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The impact of Brexit on the automotive sector

Fifth Report of Session 2017–19

Report, together with formal minutes relating to the report

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Business, Energy and Industrial Strategy Committee

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Summary

This report is intended to inform public and parliamentary debate and to influence the Government's objectives as it begins phase 2 of the negotiations on leaving the European Union.

The automotive sector is one of the most productive and successful in the UK, employing, directly or indirectly, over 900,000 people and generating almost one tenth of the country's manufacturing output. The automotive sector in Europe is heavily integrated, with highly complex and efficient supply chains relying on the friction-free transfer of components across the continent. The sector is highly competitive, with high volumes and low profit margins. UK manufacturing plants have in recent years proved successful in winning competitions for the construction of cars for the European market, where the majority of our exports go. The single market and customs union has been instrumental in forming the regulatory and trading environment which has produced a diverse market with competitive prices for UK consumers.

We conclude that leaving the EU without a deal would undoubtedly be hugely damaging to the UK automotive sector, more so than to other European countries. It would involve the introduction of a 10 per cent tariff on cars and, because of the competitive nature of the business, the shift of volume manufacturing to countries remaining in the EU. Because mass-produced cars in the UK are less than a quarter "British" for trade deal purposes, we recommend that the Government should prioritise securing the roll-over of existing EU Free Trade Agreements with the necessary amendments to allow UK content to count as EU for rules of origin purposes. New trade deals will also need to accommodate the largely European content of cars built in the UK.

Non-tariff barriers, in the form of border delays and increased bureaucracy, will also affect UK competitiveness. We recommend that the Government should, in its negotiations, place a high premium on securing frictionless trade for the automotive sector.

On the key issue of the future regulatory regime, we have not identified any potential benefits from divergence from the EU, only costs. We recommend that the Government seeks in the negotiations to preserve existing arrangements for the certification of vehicles throughout the EU, whether as part of a Mutual Recognition Agreement or some alternative arrangement. In order to maximise our trade opportunities with our biggest trading partner, and to provide certainty to global manufacturers, the Government should also aim to retain regulatory alignment with the EU regulatory framework for the short to medium term.

We looked hard at potential opportunities arising from Brexit. We found that it is unrealistic to expect an expansion of trade overseas to outweigh the loss of trade to Europe arising from a hard Brexit. Furthermore, any new bilateral trade deals secured by the Government are unlikely to lead directly to a significant increase in investment and jobs in the UK automotive sector. Trade deals are helpful, but not a pre-requisite for improving exports in the automotive sector. Retaining good access to the single market is more important than securing the freedom to secure new trade deals with third countries.

The Government should also seek a deal on immigration that enables the sector to access the full range of skills it requires and should further incentivise locating relevant research and development in the UK once we leave the EU.

Overall, no-one has argued there are advantages to be gained from Brexit for the automotive industry for the foreseeable future. We urge the Government to acknowledge this and to pursue an exercise in damage limitation in the negotiations. This involves retaining as close as possible a relationship with the existing EU regulatory and trading framework in order to give volume car manufacturing a realistic chance of surviving in this country.

1 Introduction

Background on the automotive sector

1. The automotive sector is one of our key manufacturing industries: it contributes around one per cent of the UK's output and 9.4 per cent of UK manufacturing output.[1] It employs 169,000 people directly, many in the manufacturing hub in the West Midlands, and a further 814,000 in associated supply chains throughout the UK.[2] It is also one of our most productive sectors, compared to other manufacturing sectors and to the economy as a whole.[3] The sector contributes 13 per cent of all goods exported, the second highest proportion from any one sector.[4]

2. Successive UK Governments have worked closely with manufacturers and trades unions, notably through the Automotive Council, to make the UK an attractive base for automotive manufacturing. Inward investment from major Japanese companies over the last 40 years has been instrumental in revitalising car manufacturing in the North East and West Midlands. The Government has placed the automotive sector at the heart of its Industrial Strategy, providing a sector deal which continues to support the provision of skills and technologies that helps the industry to thrive in the UK.[5]

3. The mass production of vehicles is a multi-national activity and operates to a large extent on a continental basis. In Europe, large multinational corporations choose which countries to manufacture vehicles, largely for the European market.[6] American companies dominate the US market; Japanese and South Korean companies predominate in Asia. In Europe, the sector is highly competitive and profit margins are small, between 2–4 per cent.[7] At present, the UK produces the third highest volume of passenger vehicles in Europe, behind Spain and, by some distance, Germany.[8]

4. The UK automotive industry is one of the most closely integrated sectors with the EU.[9] Complex supply chains stretch throughout Europe: typically parts are transferred through different countries before being assembled into the final product.[10] Decisions on where to base volume manufacturing for particular models are taken on a regular basis; large manufacturers can readily switch production between plants in different countries. Decisions depend on a wide range of factors, including availability of skilled labour, infrastructure, tax regimes, support for innovation and ease of exporting. Many of these factors are subject to Government influence. There are several key manufacturing decisions due to be taken during and immediately after the period of Brexit negotiations.[11]

1 House of Commons Library Briefing Paper, The motor industry: statistics and policy, April 2017
2 SMMT (BRA0005)
3 BEIS estimates that UK automotive industry productivity was 40 per cent higher than other manufacturing sectors and 80 per cent higher than the economy as a whole: the Automotive sector report, published on Exiting the European Union Committee website.
4 Behind machinery, including computers. World's Top Exports website, August 2017
5 HM Government, Automotive sector deal, 10 January 2018
6 EU countries export less than 20 per cent of total production outside the EU. ACEA website
7 Q41 [Hawes]
8 European Automobile Manufacturers Association (ACEA) website, figures for 2016. Germany produced 5.5 million vehicles compared to the UK's 1.7 million.
9 Institute for Government analysis of the World Input-Output Database for 2014
10 Professor David Bailey and Professor Lisa De Propris (BRA0003)
11 Unite the Union (BRA0004), Professor David Bailey and Professor Lisa De Propris (BRA0003)

5. The sector in the UK is also diverse. In addition to the large volume manufacturers making tens of thousands of vehicles each year, there are smaller exclusively UK-based luxury vehicle manufacturers such as Aston Martin, Bentley and Rolls-Royce that produce much lower volumes of vehicles.[12] In all, there are over 30 manufacturers making 70 different models, supported by more than 2,500 component providers.[13] These include Formula 1 cars, whose teams are largely UK-based, as well as specialist, off-road vehicles. The UK is also the largest manufacturer of construction vehicles in Europe.[14] **The Government must seek to ensure that it is able to preserve and build upon the success of the UK automotive sector as it enters negotiations on future trading arrangements with the EU.**

Our inquiry

6. This is the second in a series of reports we are publishing on the impact of leaving the European Union on specific sectors of the economy.[15] In the absence of a fully published impact assessment,[16] this report contains our assessment of the consequences for the automotive sector of different outcomes of the negotiations and seeks to establish what type of withdrawal agreement would most benefit the sector and, consequently, the UK's broader economic interests. We aim to inform public debate and influence the Government's negotiating approach and priorities.

7. As part of this inquiry we received 18 submissions of written evidence from businesses and other stakeholders. We took evidence in public from some of them and held a series of private meetings with other major car manufacturers and trade union representatives. We visited the Honda factory in Swindon to see at first hand the manufacturing process and held further meetings there. We also heard evidence from the Secretary of State for Business, Energy and Industrial Strategy, the Rt Hon Greg Clark, MP. We have received a certain amount of information from companies in confidence, which we do not publish but has nonetheless helped inform our conclusions. Similarly, we have seen the full, unredacted versions of the automotive sector analysis carried out by the Government and its so far unpublished Cross Whitehall Briefing on exiting the EU. During a visit to Brussels we held private meetings with UKREP[17] and with the European Automobile Manufacturers' Association. We are very grateful to all those who have contributed to our inquiry.

12 See Figure 3, para 41
13 SMMT (BRA0005)
14 Construction Equipment Association (BRA0007)
15 The Committee published its Second Report of Session 2017–19, Leaving the EU: implications for the civil nuclear sector, HC 378, on 13 December 2017. Further reports will be published on the aerospace, pharmaceuticals and processed food and drink sectors.
16 The Automotive sector report provided by the Government to the Exiting the European Union select committee was redacted to remove the views of industry.
17 The UK Permanent Representation to the European Union.

