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THE UK'S EXIT from the European Union and its Single Market would release the UK from up to EUR 1.3 trillion of financial liabilities, comprising:

Source	Amount
EU/liability to fund the Cash budget (aka Payments Appropriation)	EUR 746.0 billion
EU/liability to fund guarantees and debts (aka Commitments Appropriation)	EUR 441.1 billion
European Investment Bank subscribed capital	EUR 39.2 billion
European Central Bank subscribed capital	EUR 1.5 billion
UK Maximum Possible Loss	EUR 1,227.8 billion

[Source: Bruges Group, The UK's liabilities to the financial mechanisms of the European Union, March 2016]

Since the two largest amounts derive from our being a member of the EU and subject to the EU Budget, our leaving the EU would extract us from the whole liability, and it is vital for us to do so.

All of the EU, ECB and EIB are – individually and in concert – taking on the most enormous risks to try and shore up and/or reflate the Eurozone, and it is wrong that these risks can be tracked back to the UK, making us pay for problems that have not been of our creation.

The risks include the UK back-stopping the financing of Greece, through the European Fund for Strategic Investments.

The UK public were told that we were not and never would be part of the Eurozone bailout. This is palpably untrue:

- We are on-risk for debts of Greece contracted through the European Fund for Strategic Investments;
- We are on-risk for the debts of Portugal and Ireland through the European Financial Stabilisation Mechanism;
- We are on-risk as a shareholder of the EIB and ECB, whose financing programmes are enormous and a key component of bailing out the Eurozone.

Both EIB and ECB are going beyond their mandate and supposed legal powers and engaging in high levels of risk in their lending portfolios, making losses and calls on shareholders likely.

We should require, upon exit, that our shareholdings in the ECB and EIB be cancelled, in exchange for our buying the UK loan portfolio of the EIB. That portfolio more or less matches our two shareholdings, so this operation can be carried out at a near-to-nil cost to the UK.

When we leave the EU, we automatically step out of all our liabilities for the EU Budget, to which our risks associated with the European Financial Stabilisation Mechanism and the European Fund for Strategic Investments are tied.

In other words we can get out of all these liabilities at zero cost, and that must be our Brexit bargaining position.

Our liabilities as an EU Member tied in to the EU Budget

The UK's liabilities all arise because we are a party to the Treaty of the Functioning of the European Union, which requires the UK to become a shareholder in the ECB (even though we are not a Eurozone country) and in the EIB, and to take responsibility for the EU Budget, in fact for all of it.

The responsibility for the EU Budget comes in two slices: (i) cash contributions and (ii) a contingent liability caused by the EU's debts and guarantees.

The first slice, called the Payments Appropriation, is the entire EU Cash budget for the remaining years of the current Multiannual Financial Frameworks or "MFF", which has been set until 2020. It is set at 0.97% of the EU's Gross National Income ("GNI"). An annual budget is set at this level, and so the total liability is on a declining balance basis: once each Member State pays its contributions for a year, the recourse to the other Member States is

not needed for that year. In addition, there is the comfort that, in the unlikely event that the EU underspends its budget for a year, the underspend this year does not get added to what is available in subsequent years.

The other slice, called the Commitments Appropriation, is the maximum possible outstanding amount under the various funds that the EU borrows to finance, and under guarantees that the EU can issue in favour of other organisations, which then borrow and make loans. In effect, this portion is a responsibility to pay back loans taken on from global investors by the EU and its surrogates, and on-lent to someone else, in the event that the "someone else" cannot pay back.

The maximum amount is cumulative:

- Funds/guarantees already engaged during previous MFFs;
- What can be added as funds/guarantees during the current MFF, namely 0.26% of EU GNI per annum for the period 2014-2020. Additions do not have to be pro-rata: in theory the entire 0.26% of the EU GNI for the MFF period could be contracted in December 2020 and it would still count as within budget.

How a deficit on the EU's Appropriations gets tracked back to the UK

The key link between these Appropriations and the Member States is the EU Budget. All the EU's cash spending, and any calls related to EU guarantees issued or to servicing the EU's borrowings, are drawn from the EU Budget, which is not allowed to go into deficit.

Member States are responsible for the EU Budget and their contributions are set so that the EU Budget shows a surplus. The liability is on a joint-and-several basis: this means that, whilst the UK's portion should be about 16% and the same as the UK's share the EU GNI, the UK's portion can escalate to 100% if other Member States do not pay their share.

This is built into the terms of the Treaty of the Functioning of the European Union and acts as a structural guarantee of the European Union's liabilities by the Member States, including by the UK, to any creditors of the European Union. To re-emphasize: the liability is potentially for the whole amount, but drops off by 0.97% of GNI each year as the UK and other Member States pay in their Member State Cash Contributions - or rather,

for those that are net takers from the EU, the net payers pay in, and part of the pay-out to the net takers is withheld as their Member State Cash Contribution, in a round-trip. The UK – by being a large net payer – is paying the Member State Cash Contributions of other Member States.

UK's maximum possible loss under the Payments Appropriation

This is 0.97% of EU GNI per annum up to and including 2020, dropping off by that amount each year, and also depending upon the size of the EU's GNI for the year. The total for the current MFF was calculated in the Bruges Group paper of March 2016 as EUR 746.0 billion.

UK's maximum possible loss under the Commitments Appropriation

The UK's maximum possible loss under the Commitments Appropriation is composed of:

- Funds/guarantees already engaged during previous MFFs, both the drawn portion and the amount that can still be drawn;
- What can be engaged as funds/guarantees during the current MFF – and within that:
  - What has already been engaged;
  - What, of the engaged amount, has already been drawn and what can still be drawn;
  - What could still be engaged on top of that.

The available data in Figure 1 overleaf indicates that the following funds/ guarantees have either already been set up, or else the authority exists within the EU Budget for the current MFF to set them up.

There are some discrepancies in the figures, especially regarding the Macro Financial Assistance Programme (which has no stated ceiling) and the European Fund for Strategic Investments (where the break-out is not stated in information issued so far between what is at the EU's risk, what is at the EIB's risk, and what is the total project size). The places where these factors impact are marked with an * below.

These discrepancies, though, only relate to working out what has been drawn and what is drawable, and not the total ceiling – which could go as high as EUR 441.1 billion.

Figure 1.

MFF applicable/type	Ceiling	Drawn	Drawable
Funds/MFFs up to 31.12.13	€125.0 billion	€57.3 billion	€69.5 billion*
Guarantees/MFFs up to 31.12.13	€36.1 billion	€36.1 billion	0.0
EU guarantee for European Fund for Strategic Investments/MFF 2014-2020	€30.0 billion	€2.7 billion	€27.3 billion
EU guarantee for EIB lending outside the EU/MFF 2014-2020	€16.0 billion	€23.5 billion*	n/a
Headroom for further funds/facilities/guarantees under 2014-2020 MFF	€234.0 billion	0	€234.0 billion
Total	€441.1 billion	€119.6 billion*	€330.8 billion*

[Source: Bruges Group – "The UK's liabilities to the financial mechanisms of the European] Union", March 2016)

What is a typical EU "Fund"?

A typical "fund" is the European Financial Stabilisation Mechanism ("EFSM"), the first Eurozone bailout mechanism, agreed in May 2010 and involving all EU Member States. The ceiling is €60 billion; €46.8 billion is currently lent to Ireland and Portugal.

