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The impact of Brexit on the Automotive Industry

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Introduction

The UK is due to leave the European Union on the 29th March, following the results from the public referendum held on the 23 June 2016. Despite ongoing negotiations between the EU and UK, there is currently no agreement in place once the UK leaves the EU."

> **The UK automotive industry is one of Britain's most successful sectors; with a turnover of over £82bn a year and over 800,000 employees**

The UK automotive industry is one of Britain's most successful sectors; with a turnover of over £82bn a year and over 800,000 employees, it is responsible for almost one tenth of the country's manufacturing output. The single market and customs union have been hugely instrumental to the success of the industry, allowing for frictionless trade which has allowed a highly integrated supply chain to form between the EU28 Member States. Without a deal in place it is uncertain exactly what Brexit will mean for the automotive industry, however the risk of losing access to the single market and customs unions are among key concerns. This paper looks at issues facing the automotive industry post-Brexit, and how the government can ensure the industry remains competitive and continues to thrive.

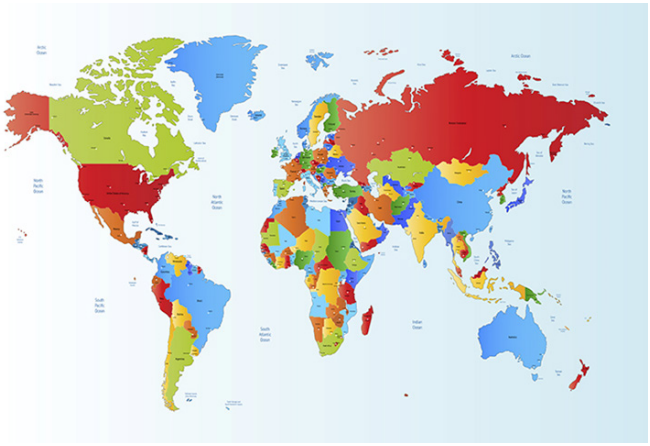
Rules of Origin

Rules of Origin are used to determine the “economic nationality” of a product, in international trade.

Each country uses its own rules and criteria to ascertain a product’s origin, however they will always require a degree of proof which demonstrates;

(i) The country in which the materials of the product were “wholly obtained.”

(ii) The location where the “last, substantial transformation” took place (for products manufactured using materials outsourced from other countries).



Goods that are produced within the EU are identified as “EU content” and their Rule of Origin applies to the EU as a whole, meaning rules and tariffs are only applied when exporting or importing outside the external customs border of the EU, thus allowing ‘frictionless trade’ between members. Rules of Origin are also an important factor to take into account when considering trade opportunities with third countries. For example, the EU-South Korea FTA contains a Rule of Origin threshold of 55% for passenger cars. Any car manufactured in the EU must meet this threshold if it is to take advantage of the preferential tariff rate included in that FTA and avoid paying an 8% tariff when exporting to South Korea. Once the UK leaves the EU, only UK originating content will be considered for the purpose of Rules of Origin. As vehicles produced in the UK currently contain around 20-25% UK content, the UK would not qualify for South Korea’s preferential trade rates without implementing significant changes to it’s supply chain.

There is still great uncertainty as to what the UKs trading relationship with the EU will look like. However, it is possible new Rules of Origin may be required to separate UK products from having EU status. Without taking into consideration the potential cost of tariffs, The 2013 Trade and Investment Balance of Competence Review stated that "British firms would be exposed to a combination of administrative and compliance costs linked to Rules of Origin, ranging (based on existing estimates) from 4% to perhaps 15 % of the cost of goods sold."

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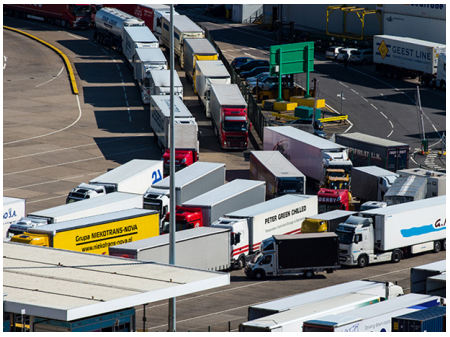
UK Tariffs on EU Imports/Exports



The UK automotive industry currently benefits from the Single Market, which allows the tariff-free movement of goods between all 28 EU Member States. This free movement has allowed the automotive industry to thrive, not just in the UK, but within many EU Member States too. If the UK loses access to the single market, tariffs may be applied which could have a significant impact on future trade.