2 Impact of tariff barriers

A "no deal" and WTO tariff scenario

8. The UK automotive industry is largely export-led, with Europe as the primary market. The UK exports just under 80 per cent of the cars produced here; some 56 per cent of which go to the rest of the EU.[18] Around 86 per cent of vehicles that are sold in the UK are imported; around 70 per cent of these from the rest of the EU.[19] Total turnover in the UK industry was £77.5bn in 2016;[20] the balance of trade deficit with the EU was around £25bn in the first quarter of 2017.[21] We were told by the Society of Motor Manufacturers and Traders (SMMT) that the single market, with its shared standards, tariff-free internal trade and seamless transportation across Europe, had enabled the UK to remain competitive in a highly competitive industry.[22]

9. Whilst the successful conclusion of phase 1 negotiations appears to make the prospect of a final agreement on withdrawal more likely, the Prime Minister has consistently asserted that "no deal for Britain is better than a bad deal for Britain".[23] As this remains a possibility, automotive businesses, like other companies, are obliged to prepare for this scenario and are doing so. The Government has committed to leaving the customs union and single market. On departure, in the absence of an agreement on trade, this would mean a reversion to World Trade Organisation (WTO) tariffs. These are 10 per cent for cars and, on average, 4.5 per cent for vehicle components.[24] At present, consumers benefit from the fact that 95 per cent of cars imported to the UK are not subject to a tariff.[25] Industry representatives told us that the additional costs of any tariffs imposed on imported cars would be likely to be passed on to consumers.[26]

10. We explored with witnesses whether the post-referendum depreciation of sterling could compensate for any imposition of tariffs and help to boost exports. Both Aston Martin and Honda were sceptical about this prospect. The picture is complicated by companies' financial hedging strategies, Government support programmes (for Aston Martin) and the fact that companies would be paying more for imported components, which comprise 60 per cent of many models.[27] The multi-national supplier GKN, for example, had noted a "small mitigating effect" of sterling's depreciation.[28] We heard that there may be short term gains from currency fluctuations, but these would be used to help offset the long term adverse impact of tariffs.[29] The CFO of Aston Martin, Mark Wilson, told us "I do not think we ought to be looking to rely on weak sterling as a way of feeling good about WTO."[30]

18 SMMT (BRA0005). Figures relate to 2016.
19 Q16, National Franchised Dealers Association (BRA0010)
20 SMMT website, 20 June 2017
21 EIPA website 15 June 2017
22 Q14 [Hawes]
23 Prime Minister, Lancaster House speech, 17 January 2017
24 Department for Business, Energy and Industrial Strategy, (BRA0012)
25 National Franchised Dealers Association (BRA0010)
26 Q30 [Hawes]
27 Qs48–50, Enterprise RentACar (BRA0002). See also, KPMG, Brexit: the impact on sectors, February 2017
28 Q115; see also Q114
29 Q50 [Wilson & Keating]
30 Q48

11. The monthly value of exports has not departed significantly from its seasonal pattern since the fall in sterling; but the value of exports for the second half of the year increased from £15.5bn in 2016 to £18.7bn in 2017.[31] If the depreciation of sterling has been a net benefit for exporters, the impact of tariffs is negative for importers and consumers alike. If the full costs of WTO are reflected in the retail price, an average £15,000 vehicle would cost around £16,500.[32] This scenario would present what the SMMT has described an "incredible challenge",[33] and "devastating",[34] and would make UK manufactured vehicles "uncompetitive".[35] Given current low profit margins and high levels of efficiency, we heard that it would be difficult for manufacturers to absorb these costs.[36]

12. Unless these additional costs were to be passed on to consumers, the current profit margin of around £450 on a £15,000 car would be comfortably wiped out. Such an increase would inevitably have an impact on sales. One study has estimated that a 15 per cent price impact would result in 550,000 fewer sales in EU countries per year, a fall of around 19 per cent.[37] Another study estimated the introduction of trade barriers to result in a £7.9bn decline in exports to the EU.[38] The SMMT has put the figure at £4.5bn.[39] Professor David Bailey has noted that there is no guarantee of future production in the UK.[40] The Japanese Ambassador to the UK, after meeting the Prime Minister with representatives of Japanese manufacturers, was very blunt: "If there is no profitability of continuing operations in the UK – not Japanese only – no private company can continue operations. So it is as simple as that."[41] In simple terms, **it is difficult to see how it would make economic sense for multinational volume manufacturers—the bulk of the UK automotive sector—to base production in the UK in a no deal or WTO tariff scenario. The shift of manufacturing to countries within the customs union and single market would be inevitable; the cost in UK jobs could be in the hundreds of thousands, and inward investment in the hundreds of millions. For the automotive sector, no deal would undoubtedly be hugely damaging. The Government should not seriously contemplate this outcome.**

The negotiations

13. It has been argued that the damage to the German car industry of a no deal scenario would be so great as to make this scenario unacceptable from the EU perspective, and the UK's negotiating position is therefore strong.[42] The UK is the largest European market for cars manufactured in Germany. Around 20 per cent of new cars manufactured there go to the UK – some 950,000 per year. One study has estimated that on WTO tariffs,

31 Figures from HMRC export statistics
32 Honda Motor Europe (BRA0008)
33 Q45 [Hawes]
34 Tony Walker, President of the SMMT, quoted in the Financial Times, Car industry faces £4.5bn bill without Brexit deal, 28 November 2017
35 Honda Motor Europe (BRA0008)
36 Qs45–6; Qs112–3
37 Deloitte Brexit briefing, Brake Block Brexit: *How a hard Brexit would impact the German automotive industry*, June 2017
38 Baker McKenzie, The realities of trade after Brexit, December 2017
39 Financial Times, Car industry faces £4.5bn bill without Brexit deal, 28 November 2017
40 Financial Times, Chart that tells a story: UK car production, 27 October 2017
41 BBC news website, 8 February 2018,
42 Truth on the market blog, A Pro-Free Market Approach to Brexit Negotiations Is Key, 15 December 2017

German vehicle exports to the UK would decline by 32 per cent, endangering some 18,000 jobs there.[43] It predicted that a hard Brexit would have a negative impact on the sales and profitability of automotive sales in Germany.[44]

14. There is little doubt that in a no deal scenario, the German car industry, as the largest manufacturer, would be hardest hit of all remaining EU Member States, but Italy, France and Spain are also net exporters to the UK. Other states would be less affected. So far at least, the EU 27 have adopted a united position on the negotiations, which has placed the preservation of the single market and customs union ahead of individual national interests. The President of the German Association of the Automotive Industry, Matthias Wissmann, said in June 2017

> In the view of the German automotive industry, everything must be done to maintain the free movement of goods and services between Britain and the other EU countries in the future. But there is a clear priority: the cohesion and the integrity of the EU are both a foundation and precondition for reaching a reasonable understanding.[45]

Around 56 per cent of UK vehicle exports go to Europe; only about 7 per cent of European vehicle exports come to the UK.[46] In a no deal scenario, German manufacturers would still be able to export to the rest of the EU, tariff free; those in the UK would not. The unilateral removal of all tariffs, as suggested by some, would retain the competitiveness of imported vehicles for UK consumers but undermine the UK as a manufacturing base. This would run contrary to the Government's own Industrial Strategy and we do not consider this a realistic choice. The option of securing a partial customs union for certain products, such as vehicles, would not be consistent with GATT and WTO rules and would therefore be liable to legal challenge if included in a withdrawal agreement.[47] The Government is not seeking a sectoral deal "in any normal sense".[48] **Whilst a "no deal" scenario would certainly be damaging to the automotive sector in many EU countries, especially Germany, the impact on the UK automotive sector would be far greater than that on each of the remaining EU Member States.** ***We recommend that the Government should not contemplate this outcome in its approach to negotiations and that it should prioritise securing a customs arrangement which removes the risks of tariffs being imposed on vehicles produced in the UK.***

43 Deloitte Brexit briefing, Brake Block Brexit: *How a hard Brexit would impact the German automotive industry*, June 2017

44 A further study by Deloitte estimated a sales loss to Germany resulting from the UK leaving the single market/ customs union of £3.4bn.

45 VDA, Press release, 29 March 2017

46 Q19 [Hawes]

47 Special Trade Commission, Brexit, movement of goods and the supply chain, February 2017, Appendix 1. Any free trade agreement must, according to GATT/WTO rules, cover "substantially all trade" in goods. The flexibility of this definition is open to question and is discussed in a report by the Institute of Directors, Customising Brexit: A hybrid option for a UK-EU trade framework

48 Rt Hon David Davis MP, oral evidence to the DExEU select committee, 24 January 2018, Q757

3 Non-tariff barriers

15. It is clearly in the interests of both the EU and the UK to reach an agreement which does not involve tariffs on components or finished vehicles, whether set at WTO or any other level. Even if that objective is achieved, the threat to the competitiveness of the UK automotive industry of non-tariff barriers—a more potent threat than tariffs for some—will need to be mitigated.[49] Setting aside the role of regulation—considered in the next chapter—as a non-tariff barrier, these primarily consist of delays at the new UK-EU border and the additional administrative requirements associated with trading outside the single market.

The impact of delays

16. The volume manufacturers rely upon the just-in-time delivery system, under which components are delivered directly to the assembly line and there is a very limited requirement for warehousing of stock. The process is a vital part of minimising costs and maximising efficiency. We saw at first hand the arrival of trucks to the Honda factory in Swindon every seven minutes and the seamless delivery of parts to the line. Because of the reliability of transportation across the Channel at Dover, warehouses held only one day's worth of stock from EU countries.[50] For imports from Japan, the scope for delays is greater, and components were stocked for two to three weeks.[51]

17. There have been various estimates of the impact of potential delays to trucks arriving at Dover arising from new customs arrangements.[52] We heard from Honda their estimate that a 15 minute delay could add around £850,000 per year in costs–a significant sum in the context of reported pre-tax profits of £9m in 2016–17 at the Swindon manufacturing site.[53] Other companies had made similar calculations of the increased costs associated with border delays.[54] For Aston Martin, the greater concern was the impact on cash flow of expensive vehicles being held up at borders for long periods.[55]

18. There are also likely to be additional administrative costs associated with trading goods outside the customs union. Ford will be required to provide 115,000 declarations for its imports alone.[56] At £35 per declaration, the supplier GKN told us that there would be "a fairly significant impact" on costs.[57] The administrative impact on smaller suppliers is likely to be proportionately greater.

