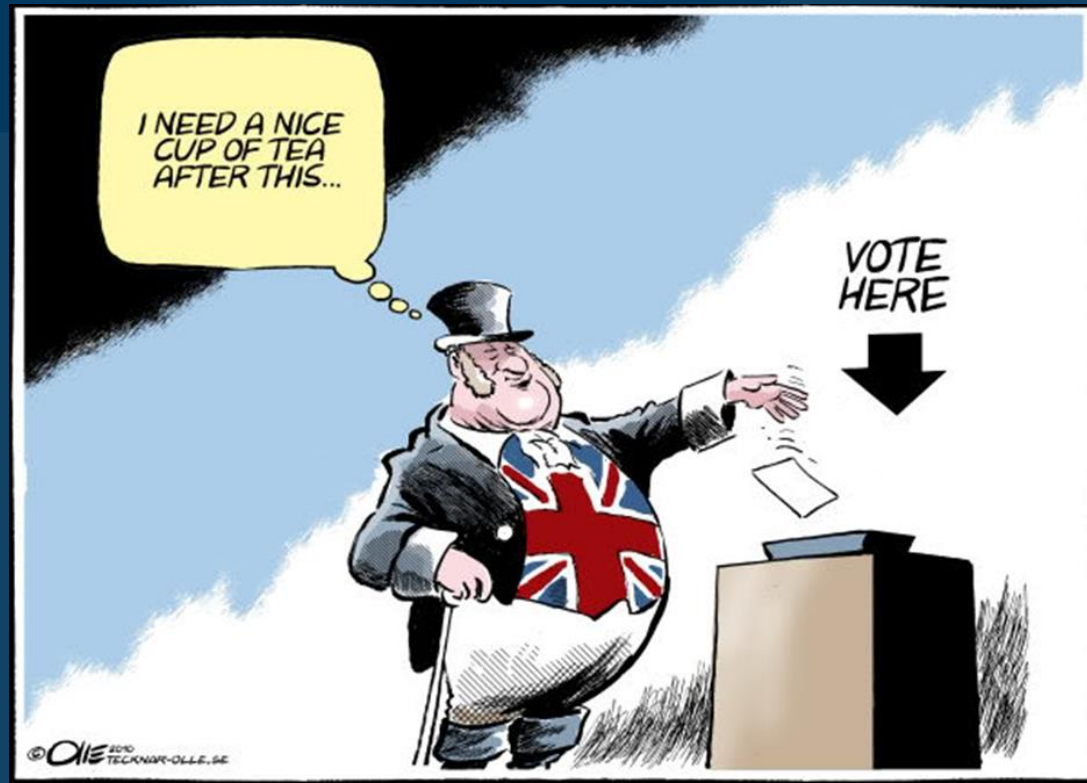
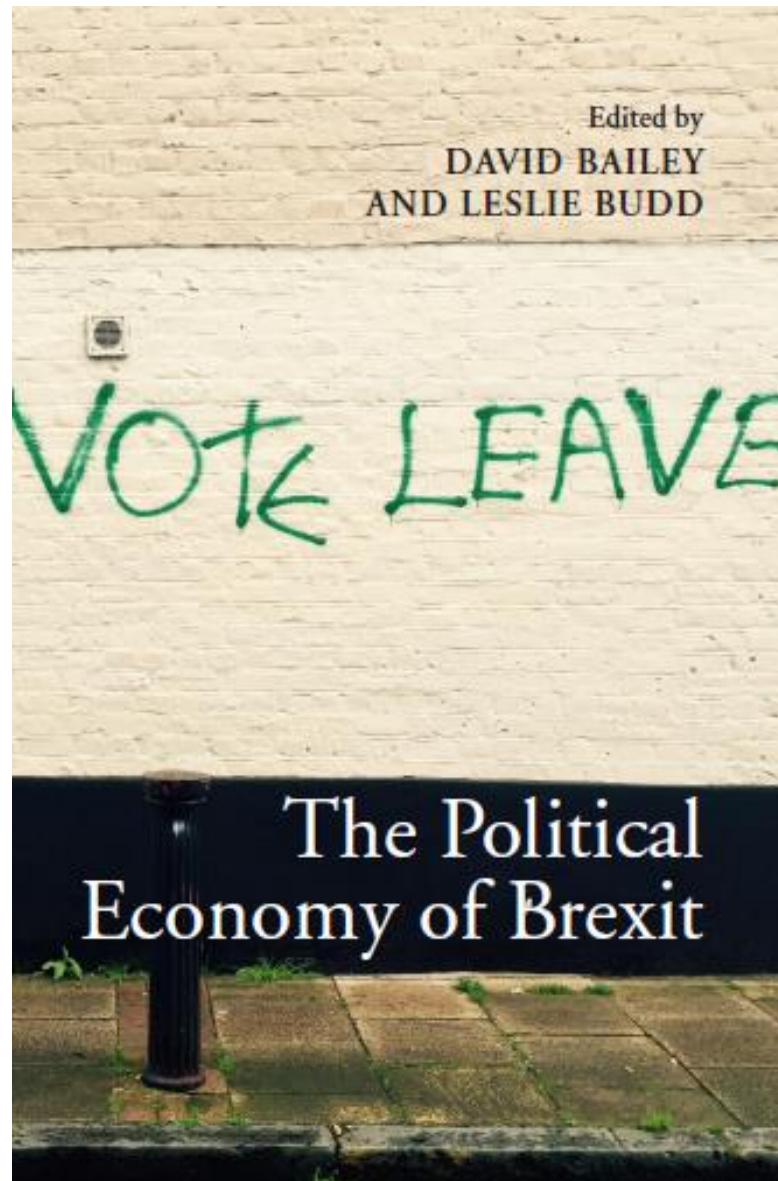


Brexit, the UK Auto Industry and Industrial Policy

David Bailey
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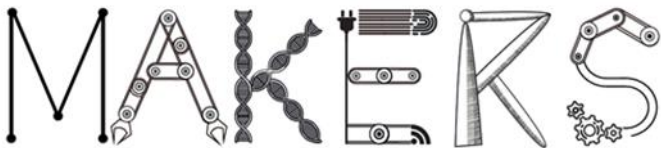




