

# Brexit update, and why this matters for UK Manufacturing...

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# **“Backstop”**

- A thing placed at the rear of something as a barrier or support.***
- an emergency precaution or last resort.***

# Where are we now?

- “It’s all very messy and will continue to be very messy”
- A deal on a withdrawal agreement *could* be reached at EU Council next week
- This could then pave way for a political declaration on the basics of a future relationship at an emergency summit the following month.
- Then May will try to get it through Parliament, BUT no certainty she will, so still a possibility of ‘no deal’ and a messy ‘Hard Brexit...
- And a possible ‘People’s Vote’ ?

# Where are we now?

- Brexit **withdrawal agreement** needs to cover: Citizens rights, envelope on the financial contribution, *Irish border question* ('backstop').
- EU seems close to agreeing that the backstop would apply to the whole UK and not just to Northern Ireland, as originally demanded - or at least it would apply to the whole UK for customs.
- A possibility: regulatory checks element will be covered in withdrawal agreement + a legally binding reference to customs arrangement (to be described in more detail in the declaration on future ties).

- Brexiteers see this backstop as ‘backdoor’ to keep the UK in the customs union indefinitely, and hence prevented from doing trade deals with other countries
- Barnier: trying to find a way to present backstop as temporary, but will never actually agree a legally binding end date to it
- *“We are looking for ways to make it more palatable...The backstop is meant to be temporary. We just cannot decide now on an expiry date...”*
- BUT this is unlikely to satisfy ERG Group and some in Cabinet...

- Is Barnier through his “de-dramatisation” of NI border checks as part of the backstop effectively saying that technology *is* a solution to keeping NI border open??
- That would please ERG Group who have argued all along that a Canada style free trade agreement is consistent with keeping open the Irish border...
- So is Barnier trying to effectively encourage the hard Brexiteers to push May into ‘chucking Chequers’ and going for a Canada style trade agreement as this will be much easier for the EU to agree to?
- But that won’t please the DUP as NI would be subject to different rules than rest of UK and wouldn’t benefit from future trade deals.
- Of course, obvious solution would be for entire UK to stay in Single Market, eliminating any barrier in Irish Sea, but that would require accepting free movement of labour...

# 5 steps to heaven? (from the FT)

- 1. Align Northern Ireland with EU goods regulation
- 2. Keep Northern Ireland, and possibly the whole UK, in an EU customs union
- 3. Show that the backstop would be temporary (how?)
- 4. Limit differences between Northern Ireland and the UK in practice
- 5. Show the backstop is probably unnecessary

# Chequers v Canada+

	Chequers	Canada +
Control of borders	EU citizens keep free movement rights until end of transition. Afterwards?	UK: total control over immigration policy. Cost: limited trading access to the EU market.
Irish question	Aligning with all EU rules "necessary to provide for frictionless trade"	UK outside customs union but would have a free trade deal with the EU, limiting the need for checks through technology.
Regulations	"Common rulebook" copying EU regulations on goods and agri-food.	UK able to change rules – cost for businesses wanting to export?
Free-trade options	The UK could in theory strike deals with countries outside of the EU. But lack of flexibility would limit its attractiveness?	Free to strike trade deals
The referee?	ECJ? British judges would have to pay "due regard" to its previous rulings	A Joint Committee, inspired by what the EU has in place with Canada and Korea, would make binding decisions to resolve issues



# Leave's incompatible Big Asks?

- A Free Trade Agreement for Goods and Services
- A Free Trade Agreement for Capital
- Restrictions on Labour Migration
- No EU budget payment
- Free from EU regulation on goods, labour and capital...
- We won't get all of these – trade offs.

# The UK's trading options after Brexit?

- **EEA (Norway):** gives access to single market in return for a 'price': a financial contribution + acceptance of EU regulations + *free labour mobility*
- **EFTA (Switzerland):** trade deals on a sector by sector basis. Financial contribution + *free lab mobility*. UK: a similar deal with EU minus free lab mobility ('Chequers'?)
- **Customs Union (Turkey):** customs union with EU, no tariff barriers in manufactured goods. Plus regulatory agreement.
- **Bilateral Agreement (Canada):** bilateral style trade deal, eliminates tariffs, better IP protection, and 'ISDS' provision. Rules of origin?
- **WTO:** Unilateral approach - UK relies on membership of WTO.