€13.2 billion is undrawn; new needs should in principle be met from the European Stability Mechanism, in which only the Eurozone members are involved, and not from the EFSM. However, there has been no formal instrument passed to withdraw the EFSM's €13.2 billion undrawn amount.

The way the EFSM works is that the EU has issued bonds in its own name, and has used the proceeds to make loans to Ireland and Portugal: the EU makes these loans direct because there is no legal person called the "European Financial Stabilisation Mechanism".

The debt service to be paid on the bonds issued by the EU – interest and capital repayments – is drawn out of the EU Budget. The debt service to be received on the EFSM's loans to Ireland and Portugal should be paid into the EU Budget. But if Ireland or Portugal do not pay in, the money to pay the debt service on the EU's bonds still has to be drawn out, and, if necessary, Member State cash contributions have to rise to do so and keep the EU Budget in surplus.

In the scenario of Ireland or Portugal not paying in, the cash contributions of the other Member States would certainly rise beyond the normal level of that country's share of EU GNI: about 16% in the UK's case. Ireland or Portugal – if they could not meet their debt service obligations under their EFSM loans – would not be able to meet extra calls for Member State cash contributions. It is then that the joint-and-several liability structure comes into play, where the other Member States have to pay more because of the failure to pay of the defaulting Member States.

Ireland and Portugal have loans outstanding from the EFSM until a final end date of 2042. Both countries have exited their bailout, but, under the way the EU works, exiting bailout does not entail repayment of bailout funds.

What is a typical EU "Guarantee"?

There are two mentioned specifically in the panel above, and both guarantees are issued in favour of the European Investment Bank to reimburse it for losses it may make on lending operations it has fronted at the behest of the EU:

1. EU guarantee for the European Fund for Strategic Investments ("EFSI") which is limited to EUR16 billion in total
2. EU guarantee for EIB's many loans outside the EU

In both cases the EU has passed a legal instrument to permit it to issue the guarantee up to a maximum ceiling for loans signed during an MFF:

1. This is the first MFF in which the EFSI has existed;
2. The EIB has made loans outside the EU in this and in previous MFFs, and the amounts are cumulative:
    a. The EU agrees a guarantee amount for loans that can be signed by EIB during each MFF;
    b. As long as the loan is signed during the MFF, it can be counted against the guarantee ceiling for that MFF;
    c. It can be drawn by the borrower (i.e. paid out) in the same or a later MFF without affecting the ceiling for the later MFF;
    d. Ceilings that expire during one MFF, with no loan signed against the ceiling, cannot be carried forward to the next MFF;
    e. But a loan that missed out on being signed during one MFF does not lose its eligibility: it can be signed under the ceiling of the following MFF.

The most important point about these guarantees in favour of the EIB is that, in the cases of both the EFSI and the loans outside the EU, the EU takes the first loss e.g. on a loan of 100 that the EIB has made and where the EU has issued a guarantee for 40% of it:

Loan	Percentage repaid	Amount lost	EU loss	EIB loss
100	90%	10	10	0
100	80%	20	20	0
100	70%	30	20	0
100	60%	40	40	0
100	50%	50	40	10
100	40%	60	40	20

- The EU loses its entire guarantee amount before the EIB suffers a loss at all;
- The EU's loss caps off at 40%;
- Only then does the EIB start to book a loss.

Loss-sharing mechanisms

This loss-sharing mechanism is important because of the structure of the call upon the Member States that it entails.

The loss-sharing amongst Member States within the EU's financial mechanisms ranges on a sliding scale between three variations:

1. Lowest sharing: the loss is shared by Eurozone members only, and no member's obligation can exceed a fixed proportion of the whole amount;
2. Middle sharing: the loss is shared by all Member States, but still no member's obligation can exceed a fixed proportion of the whole amount;
3. Highest sharing: the loss is shared by all Member States on a basis where each Member State could be asked to pay more, up to the entire amount, if other Member States cannot pay: joint-and-several liability.

Variation (3) represents the best credit risk for investors as it is the one in which obligations are "collectivised" to the highest possible degree amongst the Member States, especially the ones outside the Eurozone; by extension it is the worst one for Member States as a whole, because:

1. Each one could be asked to pay everything;
2. Euro-Out countries can, via this mechanism, be fully drawn into the Eurozone bailout.

The European authorities have tried and will continue to try to bring Variation (3) into play in as many instances as possible, both directly through mechanisms like the European Financial Stabilisation Mechanism, and also indirectly, such as in the case of the European Fund for Strategic Investments, under which the EIB - operating to Variation (2) itself - benefits from a guarantee from the European Union, which operates to Variation (3).

Contrary to David Cameron's assertion in the Referendum campaign that the UK is not and never will be part of the Eurozone bailout, most of the mechanisms used to facilitate the Eurozone recovery operate under Variations (2) and (3), in which all Member States are involved:

- The European Union
- European Financial Stabilisation Mechanism – through the EU
- European Investment Bank
- European Fund for Strategic Investments – through the EU and EIB

The three mechanisms in which the UK does not participate are:

- European Financial Stability Facility
- European Stability Mechanism
- Informal TARGET imbalances within the European System of Central Banks

This is why the EU brings the EU Budget into play as often as it is allowed, because that puts all the Member States on the hook and on a joint-and-several liability basis.

How losses can occur and be tracked back to the UK

The UK is currently a full risk-sharing partner in the EU, and it is also a shareholder in two of the other mechanisms:

- The European Central Bank
- The European Investment Bank

The losses can be created and calls for cash can ensue as follows:

Organisation	Their activity	Circumstances giving rise to a call for cash
The European Union (The EU)	• Borrowing from investors to make loans to Member States and other governments • Issuing guarantees to the EIB for their loans outside the EU • Issuing guarantees to the EIB for their loans and other capital injections connected to the European Fund for Strategic Investments	• Member States and/or other governments fail to pay back their loans • The EIB's borrowers outside the EU fail to pay back their loans and EIB calls the guarantee • EIB's engagements in the European Fund for Strategic Investments fail and EIB calls the guarantee • These failures and guarantee calls put the EU Budget in deficit • The EU makes cash calls on the Member States to cover the deficit
The European Central Bank (the ECB)	• Running the European System of Central Banks	• Operations in Euro result in losses that cannot be re-allocated out to the Eurozone National Central Banks • The losses deplete the ECB's own capital • The ECB calls up the capital that is subscribed but uncalled • The ECB raises its subscribed capital and calls it up
The European Investment Bank (the EIB)	• Borrowing from investors to make loans to projects inside and outside the EU	• Borrowers under projects inside the EU fail to repay • Borrowers under projects outside the EU fail to repay, and the call under the EU's guarantee is insufficient to cover the loss • Engagements in the European Fund for Strategic Investments fail, and the call under the EU's guarantee is insufficient to cover the loss • The losses deplete the EIB's own capital • The EIB calls up the capital that is subscribed but uncalled • The EIB raises its subscribed capital and calls it up

This is the impact if losses are made, but how likely is it that losses will be made?

Very high, because:

- The Eurozone economy is at best stagnant;
- The EU mechanisms are directly responsible for the spending that creates the illusion of GDP growth;
- The EU mechanisms are taking large and irresponsible risks to achieve this;
- The Eurozone banking system has many bad debts in its portfolio;
- The ECB is holding up parts of the banking system single-handed, and by undertaking operations way outside its mandate and supposed legal powers.