19. The trade-off between friction-free access to the single market and regulatory alignment will be a key part of the negotiations. The Prime Minister has referred to seeking to achieve trade "as frictionless as possible."[58] In its policy paper on a Future Customs Arrangement, the Government sets out two options for future customs arrangements:

49 Honda Motor Europe (BRA0008), National Franchised Dealers Association (BRA0010)
50 Honda Motor Europe (BRA0008)
51 Q70[Keating]
52 In evidence to the Public Accounts Committee, the Port of Dover reported that it processed 10,000 freight vehicles every day, the equivalent of a 180km queue, Second Report of Session 2017–19, Brexit and the future of customs, November 2017, HC 401
53 Insider Media Limited, Revenue grows by more than £1b at Honda Europe, 11 October 2017
54 Vauxhall Motors (BRA0016)
55 Q73 [Wilson]
56 Ford Motor Company (BRA0011)
57 Q108 [Saunders], Honda Motors Europe (BRA0008)
58 Prime Minister, Lancaster House speech, 17 January 2017

one based on unspecified technology-based solutions; the other on the development of a new partnership, aligning approaches in such a way as to remove the need for an UK-EU customs border. Other select committees will continue to scrutinise proposals for customs arrangements as they progress, but we note the consensus view expressed by the SMMT that, outside the single market and customs union, it is inevitable that there will be *some* additional costs.[59]

Mitigations

20. There are various options for mitigating the impact of these additional costs, including the expansion of the Authorised Economic Operator regime in the UK and trusted trader status, as well as other solutions that do not require physical checks at the border.[60] Some have advocated a regime similar to that at the US-Canada border, which sees car components cross multiple times under the provisions of CETA and a range of bilateral agreements.[61] Taxation can be administered away from the border, for example.[62] These potential solutions are likely to apply across the board, not just to vehicles. They will require further detailed exploration and the outcome is likely to be affected by whatever agreement is reached in relation to the external border with the EU in Northern Ireland.

21. Whilst the automotive sector is trading non-perishable goods, border delays are likely to result in added costs with longer journey times. Any mitigations that involve the establishment of additional warehousing facilities will contribute significantly to costs, not to mention the footprint of manufacturing plants. We are also concerned about the impact of additional bureaucratic requirements on small suppliers, which form the majority of suppliers and many of which will not have operated at all outside the single market.[63] Once the future arrangements have been agreed, the Government will need to provide comprehensive information and support to small businesses having to negotiate the new regime. **Longer journey times, with added risk of delay, plus extra customs bureaucracy would make the UK automotive sector less efficient and act as a disincentive to international companies looking for a base to manufacture cars for the European market. In a highly competitive market, small margins can make a significant impact on investment decisions.** ***If the Government wishes to uphold the UK's reputation as a good location for volume vehicle manufacturing, consistent with its Industrial Strategy, we recommend that it should in its negotiations on withdrawal place a high premium on securing frictionless trade for the automotive sector.***

59 Q70 [Hawes]. Home Affairs Committee, Home Office delivery of Brexit: customs operations inquiry International Trade Select Committee, Continuing application of EU trade agreements after Brexit inquiry

60 SMMT (BRA0005). For more information on Authorised Economic Operators, see the Government website

61 See House of Commons Library Research Briefing, CETA: the EU-Canada free trade agreement; and Special Trade Commission, Brexit, Movement of Goods and the Supply Chain, February 2017, Appendix 2

62 Ford Motor Company (BRA0011)

63 Honda Motor Europe (BRA0008)

4 Regulatory alignment

22. The key question yet to be resolved by Government on our future relations with the EU is how far the UK wishes to maintain regulatory alignment with the EU. In explaining the term "regulatory alignment", the Prime Minister has referred to different categories of regulations to be discussed in the negotiations:

> There will be some areas where we have the same goals—the same objectives in terms of regulation—but wish to achieve them by different means. There will be other areas where we have the same goals and accept that they should be achieved by the same means.[64]

In this context, we sought to examine the respective advantages for the automotive sector of regulatory alignment with EU regulations and the alternatives of divergence, or the freedom to diverge.

The Type Approval system

23. At a global level, regulatory standards for the sector are primarily established at both the United Nations and European Union level. The UN Economic Commission for Europe (UNECE) provides the foundation for the harmonisation of global standards, particularly relating to safety.[65] There is no single EU body governing the regulation of the automotive industry, but regulations governing the sector are negotiated through internal Commission working groups before being approved by the Council of Ministers. The EU tends to adopt UN safety regulations for the most part, but also takes the lead in setting some standards, for example relating to environmental matters, which other countries, including China, largely follow.[66]

24. In the EU, access to the market is gained through the Whole Vehicle Type-Approval System, under which an approval body, once authorised by the EU, can test compliance of vehicles with applicable internationals standards before approving them for sale anywhere in the EU. In the UK, the authorised approval body is the Vehicle Certification Agency (VCA). The certification process for a new model normally takes between 6–18 months but discussions between manufacturer and VCA can begin between 3 and 10 years before this formal certification process.[67]

25. Industry representatives identified potential regulatory barriers as a key concern. The ability to maintain access to the EU market through securing type approvals by the VCA in the UK was vital for some manufacturers.[68] The removal of this option was described by Aston Martin, which manufactures only in the UK, as "semi-catastrophic", as they would have to cease production until they obtained the requisite approvals.[69] It is not possible to hold a certification from two authorities, so manufacturers would have to go through the lengthy process of seeking type approval from an authority in an EU country in order to retain access to the single market, at "significant cost" and adverse impact on

64 Prime Minister, evidence to the Liaison Committee, 19 December 2017, Q13
65 SMMT (BRA005) and the Automotive sector report, published on Exiting the European Union Committee website
66 SMMT (BRA0005), Q78 [Hawes]
67 SMMT (BRA0005)
68 Honda Motor Europe (BRA0008), Ford Motor Company (BRA0011)
69 Q6 [Wilson]

planning timetables.[70] The SMMT also raised concerns over whether existing EU approval authorities would have the capacity to validate all the vehicles previously approved by the VCA and that, without the ability to grant approvals for the single market, the viability of the VCA itself might be at risk.[71]

26. The European Commission's negotiating position is that, during the transition period, existing VCA approvals will continue to be valid if granted before March 29 2019 but once outside the EU, UK bodies will not be able to act as "leading authority" for the purposes of authorisations and approvals.[72] This implies that the UK VCA will no longer be able to issue type approvals from the date of departure. The European Commission has issued a notice to stakeholders to this effect, subject to any transitional agreement.[73] The wording of the Commission's position paper seems to allow some scope for negotiation and the Government is rightly seeking greater clarity on this vital point.[74] We note that the EU has agreed mutual recognition of conformity assessment bodies with third countries such as Switzerland, Canada and the US.[75] Ministers have indicated a desire to retain similar arrangements for type approvals, even after the UK has left the EU and to be free to conduct a "race to the top" in terms of standards.[76] Companies considering where to manufacture new models in the next 2–5 years will need to decide imminently whether or not to risk staying in the UK and trusting that the Government will secure an outcome which allows future type approvals in the UK to be accepted in the single market.[77] We understand that Honda are actively looking at moving type approvals to another EU country; other companies will no doubt be doing the same if current uncertainty continues.

27. Outside the EU, the VCA will be free to set its owns standards for UK-manufactured vehicles. In theory, the UK could seek to negotiate trade deals based on conformity to new UK or alternative standards, which could diverge from those of the EU or UNECE. However, Mike Hawes, Chief Executive Officer of the SMMT, told us firmly that there are "no opportunities from deregulation or divergence".[78] We heard no contrary view. Stephen Booth from the think tank Open Europe recognised the case for staying "very much aligned" in certain sectors, including automotives[79] and the Special Trade Commission of the Legatum Institute has suggested maintaining product standard alignment until mutual recognition of conformity assessments have been secured as part of a free trade agreement.[80] **There is no argument for a separate set of UK standards: the UK market is not big enough to warrant the additional costs to manufacturers of meeting another set of standards, nor does it make sense for the UK to require vehicles manufactured in the single market to require an additional approval by the VCA in the UK.**

70 Q6 [Hawes], SMMT (BRA0005) The Automotive Council has estimated that it costs £300,000 - £500,000 to secure additional type approvals in the CETA trade deal with Canada.
71 SMMT (BRA0005)
72 European Commission, Transitional Arrangements in the Withdrawal Agreement, 7 February 2018; see also European Commission slides on regulatory issues.
73 European Commission, Notice to stakeholders, Withdrawal of the United Kingdom and EU rules in the field of type-approval of motor vehicles, 8 February 2018
74 HM Government, Draft Text for Discussion: Implementation Period, 21 February 2018
75 European Commission website, February 2018
76 Prime Minister, speech, Lancaster House, 17 January 2017, Rt Hon David Davis MP, speech in Berlin, 16 November 2017 and speech in Vienna, 20 February 2018
77 SMMT (BRA0005); Q4 [Keating]
78 Q77
79 Qs18 & 63 [Booth] (Oral evidence on Brexit: implications for UK business)
80 Special Trade Commission, Brexit, movement of goods and the supply chain, February 2017

