HM Treasury

Tom Scholar
Permanent Secretary
HM Treasury
1 Horse Guards Road
London SW1A 2HQ

020 7270 4360 / 5158
Tom.scholar@hmtreasury.gov.uk
www.gov.uk/hm-treasury

The Rt Hon Nicky Morgan MP
Chair of the Treasury Committee
By email

11 March 2019

Dear Ms Morgan

EU EXIT PREPARATIONS

Thank you for your letter of 29 January about HM Treasury's EU exit preparations.

As you know, the Treasury has policy responsibility in a number of specific areas, alongside its overall responsibility for economic policy. Specific responsibilities include the legislation underpinning financial services, financial stability, tax and customs policy, the implementation of financial sanctions, the UK's financial settlement with the EU, and public expenditure. In all these areas, as you would expect, the Treasury has been working both to support government policy, and to prepare for all possible contingencies.

You asked about preparations for 'no deal'. Turning first to financial services, we have been working to ensure that we continue to have a functioning legislative and regulatory framework at the point of leaving the EU, in any scenario, minimising disruption for UK households and businesses. This includes making the necessary amendments to the legislation to address any technical or legal deficiencies arising as a result of EU exit by day one, and introducing transitional regimes to provide a smooth transition to a stand-alone UK regime. 52 Statutory Instruments (SIs) have been laid to date (including all those that need to be in place before exit day), and 33 have already been approved by Parliament. Debates have been scheduled for the remaining SIs. We are also taking the Financial Services (Implementation of Legislation) Bill through Parliament. This would be needed in a 'no deal' scenario to prepare for future changes in financial services regulation that are likely to come into force in the two-year period after EU exit. This has completed its passage through the House of Lords and is currently before the House of Commons.

Financial stability is a statutory responsibility of the Bank of England, but of course the Treasury works very closely with the Bank and the Financial Conduct Authority on this. In its latest Financial Policy Summary[1] last week, the Bank of England's Financial Policy Committee (FPC) said that "most risks to UK financial stability that could arise from disruption to cross-border financial services in a 'no deal' scenario have been mitigated", although "some disruption to cross-border services is possible and, in the absence of other actions by EU authorities, some potential risks to financial stability remain". The FPC also said that "the core of the financial system, including banks, dealers, and insurance companies, is resilient to, and prepared for, the wide range of risks it could face, including a worst case disorderly Brexit".

On tax and customs, policy decisions are a matter for the Chancellor, while Her Majesty's Revenue and Customs (HMRC) are responsible for operational matters. Most of our work on 'no deal' in this area is to support HMRC. HMRC is introducing and scaling up a number of systems to prepare for 'no deal'. Most notable of the projects is CHIEF, which HMRC have scaled up to manage day-one volumes, and which will run in parallel with CDS until full migration takes place. To support this 'no deal' preparation, HMRC has laid several tranches of customs and VAT & Excise SIs in November, January and February, but there remain a number outstanding to be laid before exit day. A significant risk to a well-functioning customs regime is a lack of trader readiness. While HMRC would implement an adjustment period to give UK traders more time to prepare for full customs processes, the impact of EU controls would have a significant bearing on how the border would function. On all these issues HMRC take the lead, and senior HMRC officials have given evidence to Parliament on numerous occasions.

In the event of 'no deal', the UK would need to implement a new schedule for tariffs on trade with the EU. As set out in the Taxation (Cross Border Trade) Act 2018, import tariffs are set by the Chancellor, on the recommendation of the Secretary of State for International Trade. Tariff policy has an impact on sectors and regions across the economy, and so advice to Ministers has been prepared by departments across Whitehall, including the Treasury. You have written to the Chancellor on this (6 March), and he will be replying shortly.

Sanctions policy is the responsibility of the Foreign and Commonwealth Office (FCO). The Treasury is responsible for the implementation of financial sanctions, through the Office of Financial Sanctions Implementation (OFSI). The Sanctions and Anti-Money Laundering Act 2018 (SAMLA), gives the government new powers to operate the sanctions regime after EU exit. In preparation for 'no deal', we have been contributing to the FCO's ongoing work to lay SIs under SAMLA for priority country regimes before exit day. OFSI have produced timely information for stakeholders, and conducted joint stakeholder events with the FCO. OFSI has also published guidance on its Gov.uk pages relating to the implementation of financial sanctions, applicable in a 'no deal' scenario[2].