European Central Bank – the UK at risk but with no voice

The Bank of England has subscribed EUR 1.48 billion to the capital of the European Central Bank, of which EUR 56 million has been called and EUR 1.42 billion is callable *[Source ECB Annual Report 2014]*.

The ECB's capital base is very thin for the size and risk-profile of operations it is undertaking; there would only need to be very small losses as a percentage of the transaction values for the ECB's paid-in capital to be wiped out – in which case the ECB Governing Council would call up all the subscribed-but-not-called capital.

But the ECB's subscribed capital is very small as well compared to the operations being undertaken. Modest losses as a percentage of the transaction values would wipe out the ECB's subscribed capital – in which case the ECB Governing Council could impose an increase of the subscribed capital on all Member States.

The ECB's shares are owned by the National Central Bank of each EU Member State and must be subscribed in accordance with the Member State's "capital key". The "capital key" is adjusted every five years and is:

- 50% of the Member State's percentage population share of the EU in the preceding year;

- 50% of the Member State's percentage share of EU GDP over the preceding five years.

So it is a blend of the country's population size and GDP size, and countries in which both are growing will have their capital keys ratcheted up.

The ECB Governing Council is the forum for voting on increases in the subscribed capital and for calling up uncalled capital. The ECB Governing Council consists of the governors of the Eurozone National Central Banks and the Members of the ECB's own Executive Board. The UK is not represented, although its shareholding is included in the calculations of the majority needed to carry such a vote.

In other words, and to cut a long story short, the Eurozone members can raise the UK's subscribed capital, and call up any subscribed-but-not-called capital, at their leisure, and the UK cannot block it. Indeed, they can do this without the UK even being in the room.

European Central Bank – flawed from the start

The ECB governor has frequently declared that he will bring a bazooka to bear on the problems of the Eurozone, and use all the powers at its disposal. Occasionally, but not always, Mr Draghi adds the phrase "within the limitation of our mandate and legal powers".

The primary limitations would be:

- Not to make any loans unless they are secured with assets that count as "central bank money";
- Not to make any loans where the security is worth less than the loan.

A loan from the ECB is itself a loan of "central bank money" because the loan is disbursed onto a bank account in Euro held at a central bank: possibly an account at the ECB itself, but equally likely an account in Euro held at one of the Eurozone National Central Banks, they and the ECB being collectively known as the "Eurosystem".

"Central bank money" means those forms of money that are regarded as free of credit risk because they represent an obligation of a country in its own currency. Government obligations are forms of central bank

money, such that central bank money is often termed as representing the "sovereign risk" of the country concerned. The "sovereign" would be the UK, the USA, the Republic of France, the Kingdom of Norway and so on.

In the UK the forms of central bank money are:

- A credit balance on an account at the Bank of England (which can only be in GBP)
- GBP note and coin issued by the Bank of England
- UK government bonds - gilts

The different forms of central bank money must be 'fully fungible': instantly exchangeable for one of the other forms at par/without a 'haircut'.

When the Eurozone was set up, it was agreed that any loans made between members of the Eurosystem had to be secured on assets that met the Eurosystem definition of "central bank money". However, the security quality is compromised because the definition allows the Eurosystem members to secure their loans according to 'A' and 'B' lists of collateral that were spurious even at the time the Euro was launched:

- Type A – defined and valid Eurosystem-wide: one Eurosystem member can borrow from any other if it pledges Type A. These are government and government agency bonds of any Eurozone member. Since Ireland, Italy, Spain, Portugal, Cyprus etc still count as Eurozone members regardless of their credit ratings, so the central banks of these countries can borrow by pledging the government and government agency bonds of their own country;
- Type B – defined by each Eurosystem member individually and only valid for loans made by that Eurosystem member: for example, in France Type B includes unused French postage stamps and Paris metro tickets.

The flaws in the system are:

- Once assets are on the list, they are valued within the Eurosystem at near to face value, because otherwise it contradicts the logic of their qualifying to be on the list: they are by definition top-quality assets;
- There is no mechanism for reducing the valuation if the open-market price of the asset decreases;
- There is no recognition of correlation risk, where the borrower and

the collateral carry the same credit risk. A loan to the Central Bank of Ireland is secured on bonds issued by the Republic of Ireland, which is the owner of the Central Bank of Ireland. Both draw their debt service from the same well: the taxpayers of the Republic of Ireland. If the Central Bank of Ireland is unable to meet its obligations, the Republic of Ireland will be experiencing the identical financial problems. The price of the Republic's bonds will then fall, and will not cover the overdraft of the Central Bank of Ireland;

- There is no mechanism for limiting the portion of assets pledged that are illiquid e.g. Type B collateral in the form of postage stamps can only be used up gradually.

European Central Bank – running on empty

The ECB is now running on empty because it is supporting the Eurozone financial system in three ways, in each case entrenching the flaws evident in the Type A/Type B collateral system:

1. Facilitating that debtor Eurozone National Central Banks borrow from creditor Eurozone National Central Banks against security under which there is a total correlation between the loan and the security, as discussed in the previous section;
2. Facilitating that Eurozone National Central Banks make loans to commercial banks in their country at a 2-5% discount from the face value of the security pledged, but where the security would only be included in the same commercial banks' computations of their High Quality Liquid Assets at weightings of 85%, 75% or 50% of face value, not 95%-98%;
3. Enabling a below-the-horizon Eurozone bailout mechanism to be run day-to-day through their TARGET payment system.

ECB - funding the commercial banks

Against (2) the Eurozone National Central Banks are funding the commercial banks because (i) there is no private capital formation and so there has been a reduction in customer deposits; (ii) other banks will not lend interbank deposits to these banks, and (iii) these banks have large, long-term loan books such that it is not an option to reduce their loan books to match the funding available from normal sources.

There is a structural funding gap and it is the Eurosystem that is filling it, lending to these banks against collateral that is not definitionally "central bank money", but which carries the same or better credit ratings as many assets that do qualify definitionally as "central bank money".

These are bonds which are legally tradeable but which vary in their practical liquidity. Commercial banks are allowed to include them in their computations as so-called High Quality Liquid Assets ("HQLAs") for the purposes of their compliance with the Basel III Liquidity Coverage Ratio, but only with a substantial haircut (meaning a discount to the face value).

The Basel III Liquidity Coverage Ratio assigns the following haircuts:

- AA- or higher corporate debt securities and covered bonds – 15%;
- Residential mortgage-backed securities – 25%;
- A+ to BBB- corporate debt securities – 50%.

These are not "central bank money" assets so the Eurosystem should arguably not be lending against them at all. But actually these assets have the same credit ratings as Eurozone government bonds or better.

If Spain is rated BBB+ and Italy is rated BBB-, and their bonds are valued in the Eurosystem as Type A at 100%, why should corporate bonds rated A- or A+ be valued any lower?

The ECB is caught in its own web: by allowing any Eurozone government bond to be valued at par, whatever its independent credit rating, the ECB entrenches a problem at the heart of the euro: it is not a unitary currency. It exists in many different forms, and just as there is a wide spectrum of credit quality within the Eurozone government bonds, so collateral in the form of corporate bonds and mortgage-backed securities with similar ratings can treated on an equal footing.