28. Given that the EU will remain the UK's main market for the short to medium term at least, and that what is widely regarded as our fastest growth market, China,[81] generally aligns itself to many EU regulations, it would be self-defeating to depart from the EU regulatory framework. Alignment is also likely to require compliance with other regulatory regimes relevant to the content of vehicle components, such as the EU chemicals regulatory framework, REACH, end of vehicle life and also intellectual property regulations.[82] Such alignment will in any case happen naturally: UK based manufacturers seeking to export to the single market will have to align with EU standards, regardless of any domestic regulatory changes, unless a trade deal allows for a degree of divergence.[83]

29. On a visit to Honda, we explored the Prime Minister's suggestion of securing the same regulatory objective by different means: "outcome alignment" rather than "harmonisation". We did not hear complaints about existing EU regulations, nor any suggestions as to how the UK could benefit from meeting existing EU standards in another way. We have not seen what this might mean for the automotive sector, nor has industry requested any changes, certainly none that may affect access to the market.[84] **In a global automotive market dominated by large multinationals, regulatory convergence is a desirable trend. It brings down costs, promotes consistent, high standards and therefore benefits consumers. No company wants to make cars to different sets of standards. It makes commercial sense for the UK to remain aligned with standards in the single market, which provides the majority of our trade. The establishment of a new regime for the approval of UK-manufactured vehicles would increase costs and bureaucracy for UK-based companies, and make the UK less attractive as a development and manufacturing base for vehicles. It is not a viable option and *we recommend that the Government rule it out.***

30. Any regulatory divergence sought by the UK would inevitably have costs in terms of access to the single market.[85] The EU is not likely to be prepared to negotiate a deal which allowed the UK to diverge, potentially to gain a competitive advantage, whilst continuing to allow UK manufactured vehicles easy access to the single market.[86] **We support the Government's commitment to maintaining existing employment protections and high standards of environmental protection, for example by pursuing low carbon options for vehicles. We also welcome its preference for seeking similar arrangements on type approvals to those currently in place.[87] Given this, and the continued need of UK-based manufacturers to have access to European markets, we have not identified any potential benefits from regulatory divergence from the EU, whether in terms of competitiveness or improved access to new overseas markets. There are only costs. *We recommend that the Government, in negotiations, prioritise the continuation of existing arrangements for the Vehicle Certification Agency to authorise type approvals for the European single market, whether as part of a Mutual Recognition Agreement or some alternative arrangement. As a negotiating objective, the Government should seek to ensure that it is able to retain regulatory alignment with the EU regulatory framework for the short to medium term.***

81 See figure 2, para 38.
82 SMMT (BRA0005), Honda Motor Europe (BRA0008), Vauxhall Motors (BRA0016)
83 London Electric Vehicle Company (BRA0001), Ford Motor Company (BRA0010)
84 SMMT (BRA0005)
85 Honda Motors Europe (BRA0008)
86 The Legatum Institute, in The Brexit Inflection Point, has argued that supply chains will re-orientate to a better regulated UK environment, which would be recognised by the European Union for the purposes of trade.
87 Rt Hon David Davis MP, speech in Vienna, 20 February 2018

European Court of Justice jurisdiction

31. It is possible that, in the negotiations, the EU may ask that any such arrangement must include recognition of some involvement of the European Court of Justice (ECJ) in any dispute resolution procedure. The Government has identified only three cases involving automotives that have been lost by the UK in 38 years, none of which resulted in a fine.[88] It is acknowledged that ECJ judgements will continue to have some influence. UK companies seeking access to the single market will need to comply with single market rules, and any agencies monitoring compliance with EU standards would need to have regard to European law, but that is not the same as the ECJ determining whether or not there is regulatory divergence for the purposes of a trade deal.[89]

32. The automotive sector is liable to be subject to a broader arrangement on dispute resolution or divergence management mechanisms, which we have not explored in this inquiry. The Government took a pragmatic approach in the phase 1 negotiations to the continuing involvement, for a limited period, of the ECJ in cases involving citizens' rights. Given the low risks of adverse impact on the UK in the automotive sector, and the huge benefits of continued market access, ***we recommend that the Government should adopt a pragmatic approach in relation to any potential continuing ECJ role in the automotive sector.***

Maximising influence

33. If the UK is to remain broadly in line with the EU automotive regulatory regime in order to retain full access to the market, it is in our interests for the Government to try to retain as much influence as possible in the development of standards, through the UNECE and the EU. Outside the EU, the UK will still continue to retain a voice at the UNECE, where, according to the Government, the UK is a respected member.[90] Similarly, at the EU level, the UK has had a strong voice: it participates in the Working Group on Motor Vehicles, which brings together government, industry and consumer representatives to develop legislative proposals,[91] and is one of 12 Member States serving on a group[92] that aims to co-ordinate a European approach to addressing technological challenges such as autonomous vehicles.[93] Witnesses told us that the UK has been a "rule maker":[94] the Government has, for example, been able to secure reliefs from some environmental and emissions requirements for UK small, luxury car manufacturers,[95] and has pushed hard to cut down harmful emissions from vehicles in pursuit of climate change targets.[96]

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88 BEIS, Supplementary evidence, Court of Justice BEIS Cases
89 Q18 [Booth]
90 The Automotive sector report, published on Exiting the European Union Committee website
91 See Commission Register of Expert Groups website
92 The GEAR 2030 High Level Group
93 See Commission Register of Expert Groups website
94 SMMT (BRA0005), Enterprise Rent-A-Car (BRA0002), Honda Motor Europe (BRA0008)
95 Q78 [Hawes]. There are different emissions reduction targets for manufacturers selling fewer than 10,000 and between 10,000–300,000 units per annum for example. See also, KPMG, Brexit: the impact on sectors, February 2017
96 Professor David Bailey and Professor Lisa De Propris (BRA0003), SMMT (BRA0005), Construction Equipment Association (BRA0007), the Automotive sector report, published on Exiting the European Union Committee website

34. Outside the EU, it will inevitably be more difficult to secure measures which are primarily aimed at meeting the concerns of UK manufacturers and reduce our capacity to be a leader on evolving technologies, such as electric and autonomous vehicles.[97] However, there are a range of options regarding our future relationship which the Government can pursue. These may include some form of observer status or other form of close association, as is being pursued in relation to our relationship with Euratom.[98] The CBI has argued that "a close future relationship between UK and EU rules is key to the success of Brexit".[99] In our view, this holds true for the automotive sector, because of the high levels of integration and because the UK, as a research leader, plays an influential role in developing new technologies, which need acceptance in the international regulatory regime.

35. Some have argued that the UK should not allow itself to become a "rule taker", by sticking close to EU regulations whilst losing influence.[100] However, in the automotive sector, where standards are international, every country is a rule taker; some have more influence than others in helping to develop those rules. The UK will certainly lose influence by leaving the formal standard setting processes of the EU, but need not be a silent recipient.

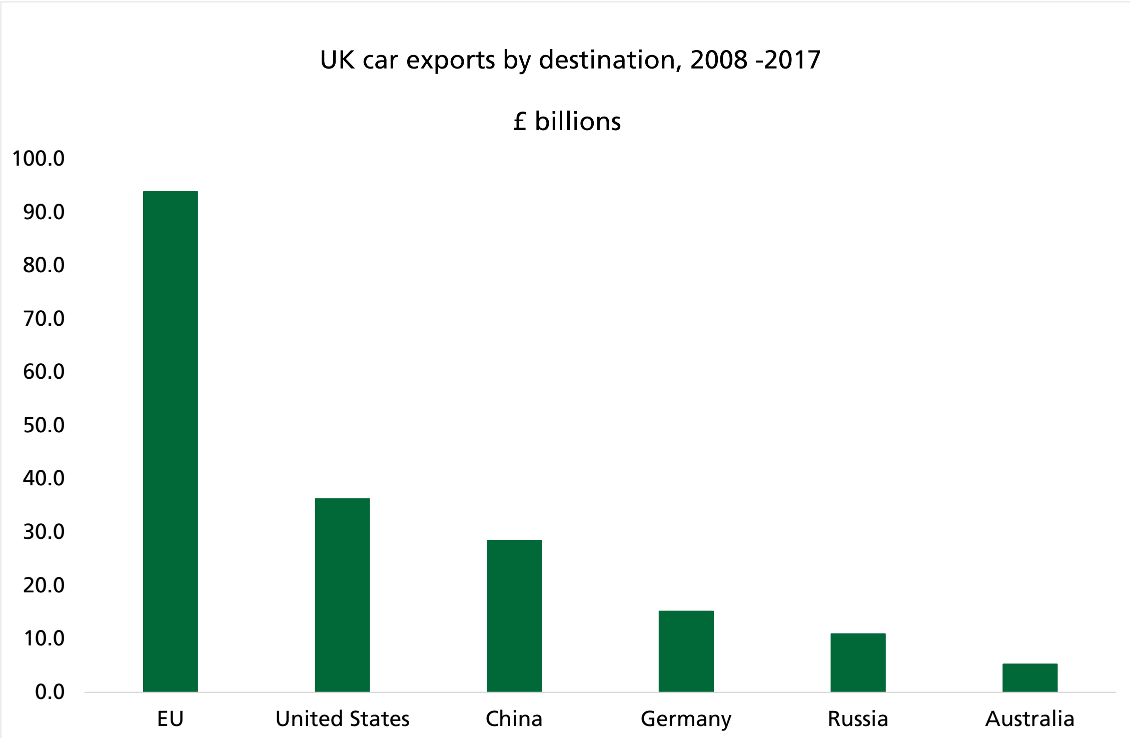
36. Stephen Booth from Open Europe agreed on the case for the UK to remain part of some agencies and groups, and stressed that this was in the interests of the EU as well as the UK.[101] Given this, and the size of the UK marketplace, there should be mutual interest in maintaining a close dialogue with EU bodies, post-Brexit. If the UK wants to increase vehicle exports to China, for example, it makes sense to influence their vehicle specifications, which tend to follow those of the EU in many respects. The Government will, of course, continue to pursue UK interests at the UNECE level, where it is one voice among many, but the EU will also continue to be a leading influence on many international standards. The Government has indicated a desire for "our regulators [to] work together within European Agencies", although without specifying which ones.[102] **We welcome the ambition of the Government to continue to work with existing European regulatory agencies, which for the automotive sector is the best way to exert influence at a global level.** ***We recommend that, in the negotiations on the withdrawal agreement, the Government seeks to support the interests of the UK automotive industry by maintaining a close association with the EU expert groups that develop regulatory standards.***