EU Exports

Although the UK has a substantial consumer market, the automotive industry relies heavily on imports and exports from outside of the UK. In 2016, SMMT revealed that nearly 60% of cars produced in the UK were sold within the EU, while 55% of engines were also exported to the EU.

If the UK is unable to negotiate a deal which allows the continuation of trade within the single market, companies selling components to the EU after Brexit will face an average export tariff of 4.5%. For manufacturers, the average export tariff will be 10%. Despite government plans to expand the market outside of the EU, SMMT have declared it is essential the EU remains the single largest export market if the sector is to continue to thrive, and if the UK is to remain competitive, tariffs must be avoided at all costs.

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EU Imports

According to SMMT statistics, the EU member states are responsible for supplying 20% to 50% the UK automotive supply chain. If a tariff rate of 4.5% is applied to the components currently outsourced from the EU, it is predicted that tariff costs could cost between £350m and £875m per year. These figures do not factor in potential tariff costs from smaller supply chains, or take into account the cost of tariffs when importing whole vehicles, which is predicted to be several billion pounds. This would reduce the UK's competitiveness and increase costs for consumers.

When looking at the additional cost for consumers, SMMT calculated that an average cost of a UK-built car sold in the EU would rise by £2,700 and £2,000 for a commercial vehicle, which could lead to a significant fall in demand.

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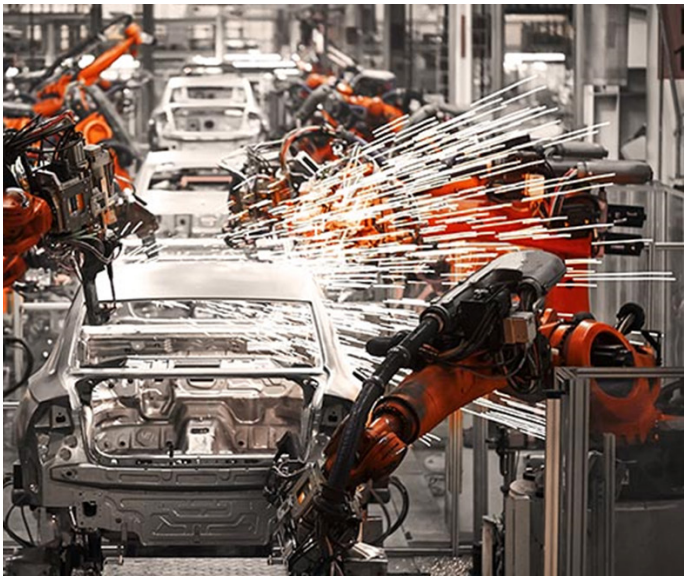
Just-in-time Production

The smoothness and efficiency of the automotive production line largely depends on the operation of 'Just in Time (JIT) production. JIT production allows manufactures to issue production instructions as soon as a vehicle order is received, allowing the production to be completed, and the vehicle delivered to the customer as soon as possible, resulting in minimal waste and limited requirement for warehousing of stock.

As a result of JIT, a huge volume of parts are transported in and out of the UK each day. The Mini factory in Oxford sees over 220 delivery trucks transporting goods each day alone, bringing parts needed for production on the right day for a set time. Auto manufacturers outside the UK also rely on JIT production, with the Honda factory in Swindon seamlessly receiving parts from trucks every seven minutes. The Channel at Dover plays a significant part in ensuring parts



can reach manufactures quickly and because of its reliability and efficiency, warehouses will usually hold just one day's worth of stock from EU countries.

If Brexit introduces new custom arrangements, this could cause delays at the UK borders which would create serious disruption for JIT production resulting in additional costs for manufacturers. Honda has estimated that a 15-minute delay could add around £850,000 per year in costs, while Aston Martin has expressed concerns regarding the effects on cashflow if expensive vehicles are delayed at borders for a long period of time.

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Free Movement of Labour

Free movement of labour within the EU has allowed UK automotive companies to transfer skilled workers between manufacturing plants as and when needed. This has caused intra company transfers to become key to the success of multinational companies operating in the UK. There are roughly 814,000 employees within the UK automotive sector, and it's estimated an average of 10% are EU migrants. These workers provide their skills and expertise across a multitude of roles which include senior executives/ leadership, finance, customer service, HR, engineers, technicians, IT and shop floor workers.

