Much remains unknown or highly uncertain about the UK’s likely Brexit ‘deal’ with the EU27, but it is already evident that Brexit can affect the UK economy along many different dimensions, including:

1. The Brexit process, and associated uncertainty, could cut the likely growth of UK GDP – possibly just temporarily if some investment is merely delayed, possibly for a longer period if important investment is diverted elsewhere. If this happens, it would very likely reduce government revenues from taxation of all sorts, as compared to the growth path previously expected.

2. While the major taxes (VAT, income tax, national insurance, corporation tax, excise duties, etc.) are unlikely to be changed markedly or at all, Brexit could still affect government revenues because it could affect the country’s net customs tariff revenue (much of which currently goes to Brussels as part of our budget contribution). At the moment, we don’t know what our post-Brexit trade regime will look like, though many options are examined in recent literature. The simplest option, for instance, would be free trade with the EU27 (implying no tariff revenue from that direction of our trade), and existing EU tariffs for all other trade partners; this would be a mix of preferential tariffs and the EU’s Common External Tariff, depending on the trade partner (this would generate some tariff revenue, but I have not seen any forecasts of this). Alternatively, we might decide to formulate an entirely new UK customs tariff, and revenue forecasts would then be based on that.

3. Until the formal exit from the EU at the end of March 2019, the UK will be paying into the EU budget its normal and agreed budgetary contributions. Indeed, since the EU’s present Multi-annual Financial Framework (MFF) runs for the seven-year period, 2014-2020 it is arguable (and is being argued by the EU) that part of the exit settlement should include the UK continuing to make its normal EU budgetary contributions until 2020. Should this be agreed, the UK would also continue to receive its budgeted benefits from the EU until the end of the present MFF. The UK Government, in any case, has stated that it expects budgetary contributions to cease after March 2019. This matter is yet to be settled.

4. When the UK leaves the EU, various payments made by the EU to the UK Government in respect of Social Policy, Regional Development Funds, the Common Agricultural Policy (CAP) and the Common Fisheries Policy (CFP) will cease (once outstanding contractual commitments are fulfilled). This then raises an important policy question, P1, outlined below.
5. Likewise, diverse EU payments to individuals and non-governmental organisations, often won competitively, will also cease, again once existing contracts have been completed. These payments include such things as Erasmus scheme awards to support student mobility within the EU, research grants under the current Horizon 2020 programme (from which UK universities do very well, as do those in Scotland in particular), and various other schemes. This type of funding stream gives rise to policy question, P2, set out below.

6. A very controversial issue concerns the overall exit settlement to be agreed between the UK and the EU; this was referred to in passing above, in paragraph 3. Without stating specific figures, the EU has published a guidance note setting out the principles it considers should determine the exit settlement. The UK Government has not (yet) put forward a detailed response, nor has it set out any specific proposals of its own. It has only acknowledged the principle that the UK probably does have residual financial obligations to the EU as a result of Brexit. This lack of clarity has not prevented numerous bodies from coming up with estimates of the likely exit bill; these range from as little as euros 10 billion up to about euros 100 billion. Moreover, even if a number is agreed, there is the further question whether it should be paid as a single one-off payment, or as a series of instalments over an agreed period.

7. There are many other aspects of Brexit that will have important effects on the UK Government and/or many UK citizens, while not notably affecting the budget which is our main focus in this note.

The likely impact of Brexit on the Scottish budget will depend not only on the points and factors listed above, each of which has an impact on the UK’s public finances, but also on the policy responses of the UK Government. These responses partly deal with aspects of Brexit, including some of the above points, and partly deal with wider issues of UK public finances, including the current rules of the game in regard to public finance under devolution, and the pace at which the UK Government seeks to bring down the deficit (balancing the public accounts seems to recede ever further into the future).

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1 This is not the place for a detailed discussion. But it is perhaps worth summarising the main areas to be taken into account in determining the exit bill. These are: outstanding budget commitments; EU officials’ pensions; contingent liabilities (these would be repaid in due course if the potential liabilities don’t occur); financial contributions to the European Central Bank and the European Investment Bank; costs of withdrawal (e.g. relocating EU institutions based in London). A further issue, not mentioned in the EU guidelines for the financial settlement, is whether the UK could claim some credit for a share of the value of accumulated EU assets. The sums involved under all of these headings are themselves subject to much debate, so reaching a fully agreed settlement will not be easy.

2 These include the rights of EU citizens currently working in the UK, and of our own citizens living and working in the EU27; the delicate issue of Ireland, and the need to avoid creating a ‘hard’ border between Northern Ireland and the Republic; the future of ‘open skies’ and the possible impact on UK air travel; future health insurance arrangements across the EU, and the effect on UK travellers to the EU27, EU27 visitors to the UK; and numerous other issues.
P1. The policy question here relates to point 4, above. There are two issues: (a) Will the UK Government put in place its own funding arrangements to replace one or more of the listed EU policies? It need not simply replicate what the EU currently does, and would be more likely to come up with new policy designs and models. This would reflect specific UK policy priorities and objectives. The second issue, (b), concerns whether the UK Government would aim to make any new policies (and associated funding streams) solely or mainly a Westminster responsibility, or whether it would devolve both policy design and funding to the devolved administrations. The latter approach would allow different parts of the UK to operate quite distinctive policies, should they so choose.