97 Enterprise Rent-A-Car (BRA0002), Honda Motor Europe (BRA0008). See speech by Rt Hon David Davis MP, Vienna, 20 February 2018 on an UK lead on autonomous vehicles regulation.
98 HC Deb, Written Statement, 11 January 2018
99 See CBI, The Room where it happens, December 2017
100 Special Trade Commission of the Legatum Institute, The Brexit Inflection Point, November 2017
101 Q15
102 Rt Hon David Davis MP, Berlin speech, 16 November 2017

5 Trade opportunities post-Brexit

37. We were keen to explore with car manufacturers the potential advantages to be gained outside the customs union, with the potential for new and bespoke free trade agreements (FTAs) with emerging markets. At present, 56 per cent of UK vehicle exports go to the EU; some 6 per cent to China and 14 per cent to the US.[103] In terms of value, Figure 1 (below) indicates how reliant on European trade the UK is and how much our trade with other countries will have to increase to offset any drop in sales to Europe. The EU signed an FTA with South Korea in 2009 (after two years' negotiations),[104] with Japan in July 2017 (after four years' negotiations), and is in the process of negotiating deals with China and India.[105]

Figure 1: UK car exports main destinations[106]



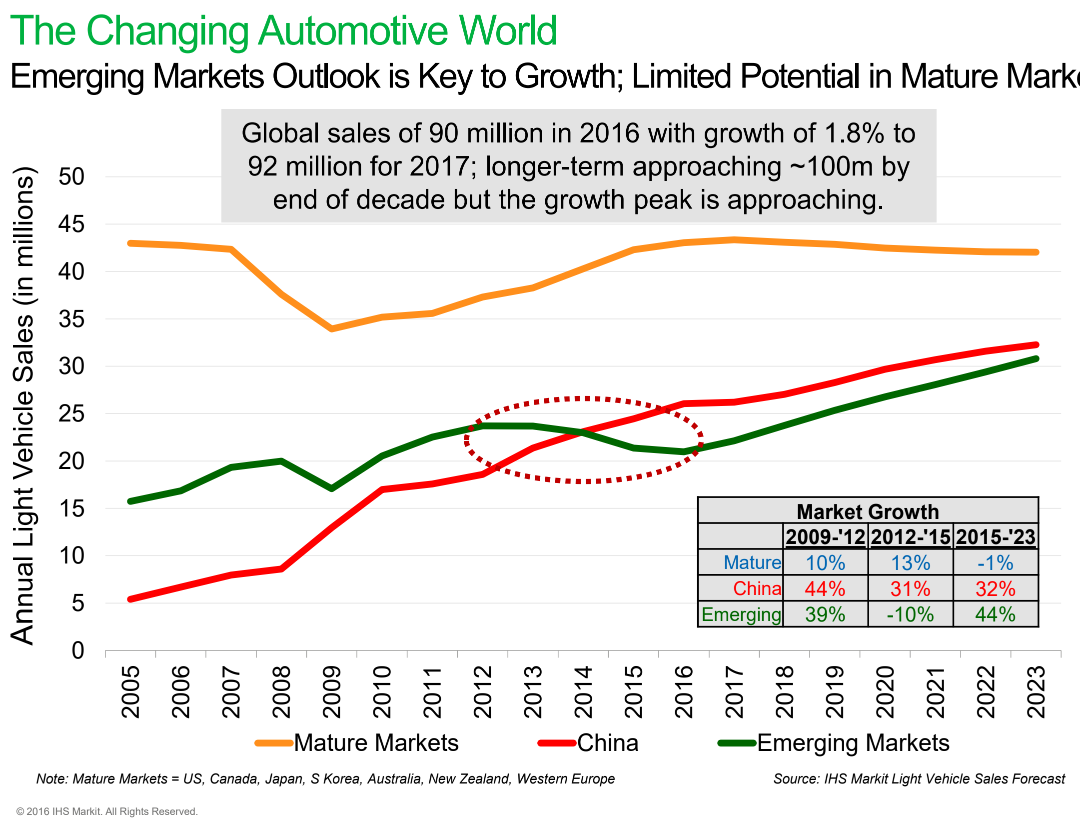
Souce: HMRC UK Trade info

38. It is expected that 90 per cent of global economic growth in the next two decades will come from outside Europe.[107] On this basis, Ministers have argued that that it is likely that an increasing proportion of UK trade will be with non-EU countries and that departure from the customs union is necessary to secure trade deals to take advantage of this growth.[108] Industry forecasts for the automotive sector reflect this global forecast, with the Chinese market estimated to grow by 32 per cent in 2015–23, whilst mature markets do

103 Figures from Statistica for 2016
104 It came into force on a provisional basis in 2011 and was ratified in December 2015.
105 SMMT (BRA0005). Negotiations with India began in 2007, and with China (on an "Investment Agreement") in 2013.
106 Germany included as the UK's largest EU trading partner on automotives but included in EU total
107 Department for International Trade, Preparing for our future trade policy, October 2017
108 Department for International Trade, Preparing for our future trade policy, October 2017; Rt Hon Boris Johnson MP, Foreign Secretary, speech, 14 February 2018

not expand at all (see Figure 2). A successful outcome of Brexit for the automotive sector would see any contraction in the volume of trade with the EU more than compensated by an increase in trade with other countries.

Figure 2: Estimated future sales growth



39. Membership of the EU has *not* been a barrier to expansion into overseas markets, either for volume manufacturers or for premium producers.[109] The barriers are more economic and geographic. We heard that the UK tends to produce for the European market close by and caters for European tastes.[110] The SMMT could not envisage a UK-based manufacturer trying to compete with the best-selling vehicle in the US—a Ford pickup truck—given the logistics that support manufacturing close to the market.[111] Even accepting this, there is scope for improving UK exports at present, and the SMMT agreed that there are "substantial global trade opportunities for the UK", albeit requiring Government assistance to obtain market access.[112] Germany, for example, is responsible for 52 per cent of all EU automotive exports to China, compared to the UK's 29 per cent.[113] Aston Martin saw China as the biggest opportunity for increased exports in an otherwise "mature" global market,[114] and it announced £600m investment to increase its presence

109 Q21 [Hawes], Q22 [Wilson]
110 Q21 [Hawes]
111 Q21
112 SMMT (BRA0005)
113 Bruegel, blog post, 29 charts that explain Brexit, 28 March 2017
114 Q22 [Wilson]

in China as part of the Prime Minister's trade mission there in January 2018.[115] Whilst free trade agreements should be helpful, in the automotive sector they are by no means a requirement for improved export performance in emerging markets.

40. The diverse nature of the UK automotive sector was reflected by the differing strength of concerns over tariff and non-tariff barriers. For those companies, such as Jaguar Land Rover (JLR), who sell mainly outside the EU, the additional costs of non-tariff barriers may be less of a concern compared to those who sell predominantly to EU countries. In addition to JLR, there are a small number of UK-manufactured luxury vehicles with global recognition, which can expect growing sales in emerging markets, but export volumes of Aston Martins, Bentleys and Rolls-Royces are on an entirely different scale than the volume manufacturers.[116] If the greatest opportunity for expansion into emerging markets is for premium products, it would take an unrealistic increase in volumes to make up for the reduction in sales of mass market vehicles to Europe resulting from the imposition of tariff or non-tariff barriers (see Figure 3 below). Mike Hawes considered that "substituting the large market of the EU with others would be very difficult."[117] We have seen no analysis that contradicts this assessment.