*Agenda
Publishing*

*March
2017*

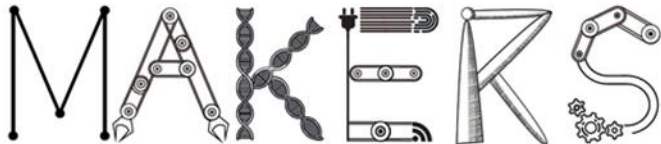
- Long term impact of Brexit will depend on a range of factors:
- 1. Trading arrangements between the UK and remaining EU countries. These will now have to be negotiated after Article 50 is activated.
- 2. Actual economic policies adopted by the UK government after we leave.
- → a range of possible outcomes... most economists think that leaving **will come at *some* economic cost**



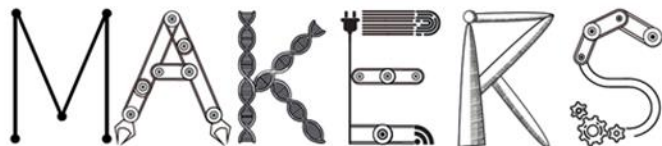
- FT survey of 100 economists last year: three-quarters thought leaving would reduce size of the economy in the medium term compared to staying in. Less than one in ten thought it would improve growth.

Three studies published last year:

- Centre for Economic Performance (LSE)
- Price Waterhouse Coopers for the CBI
- Oxford Economics



- All 3: Brexit will have some negative impact on the UK economy compared to staying in.
- BUT impact is *smaller the closer any new arrangements are to our current economic relationship with the EU*.
- Estimates range from near zero (if stay in Single Market, + allow free movement of labour...) to significantly *negative* if leaving results in substantial new barriers to trade.
- Treasury Study: 6% smaller by 2030. OECD, IMF
- NIESR: GDP could be 1.5-7.8% lower by 2030 + “substantial loss of export trade”.
- **Cost of leaving Single Market: 4% by 2030? (IFS)**

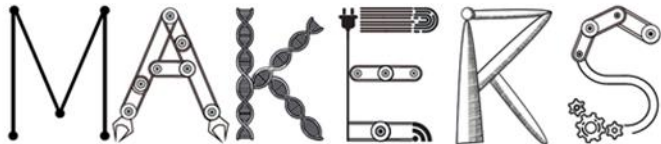


Trade, Investment → Jobs?

- EU is the UK's major trading partner: 45% UK exports & 53% UK imports of goods & services in 2014
- EU is the largest source of inward investment in UK. In 2013, EU countries accounted for £453bn worth of the stock of inward FDI, or **46% of the total.**
- UK accounts for 16% of EU exports (US 15%, China 8%)
- **UK trade with EU accounts for 12% of UK GDP; EU trade with UK accounts for 2% of EU GDP.**

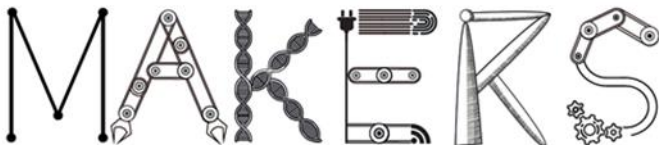
Leave's incompatible Big Asks?

- 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...



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: free trade deal with EU + better access for financial services?
- **Customs Union (Turkey):** customs union with EU, no tariff barriers in manufactured goods.
- **Bilateral Agreement (Canada):** bilateral style trade deal, eliminates tariffs, better IP protection, and 'ISDS' provision
- **WTO:** Unilateral approach - UK relies on membership of WTO.