**“Sorry, Prime Minister, no cherries...”**



# Why is this important to manufacturers like the auto industry?

Tariffs

Non Tariff Barriers

Customs delays (JIT)

Bureaucracy, form filling

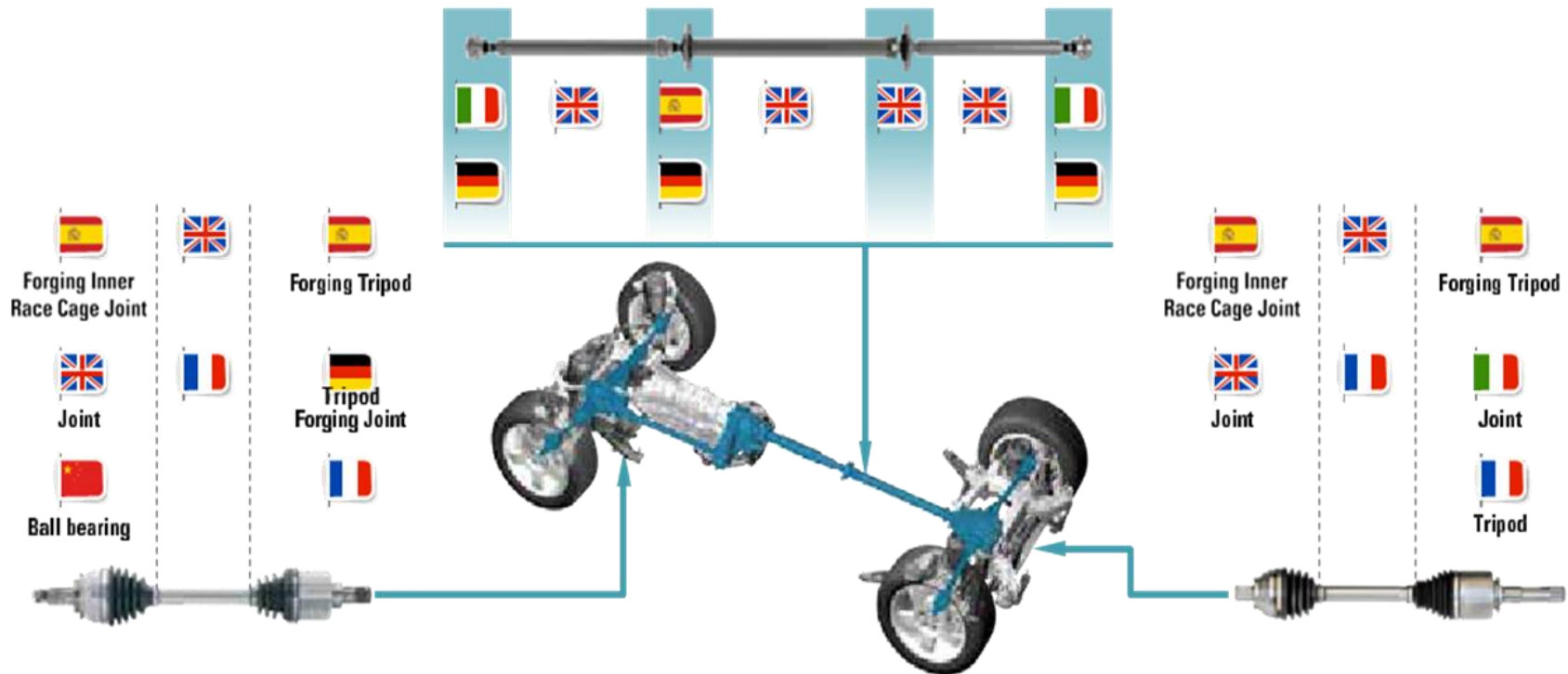
# Value chains crossing borders (source: KPMG)

## Case study

### GKN Driveline – Illustration of an integrated supply chain

**A typical driveline system produced by GKN incorporates specialist parts largely from the rest of the EU.**

GKN sources specialist forged parts from Spain, Italy, France and Germany which are then assembled at GKN Driveline's factory in the UK and supplied to UK and EU OEMs.



Source: **KPMG/SMMT** (2014) *The UK Automotive Industry and the EU*.

