's opt-in decision, at the earliest opportunity. Second, recitals to the proposed Decision indicate that its purpose is to "preserve the unity of the EU position in order to ensure that the final text of the Global Compact for Migration is consistent with EU *acquis* and policy".**[204] **This might imply that there are elements of the Global Compact for which the EU has acquired exclusive competence (meaning that only the EU can act) or that the EU is exercising shared competence.**[205] **We therefore ask the Minister again to identify specifically the extent to which the EU has exclusive competence for the Global Compact (or parts of it) and the extent to which compoetence is shared.**

8.13 **Pending further information, document (b) remains under scrutiny. We draw this chapter to the attention of the Home Affairs Committee and the International Development Committee.**

Full details of the documents

(a) Proposal for a Council Decision authorising the Commission to approve, on behalf of the Union, the Global Compact for Safe, Orderly and Regular Migration in the field of development cooperation: (39583), 7400/18 + ADD 1, COM(18) 167. (b) Proposal for

203 See Article 4(4) TFEU which provides that the competence conferred on the EU in the area of development cooperation shall not prevent Member States from exercising their competence in the same area.

204 See recitals (8) and (12).

205 Where competence is shared, either the EU or the Member States may exercise it—the choice is one of policy. Government policy is that normally Member States should exercise shared competence, leaving the EU to exercise competence only where it is exclusive.

a Council Decision authorising the Commission to approve, on behalf of the Union, the Global Compact for Safe, Orderly and Regular Migration in the area of immigration policy: (39584), 7391/18 + ADD 1, COM(18) 168.

Background

8.14 The Global Compact on Migration is intended to address all aspects of international migration, including its humanitarian, developmental, human rights-related and other dimensions. According to the International Organisation for Migration it will:

- make an important contribution to global governance and enhance coordination on international migration;
- present a framework for comprehensive international cooperation on migrants and human mobility;
- set out a range of actionable commitments, means of implementation and a framework for follow-up and review among Member States regarding international migration in all its dimensions;
- be guided by the 2030 Agenda for Sustainable Development and the Addis Ababa Action Agenda; and
- be informed by the Declaration of the 2013 High-Level Dialogue on International Migration and Development.[206]

Previous Committee Reports

Twenty-fifth Report HC 301–xxiv (2017–19), chapter 7 (25 April 2018).

206 See the website of the International Organisation for Migration for further details.

9 Establishing a European network of immigration liaison officers

Committee's assessment	Politically important
Committee's decision	Not cleared from scrutiny; further information requested; drawn to the attention of the Home Affairs Committee
Document details	Proposal for a Regulation on the creation of a European network of immigration liaison officers (recast)
Legal base	Articles 74 and 79(2) TFEU, ordinary legislative procedure, QMV
Department	Home Office
Document Number	(39717), 9036/18 + ADDs 1–2, COM(18) 303

Summary and Committee's conclusions

9.1 EU Member States currently deploy around 500 Immigration Liaison Officers ("ILOs") to 105 third (non-EU) countries.[207] Since 2004, these ILOs have operated as part of local or regional networks, with meetings convened and coordinated by the Member State holding (or acting as) the Presidency of the EU Council.[208] In recent years, their numbers have been supplemented by European Migration Liaison Officers ("EMLOs") deployed by the Commission in 13 priority countries and by officers from the EU's European Border and Coast Guard Agency (formerly Frontex).[209]

9.2 Whilst recognising that ILOs remain "highly relevant in the current global migration context", the Commission considers that the networks established in 2004 do not ensure "optimal utilisation" of their "operational expertise, first-hand knowledge and contacts in third countries".[210] Its proposal for a Regulation would establish a European network of immigration liaison officers to strengthen cooperation, information exchange, and coordination amongst ILOs and EMLOs so that they contribute more effectively to the EU's migration policy priorities: better management of migration flows and of the EU's external borders; the prevention and countering of illegal migration, migrant smuggling and human trafficking; and support for the return and readmission of illegal migrants.

9.3 The main change proposed by the Commission is the creation of a Steering Board on which each Member State, the Commission, the European Border and Coast Guard Agency, Europol and the EU Asylum Agency would be represented. The Board would be chaired by the Commission and meet at least twice a year. It would agree a two-year programme establishing "priorities and activities" for the networks, oversee their work and identify deployment gaps. It would also be responsible for ensuring that ILOs upload

207 17 EU Member States, plus Switzerland and Norway, deploy ILOs.