The ECB is indulging in an electronic form of coin-clipping: the currency becomes debased by existing in so many different forms that the ECB values as if they were "central bank money". The currency represented by these assets – the euro - can be viewed as completely synthetic: the currency exists in many different flavours of credit risk between AAA and BBB- but they all say 'euro' on the tin.

ECB – running the TARGET "below-the-horizon" Eurozone bailout mechanism

Eurosystem members hold current accounts with one another to settle Euro payments traffic – within a system called TARGET.

Normally current accounts used for payment settlement have to be brought to zero at the end of each day, but not in TARGET. Lombard Research recently estimated that there is a daily imbalance of EUR600 billion being lent by creditor nations back to debtor nations, in order to finance the payments by the latter to the former.

This is not one day's net payment traffic; it is the build-up of a net outflow of funds from the debtor nations over a period of time. The overdrafts of the debtor nations are secured, as ever, with bonds issued by their own governments.

The size of the TARGET bailout comes into perspective when it is compared to the total ceiling of Eurozone bailout mechanisms:

Mechanism	Ceiling	Utilised	Available
• European Financial Stabilisation Mechanism	€60 billion	€46.8 billion	€13.2 billion
• European Financial Stability Facility	€187.3 billion	€187.3 billion	- Closed -
• European Stability Mechanism	€500 billion	€127.02 billion	€372.98 billion
• Total of official bailout mechanisms	€747.3 billion	€361.12 billion	€386.18 billion
TARGET	- Unlimited -	€600 billion	- Unlimited -
Total of all bailout mechanisms	- Unlimited -	€961.12 billion	- Unlimited -

The TARGET bailout amount outstanding is approximately double that outstanding under the officially-recognised bailout mechanisms. The TARGET bailout has no ceiling, and it could theoretically expand to be the aggregate of all Type A collateral held by all Eurosystem members.

This make a joke of German court rulings that attempted to limit Germany's exposure under all Eurozone bailout mechanism to EUR500 billion.

Germany is the main TARGET creditor and is in for well over its supposed EUR500 billion limit: only under the European Financial Stability Facility and the European Stability Mechanism is Germany's exposure limited (i) to a ceiling and (ii) to a ceiling that is lower than the maximum ceiling of the mechanism involved.

Conclusion about the ECB

This is central banking gone completely out of control. The ECB has gone way outside its mandate by allowing Eurosystem members not to zero-balance their current accounts in TARGET every night.

It has gone outside its mandate in its setting of commercial terms for both (a) the loans it is itself making to Eurosystem members, and (b) the loans it is allowing Eurosystem members to make (i) to one another and (ii) to commercial banks, because the security does not have to be both in proper "central bank money" and to cover the loan. Either the collateral qualifies definitionally for valuation at face value as "central bank money" but its market value is lower, or it is not definitionally "central bank money" and is valued at very close to its market price, without an adequate buffer. If either type of collateral had to be liquidated in the open market, the sale proceeds might not pay off the loan – with certainty or with high likelihood.

The ECB has deviated from basic banking practice by:

- failing to recognise, control or exclude Correlation Risk, a risk that banking supervisors do not permit within commercial banks;
- allowing commercial banks to borrow from Eurosystem members at collateral valuations far higher than the same banks are allowed to value that collateral for their Basel III liquidity returns.

Not only is the UK's current capital at risk, the Governing Council of the ECB can increase the UK's liability and call it all up in cash without the UK even being in the room.

European Investment Bank

The UK has a shareholding of EUR39.2 billion in the EIB, of which EUR3.5 billion is paid in and EUR35.7 billion is subscribed-and-callable. The EIB, by an exercise in Qualified Majority Voting, can call up the UK's EUR35.7 billion,

and that amount forms part of the total of EUR221.6 billion of EIB capital that subscribed-and-callable. This amount acts as a third-loss cushion for lenders to the EIB, behind the second-loss cushion, which is the small called-up capital of EUR21.7 billion and the EIB's accumulated reserves.

The EIB's first-loss cushion is a direct call on the EU Budget where it can invoke the EU's guarantees in its favour to cover losses the EIB has made on loans to borrowers outside the EU, and on loans into projects in the context of the European Funds for Strategic Investments. Global investors in the EIB need to be able to look at these cushions of recourse to the Member States: the EIB is one of the largest borrowers on global capital markets, and so the buyers of its bonds want to be sure that there is a look-through to the Member States for more money, in case the EIB makes losses in its loan portfolio. The EIB has four types of borrower:

- Commercial banks within the EU, for the EIB's SME (Small and Medium Enterprises) financing programmes – the same banks that Eurosystem members are propping up;
- Public sector entities within the EU, for projects within the EU;
- Public sector entities outside the EU, for projects outside the EU, where the EIB is the beneficiary of a first-loss guarantee from the EU for a part of its loans;
- Projects in the EU in the context of the European Fund for Strategic Investments, where the EIB either directly invests in debt or capital-like securities of a project, or co-finances an SME with its subsidiary the European Investment Fund, and where the EIB is again the beneficiary of a first-loss guarantee from the EU for a part of its financing.

The EIB is thus an intermediary between the end-user – not always of high quality and not able to access capital markets on the same terms as the loans it gets from EIB – and the global investor who only wishes to buy high-quality Investment Grade bonds. EIB is lending its "credit enhancement" to the end-user's loan, a "credit enhancement" that derives from the EU's first-loss guarantees, and from EIB's ability to call up extra capital from its shareholders. EIB claims that the loans to end-users are of high quality because:

- They are made to public sector entities, inside and outside the EU; or
- They are made to major commercial banks in the EU; and
- The EIB benefits from preferred creditor status in law.

The EIB's policies since the crisis, combined with (i) the giving up of preferred creditor status in the context of the EFSI (ii) the ongoing issues around public sector debt in the Eurozone and (iii) the issues about the creditworthiness of the Eurozone's banks, must make us question the quality of the EIB loan book.

As the quality of the underlying EIB loan book goes down, so the reliance placed by global investors on the look-through to the Member States to inject more money goes up.

EIB lending policy since the crisis

The EIB's loan policy since the Eurozone crisis has been in line with the agreement made between Angela Merkel and Francois Hollande in 2012 - to fully mobilise the potential of the EIB for engaging in counter-cyclical public spending.

"German Chancellor Angela Merkel added her voice on Saturday to calls to bolster the European Investment Bank (EIB) and to use EU infrastructure funds more flexibly to help spur economic growth in Europe. Her comments are part of a new German emphasis on growth-boosting measures to complement painful tax hikes and spending cuts that have triggered a political and popular backlash against austerity across the Eurozone."

Specifically the bank claims, of 2015, that "the EU bank's operations will have a considerable impact on Europe's economy, adding 830,000 jobs by 2017 and 1.4 million by 2030".

Its new lending commitments for 2015 were:

Borrower Area	Loans approved	Loans signed	Loans disbursed
Non-EU	€9.0 billion	€7.8 billion	€4.9 billion
EU	€85.0 billion	€69.7 billion	€57.4 billion

The leading borrower countries in the EU were Spain and Italy.

