Worries for UK Automotive

David Hearne, Researcher, Centre for Brexit Studies

Recent “Brexit news” has focussed on the fact that the EU has pushed back against UK proposals to permit some automotive componentry from Japan and Turkey as “local content”. Although such “diagonal cumulation” is not unprecedented in trade agreements, it is hardly a universal norm either[1].

This immediately called to mind one of the panels at our Annual Conference last week, which considered the prospects for manufacturing. Professor Bailey of Birmingham Business School noted that manufacturing was likely to be the sector hardest hit by Brexit, a point reiterated by his colleague Professor Ortega-Argilés. This is undoubtedly a point of concern in a region where manufacturing and services related to it account for almost one-third of economic activity (again pointed out by both).

Whilst the primary problem will vary by sector, a wide range of manufacturing industries will be hit, particularly in a no-deal scenario. For the automotive sector, tariffs are a particular threat, whereas for aerospace the threats are different. Indeed, as pointed out by Professor Bailey and Ian Henry of AutoAnalysis (and a Visiting Professor here at the Centre for Brexit Studies), in the case of the automotive sector there is the added challenge of low local content (unless trade partners agree a deal that includes cumulation).

Even in the event of a last-minute agreement between the UK and EU, this problem will not go away. Firms will need to be able to demonstrate the origin of parts, yet at present firms often have very poor visibility of their supply chains (in contrast to aerospace, where for safety reasons, understanding of the entire supply chain is much better). Insofar as this information exists, it is not held centrally or in systems that could be easily integrated.

Ian Henry also pointed out the challenges that customs checks will present for just-in-time processes that have been honed over many years. He suggested that these non-tariff barriers might be the equivalent of anywhere between ad-valorem tariffs of 1.5% and 9%

according to a plethora of studies. In spite of the uncertainty, there are reasons to believe that due to the complexity of supply chains, the automotive sector would fall at the higher end of this spectrum.

It is not as simple as re-routing traffic – the nature of freight transport (roll-on, roll-off vs. lift-on, lift-off) and vehicle capacities will all need to be considered. Panellists were unanimous that they don't see an upside to manufacturing, regardless of the form of Brexit, although they viewed a trade agreement as vastly preferable to "no deal" for manufacturers.

Amongst manufacturers, Professor Bailey noted that there was a spectrum of severity, depending on the nature of changes. Food & drink manufacturing was particularly exposed given its high dependence on both trade (and high tariffs in the absence of a trade-deal) and migrant labour. EU countries provide a significant proportion of the workforce in parts of the sector.

This was reiterated by Professor Ortega-Argilés, who pointed out that even if its viability wasn't ultimately threatened there would be price increases (over 5%) and that increases in intermediate costs would erode any benefits that one might imagine would accrue to domestic producers from higher prices. Moreover, she noted that around 8.9% of the service sector's GDP in the West Midlands would be impacted by Brexit. This poses a major challenge.

Indeed, she suggested that Brexit would ultimately have a larger impact on GDP in the West Midlands than the pandemic. In the event of a successful vaccine, much of the pandemic-induced fall in GDP will be reversed. This is not true of Brexit, where annual GDP might be in the region of 6-9% lower than it otherwise might have been. In addition, regions like the West Midlands will have to bear persistent restructuring costs (in the West Midlands this is likely to fall particularly heavily on the automotive sector and related industries).

Brexit and Covid were thus seen by panellists as a toxic combination, with each having distinct impacts that interact. The pandemic has forced business services into a dramatic attempt to restructure and a shortage of ICT skills is clearly a challenge (particularly for smaller firms). Yet the additional bureaucracy of Brexit will hinder productivity.

The understandable focus on Covid has meant that we are not considering the impact of Brexit on longer-term productivity.

Jack Dromey MP presented evidence from a network of SMEs, sounding a note of alarm over the scale of redundancies. Again, he noted that Brexit and Covid are seen as a toxic combination and there are frustrations over the (small) scale of investment relative to France and Germany. He noted that greater devolution and a reallocation of (public sector) capital spending by population would go some way to ameliorating these problems.

Ian Henry noted that, in the event of a “no deal” outcome, the optimum solution might be to continue trying to get a trade deal (a late trade deal is better than a non-existent one). Mass-market manufacturers are likely to be heavily affected and EU tariffs will probably make UK production unviable. Some 90% of production from Ellesmere Port (Vauxhall), 85% from Burnaston (Toyota) and over 65% of production from Sunderland (Nissan) is exported to the EU.

Whilst not a substitute to demand from the EU, it was suggested that some direct intervention might help. This could be done via procurement rules or incentives to use UK-built vehicles in the public and regulated sectors. The need for a major UK battery factory was also noted.

In short, there was consensus that any form of Brexit that took the UK outside of the Single Market (and, especially, the Customs Union) would be quite damaging for the advanced manufacturing sector. However, it was also made clear that the extent of this would depend critically on the precise form of agreement negotiated with the EU. Most manufacturers in the sectors considered had limited ability to pivot to serving other markets, making plant closures a more likely option. It was felt that the long-term ramifications of these would be substantially greater than those of the pandemic. There is therefore clearly a lot of work to be done in a very short time in terms of negotiating a satisfactory agreement.

[1] The criteria for assessing rules of origin are actually quite complex, particularly where cumulation is involved. Indeed, whether goods can be cumulated or not will depend on the precise form of cumulation negotiated and this can differ according to the specific product code.

For interested readers, the UK Trade Observatory have produced quite a nice summary of the main issues and challenges: https://blogs.sussex.ac.uk/uktpo/publications/were-going-to-make-them-an-offer-they-can-refuse-rules-of-origin-and-the-uk-eu-free-trade-agreement/