Automotive Industry: consensus on benefits of Europe for UK (SMMT, 2016)

- Single Market
- Shaping Regulations
- International Trade Deals
- Accessing skilled workers
- R&D funding

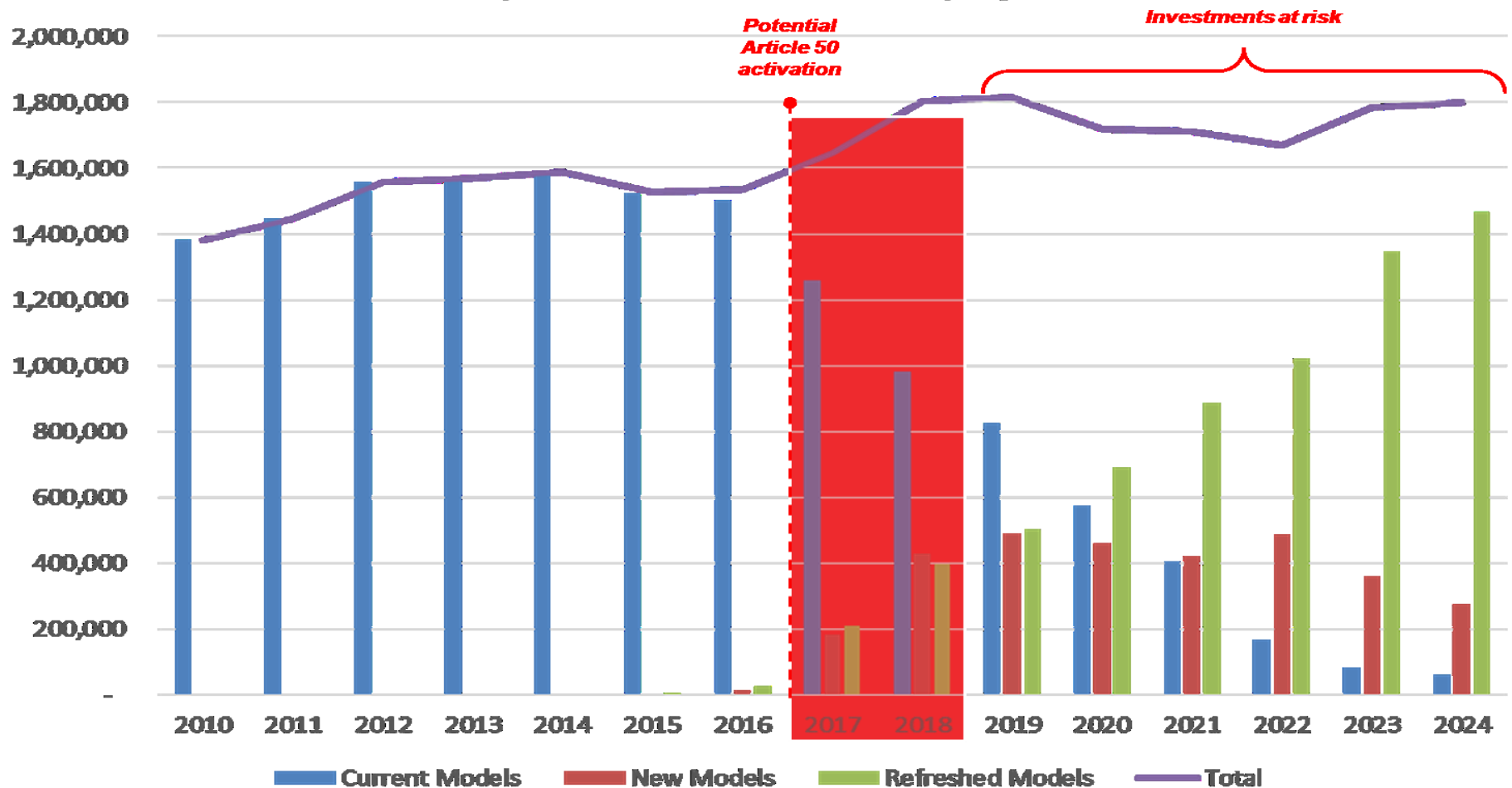
## Brexit: Some economic impacts on UK auto?