P2. While with policy question P1 there was never any likelihood that the UK Government would wish to remain in some sense a ‘paid up member’ of these funding mechanisms post-Brexit, the situation could be very different in regard to the funding streams referred to in point 5, from which the UK currently benefits considerably. Thus it has already been widely proposed that the UK should be willing to pay a continuing subscription to the EU (the amount to be settled as part of the exit negotiations) to retain membership of the EU’s student and academic mobility programmes, R&D programmes (like Horizon 2020), and possibly a few other things (to be agreed). Access to the wider EU research networks is very beneficial to UK universities, for instance, and continuing with these EU programmes would benefit from their existing, well established administrative and management arrangements. A possible barrier to proceeding in this way is that in case of disputes, these programmes (like all EU programmes) provide for reference to the Court of Justice of the EU (CJEU); this might prove to be a sticking point for the UK Government, even though such references hardly ever occur in practice.

P3. How will the UK Government determine its public spending post-Brexit? Changes in economic growth, as well as in contributions to and receipts from the EU, will clearly change both the level and projected trend of net budgetary receipts. Given this, the UK Government then needs to update its views on how rapidly it considers that the budget deficit should be falling (or possibly not falling for a while longer) bearing in mind concerns about aggregate indebtedness, alongside the need to deliver modest stimulus to the economy. Public spending projections and plans that somehow square this circle can then form the basis for the early post-Brexit budgets. In turn, via the Barnett formula (assuming this still to be in place), this gives the devolved block grant for Scotland (and similarly for the other devolved administrations).

What does the above imply for the **Scottish budget**? As was apparent, there remain many important uncertainties which will be gradually resolved and
settled as Brexit proceeds. For the moment, only a few sketchy remarks can usefully be made regarding the Scottish budget.

S1. Much of the Scottish budget will be determined just as in the recent past, taking account of the recent devolution of some taxes, and the power to change certain tax rates, to the Scottish Government. That said, the main block grant payable to Scotland will be largely determined by the policy considerations set out in paragraph P3, above.

S2. Current Scottish Government websites for agriculture and for fisheries (Marine Scotland) give no indication that much new strategic thinking is yet going on to deal with the implications of Brexit for these important areas. Likewise for the Scotland Rural Development Programme which currently delivers Pillar 2 of the CAP. The same is true for the European Structural Funds (European Regional Development Fund, European Social Fund), for which the Scottish Government is the Managing Authority. Naturally, I would hope that my initial impression is mistaken, since with Brexit all these funding streams from Brussels will cease, and as noted above it is not yet clear how if at all they will be replaced by new funding from Westminster. Hence it would be wise for the relevant Scottish Government departments to review their policies towards agriculture\(^3\), fisheries and rural development quite urgently, as well as their policies regarding the Structural Funds, for three reasons: (a) to update their views on how these significant areas of Scottish life should develop post-Brexit; (b) to review possible funding and support models; and (c) to lobby the UK Government both about funding and about associated devolution issues.

S3. As noted at paragraph P2, significant EU funds are also won competitively by non-governmental organisations such as universities and research institutes, as well as by individual students (Erasmus programme awards). There are also other channels through which EU funds are allocated competitively, such as consultancy contracts in many areas. While the likely ending of these flows post-Brexit does not directly impact the Scottish budget, it could easily do so indirectly. For instance, the Scottish Government may wish to join with the UK Government in supporting continued UK membership of the EU's Erasmus and R&D programmes, among others, with agreed financial contributions being made to Brussels to pay for this. In all such areas, therefore, it seems important for the Scottish Government, in consultation with relevant non-governmental bodies (e.g. the Scottish Funding Council), to develop clear and

\(^3\) This is important at least in part due to the confusing messages that have already come forward from the UK Government, with different Ministers and officials simultaneously arguing for cheaper food, implying more New Zealand lamb rather than lamb from Welsh and Scottish hill farms; higher domestic food production to make us more self-sufficient and less dependent on imports; and a more efficient, environmentally friendly agriculture. It is far from clear that these diverse goals are wholly compatible, so the Scottish Government needs to decide what it thinks would be best for Scotland.
carefully formulated policies of its own as a basis for constructive discussions with the UK Government.

S4. Hence there are two basic messages to put forward regarding the Scottish budget in the near to medium term. These are:

(a) Business as usual, no major changes needed or expected in the immediate future.

(b) A little further down the line, all the current financial flows to Scotland from the EU, whether these are for programmes administered by the Scottish Government, or whether the funds are secured competitively by non-governmental organisations or individuals, will come to an end. It then becomes very important for the Scottish Government to develop its own policies and strategies in all the spending areas formerly supported by EU funding streams, partly as a basis for discussions with the UK Government, and partly to determine how and to what extent its own budget might be revised and restructured to replace some of the former EU funding.