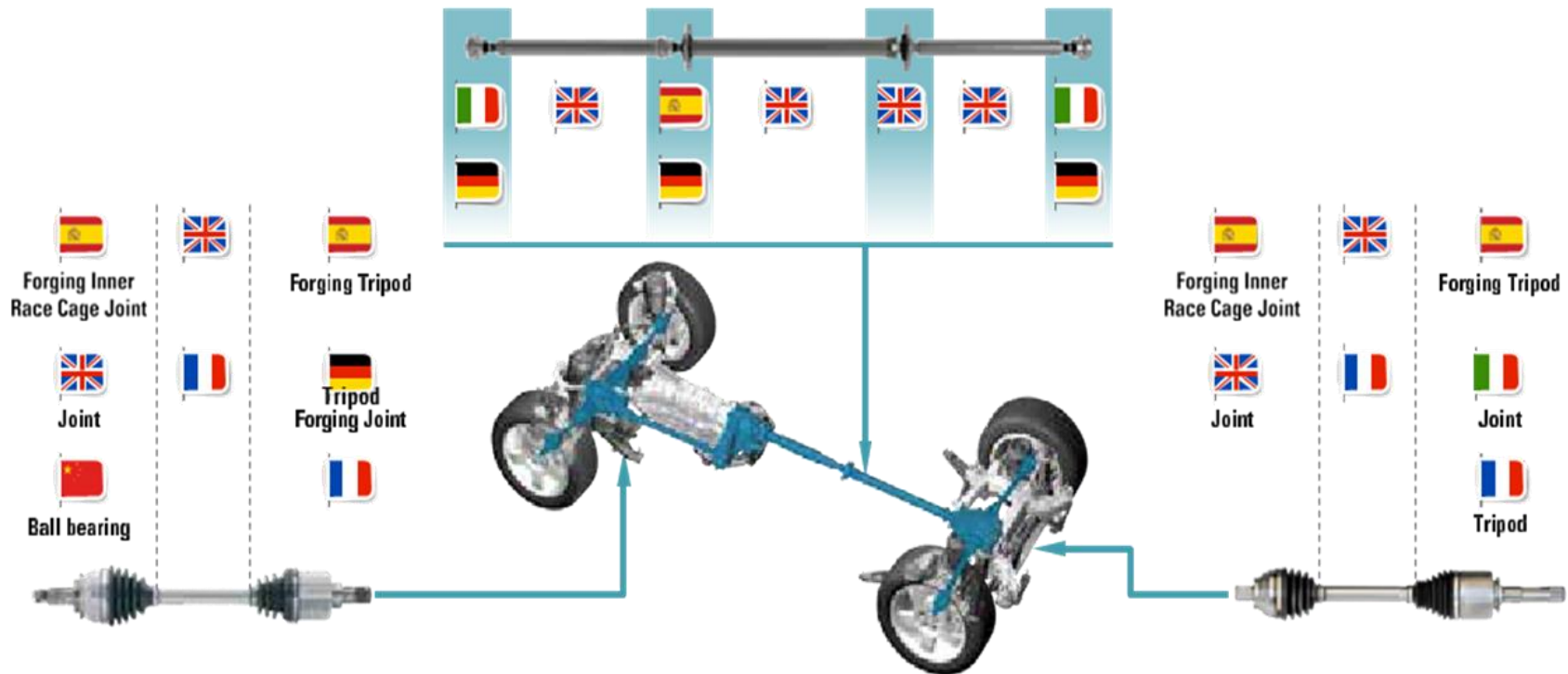


Case study

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.

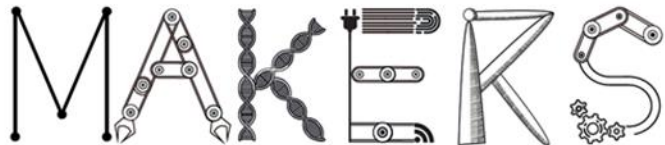


KPMG (2016): In the event of Brexit...

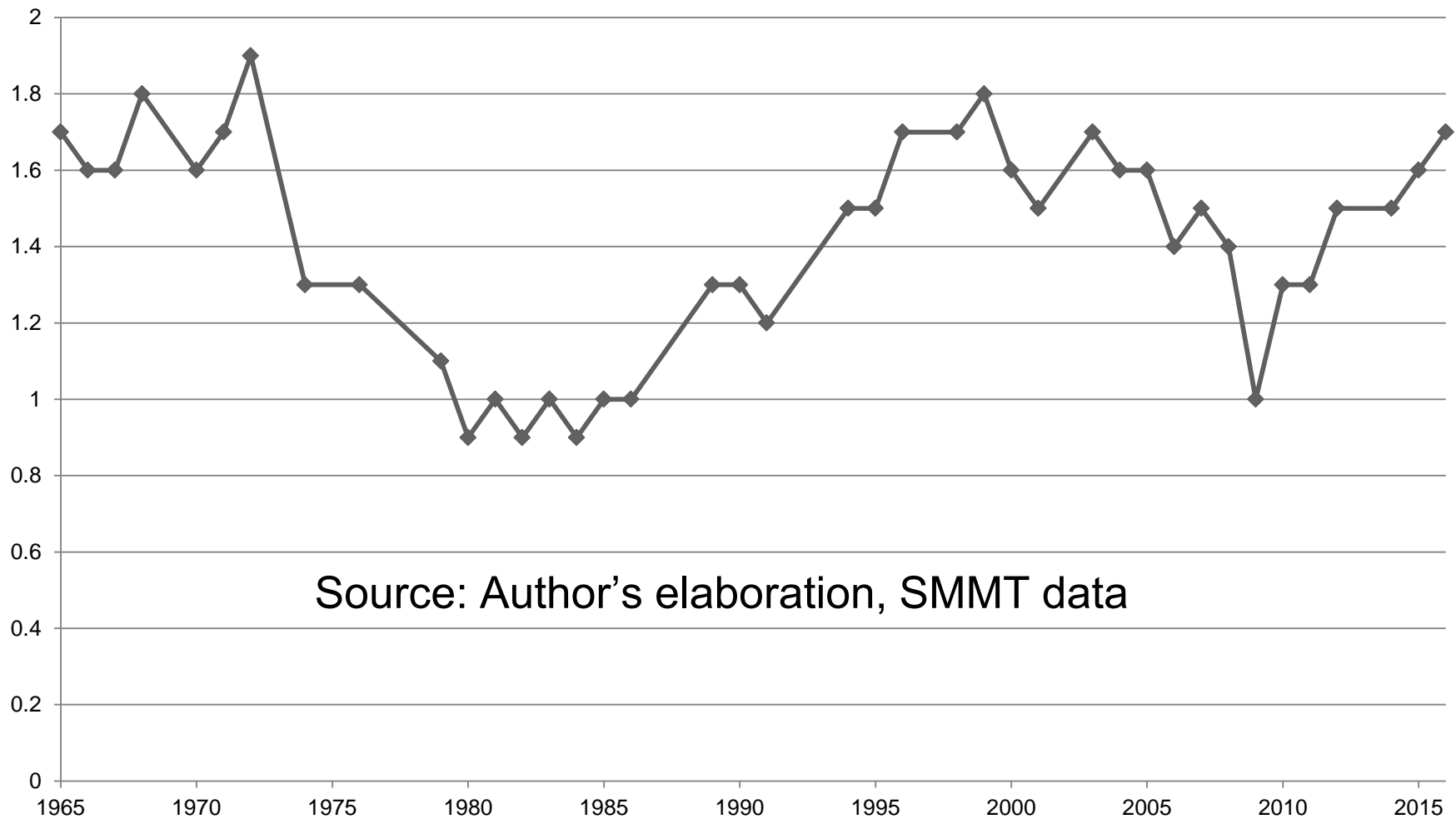
- *“Original equipment manufacturers such as aircraft and automotive manufacturers could perhaps favour the simplicity and flexibility of an EU-supply base rather than dealing with the potential complexities of a company based outside the union. In the long term, more EU-based alternatives would emerge. **As buyers churned their suppliers, UK firms might become more marginalised. The integration of supply chains is a double edged sword – our manufacturers are not indispensable**”.*

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

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



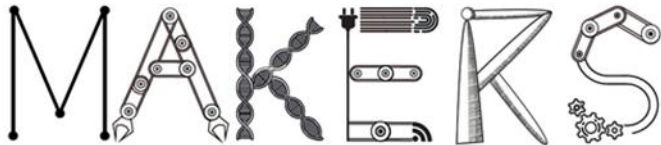
UK Car Production - units (m)