41. The economics of mass market car manufacturing point towards locating manufacture close to the region of sales or where labour costs are relatively low.[118] The anticipated increase in demand for vehicles in an emerging market such as India is more likely to create jobs there than at UK-based plants. **The UK cannot expect an expansion of trade overseas to outweigh the loss of trade to Europe arising from a hard Brexit. As most volume manufacturers in the UK are global and foreign-owned, any new bilateral trade deals secured by the Government are unlikely to lead directly to a significant increase in investment and jobs in the UK automotive sector.** ***In its negotiations, we recommend that the Government prioritises continued friction-free access to the single market in automotives over securing the freedom to secure new trade deals with third countries.***

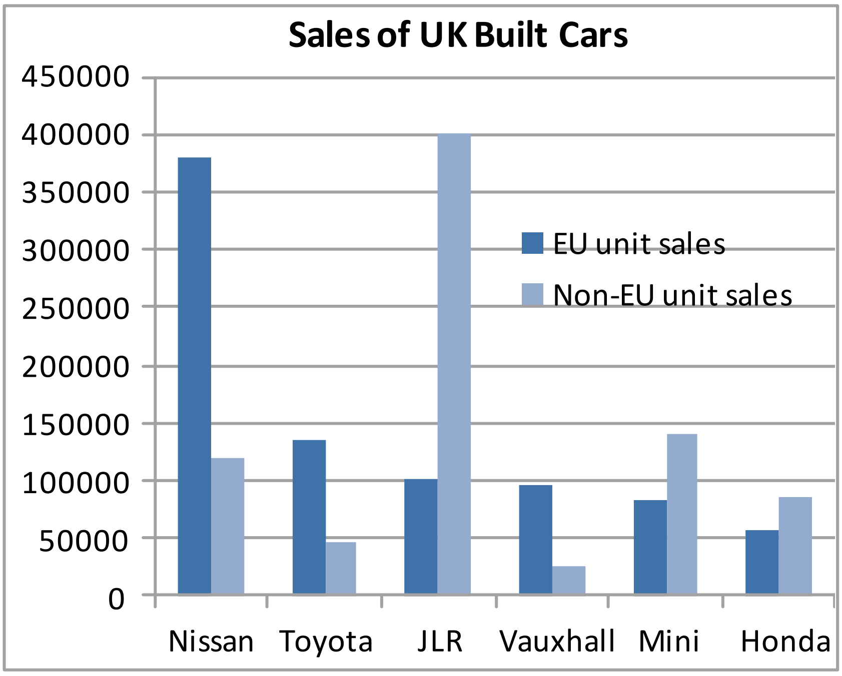
115 The Business Desk news, 31 January 2018

116 Sales of Bentleys in 2016 were around 11,000, Rolls-Royces 4,000. See Figure 3.

117 Q22

118 For example, GM has announced that it is shifting production of the Ford Focus from the US to China in 2019, for sale in China and importing into the US. New York Post, July 2 2017.

Figure 3: Sales of UK built cars in 2016



Source: SMMT, Brexit papers. NB, the combined total of vehicles built in the UK by all other makes, including Bentley, Rolls-Royce, Aston Martin, Lotus and Morgan was less than 30,000.[119]

Free trade deals and rules of origin

42. The priority on trade deals for the industry is the rolling over of existing EU trade deals so the UK can continue to enjoy their enhanced trading arrangements.[120] The Government has announced its objective of establishing "continuity arrangements" for these agreements.[121] This is not necessarily a straightforward matter, due to the rules of origin provisions in these and other trade deals. Typically, an EU FTA will require 60 per cent of the content of a product to be locally sourced to be included under the terms of the agreement.[122] Were this provision to be simply rolled over in a UK-South Korea deal, UK manufactured vehicles would not contain sufficient UK content to qualify.[123] At present their typical UK content for rules of origin purposes amounts to no more than 20–25 per cent of the vehicle.[124] Unless the terms of existing FTAs are altered, the UK would not benefit from the tariff-free access that they provide. The Government will therefore need to renegotiate every existing EU FTA and reach agreement on a new threshold for rules of origin, or agree that, for the purposes of the agreement, EU content can count as UK and vice versa.[125]

119 Figures on other makes from SMMT News release, 26 January 2017
120 The EU concluded trade agreements with South Korea in 2009 and Japan in July 2017. London Electric Vehicle Company (BRA0001), Honda Motors Europe (BRA0008). SMMT (BRA0005)
121 Department for International Trade, Single Departmental Plan, January 2018
122 That is 60 per cent from all EU countries cumulatively. Professor David Bailey and Professor Lisa De Propris (BRA0003). For the NAFTA, the figure is 65 per cent and President Trump has expressed a desire to increase this figure.
123 The FTA with South Korea includes a requirement for regulatory convergence, with either UNECE or EU standards.
124 Q54 [Hawes]. This reflects the fact that many UK-supplied components themselves contain components produced elsewhere.
125 This "diagonal cumulation" rule has been used in a pan-Euro-Mediterranean system, provided that an FTA is in place with all contracting parties. Neighbouring countries may also join if they have an FTA in place with one of the contracting parties. See European Commission website for further detail.

UK supply chains

43. The other option is for the UK to develop its own supply chains rapidly, generating jobs, reducing reliance on imported components and delivering a high enough proportion of domestic content to take advantage of new trade deals.[126] This is a challenging task in the automotive sector. One tier 2 supplier did identify some opportunities for such "reshoring", although these would be diluted by any new tariffs and the weakness of sterling.[127] Tier one suppliers import 70 per cent of components from the EU, largely because of the location of raw materials and the economics of volume production resulting in specialist companies serving the European market.[128] The Government is supporting the industry's efforts to increase the value of UK content in the supply chain and has provided £16m of match-funding to supply companies in the automotive sector deal.[129] The aim is to increase the value of UK content in domestically produced vehicles to 50 per cent by 2022. It has increased from 36% in 2011 to 44% in 2017,[130] but, as mentioned above, for rules of origin and trade deal purposes, the current level is 20–25%. The greater the future level of border friction, the higher the incentive is for the UK to increase the proportion of components manufactured domestically, but this is also likely to increase the cost, compared to existing specialist suppliers, at least in the short term.

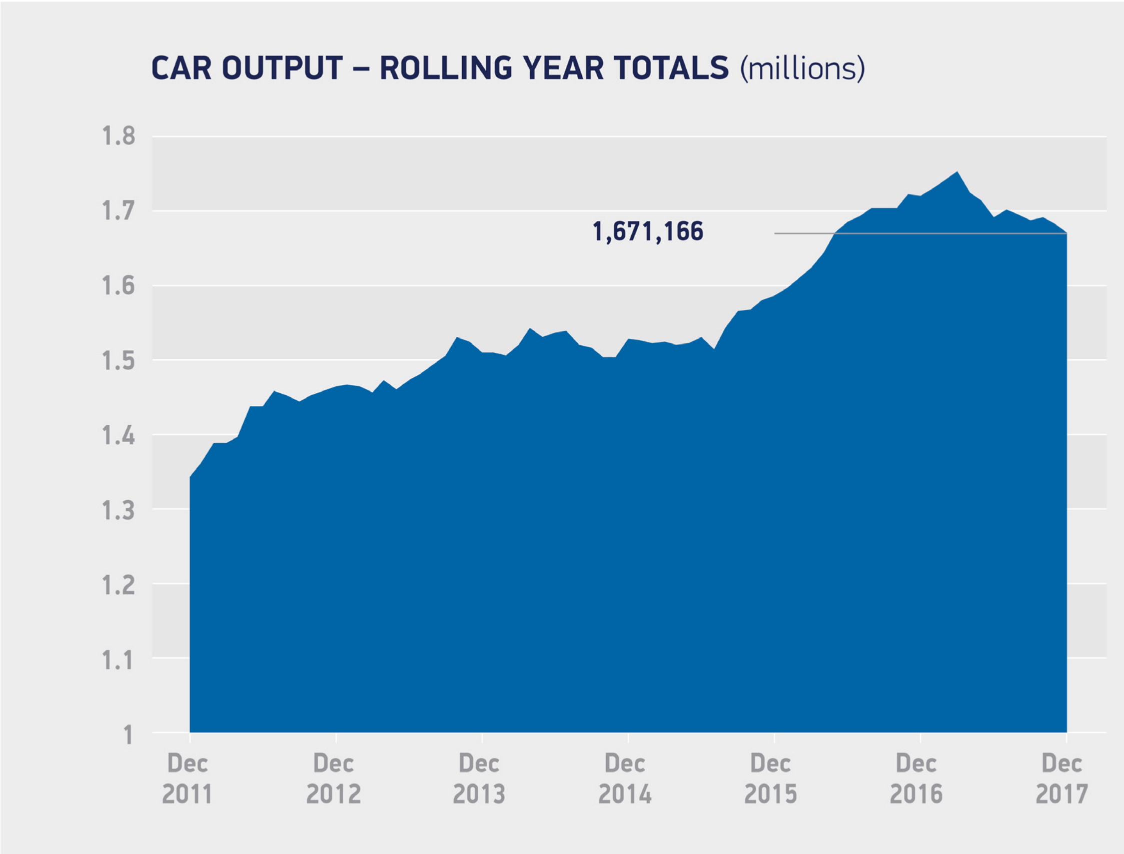
44. Witnesses described the development of a UK supply chain in time to take advantage of trade deals as "a very difficult thing to envisage happening".[131] We agree. The measures announced so far by Government and industry are insufficient to address the issue. **We welcome the Government plans to improve the UK content of supply chains, but this is not going to deliver what is needed in the short to medium term.** ***The Government should therefore prepare the ground to negotiate new trade deals which allow for a lower than usual threshold for domestic content in vehicles or ideally to be able to continue to include EU content for FTAs with other countries in the future. In negotiating the roll-over of existing EU FTAs to the UK, the Government should seek to secure the necessary amendments to allow UK content to count as EU content for rules of origin purposes in the automotive sector.*** **Without such provisions, the business case for locating volume manufacturing of vehicles for export in the UK would be flimsy at best and non-existent at worst.**