Over the period from the Eurozone crisis until 2014, these countries were the biggest borrowers, despite the reduced access that the sovereign borrowers in the same countries had to the capital markets. The loan amounts are in € billions:

Nr	Country	% 11-15	2014	%	2013	%	2012	%	2011
1	Spain	+20%	€86.7	+8%	€80.6	+7%	€75.1	+4%	€72.0
2	Italy	+13%	€67.5	+3%	€65.6	+7%	€61.5	+3%	€59.9

The figures for new loans signed in 2015 were:

Nr	Country	New signed loans in 2015	% from year before	2014	% from year before
1	Spain	€11.9 billion	+15%	€11.9 billion	+15%
2	Italy	€10.9 billion	+14%	€10.9 billion	+14%

Let's remember that EIB loans – and still more EFSI loans – are mainly public sector debt, but not lent to the sovereign borrower, such as the Republic of Italy or the Kingdom of Spain. Instead they are made to regional or municipal authorities, or to limited liability companies that are owned by one or more such authorities.

Undermining of the Treaty on Stability, Co-ordination and Governance in the EMU, aka *The Fiscal Stability Treaty*

The EIB's loans count as Eurozone secondary public sector debt, and the EIB and EFSI have been tasked with aggressively increasing that part of the public sector debt.

At the same time the European Commission has been devising and trying to obtain compliance with the Treaty on Stability, Co-ordination and Governance in the EMU, aka the Fiscal Stability Treaty. This was signed amongst the EU Member States that are part of the Single Currency to agree to reduce the ratio of government debt to GDP to 60% by 2030, and to make such adjustments as are needed to spending to take account of additional age-related social costs that may arise up to 2050 i.e. to adjust welfare spending downwards before 2030 so that the 60% ratio can be sustained up until 2050.

The aim of the Fiscal Stability Treaty is to control and reduce primary public sector debt.

In parallel and taking Spain as the example, the EIB and EFSI have been acting in a way that circumvents and frustrates Fiscal Stability Treaty:

- Aggressive expansion of lending, whilst severe doubts were being expressed as to the financial viability of the "sovereign borrower" (the Kingdom of Spain) in the same country;
- Lending to all parts of the public sector except the sovereign borrower, and eschewing any sovereign's guarantee;
- Depending upon the same source of debt service as primary public sector debt: the capacity of the citizen and businesses to come up with taxes, levies and charges, and the right of public authorities to impose those taxes/levies/charges and collect them;
- That capacity question hangs on economic prosperity. Why should it be considered that, at a time when a lack of economic prosperity was weighing down on the Kingdom of Spain, it should not weigh down also on its sub-divisions, like Castilla-La-Mancha or Aragon?
- These loans do not appear in the public accounts that the Fiscal Stability Treaty is benchmarked to. The loans are not consolidated into the debts of the Kingdom of Spain. They make up the country's secondary public sector debt on the books of the respective region or municipality, or they even fall below the horizon and onto the books of a project company (like a Ibersol Electricidad Solar Iberica, S.L.U.), and do not get shown in the public accounts at all, as per the UK's Private Finance Initiative model.

This is incoherence on an epic scale: negotiating the control and reduction of primary public sector debt on the one hand, and totally undermining that policy by actively encouraging the build-up of secondary and below- the-horizon public sector debt on the other, the debt service for both coming from the same well. This is just double- or triple leveraging the same capital base, or even worse than that because the individuals and business who form the country's tax-paying capacity have direct debts of their own.

Example new EIB loans in 2015

Here are just two examples of EIB lending policy in action, all very laudable in their own right but having very little to do with building new economic infrastructure to underpin direct economic growth, and therefore having very little to do with the EIB's mandate.

EIB agrees record EUR 200m support for investment in 71 Irish schools
On 17 October 2016, the Irish Minister for Education and Skills, Mr Richard Bruton TD, and the Vice-President of the European Investment Bank, Mr Andrew Mc Dowell, signed a long term loan to support the

construction, enlargement and modernisation of 71 schools over the next four years.

EU supports the modernisation of Lisbon's infrastructure with a EUR 250 million EIB loan under the Investment Plan for Europe
A EUR 250 million EIB loan will finance the upgrading of public infrastructures in the Portuguese capital to enhance flood prevention, promote sustainable mobility and modernise social housing. Lisbon is the first municipality to benefit directly from EU support under the Investment Plan for Europe.

The problem is that, laudable as the social intentions of these loans may be, neither is a direct money-making scheme. The idea of a financial investment is that it should produce a direct financial return. The returns from these projects are likely to be mainly non-financial, and any financial returns are likely to be indirect at best.

This is not what a private company would call an investment:

- Starting up a new subsidiary in a foreign country;
- Opening a new production plant;
- Buying extra lorries to deliver an increased level of production.

No commercial bank would make these EIB loans, and that is important. The EIB's original purpose was to make commercial loans, but to focus on projects that had a build-time and a pay-back period far longer than a commercial bank would consider, and to make loans that carried a fixed – rather than variable – rate of interest because the EIB could raise fixed-rate funds itself, whereas the sources of funding available to banks were mainly on a variable rate of interest. Such a project could be a mining project, or a hydroelectric dam: to create resources and products for sale that did not exist before, and which were being sold for money.

The EIB has gone a long way off that track:

- Loans for replacement - not new - resources and products;
- Loans for projects that have mainly non-financial returns, and financial returns that are indirect, not to say non-existent.

It is as if they was no market space in the EU for new resources and

products, such that the EU has to find different types of projects upon which to fill its quota for new lending.

Looked at another way this is not surprising: the EIB is Europe's largest borrower and its borrowing programme is so large that it is sucking out a major proportion of available investor funds to spend on its projects It is expending a lot of money, but the projects upon which this money is spent do not in turn generate money. The debt service is drawn from general taxation: Irish schools do not generate the debt service on the EIB loans. This is just stacking up secondary public sector debt, not creating prosperity. Its aim is discernible from Chancellor Merkel's statement about using "EU infrastructure funds more flexibly to help spur economic growth in Europe": spend a lot and now. That adds to GDP and now, and don't worry how to pay it back.

European Fund for Strategic Investments (EFSI)

Then finally we have the European Fund for Strategic Investments, which is not a fund but a permission to the EIB to borrow even more money itself and lend it out into projects either itself or through its subsidiary the European Investment Fund:

- Taking a higher risk position in the financing of the projects compared to the EIB's traditional loans, which carry a 'preferred creditor' position and are frequently cited by the EIB itself as a reason for its own creditworthiness;
- This means that the EIB has a much higher risk of loss, because the class of finance it has injected into the projects sits far further down the creditor ladder;
- The EIB is doubling its loan portfolio but on the same capital base, and this reduces the percentage of total loans that need to be lost before the EIB capital is wiped out and needs to be replenished with new pay-ins by Member States.

The EIB, through the EFSI, has embarked on venture capitalism with no more capital itself.

Loss transfer from the EFSI to the EU general public

But apparently we do not need to worry about the EIB because, in the EFSI, the EIB benefits from a first-loss guarantee of EUR 16 billion from the EU.

It can pass back its first losses to the EU, which can pass them back to the Member States via the EU Budget.

However, in addition to the EUR 16 billion of EFSI loans for which the EIB has an EU guarantee, the EIB can put at risk up to EUR5 billion of its own resources into EFSI projects through the European Investment Fund.