Source: Author's elaboration, SMMT data

- Over **£8bn** invested in UK auto sector in last 3-4 years
- Some plants have gone to 24/7 working with **3 shifts** (Halewood, Sunderland) – others (JLR) working very flexibly
- c10% increase in export production volumes in 2015
- value of car exports doubled between 2005 and 2014.
- 80% of UK produced cars exported. now c12% value of all exports (trade deficit in 2007 of £7.5bn).
- UK exports. c**57%** of exports go to EU. Emerging markets now account for 12% of UK auto exports

- UK engine production c2.5 million in recent years and rising (JLR)
- Plant utilisation rate in UK > 70%
- highest productivity in Europe
- Industry employs c800,000 people
- Strong productivity growth, unlike much of UK economy



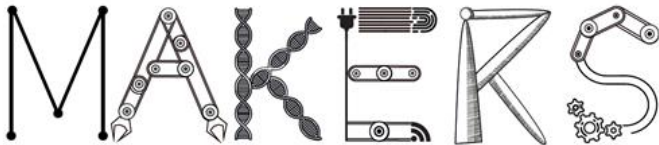
- 80% exports
- 80% R&D spend
- 1 in 4 private sector jobs in industry. Many highly skilled
- Every Manufacturing job → 2 other jobs (auto: 8)
- Drives productivity gains

- **Being part of Single Market**
- skilled and flexible workforce – unions key part of the ‘solution’
- what’s left is genuinely ‘world class’
- The shift ‘up market’ (2020: 54% premium, 27% mid market SUVs/crossovers, 19% mid market)
- exchange rate depreciation over 2008-9 really helped re exports. Unwound until late 2015. Last year, post-Brexit vote: depreciation again
- Emerging economy success –middle class +
- Industrial policy did help, up to a point...

2016 Figures....

Production in the UK	Total Exports	Exports to the EU	Registrations in the UK	Imports from EU (or taken from stock)
1.72m	1.35m	0.76m	2.69m	2.22m

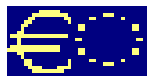
- Impact of Brexit on UK industry could be felt via: economic growth, investment delays, shifting cost bases, export disruption (and policy measures).
- Policy intervention: monetary policy easing by Bank of England, fiscal ‘reset’?



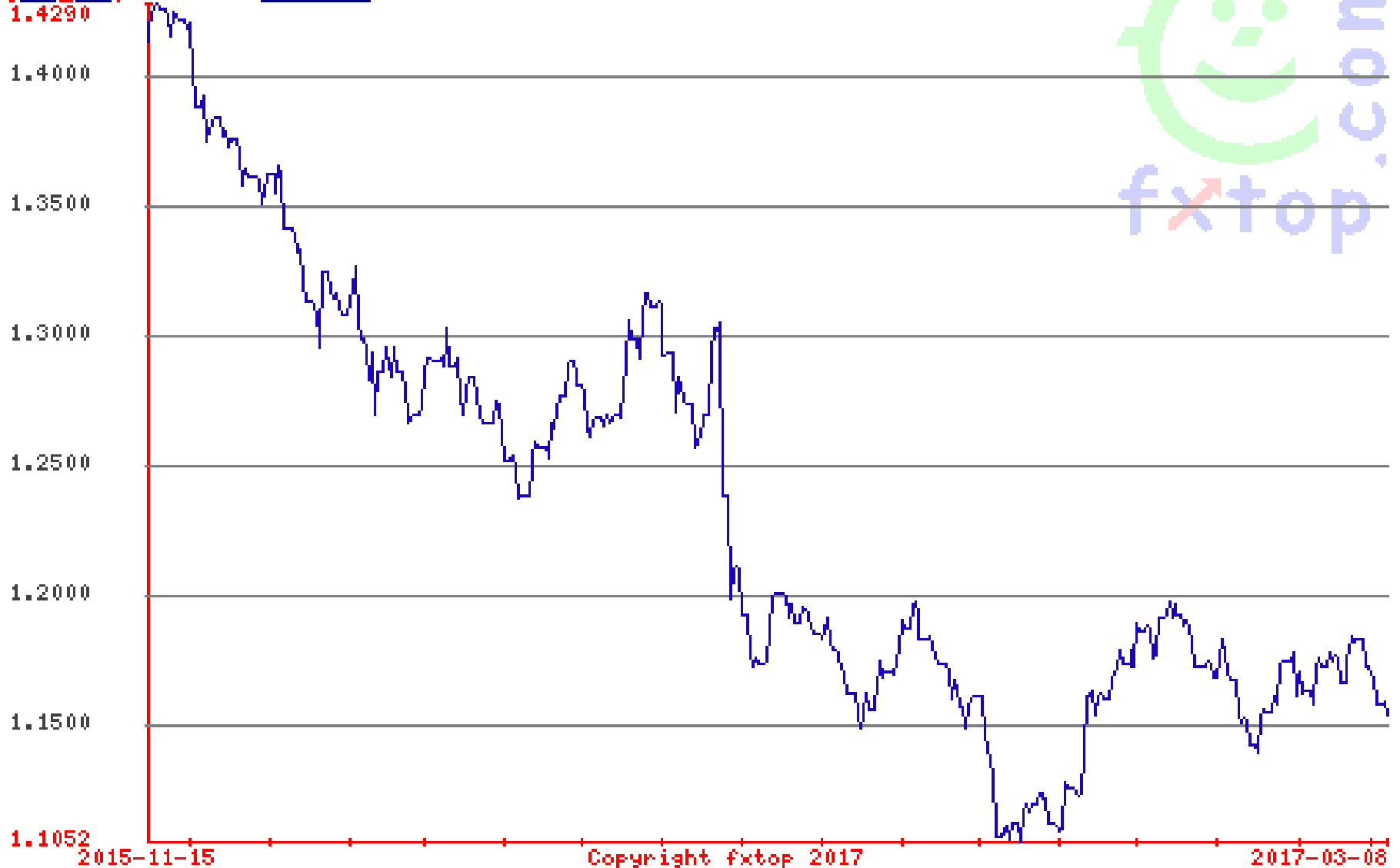
Sterling/Euro depreciation since late 2015