208 See Council Regulation (EC) No 377/2004 on the creation of an immigration liaison officers network, as amended by Regulation (EU) 493/2011.

209 EMLOs are deployed in Ethiopia, Jordan, Lebanon, Mali, Morocco, Niger, Nigeria, Pakistan, Senegal, Serbia, Sudan, Tunisia and Turkey.

210 See pp 2–5 of the Commission's explanatory memorandum accompanying the proposed Regulation.

and exchange information through a secure web-based information exchange platform.[211] The Commission anticipates that its proposal would improve the flow of strategic and operational information "upwards" from the networks to the EU and its Agencies as well as "horizontally" across participating Member States.

9.4 Other changes envisaged in the proposed Regulation would:

- expand the networks to include EMLOs deployed by the Commission, liaison officers deployed by EU Agencies, and law enforcement officials deployed by Member States to third countries (to the extent that they deal with immigration-related issues);[212]
- give the Commission the lead role in coordinating networks in countries where it has deployed a EMLO;
- extend the information-gathering tasks of ILOs to include asylum and other forms of protection in the country in which they are deployed, as well as resettlement and other legal immigration channels to the EU and "pre-departure measures" to support successful integration within the EU; and
- require ILOs to coordinate the delivery of capacity building activities in their host country or region.

9.5 The proposed Regulation would build on, and form part of, the Schengen rule book as ILOs make an important contribution to the management of the EU's external borders. Although the UK does not participate in the Schengen free movement area or apply Schengen rules on external border controls, it does take part in some Schengen measures concerning illegal immigration, including the existing ILO network. Under the Schengen Protocol annexed to the EU Treaties, the UK will be bound by the proposed Regulation unless the Government notifies the Council within three months that it does not wish to participate.[213]

9.6 Third countries associated with the implementation, application and development of Schengen (Iceland, Norway, Liechtenstein and Switzerland) would be entitled to participate in the network's Steering Board as non-voting observers. Other non-EU and non-Schengen participants may be invited to attend as observers at the discretion of the Steering Board.

9.7 The Commission envisages that the network would be financed by the EU's Internal Security Fund (the component on support for the management of external borders and the common visa policy) until the end of 2020 and by a similar budget line in the next Multiannual Financial Framework (covering the period 2021–27). The UK does not participate in the relevant EU funding instrument.

9.8 In her Explanatory Memorandum of 5 June, the Immigration Minister (Caroline Nokes) confirms that the UK deploys ILOs overseas, focusing on illegal immigration (Immigration Enforcement International staff) and returns (Migration and Returns

211 The information would include relevant documents, reports and analytical products in the area of immigration as well as factual information on the host third countries or regions.

212 The UK uses the ILO network to tackle organised immigration crime "upstream".

213 The three-month opt-out period starts to run from the date on which the last language version of the proposed Regulation is published.

Liaison Officers). She describes the proposed Regulation as "a bid by the Commission to provide an over-arching structure" to task and manage the activities of Member States' ILOs more systematically and highlights the creation of a Steering Board as "the key new element". Whilst the aims of the proposed European network and the role of ILOs "are aligned with UK migration priorities", a key issue for the Government will be to determine the extent to which the proposed Regulation would "impinge on a Member State's ability to task their own staff effectively, without oversight of the Commission, and to develop bilateral relationships with third countries".

9.9 The Minister indicates that the Government will seek to "maintain the ability to continue good local working relationships with EU partners and those outside the EU" and to "align activity with both EU and non-EU partners where relevant, whilst maintaining the ability to follow its own priorities". In deciding whether to opt out of, or remain bound by, the proposed Regulation, the Government will have particular regard to the effectiveness of the existing Regulation, the extent to which the changes proposed would bring greater benefits for Member States, and the UK's decision to leave the EU in March 2019. She adds:

> "Where the UK has no ILO posted to a third country there are benefits in utilising EU or Member State ILOs to further UK objectives on migration. Both opting out and exit from the EU may impact on the UK's ability to utilise these resources."

9.10 Should the UK decide to opt out of the proposed Regulation, and once the UK is no longer a member of the EU, the Minister notes that it would be possible to seek an invitation to Steering Board meetings as an observer.

9.11 The Minister expects the Austrian Presidency (in post from July to December 2018) to "take forward and finalise negotiations" on the proposed Regulation.