EIB can thus inject EUR 21 billion into the highest-risk portions of the financing of a project, but only EUR5 billion of the losses will deplete its own capital; the other EUR 16 billion can be retrieved from the EU Budget. The EU guarantee enables the EIB to increase its own borrowings and leverage through the EFSI, but it also enables the EFSI projects themselves to gear themselves up under the so-called "multiplier" effect. This means that an EFSI project will take on:

- EFSI funding from the EIB; and
- Traditional loan funding from the EIB; and
- External loan funding.

The EFSI funding will be the thin, first-loss funding for the project, and EUR 16 billion of losses there will not impact the EIB at all, but be drawn from the EU Budget. This should be of no comfort to EIB's shareholders who are also the guarantors of the EU Budget:

- Transferring the highest slice of risk from the EIB to the EU under the EU's first-loss guarantee merely alters the nature of the Member State liability from several-but-not-joint through the EIB, to joint-and-several through the EU;
- The "multiplier" effect of the EFSI means that, because the "Traditional Loans" department of the EIB can see "investors" subscribing to the higher-risk levels of capital, the EIB is willing to commit "Traditional Loans" to the same project;
- It does not seem to interrupt the logic chain that these "investors" are the EIB itself either acting directly and under EU guarantee or at the EIB's own risk through the EIF;
- The EIB "Traditional Loans" are only the first multiplying effect – the second one is the raising of further private loan finance in a top-slice: "top" meaning highest-ranking on the creditor ladder and at the lowest risk of loss;

- In both the EFSI bottom-slice and the EIB "Traditional Loans" middle-slice, the EIB explicitly gives up the preferential status on the creditor ladder which, elsewhere, it cites as a reason for its own creditworthiness;
- These circumstances make losses for the EIB on EFSI-backed projects far more likely than losses on traditional EIB loans.

Multiplier effect – loads more debt supported by the single amount of capital

The EFSI is limited to a size of EUR 315 billion, based on the EIB lending against the EU guarantee of EUR 16 billion, plus the EIF being allowed to put EUR 5 billion at risk, and maximum amounts set for the EIB "Traditional Loans" of EUR 40 billion into the same projects.

The EIB's and EIF's combined EUR 21 billion of EFSI funding are injected into the types of finance sitting lowest down the creditor ladder and at the highest risk of loss.

The EIB's "Traditional Loans" sit higher up the creditor ladder than the EIB's and EIF's combined EFSI funding, but below the private loans.

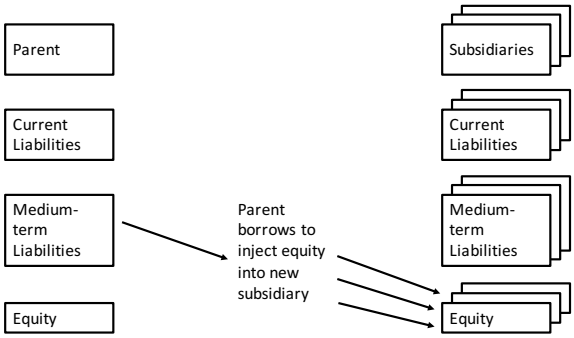
The multiplier effect in the EFSI works as follows:

Level/multiplier	**Amount**
EFSI funding of the EIB or EIF/highest risk	EUR 21 billion
First-level Multiplier	190%
EIB "Traditional Loans"/middle-risk	EUR 40 billion
EFSI and EIB funding combined on EIB balance sheet	EUR 61 billion
Second-level Multiplier	416%
Private loans/lowest-risk	EUR 254 billion
Total funding raised	EUR 315 billion
Leverage of Total funding to EFSI funding	15 times
Leverage of Total funding to EFSI+EIB Loans funding	5.2 times

Double-leveraging – sounds like Enron, and it is

This is a clear Enron-like example of double-leveraging the same capital. The Enron parent company was already highly leveraged itself, and then it used borrowings at the parent level to inject capital into subsidiaries, which then in turn borrowed on a similar multiple of loans-to-capital:

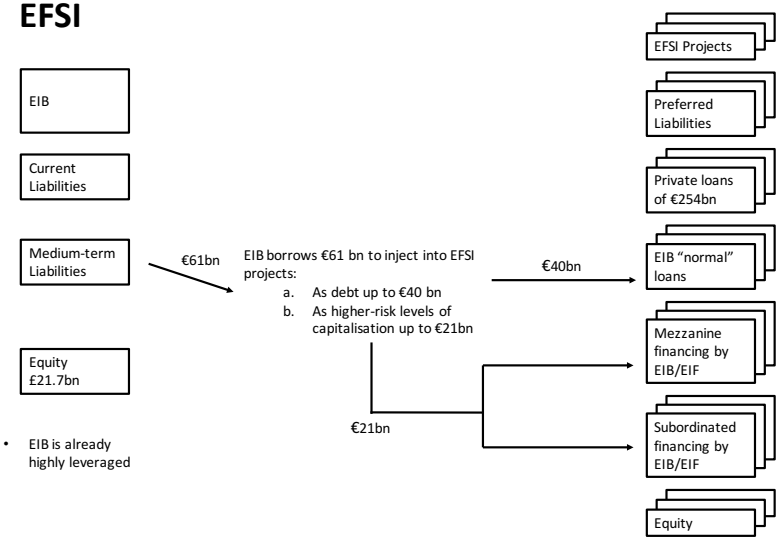
Enron



- Parent is already highly leveraged
- Four or five leveraged balance sheets are supported on just one small base of equity

In the context of the EFSI the EIB will borrow an extra EUR61 billion itself and then inject it into EFSI projects, either as mezzanine or subordinated financing itself or through the EIF, or as "traditional" loans. The projects will then borrow an extra EUR254 billion themselves, just as the Enron subsidiaries did:

EFSI



- EIB is already highly leveraged
- Seventy or eighty balance sheets are created and leveraged, all on the basis of the EIB's current capital base, as well as the EIB over-leveraging itself

EFSI projects – Greece, wind farms, venture funds…

The type of projects being financed through the EFSI is clear from the EFSI's own listing on http://www.eib.org/efsi/efsi-projects/index.htm. Just a small selection:

- Toscana energia gas network and metering, Italy
- Tripla Near-Zero Energy building project, Finland
- Rentel Offshore Wind, Belgium
- Energy Efficient Buildings, Germany
- MM Water Infrastructure Upgrade, Italy
- Primary Care Centres Public Private Partnership, Ireland
- Growth Equity Fund Mid-caps, Spain & Portugal
- QUAERO European Infrastructure Fund, any EU country
- Fonds SPI - Sociétés de projets industriels, France
- BPI Employment & Start-ups Programme, Portugal
- BST Employment & Start-ups Programme, Portugal
- BCP Employment & Start-ups Programme, Portugal
- CGD Employment & Start-ups Programme, Portugal

This list contains:

– energy projects to replace fossil-fuel usage;
– money for investment funds that will make investment decisions of their own about what to do with EFSI money;
– money injected through – and at the discretion of – the four largest Portuguese banks (BPI, BST, BCP and CGD), in the same way as the EIB organises its SME Financing Programmes through the self-same commercial banks, which are the ones being propped up by the ECB;
– a distinct lack of projects whose aims are both to make money and to do something new – to make or do something for money that no-one else is doing now. That, surely, should be the aim of a "Strategic Investment".