GBP / EUR

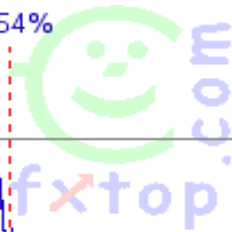


First 1.4143 Last 1.1527 Change -18% Avg 1.2322 Volat 11 Max/Min 29%

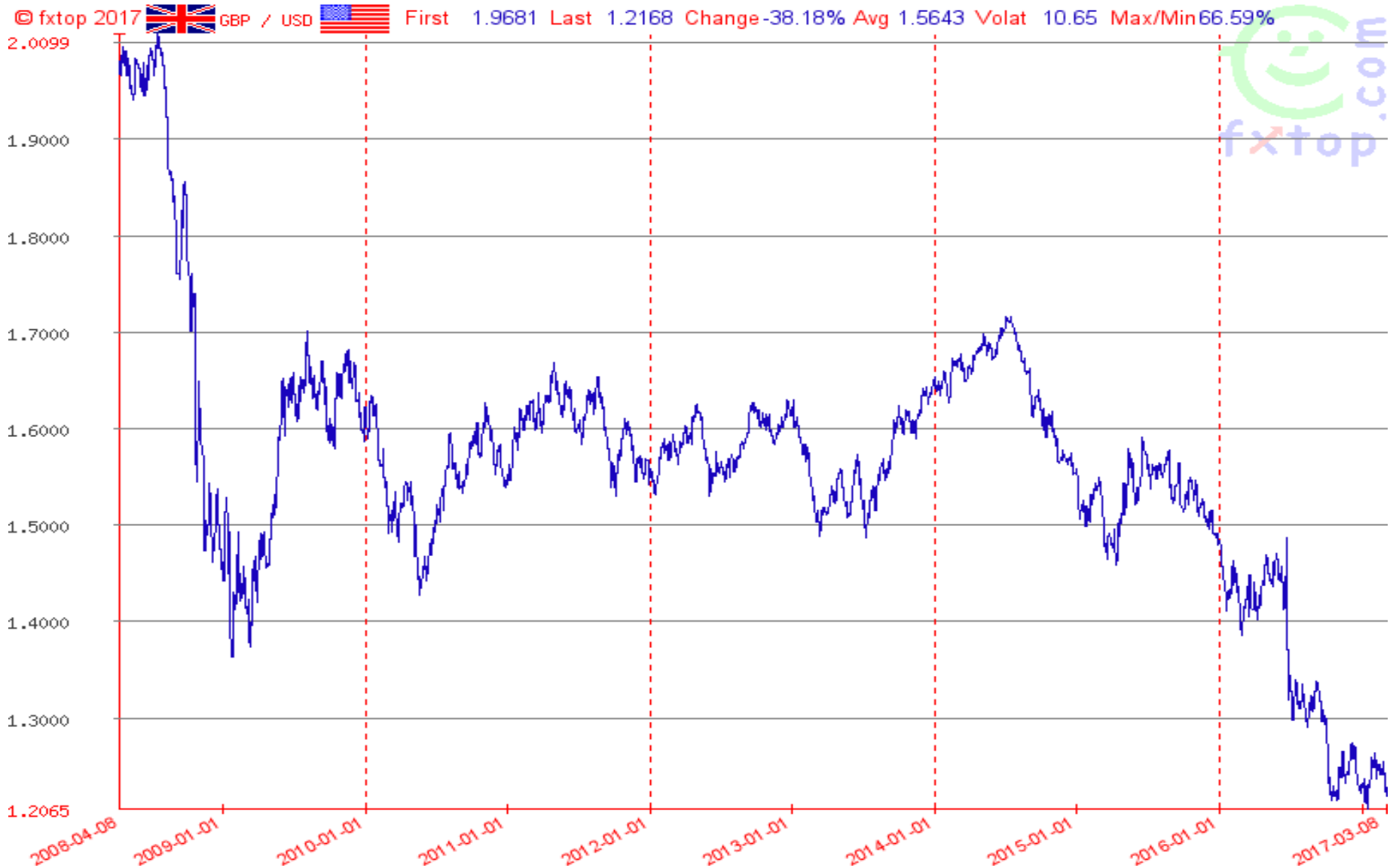


Back to levels last seen in Global Financial Crisis

© fxtop 2017  GBP / EUR  First 1.2541 Last 1.1527 Change -8.08% Avg 1.2133 Volat 9.34 Max/Min 40.54%