- Slower growth: lower cars sales in UK (-5 to -10%)
- Depreciation of sterling: Imported cars more expensive.
- Depreciation of sterling: should be **boost to exports** (*BUT imported components more expensive*).
- Just in Time systems – customs delays
- Challenges for suppliers using East European labour
- Foreign investment?

1. Uncertainty during talks the between the UK and the EU over Brexit — the countdown clock is ticking, then ‘transition period’ IF there is a withdrawal deal — could see auto makers place work on model upgrades or new models at non UK plants;
2. If UK’s access to the EU single market after Brexit is seen as inadequate by auto makers, then they might close some of their UK factories.



### Total production and volumes projection



Source: **PA Consulting**, 2016. *Brexit: the impact on auto manufacturing in the UK*

# Upcoming model upgrade decisions

	2017	2018	2019	2020	2021	2022	2023	2024
Honda	Civic						Civic	
GM (Vauxhall)					Astra		MPV	
BMW (Mini)		Countryman				Clubman	Mini	
Toyota		Auris Avensis				Auris		
Nissan	Leaf Juke	Note		Qashqai XTrail	Infinity Q30			
Tata (Jaguar)	XJ				F-Type	XF /XE	F-Pace	XJ / XJR
Tata (Land Rover)		Evoque	New Defender	Range Rover Sport		Discovery Sport		Evoque Discovery

*Source: adapted from PA Consulting (2016)*

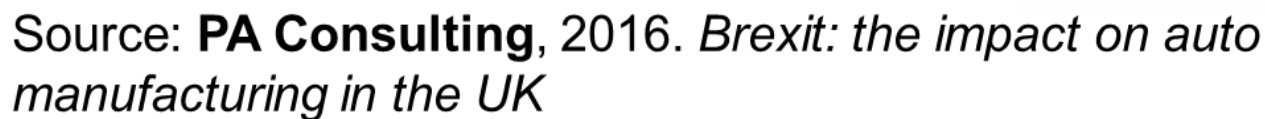
Assemblers examining assembly location will consider a range of issues:

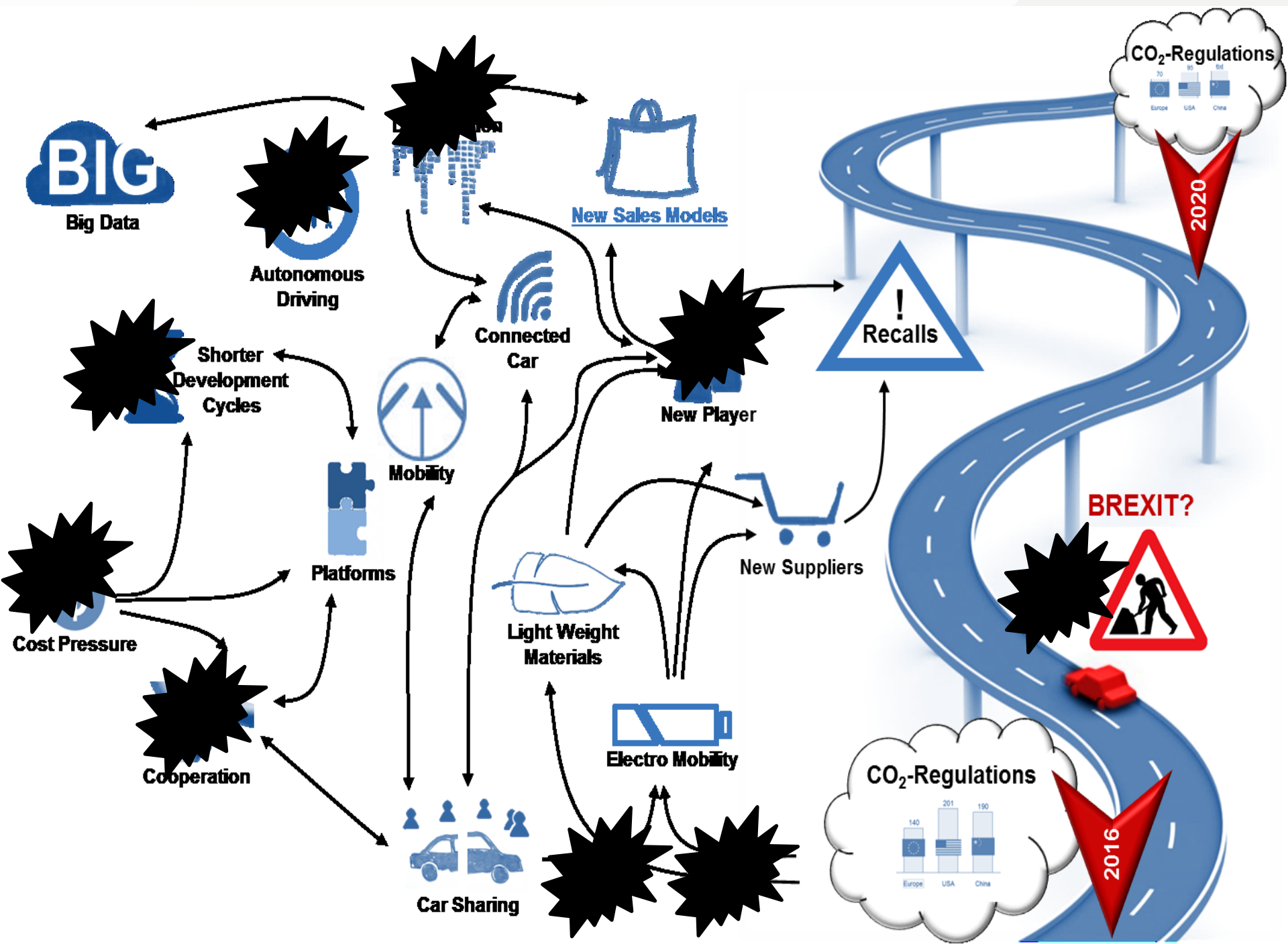
- Relative cost differences between UK and EU locations
- How dependent are sales on the European vs UK market?
- Relative importance of “Made in Britain” to the brand
- Volume of imported components
- Switching options in the EU
- Profitability of UK operations
- Plus: ease of exit from UK as against other countries?