The EFSI project listings do not:

- give loan amounts at the project level in all cases, stating amounts as "undisclosed";
- show the amount of EIB "traditional loans" into the same projects as are receiving EFSI loans;

- break out signed projects into 'drawn' and 'drawable' amounts under the three slices of financing:
  - EFSI;
  - EIB "traditional loans";
  - Private loans.

This is a completely inadequate level of reporting.

And then we have projects in Greece, which are at least the following:

Borrower/Project	**EFSI funding**	**Total EFSI-related investment**
National Bank of Greece – loans for SMEs and MidCaps	EUR 215 million	Undisclosed
Agro Food Industry RDI	EUR 15 million	EUR 31 million
Diorama Hellenic Growth Fund	EUR 20 million	Undisclosed
Greek Regional Airports PPP	EUR 300 million	EUR 400 million
Viotia Wind Parks	Undisclosed	Undisclosed

In addition to these direct financings of Greek projects, the list of EFSI projects has numerous ones into a fund – like Capenergie 3 Fund into which the EFSI has committed to lend EUR50 million - where the destination of investments out of the fund is simply stated as "EU countries", which could of course include Greece.

It simply unaccepted that the EIB can issue a list for the EFSI where any amount – injected by itself or raised in total for the project – can remain "undisclosed".

It should be unacceptable that the EIB start to finance Greece without debate in Member State Parliaments but, as stated before, the EU mechanisms benefit from many loopholes through which money can be injected, at Member State risk, into projects and countries that:

- Cannot access money in those quantities, or on those terms, or at all, in the open market;
- The other Member States would not lend to directly themselves.

The UK <u>is</u> therefore part of the Greek bailout because:

- Losses on these loans would be covered by the EU guarantee;

- The EIB is reimbursed from the EU Budget;
- The UK is responsible for the entire EU Budget, on a joint-and-several basis.

EFSI – Private Finance Initiative by another name, and it doesn't smell any sweeter

Instead of projects whose aims are both to make money and to do something new, there is a preponderance of a well-known project type, for those familiar with how wind farms have been introduced into the UK:

- The electricity generated is replacement energy, replacing fossil-fuel sources;
- The offtake is expensive – it drains value out of the rest of the economy rather than adding financial value to it;
- The financial value is earned by the project sponsors: they have a guarantee of the sale of the offtake to the general public and usually at a guaranteed and inflated price;
- The commercial contract between the project and the general public – made through a public authority – is normally so watertight that it makes the loans taken on by the project presentable as "sovereign risk" to investors because the debt service is secured on a cashflow underwritten by a national government;
- The loan does not appear as either primary public sector debt or secondary public sector debt, because the loan was taken on by a private company and the public's financial liability is recorded in a commercial contract, not a financial instrument;
- Nevertheless the debt service is drawn from the self-same well.

The EFSI's rationale is that there are not enough capitalists out there willing to take risk, so the hapless EU taxpayer must be exposed to more risk to get the EU economy going.

Is it not rather the case that the EIB and EFSI are such a soft touch that capitalists do not need to run risks: there is an endless supply of public-guaranteed projects out of which they can get equity-style returns for taking "sovereign risk"?

In fact the reality is that the EU has distorted the marketplace by:

- Sucking out too big a slice of available capital itself;
- Recycling it into projects that may have laudable aims but which do not make money;
- Causing secondary and below-the-horizon debts to be built up, all drawing on the same well for their debt service;
- Torpedoing any chance of the capital market functioning as was intended when the euro was launched;
- Borrowing – directly or indirectly – huge amounts simply to spend it now and create the illusion of economic stability;
- Storing up a mountain of debt for future generations;
- Building up that debt at the secondary and below-the-horizon levels whilst simultaneously – pusillanimously and hypocritically – demanding under the Fiscal Stability Treaty that primary public sector debt be reduced.

EIB activities as a % of total EU activity – on its own account and through EFSI

Basically EIB's racking-up secondary and below-the-horizon public sector debt is all that is keeping the EU from depression.

Here are the percentages of the EU economy that EIB's new 2015 lending represented:

EU GDP in 2015	EUR16.6 trillion	As % of EU GBP
EIB loans approved in 2015	EUR84.9 billion	0.51%
EIB loans signed in 2015	EUR69.7 billion	0.42%
EIB loans disbursed in 2015	EUR57.4 billion	0.35%

The EFSI had not got into full swing in 2015. Neither EIB's nor EFSI's figures breakout the EIB's "traditional loans" into EFSI projects, and both EIB and EFSI loans have a lead time between approval, signature and disbursement. So we have to make assumptions about the plans for the EIB's sustained lending now that the EFSI has got into full swing.

We can assume that some of EIB's loans *approved* in 2015 were for EFSI projects, but it is also safe to assume that none of the loans *signed* were for EFSI projects.

Thus we can take it that EIB is aiming to ramp up its annual disbursements of non-EFSI loans at the rate at which it was signing loans in 2015 - EUR69.7 billion per annum.

We have the EFSI figures so far as well for financings approved and signed, not for the ones disbursed. These figures are more complex, because they are partial:

- The EIB's engagement in the project through the EFSI is stated; and
- So is the total project size; but not
- EIB's "traditional loans" into EFSI projects; nor
- Where amounts are undisclosed;
- And where EIB's loans into EFSI projects may be included in the EIB's overall figures.

Nevertheless, we know that the EFSI had scarcely got off the ground in 2015. Thus the EFSI figures we have now can be considered as incremental to the EIB's 2015 figures, especially as there are several instances of "Amount undisclosed" to counterbalance any double-counting.

Here are the figures for the EFSI so far, up to 14th November 2016:

EU GDP in 2015	**EUR16.6 trillion**	**As % of EU GBP**
EIB's EFSI engagements *approved* so far	EUR 6.1 billion	0.04%
Total investment in EFSI projects *approved* so far	EUR 13.1 billion	0.14%
EIB's EFSI engagements *signed* so far	EUR 6.9 billion	0.04%
Total investment in EFSI projects *signed* so far	EUR 23.4 billion	0.08%
Total EFSI engagements so far	EUR 13.0 billion	0.08%
Total investment of EFSI so far	EUR 36.5 billion	0.22%

It seems fair to assume that the "Total investment of EFSI so far" is the amount that the EFSI expects to be disbursed and spent in the EU economy annually for the next eight years, at which point the ceiling of the EFSI of EUR315 billion will have been reached. This can be taken to be incremental to the EIB's increases in "traditional loans" outside of the context of the EFSI. The EIB is under orders to sustain its recent level of increase in "traditional loans" too, both within and outside the EFSI.