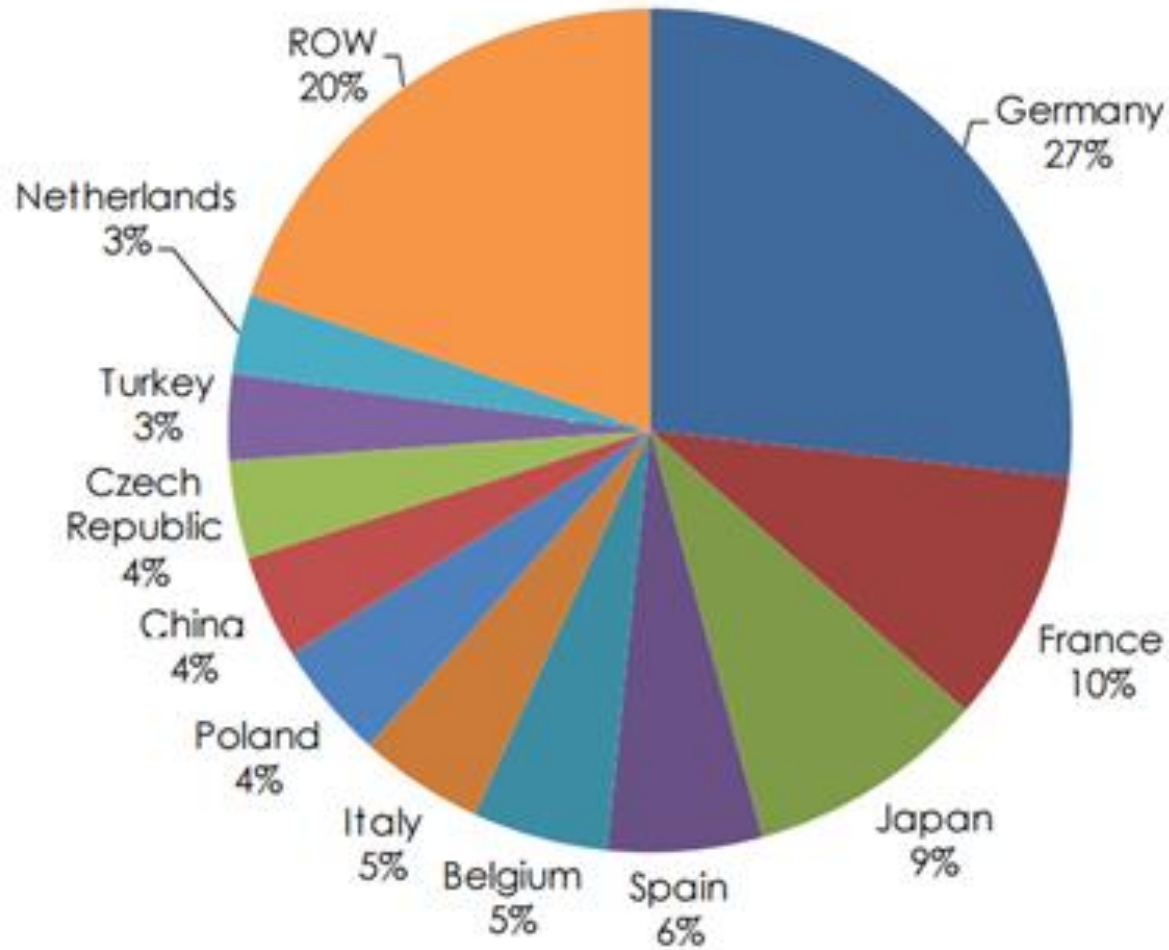
£/\$ even more marked depreciation



Brexit: Some economic impacts on UK auto?

- IF Slower growth: lower cars sales in UK (-5 to -10%?)
- Depreciation of sterling: Imported cars more expensive. GM. Ford. **Profitability of UK plants?**
- Depreciation of sterling: **boost to exports** (BUT imported components more expensive).
- Opportunity for **more reshoring** of components supply? BUT slow: need policy to push this along
- Challenges for suppliers using East European labour
- Foreign investment?
- **Short term impact likely to be: lower UK car sales but output up, and likely profitability up**

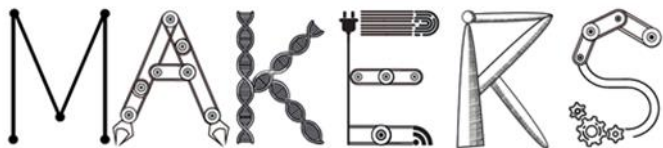
Automotive component imports (Davis et al 2014)



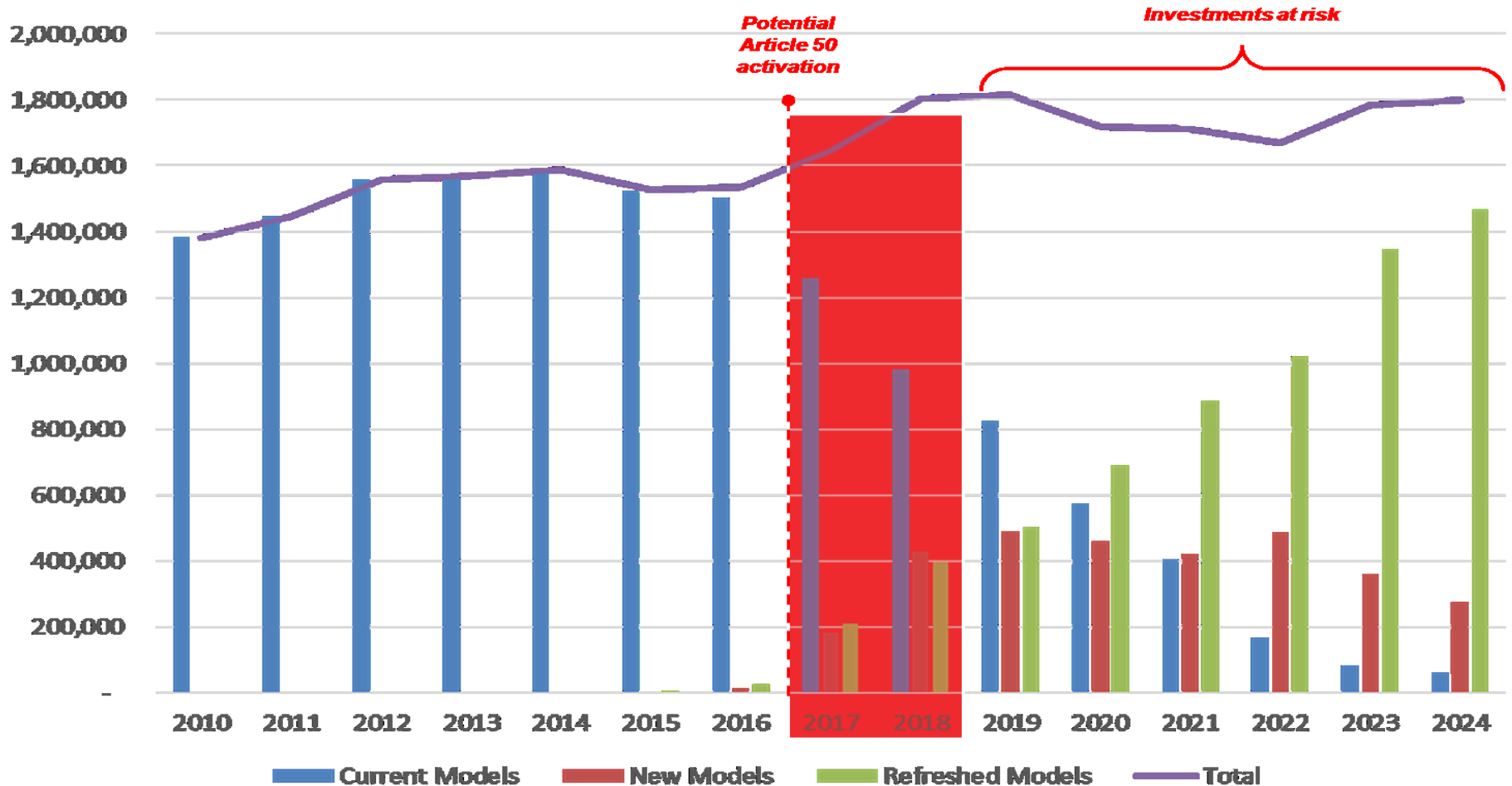
- Possible **short term boost** offset by **uncertainty** over UK trading position with EU.
- Uncertainty: big deterrent to foreign direct investment.
- Comments by Japanese government, Nissan and Honda
- Senior manager, UK car plant: *“At the point when we need the next round of investment, if we can’t compete and if the British government doesn’t help us then I will be very, very worried... we have to make a decision that makes economic sense.”*