126 The Legatum Institute in The Brexit Inflection Point, has argued that supply chains will "re-orientate" over time.
127 Q96, [Sterne], Professor David Bailey and Professor Lisa De Propris (BRA0003)
128 Q96 [Sterne] [Saunders]; Q104 [Saunders]
129 HM Government, Automotive sector deal, 10 January 2018
130 HM Government, Automotive sector report, published on Exiting the European Union Committee website
131 Q59 [Wilson]

6 Certainty and transition

45. Like other sectors, the automotive industry in the UK has been seeking greater certainty from Government over the nature of the transition period and the intended end state for relations with the EU.[132] There are signs now that the continuing uncertainty is affecting investment decisions, which will have a long-term impact on jobs in the sector. There have been mixed signals from recent sales figures. Whilst demand had tapered off in the UK and in Europe since 2016, it is still healthy when compared with the previous decade (see Figure 4).

Figure 4: Car output totals



Source: SMMT News release, 31 January 2018

The drop in demand has contributed to the reduction of work in some plants, such as the Vauxhall plant at Ellesmere Port, and the JLR plant at Halewood, where Brexit uncertainty was cited by the company as a contributory factor.[133] Whilst the uncertainty of Brexit cannot have improved consumer confidence, it is in our view likely that sales have been more affected by the move against diesel vehicles on environmental grounds and the uncertainty around the pace of the transition to electric vehicles.[134]

132 Vauxhall Motors (BRA0016), SMMT (BRA0005)
133 The Guardian, Jaguar to cut production at Halewood, 22 January 2018
134 We are conducting a separate inquiry into electric vehicles at present.

46. Decisions around where to base the future production of vehicles are of more concern than fluctuating sales and are highly sensitive to the current uncertainty.[135] We have referred to Honda seeking to secure type approval for a new model outside the UK. Other manufacturers have not finalised where to base the production of new models, such as the Toyota Auris and Range Rover Sport. Competition between plants in different countries is healthy and is affected by long term assessments of the regulatory environment.[136] We heard that decisions were being delayed and that, in some cases, decisions were going with countries that will have guaranteed access to the single market.[137] Investment has declined from an average of £2.5bn per annum between 2012 and 2015 to £1.6bn in 2016 and £1.1bn in 2017,[138] although the lumpy pattern of investment in the sector should not allow too much to be deduced from these figures. In this context, it is not surprising that Japanese companies have sought reassurances from the Government about its future plans.[139]

47. In view of the 2–3 year length of planning cycles for production, the industry was initially seeking clarity by the end of 2017; and then by the end of March 2018.[140] Companies are now beginning to implement contingency plans, at additional cost.[141] The Government's flexible approach to the transition period of "around two years"[142] is welcome, provided that there is no departure from the existing regulatory and trading framework during this period.[143] This should include the ability of the VCA to continue to make type approval decisions for the single market, as discussed in chapter four. But, to be useful, it is essential that the automotive sector—like other sectors—knows, as early as possible, what the transition is to: in particular, whether there are going to be tariffs and whether the Government plans to align UK regulations governing vehicle manufacture with those of the EU in order to maximise market access, for the medium term at least.

48. We welcome the Government's intention to ensure that a transition period will only ensure that businesses face only one change to a new circumstance.[144] The Government has indicated that it expects agreement on the transition period to be reached by the end of March 2018, but so far it has given no clear indication on where it will seek to diverge. The Secretary of State for the Department for Exiting the European Union has indicated his intention in negotiations only to secure the right to diverge in future.[145] This lack of clarity on divergence is harmful to UK businesses and will drive away investment for as long as it persists. **Whatever choice the Government makes regarding the future UK-EU relationship, it should make it quickly. The wait-and-see approach to the future direction of regulation may be a convenient compromise for the short term, but it would not provide the certainty needed by the sector and would undoubtedly lead to a shift in jobs and investment from the UK to the rest of the EU in the period up to exit.** ***We recommend that the Government clarifies its intention at the earliest opportunity to seek continued regulatory alignment with the EU in the automotive sector.***

135 Professor David Bailey and Professor Lisa De Propris (BRA0003)
136 Unite the Union (BRA0004), Professor David Bailey and Professor Lisa De Propris (BRA0003)
137 Private meetings in London and Brussels. Construction Equipment Association (BRA0007)
138 Q2 [Hawes], Financial Times, online, 31 January 2018
139 BBC News, Nissan to build new model in Sunderland, 27 October 2016
140 Qs2–3
141 SMMT (BRA0005)
142 This period is subject to negotiation, as referenced in the Government's Draft Text for Discussion: Implementation Period, 21 February 2018
143 Honda Motor Europe (BRA0008)
144 Prime Minister, speech, Florence, 22 September 2017
145 Oral evidence to the DExEU select committee, 24 January 2018, Qs703 & 740

7 Skills

49. Freedom of movement within the EU has been beneficial to the UK automotive sector, which values highly the ability to transfer high skilled people from one plant to another at short notice with no bureaucratic barriers. The ability to move employees from one plant to another through intra-company transfers is core to the business model of many multinationals operating in the UK.[146] At present, between 7 and 10 per cent of the total workforce in the automotive sector are estimated to be from EU countries,[147] but the proportion in some companies in the supply chain may be as high as 30 per cent.[148] In general, car manufacturing requires higher level skills from EU countries than the automotive retail sector.[149] The shortage of UK engineers is well established. The Automotive Council has reported that the 5,000 current vacancies were having a “significant impact” on business operations.[150] Witnesses told us that it was important to maintain access to “top-class engineers, aerodynamicists, vehicle dynamics engineers”[151] from other European countries. For the automotive sector, jobs that feature on the Home Office shortage occupation list include product design and development engineers.[152] The SMMT report that this skills gap is projected to increase because of the ageing workforce and insufficient numbers coming through the system.[153]

50. The Government is taking steps to address the most critical skills gaps, not least via the Automotive Industry Partnership for Skills and support for more engineering apprenticeships.[154] These long-term measures are welcome and essential: the development of a stronger pipeline of domestic engineering talent will be vital to offsetting any adverse impact on supply arising from Brexit. However, in the short term, they are unlikely to make up the shortfall if there is serious leakage of skilled Europeans up to and after the date of departure from the EU. Not all companies routinely keep updated statistics on the number of EU nationals in the workforce, but we heard anecdotal evidence that firms are already struggling to retain people.[155] Any increase in difficulty in recruiting skilled workers from EU countries is unlikely to be easily compensated by heavier recruitment from non-EU foreign countries, which is much slower.[156] This is an issue which will be pertinent to many sectors, although the broader issue of immigration policy lies outside the scope of our inquiries.

51. The Government’s commitment to protecting the rights of EU citizens residing in the UK should help to mitigate the immediate impact of Brexit on skills retention in the automotive sector.[157] In this context, we welcome the increased clarity and assurance provided by the phase 1 Negotiations Report on EU citizens’ rights and the repeated statements from the Government that it wishes to retain access to skilled EU workers in this country. The automotive sector is affected, not only by the general concerns of

146 SMMT (BRA0005), Vauxhall Motors (BRA0016)
147 HM Government, Automotive sector report, para 28; SMMT (BRA0005)
148 SMMT (BRA0005), Q83 [Hawes}
149 National Franchised Dealers Association (BRA0010), EEF (BRA0013)
150 See Report by the Automotive Industry Partnership, February 2016
151 Q18 [Wilson]
152 Home Office, Immigration Rules Appendix K: shortage occupation list (accessed 8 December 2017) Table 1
153 SMMT (BRA0005)
154 HM Government, Automotive sector deal, 10 January 2018
155 Q83 [Hawes]
156 Q82 [Wilson], EEF (BRA0013)
157 Migration Advisory Committee, commissioned by the Government, Press Release, 27 July 2017

EU citizens around the impact of Brexit on their future status working here, but by the longer-term impact on our ability to attract the necessary skills from the EU. The Government is now not planning to publish a White Paper on immigration until after the Migration Advisory Committee has reported on the impact on the UK labour market of Brexit and the alignment of immigration policy with the Industrial Strategy, which is expected to be in September 2018.[158] The report should provide more detail on the nature and consequences of engineering shortages for a number of sectors. For the automotive sector at least, skills shortages are already well known and should influence negotiation objectives. ***In determining its negotiating objectives on freedom of movement and subsequent immigration policy, the Government should prioritise ensuring that our key manufacturing sectors such as automotive retain sufficient access to essential skills to ensure that gaps can be filled adequately with UK workers.***