According to SMMT, there are up to 5,000 current vacancies in the automotive industry creating serious impacts for business operations. By 2020, they have predicted the automotive sector may need up to

50,000 more people to meet growth opportunities. Where talent could previously be accessed from Member States, this will no longer be possible post Brexit, so the UK will be forced to recruit internally. Given the volume of current vacancies, this is sure to be a serious challenge for the industry.

The Government has recognised this issue and is offering support for more engineering apprenticeships in order to address skill gaps which will certainly be beneficial to the industry in the long-term. However, this will not help provide a short-term solution if workers are forced to return to their originating countries or unable to move freely after Brexit.

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Access to EU Funding

The UK currently has access to EU funding, which supports research and development within the automotive sector. According to SMMT, £5.5 billion of EU funds are available to automotive companies and their partners. For example, universities receive approximately £100 million of structural funds each year, a large amount of which is used to support research and development by businesses.

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Horizon 2020 is another example of EU funding available to the automotive industry. The largest ever EU research and innovation programme is funding around £70bn between 2014 and 2020, with approximately £6bn dedicated to transport. Between 2014 and 2015, the UK received approximately £334m through Horizon 2020.

It is possible for Non-EU countries to gain access to Horizon 2020; therefore, funds may still be available to the UK post Brexit. However, given the uncertainty of future eligibility of UK partners, European partners may be less willing to collaborate with the UK on R&D projects. If the UK is unable to maintain EU funding, the UK government will need to provide funding of its own to ensure the growth and development of the industry.

Type Approvals

Type Approval certifies that a vehicle has met the required EU safety and environmental standards. The Type Approval process involves a series of tests on multiple vehicle prototypes including; light installation checks, braking performance, stability control and crash tests. It also includes environmental checks based on emission limits as well as production requirements. If a vehicle has met the requirements, the national authority issue their approval, authorising the sale of the vehicle type anywhere in the EU.

The UK's Type Approval authority is The Vehicle Certification Agency (VCA), and it's currently recognised across all EU member states. However, there is uncertainty regarding the status of existing and future VCA approvals post Brexit. The EU and the UK have agreed upon a transition period which allows businesses to operate as normal while they prepare new arrangements.

During this period VCA approvals must continue to be recognised and issued accordingly. Failure to enforce this would mean vehicles would need to be re-approved by an alternative authority within the EU-28. On average, approval of a standard car can cost between £350,00-£500,00 and the process can take between 6 to 18 months. If manufacturers are to repeat this process it would cause huge cost and disruption across all Member States, as well as countries outside of the EU-28 using VCA approval. Such concerns around the future validity of VCA approvals are already causing manufacturers to look towards other Member States for approval.

Emission Regulation and Legislation

The EU is responsible for the introduction of Euro Emission Standards, a regulation put in place to reduce the levels of harmful emissions produced by all vehicle types. The latest Euro emission standard was introduced in 2017 and saw NOx emission limits lowered from 0.18g/km in Euro 5 to 0.08g/km. Euro emission standards are a mandatory requirement for all large-scale car manufacturers, however the EU has also set targets for smaller scale manufacturers to help reduce the overall average CO2 emissions.

Currently, the Euro Emission standards are recognised across all EU-28 Member States, so to maintain competitiveness within

the EU market, the UK will need to ensure regulations are in place which are consistent with EU regulatory requirements.

Conclusion

The consequences of a no-deal Brexit with the introduction of WTO tariffs would be extremely damaging for the automotive sector, as it would impact massively on the industry's highly integrated and efficient supply and production chains. Therefore, a no-deal Brexit would undoubtably result in a shift of manufacturing to countries within the single market and customs union, and a fall in consumer demand for UK cars would occur due to increased product costs.

If the UK is to reach a deal with the EU, changes to Rule of Origin policies and Type Approvals are inevitable, and these could amount to significant costs for manufacturers affecting their already small profit margins. Although the government plans to introduce new trade opportunities, its clear trade deals with third countries will not outweigh the loss of trade in Europe for the UK automotive industry, if the government decides on a hard Brexit. The Government has been unable to provide any concrete advantages that can compensate for the competitive disadvantages of restricted access to the single market and the automotive industry. The industry is therefore urging the government to maintain a close relationship with the existing EU regulatory and trading framework to drive continued growth and success.

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