- Tim Lawrence (Head of manufacturing at PA Consulting):
- *“The current lack of certainty about tariffs places a question mark over the future of a significant number of UK plants and jobs. As the supply chain investment tends to move with Original Equipment Manufacturers’ volumes, the impact on UK jobs and the economy will be felt beyond the automotive industry.”*

1. Uncertainty during talks the between the UK and the EU over Brexit — negotiations might start in May 2017 and might last two years — 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

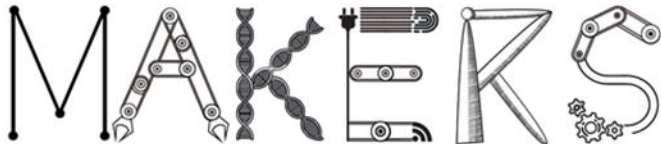
Source: adapted from PA Consulting (2016)

- **‘Leavers’**: Honda and Toyota plants most at risk of closure. Reliant on exports to Europe, + low margins and profitability (running below capacity). New models decisions coming.
- **‘Question Marks’**: Mini, Nissan, *Vauxhall*. Strong British heritage but EU options
- **‘Stayers’**: JLR, Bentley, Aston Martin. Dependent on EU & overseas markets, British-centred.
- BUT see comments by GM CFO. \$400m ‘headwind’ (Ford: \$500m over next two years) + Peugeot take over of GM Europe?

Plant location decisions:

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?



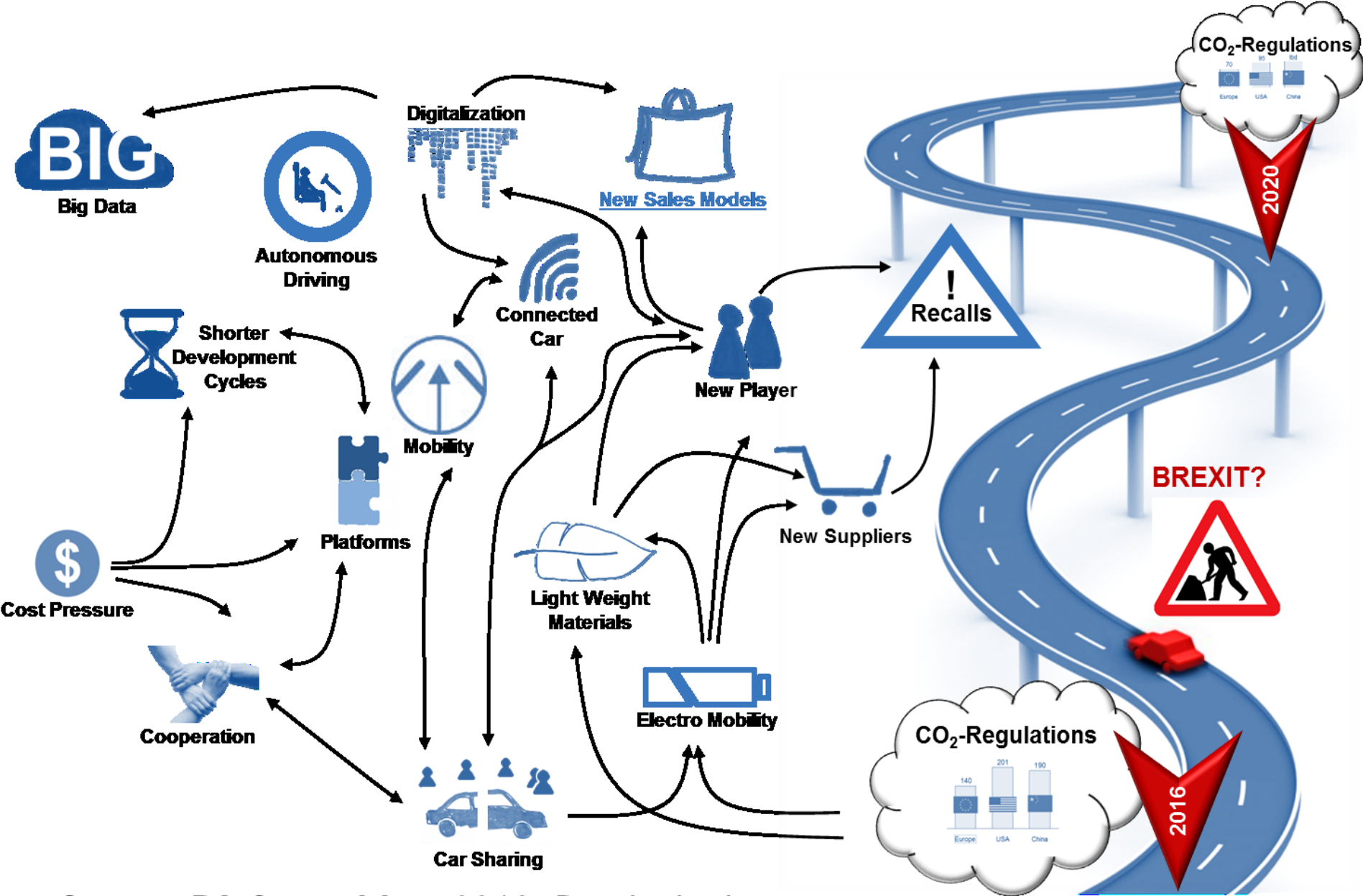
- Nature of specific deal – launch aid? And what about supply chain?
- What said to Nissan re future of UK's trading relationship with EU?
- What said to Nissan re future Industrial Strategy now being developed

- What 'deal' Nissan received, other car makers will want
- Some practical issues over a trade deal on auto? (Rules of Origin, Mutual Recognition for conformity assessment...)