---

[1] More detail available here: https://www.bankofengland.co.uk/-/media/boe/files/financial-policy-summary-and-record/2019/march-2019.pdf?la=en&hash=984FDE1B860F4BCE65B4E93203C30E9E6C5A8673

[2] E.g. https://www.gov.uk/government/publications/post-eu-exit-financial-sanctions-general-guidance

As part of the overall agreement with the EU on the UK's withdrawal, the government reached a negotiated agreement on the financial settlement. As set out in para 96 of the Joint Report agreed in December 2017, this settlement is conditional on an overall agreement under Article 50 on the UK's withdrawal, taking into account the framework for the future relationship, including an agreement on transitional arrangements. In the event of 'no deal' the government would need to decide its approach to the financial settlement. We have provided advice to Ministers on the options and the issues to be considered in reaching a decision.

Turning to public expenditure, many departments have incurred additional costs in preparing for EU exit, and so since 2016 the Chancellor has made over £4bn available for EU exit planning. Funding for the 2019-20 financial year has been allocated to departments, as set out in the Chief Secretary's Written Ministerial Statement of 18 December 2018[3]. This is funding to support preparations for leaving the EU in any scenario. In addition, the Chancellor and Chief Secretary have made arrangements to ensure that departments and the Devolved Administrations can fund measures to address urgent civil contingencies in a 'no deal' scenario, including expedited Treasury approval for necessary expenditure. We are also working with departments to support their plans to deliver the government's guarantee for EU-funded programmes in the event of 'no deal'. This guarantee ensures that UK organisations will continue to receive funding over a project's lifetime if they successfully bid into EU-funded programmes before the end of 2020 (for example, payments to farmers under the CAP, to universities under Horizon 2020, or to local areas under structural funds).

In the event of 'no deal', the government would of course have to consider its economic policy response. Monetary policy is for the Bank of England. Fiscal policy and overall economic policy is set by the Chancellor at each fiscal event. The Treasury always keeps economic developments under close review. That includes careful analysis of issues by sector and region, as well as distributional impacts. The Treasury does not produce short-term economic forecasts, but to inform this work we have of course studied those published by others, including the scenarios prepared by the Bank of England. And, as you know, in November 2018 the government published its own long-term economic analysis of EU exit, including an assessment of 'no deal'.

You also asked about preparations for an extension of Article 50. The Prime Minister has stated that "…if the House, having rejected leaving with the deal negotiated with the EU, then rejects leaving on 29 March without a withdrawal agreement and future framework, the government will, on 14 March, bring forward a motion on whether Parliament wants to seek a short limited extension to Article 50"[4]. Across the areas of the Treasury's responsibility, an extension would not raise new issues beyond those that we have already

[3] https://www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Commons/2018-12-18/HCWS1205/

[4] https://www.gov.uk/government/speeches/pm-statement-to-the-house-of-commons-26-february-2019

prepared for in support of the government's policy of a period of EU membership (until 29 March 2019) followed by an implementation period (until 31 December 2020).

Finally, you asked how many staff are working on these issues. As I told the Committee in October, last year we estimated that staff time equal to about 400 full-time equivalents was devoted to EU exit-related work. The number has increased since then. Our total staff complement for March 2019 is around 1450 full-time equivalents, so about 30 per cent of total staff time is taken up by EU exit work. The core Treasury's total administration resource Delegated Expenditure Limit for 2018-19 is £148 million, as set out in the Supplementary Estimates published in February, so pro-rated this would work out at about £44 million of spending on EU exit costs in 2018-19. These costs have been in part met through additional support of £24.8 million, as set out in the Supplementary Estimates, and in part have been absorbed through budget management and reprioritisation. These estimates are for total EU exit work. We have not made separate estimates of the amount of time devoted to 'no deal' preparations, since in nearly every case it is the same people, whose work is both to support government policy and to prepare for the contingency of 'no deal', though it is certainly the case that over recent months there has been a significant shift in the balance of our work towards 'no deal' preparations.

Yours,

Tom.

Tom Scholar