Our Conclusions

9.12 **We ask the Minister to provide further information on:**

- **the need for further legislation to achieve the objectives set out in the proposed Regulation;**
- **the implications of the UK's Schengen opt-out decision;**
- **third country participation in ILO networks; and**
- **the wider Brexit implications of the proposal.**

The need for EU action

9.13 **In her subsidiarity assessment, the Minister accepts that more effective coordination amongst ILOs deployed by Member States, the Commission and EU agencies "cannot be achieved by Member States alone" and that EU action is justified. This is difficult to reconcile with the view expressed later in her Explanatory Memorandum that the 2004 Regulation creating the existing ILO network (which this proposal would repeal and replace) was "unnecessary", since ILOs from EU Member States and from other third countries (the US, Canada, Australia and New Zealand) shared "common goals"**

and had in an interest in establishing local coordination on the ground. We ask the Minister whether she considers that the specific changes proposed in the Regulation, which place greater weight on the EU dimension of external migration policy, justify this type of legislative intervention by the EU.

The UK's Schengen opt-out

9.14 **We ask the Minister to confirm the date by which the Government must notify its opt-out decision. Should the Government decide to opt out, we would welcome her assessment of the implications for the UK's continued participation in the existing ILO network established in 2004 until exit and during the post-exit transition/ implementation period.**[214]

9.15 **We note that the network would be funded (until the end of 2020) from the borders and visa component of the EU Internal Security Fund. As the UK does not participate in this Fund, we ask the Minister whether the UK would be expected to make a financial contribution towards the administrative and operational costs of the network if the Government were to decide to participate in the proposed Regulation.**

Third country participation in ILO networks

9.16 **In its consultation of stakeholders, the Commission reports that Member States underlined the importance of cooperation with ILOs deployed by non-EU countries and requested flexibility in deciding on the formation of local and regional networks.**[215] **The proposed Regulation would empower the Steering Board to invite third country representatives to attend its meetings but does not appear to envisage the inclusion of third country ILOs in local or regional cooperation networks. We ask the Minister whether this is her understanding of the Commission proposal and how this would affect the operation of the existing networks.**

Brexit implications

9.17 **We ask the Minister to explain how the UK's exit from the EU will affect the UK's ability to participate in local and regional ILO networks established under the proposed Regulation and to access information exchanged through the EU's secure web-based information exchange platform. Does she anticipate that a reduction in access would have resource implications for the UK, necessitating the deployment of more ILOs in third countries?**

9.18 **Pending further information, the proposed Regulation remains under scrutiny. We draw this chapter to the attention of the Home Affairs Committee.**

Full details of the documents

Proposal for a Regulation on the creation of a European network of immigration liaison officers (recast): (39717), 9036/18 + ADDs 1–2, COM(18) 303.

Previous Committee Reports

None on this document.

214 Under Article 5(3) of the Schengen Protocol, the Council may decide that the UK can no longer participate in the exiting ILO network if it considers that the UK's opt-out from the proposed Regulation would seriously affect the practical operability of various parts of the Schengen rule book.

215 See p.7 of the Commission's explanatory memorandum accompanying the proposed Regulation.

10 Documents not raising questions of sufficient legal or political importance to warrant a substantive report to the House

Department for Education

(39766) 9230/18 COM (18) 268	Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions Building a stronger Europe: the role of youth, education and culture policies.

Department for Environment, Food and Rural Affairs

(39892) 10116/18 +ADD 1 COM(18) 454	Proposal for a Council Decision on the signing, on behalf of the European Union, of the Agreement to prevent unregulated high seas Fisheries in the Central Arctic Ocean.
(39893) 10109/18 +ADD 1 COM(18) 453	Proposal for a Council Decision on the conclusion, on behalf of the European Union, of the Agreement to prevent unregulated high seas Fisheries in the Central Arctic Ocean.

Department for Exiting the European Union

(39607) 7586/18 —	Amendments to Protocol No 3 on the Statute of the Court of Justice of the European Union.

HM Treasury

(39684) 8355/18 +ADD 1 COM(18) 323	Proposal for a Interinstitutional Agreement between the European Parliament, the Council and the Commission on budgetary discipline, on cooperation in budgetary matters and on sound financial management.