EIB and EFSI inflations of EU GDP

With EU GDP basically stagnant, we can use the 2015 EU GDP figure as a base, and so we can extrapolate the intended on-going spend enabled by (i) the EIB through its "traditional loans" outside the context of EFSI and then (ii) the EFSI programme as a whole, as being:

Scheme	Anchor figure	Annual amount	% of EU 2015 GDP
EIB	EIB loans signed in 2015	EUR 69.7 billion	0.42%
EFSI	Total investment of EFSI so far	EUR 36.5 billion	0.22%
Combined	Annual spending caused by EU mechanisms	EUR 106.2 billion	0.64%

Then we can compare these figures to the individual statistics of GDP growth in a selection of EU Member States in the next table:

GDP	Inflation	'Real' GDP	EIB/EFSI contribution to EU GDP		
	growth	growth	EIB	EFSI	Total
Germany	0.4%	0.7%	(0.3%)		
Netherlands	0.6%	0.1%	0.5%		
France	(0.1%)	0.4%	(0.5%)		
Finland	0.0%	0.4%	(0.4%)		
Spain	0.8%	0.3%	0.5%	0.42%	0.22%	0.66%
Italy	0.0%	0.1%	(0.1%)		
Greece	0.2%	(1.0%)	0.3%		
Portugal	0.3%	0.6%	(0.3%)		

[Source: Trading Economics/EIB 2015 Annual Report]

The message is very clear: the spending of the loans being made and enabled by EIB/EFSI exceeds the general level of GDP growth.

The EIB/EFSI are all that is keeping the EU economy out of nominal recession and, as this lending is being done on a sustained basis, out of depression.

EIB and EFSI – borrowing to spend

EIB and EFSI are simply spending money now, on projects which may have laudable social and environmental rationale but which have very limited financial rationale:

- Inflating GDP and employment in the short term;
- Creating debts in the long term, over-leveraging the single source of debt service at the secondary and below-the-horizon levels;
- Making a mockery of the existence of the Fiscal Stability Treaty.

This is quite simply a colossal and irresponsible form of Equity Release: borrow and spend now, but in this case the equity being released is not based on a tangible and valuable asset. It is based on the tax-paying capacity of future generations.

Critique of this "washing machine" in a time when the UK has imposed austerity on itself

Why is the UK participating in all of this, at a time when the UK's own public finances are in disorder? It seems absurd to allow these EU organisations to have the right to call for cash and to create engagements for which the UK is identified by credit rating agencies as a primary source of "credit enhancement", and in such quantity and with such long maturity periods.

Even the UK's regular Member State cash contributions are simply being to be added to the UK's deficit and borrowed on our own name. The UK is one of the biggest of the very few net payers-in of cash: the UK's net cash contribution of EUR 10 billion per annum is distributed to other EU Member States.

Without that cash, *which we are borrowing*, those Member States would have to borrow themselves to maintain their levels of public spending. Only the UK and the Czech Republic are not committed to the Fiscal Stability Treaty. The twenty six other Member States, to the extent they are able to receive EU net cash, can renounce new borrowing in the same amount. In other words the UK is borrowing in order to spare those other Member States from new borrowing and to stop them exceeding their Fiscal Stability Treaty commitments. We are simply subsidising their compliance with the Fiscal Stability Treaty, to our own detriment.

On top of that the EIB is borrowing at the UK's risk, and on-lending mainly to the same EU Member States – but to borrowers whose debts are not consolidated into the debts controlled by the Fiscal Stability Treaty. Once again, without these loans these other EU Member States would have to borrow in their own name – if they could – to maintain levels of public spending.

The racking-up of this secondary and below-the-horizon EU public sector debt is being enabled by one set of the organs of the EU, undermining the efforts of other EU organs to impose compliance with the Fiscal Stability Treaty and the integrity of the euro itself: this is incoherence on an epic scale.

Impact on the UK

For the UK the net effect is simply that the UK is enabling high levels of public spending in other EU Member States when we are having great difficulty in maintaining our own.

The UK is outstripping the EU average on all the measures that drive the size of contributions and share of risk, meaning the UK would have progressively shouldered – thanks to the success of its policies – the burdens of the failure of the policies pursued by the rest of the EU.

The amounts of money the UK receives from these EU mechanisms are moderate – EUR4 billion per annum - and could as easily be borrowed from global investors on our own name by the UK Debt Management Office – why do we need to guarantee a multiple of that amount to the same pool of global investors in order to have a small fraction of it advanced to the UK?

This is an area where the UK's leaving the EU would relieve us of considerable risks and liabilities without a corresponding give-up of meaningful benefits, and insulate us from those risks and liabilities increasing.

It is, of course, totally unacceptable that the UK should have exposed to risk on Greece, after the assurances we have been given, by the EU guaranteeing the EIB, and then the EIB sets up the EFSI, and then the EFSI lends to Greece.

But then that is the way in which the EU mechanisms establish a sham set of controls, and then navigate their own way round them, and we in the UK must escape from this nexus, completely, decisively, and as quickly as possible.

Bob Lyddon December 2016

Summary of
The UK's liabilities to the EU: the biggest risk of all

Why leaving the Single Market is the only way to avoid the huge risk from financial gambling by EU insitutions

- The UK has liabilities of nearly EUR1.3 trillion by being part of the EU – including responsibility for the entire EU cash budget, and for the EU's loans and guarantees
- We are also shareholders in the European Central Bank and the European Investment Bank, out of which the UK has loans in about the same amount as our shareholdings
- The good news is that, when we step out of the Treaty on the Functioning of the European Union, we step out of all the liabilities relating to the cash budget, debts and guarantees of the EU itself, and are no longer obliged to be shareholders in the ECB or EIB: we can have our shareholdings cancelled in exchange for our taking over the EIB's loans to ourselves, a zero-sum exercise
- We can step out completely from these liabilities, and we must do so and quickly
- The EU, ECB and EIB – acting individually and in concert – are taking the most enormous risks and in huge quantity to bail out the Eurozone, and on our credit card
- The spending of the loans being signed off is all that is keeping the Eurozone out of depression
- These loans are being extended in the form of secondary and below-the-horizon public sector debt:
  - To regional and municipal authorities, to projects in which public authorities have an involvement, and to projects – on the Public Private Partnership model – where a public authority guarantees to buy the offtake, for a long period and usually at an inflated price;
  - Making a mockery of the Fiscal Stability Treaty, which only controls primary public sector debt;
  - Creating a form of irresponsible Equity Release, to enable spending now, but secured, not on assets, but on the tax-paying capacity of future generations.
- Within this feeding-frenzy of new lending there is new credit to Greece, made out of the European Fund for Strategic Investments ("EFSI")
- The UK is directly on-risk for losses on those loans, in the way as we are on-risk for losses under many elements of the Eurozone bailout, contrary to the contentions made by David Cameron
- The ECB has gone way off its mandate and legal powers in the way it is allowing its members – the Eurozone National Central Banks – to finance one another, to finance commercial banks, and to settle (or rather not to settle) their payment traffic, all against collateral that is overvalued
- The EIB has gone off the reservation in lending to projects that have only the most tenuous connection to wealth-creation, and supporting projects simply on the basis of creating spending now, to inflate GDP figures
- The nexus of the EU, EIB, ECB and the EFSI is a steam engine for public debt creation that has lost its governor. We need to get out before the inevitable train wreck.

About the author...

Bob Lyddon

Bob Lyddon is an experienced management consultant both privately and with PwC. Recent engagements include running an international banking alliance, advising small payment providers how to access UK payment systems, and advising a major player in global payments as to the opportunities and threats arising from the establishment the UK's Payment Systems Regulator.

With PwC Bob managed several Euro implementation programmes. Prior to that, he had a diverse 17-year career in international banking, encompassing Transaction Banking, syndicated loans, export finance and derivatives.

Bob holds a First Class degree in Modern Languages from the University of Cambridge.

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