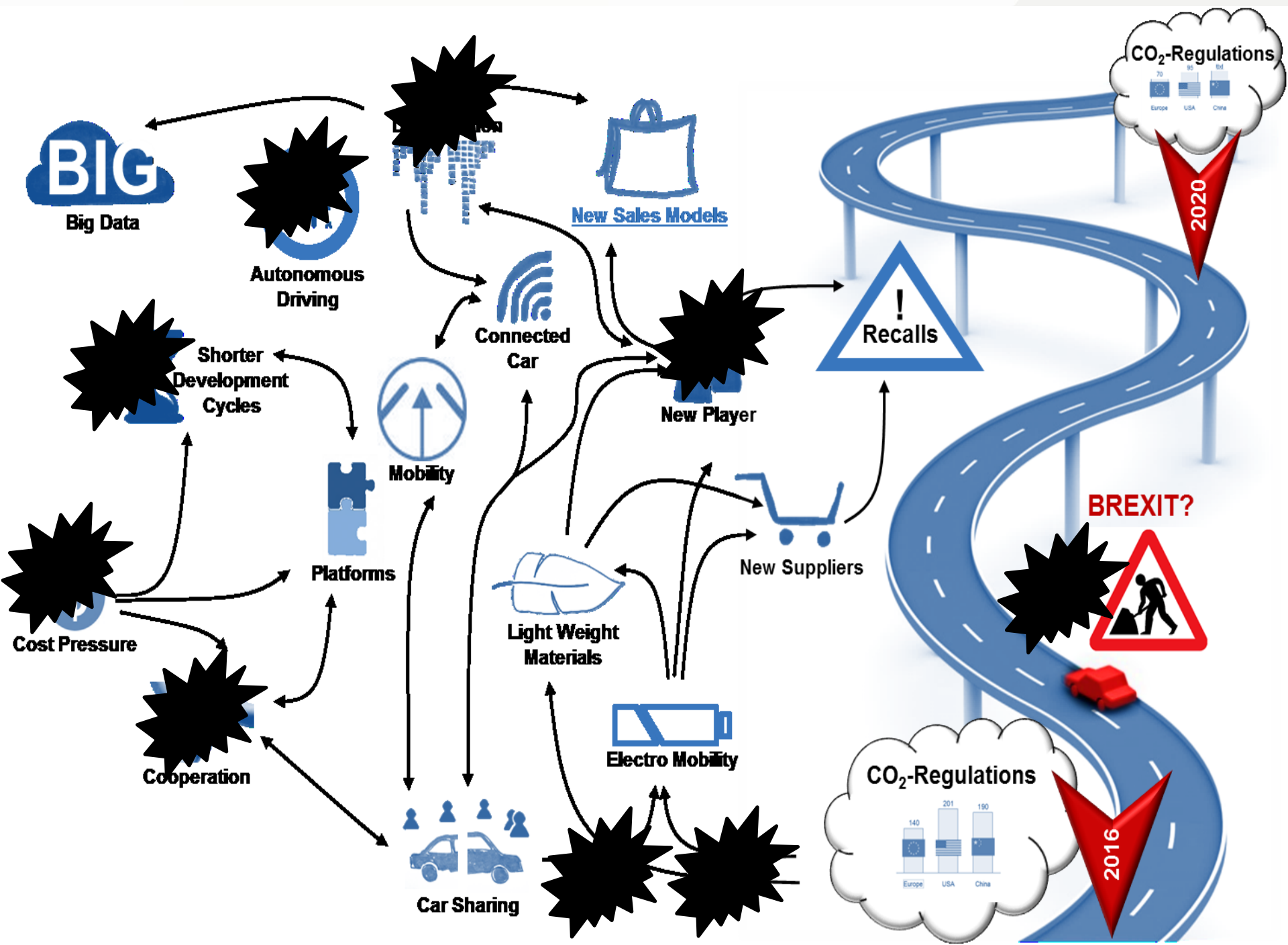
- Reality of trade offs?
- Is No deal really 'better than a bad deal'?
- Leaving the Single Market will likely increase long term economic costs of leaving the EU
- Probably more likely that the UK changes its economic model ?
- Leaving the customs union? Likely that complex sector by sector deals will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

Other issues?

- Skills
- Regulation
- Access to research networks and funding



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



- Birth of new ‘distributed manufacturing’ (additive manufacturing, web, consumer design, localised manufacturing)
- Changing demand. Personalisation of offering
- Manufacturing & services (‘Manuservices’ / ‘servitisation’)
- Sustainability

- → possibilities for reindustrialisation?

Some immediate priorities to consider:

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

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: needs an industrial policy for auto & manufacturing.

- Automotive Council e.g. sourcing road maps, technology road maps
- APC and Catapults
- Skills
- Loan Guarantees (→ access EIB funds)
- *RGF support → JLR, Nissan, GM, supply chain,*
- *AMSCI (£245m)*
- InnovateUK + EPSRC investment into research
- OLEV
- *MAS*
- *MAS Tooling Up Fund*
- Automotive Research Campus at WMG
- Automotive Investment Organisation

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
 - Skills – **devolution to regions.**
 - Support for exporters
 - Attracting tier 1s? Segments of supply chain.
 - Innovation
 - Energy costs? Proper compensation scheme.

Need to join up sectoral industrial policy with place based approaches at regional level.

Acknowledgements for use of figures, stats, diagrams and images...

- KPMG
- SMMT
- PA Consulting
- Fxtop.com
- Gowling WLG
- Agenda Publishing

Thanks for listening

- Comments and questions welcome
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