(39732) 9068/18 —	Opinion of the European Central Bank of 11 May 2018 on a proposal for a regulation of the European Parliament and of the Council amending Regulation (EU) No 1095/2010 establishing a European Supervisory Authority (European Securities and Markets Authority) and related legal acts; and on a proposal for a directive of the European Parliament and of the Council amending Directive 2014/65/EU on markets in financial instruments and Directive 2009/138/EC on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (CON/2018/26
(39796) 9461/18 COM(18) 298	Proposal for a Council Directive amending Directive 2006/112/EC on the common system of value added tax as regards the period of application of the optional reverse charge mechanism in relation to supplies of certain goods and services susceptible to fraud and of the Quick Reaction Mechanism against VAT fraud.
(39803) 9402/18 + ADDs 1–2 COM(18) 331	Proposal for a Regulation of the European Parliament and of the Council amending Regulations (EU) No 596/2014 and (EU) 2017/1129 as regards the promotion of the use of SME growth markets.

Department for Transport

(39713) 8991/18 COM(18) 289	Proposal for a Regulation of the European Parliament and of the Council amending and correcting Regulation (EU) No 167/2013 on the approval and market surveillance of agricultural and forestry vehicles.
(39823) 9113/18 + ADDs 1–2 COM(18) 314	Proposal for a Council Recommendation on safety goals and functional requirements for passenger ships below 24 meters in length.

Department for Work and Pensions

(39797) 9421/18 COM(18) 342	Report from the Commission to the European Parliament and the Council on the implementation of the Union authorisation of biocidal products in accordance with Article 42(3) of Regulation (EU) No 528/2012 of the European Parliament and of the Council concerning the making available on the market and use of biocidal products (Text with EEA relevance).

Formal Minutes

Wednesday 4 July 2018

Members present:

Sir William Cash, in the Chair

Mr Marcus Fysh	Mr David Jones
Kate Green	Andrew Lewer
Kelvin Hopkins	Michael Tomlinson
Darren Jones	

2. Scrutiny Report

Draft Report, proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1.1 to 10 read and agreed to.

Summary agreed to.

Resolved, That the Report be the Thirty-fourth Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

[Adjourned till Wednesday 11 July at 1.45pm.

Standing Order and membership

The European Scrutiny Committee is appointed under Standing Order No.143 to examine European Union documents and—

a) to report its opinion on the legal and political importance of each such document and, where it considers appropriate, to report also on the reasons for its opinion and on any matters of principle, policy or law which may be affected;

b) to make recommendations for the further consideration of any such document pursuant to Standing Order No. 119 (European Committees); and

c) to consider any issue arising upon any such document or group of documents, or related matters.

The expression "European Union document" covers—

i) any proposal under the Community Treaties for legislation by the Council or the Council acting jointly with the European Parliament;

ii) any document which is published for submission to the European Council, the Council or the European Central Bank;

iii) any proposal for a common strategy, a joint action or a common position under Title V of the Treaty on European Union which is prepared for submission to the Council or to the European Council;

iv) any proposal for a common position, framework decision, decision or a convention under Title VI of the Treaty on European Union which is prepared for submission to the Council;

v) any document (not falling within (ii), (iii) or (iv) above) which is published by one Union institution for or with a view to submission to another Union institution and which does not relate exclusively to consideration of any proposal for legislation;

vi) any other document relating to European Union matters deposited in the House by a Minister of the Crown.

The Committee's powers are set out in Standing Order No. 143.

The scrutiny reserve resolution, passed by the House, provides that Ministers should not give agreement to EU proposals which have not been cleared by the European Scrutiny Committee, or on which, when they have been recommended by the Committee for debate, the House has not yet agreed a resolution. The scrutiny reserve resolution is printed with the House's Standing Orders, which are available at www.parliament.uk.

Current membership

Sir William Cash MP (*Conservative, Stone*) (Chair)

Douglas Chapman MP (*Scottish National Party, Dunfermline and West Fife*)

Geraint Davies MP (*Labour/Cooperative, Swansea West*)

Steve Double MP (*Conservative, St Austell and Newquay*)

Richard Drax MP (*Conservative, South Dorset*)

Mr Marcus Fysh MP (*Conservative, Yeovil*)

Kate Green MP (*Labour, Stretford and Urmston*)

Kate Hoey MP (*Labour, Vauxhall*)

Kelvin Hopkins MP (*Independent, Luton North*)

Darren Jones MP (*Labour, Bristol North West*)

Mr David Jones MP (*Conservative, Clwyd West*)

Stephen Kinnock MP (*Labour, Aberavon*)

Andrew Lewer MP (*Conservative, Northampton South*)

Michael Tomlinson MP (*Conservative, Mid Dorset and North Poole*)

David Warburton MP (*Conservative, Somerton and Frome*)

Dr Philippa Whitford MP (*Scottish National Party, Central Ayrshire*)