- Reality of trade offs?
- Is No deal really 'better than a bad deal'?
- Leaving the Single Market will likely increase long term economic costs of leaving the EU
- Probably more likely that the UK changes its economic model ?
- Leaving the customs union? Likely that complex sector by sector deals will be needed
- Free Trade Agreement will also need a regulatory agreement: Rules of Origin, conformity of assessment. → International supervision

# UK car industry now contracting

- UK sales down 5% last year, down 7.5% this year
- UK output down this year
- JLR: 1000 job losses at Solihull, extended shut downs earlier in year at Halewood and Castle Bromwich (CB), CB on an a 3 day week, Solihull shutdown for 2 weeks.
- Honda; stockpiling parts
- BMW to shut Mini plant for a month at end of March 2019
- Toyota also said that in the event of a 'hard Brexit' Burnaston will close for an unspecified period.
- JLR: doesn't know if it can operate plants at end of March.
- Hard Brexit will cost JLR £1.2bn
- £80bn of investment by JLR over next five years now being questioned
- JLR has effectively stalled investment in UK other than R&D at Gaydon.
- New models at BC and Solihull? EVs? Battery Plant?





## Some immediate priorities to consider:

- Impact of Brexit on UK industry could be felt via: economic growth, investment delays, shifting cost bases, export disruption.

### **Need?:**

- Prioritise Single Market in negotiating position with the EU or at least Customs Union +;
- Being able to hire skilled workers from EU;
- Exploiting opportunities on reshoring and the technological revolution underway: needs a much stronger industrial policy for auto & manufacturing.



# What's to be done?

- Eliminate uncertainty over trade position as soon as possible
- Make the most of **opportunities** to export and reshore components supply
- Boost capital allowances rather than general cut to corporation tax?
- 'Re-boot' industrial policy and funding:
  - More to rebuild supply chain – *reverse previous mistakes*
  - Skills and finance – **devolution to regions.**
  - Support for exporters
  - Attracting tier 1 suppliers? Segments of supply chain.
  - Innovation eg 'phoenix industry' linked to open innovation
  - More holistic approach to encouraging the shift to EVs
  - Energy costs? Proper compensation scheme.

Auto industry: greater certainty over policy on diesels and better support for take up of EVs (UNITE: 'triple whammy')

***Need to join up sectoral industrial policy and technology policies with place based approaches at regional level. A Federal approach?***

# Thanks for listening

- Comments and questions welcome
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