158 Rt Hon Amber Rudd MP, Home Secretary, on the BBC Today programme, 6 February 2018

8 Research and Development

52. Recent governments have supported the UK automotive industry through strong investment in relevant research facilities and match-funding for applied research. Much of this has been geared towards enabling the UK to be at the forefront of the development of new, low-carbon technologies in place of petrol and diesel engines. For example, the Government has invested £500m over ten years from 2013 in low-carbon automotive technologies and has announced £246m funding for research and development (R&D) for electric vehicle batteries. This followed the investment of £225m to support R&D in the automotive sector from 2023 to 2026.[159] The availability of such funding has helped to make the UK an attractive option for international companies to locate the design and manufacture of vehicles, and now electric vehicles,[160] as well as providing facilities for smaller, high-end manufacturers. The industry as a whole invests £2.75bn each year in automotive R&D.[161]

53. European Union R&D support for transport is provided under the Horizon 2020 programme, which allocates around £6bn to transport-related research out of the total of £70bn for the 2014–2020 period.[162] The UK automotive sector has been a significant beneficiary of EU funding under the Horizon 2020 programme, securing €21m out of a total budget of €344m for 2014 and 2015, a respectable 6 per cent. We heard that companies welcomed access to this stream of funding, which had helped to facilitate the integration of R&D with EU countries.[163] The Government has committed to underwrite the funding for all successful bids made by UK participants for Horizon 2020 projects that are submitted before EU exit,[164] but it is not yet clear whether this will support collaborative R&D projects promoted by industry. Mike Hawes of SMMT reported anecdotal evidence from universities of an adverse effect on the willingness of European partners to engage with UK institutions because of the uncertainty around the future eligibility of UK partners.[165]

54. The longer the current uncertainty persists, the greater the chances of UK institutions missing out on participating in collaborative projects of potential benefit to UK manufacturers. This would be unfortunate, but not disastrous. The amount of EU funding available to all 28 countries is less than half of the £2.7bn total investment in R&D by UK industry. Despite this, the Government has said that the automotive sector is "suffering from suboptimal business investment in R&D".[166] It is therefore vital that, if the UK automotive sector is to thrive post-Brexit, the Government continues to offer incentives to locate R&D activities in the UK, particularly to counteract the negative impact on manufacturing of any new barriers to trade with EU countries. **We welcome the investment the Government is making in R&D activities, particularly in low-carbon technologies, and *we recommend that the Government reviews its investment strategy once our future relationship with the EU becomes clearer, with a view to enhancing existing incentives to locate automotive R&D in the UK.***

159 HM Government, Automotive sector deal, 10 January 2018

160 The Nissan Leaf Electric Vehicle is being manufactured in Sunderland; Rolls-Royce has announced it will produce an electric version of its vehicles; BMW is to manufacture electric Minis in Oxford.

161 SMMT (BRA0005)

162 SMMT (BRA0005)

163 Q84 [Hawes]

164 HM Treasury, Press notice, Chancellor Philip Hammond guarantees EU funding beyond the date UK leaves the EU, 13 August 2013; see DExEU policy paper, Collaboration on Science and Innovation – a future partnership paper, September 2017

165 Q84 [Hawes]

166 Second Special Report of Session 2016–17, Government Response to the Committee's Report on the Government's Productivity Plan, HC 931

9 Conclusion

55. The supply chains that underpin the UK automotive sector are inextricably intertwined with those of the EU. The regulatory consistency and friction-free trade guaranteed by the single market and customs union have benefitted companies, consumers and workers in the sector. Outside the EU, the UK will be competing with those inside and out the single market to be a location for volume manufacturing for Europe and beyond. The Government has not yet identified regulatory or other advantages to make up for the competitive disadvantages of restricted access to the single market. Outside the EU, the Government will rightly pursue trade deals with third countries, as the EU is doing, but there is no evidence that EU membership has made it harder to increase exports; quite the opposite, in fact.

56. We welcome and support the Government's commitment to securing a "deep and special partnership" with the EU post-Brexit, to expanding global trading opportunities and to adopting a pragmatic approach to the negotiations on a withdrawal agreement. For the automotive sector, the negotiation outcomes to be sought in pursuance of these agreed overarching objectives are clear and indisputable. **There are no advantages to be gained from Brexit for the automotive industry for the foreseeable future. The negotiations are an exercise in damage limitation. The Government should acknowledge this and be pragmatic in seeking for the sector as close as possible a relationship with the existing EU regulatory and trading framework to provide for volume car making—one of our great manufacturing success stories—a hopeful future.**

Conclusions and recommendations

Introduction

1. The Government must seek to ensure that it is able to preserve and build upon the success of the UK automotive sector as it enters negotiations on future trading arrangements with the EU. (Paragraph 5)

Impact of tariff barriers

2. It is difficult to see how it would make economic sense for multinational volume manufacturers—the bulk of the UK automotive sector—to base production in the UK in a no deal or WTO tariff scenario. The shift of manufacturing to countries within the customs union and single market would be inevitable; the cost in UK jobs could be in the hundreds of thousands, and inward investment in the hundreds of millions. For the automotive sector, no deal would undoubtedly be hugely damaging. The Government should not seriously contemplate this outcome. (Paragraph 12)

3. Whilst a "no deal" scenario would certainly be damaging to the automotive sector in many EU countries, especially Germany, the impact on the UK automotive sector would be far greater than that on each of the remaining EU Member States. *We recommend that the Government should not contemplate this outcome in its approach to negotiations and that it should prioritise securing a customs arrangement which removes the risks of tariffs being imposed on vehicles produced in the UK.* (Paragraph 14)

Non-tariff barriers

4. Longer journey times, with added risk of delay, plus extra customs bureaucracy would make the UK automotive sector less efficient and act as a disincentive to international companies looking for a base to manufacture cars for the European market. In a highly competitive market, small margins can make a significant impact on investment decisions. *If the Government wishes to uphold the UK's reputation as a good location for volume vehicle manufacturing, consistent with its Industrial Strategy, we recommend that it should in its negotiations on withdrawal place a high premium on securing frictionless trade for the automotive sector.* (Paragraph 21)

Regulatory alignment

5. There is no argument for a separate set of UK standards: the UK market is not big enough to warrant the additional costs to manufacturers of meeting another set of standards, nor does it make sense for the UK to require vehicles manufactured in the single market to require an additional approval by the VCA in the UK. (Paragraph 27)

6. In a global automotive market dominated by large multinationals, regulatory convergence is a desirable trend. It brings down costs, promotes consistent, high standards and therefore benefits consumers. No company wants to make cars to

different sets of standards. It makes commercial sense for the UK to remain aligned with standards in the single market, which provides the majority of our trade. The establishment of a new regime for the approval of UK-manufactured vehicles would increase costs and bureaucracy for UK-based companies, and make the UK less attractive as a development and manufacturing base for vehicles. It is not a viable option and *we recommend that the Government rule it out.* (Paragraph 29)

7. We support the Government's commitment to maintaining existing employment protections and high standards of environmental protection, for example by pursuing low carbon options for vehicles. We also welcome its preference for seeking similar arrangements on type approvals to those currently in place. Given this, and the continued need of UK-based manufacturers to have access to European markets, we have not identified any potential benefits from regulatory divergence from the EU, whether in terms of competitiveness or improved access to new overseas markets. There are only costs. *We recommend that the Government, in negotiations, prioritise the continuation of existing arrangements for the Vehicle Certification Agency to authorise type approvals for the European single market, whether as part of a Mutual Recognition Agreement or some alternative arrangement. As a negotiating objective, the Government should seek to ensure that it is able to retain regulatory alignment with the EU regulatory framework for the short to medium term.* (Paragraph 30)

8. *We recommend that the Government should adopt a pragmatic approach in relation to any potential continuing ECJ role in the automotive sector.* (Paragraph 32)

9. We welcome the ambition of the Government to continue to work with existing European regulatory agencies, which for the automotive sector is the best way to exert influence at a global level. *We recommend that, in the negotiations on the withdrawal agreement, the Government seeks to support the interests of the UK automotive industry by maintaining a close association with the EU expert groups that develop regulatory standards.* (Paragraph 36)

Trade opportunities post-Brexit

10. The UK cannot expect an expansion of trade overseas to outweigh the loss of trade to Europe arising from a hard Brexit. As most volume manufacturers in the UK are global and foreign-owned, any new bilateral trade deals secured by the Government are unlikely to lead directly to a significant increase in investment and jobs in the UK automotive sector *In its negotiations, we recommend that the Government prioritises continued friction-free access to the single market in automotives over securing the freedom to secure new trade deals with third countries.* (Paragraph 41)

11. We welcome the Government plans to improve the UK content of supply chains, but this is not going to deliver what is needed in the short to medium term. *The Government should therefore prepare the ground to negotiate new trade deals which allow for a lower than usual threshold for domestic content in vehicles or ideally to be able to continue to include EU content for FTAs with other countries in the future. In negotiating the roll-over of existing EU FTAs to the UK, the Government should seek to secure the necessary amendments to allow UK content to count as EU content*

for rules of origin purposes in the automotive sector. Without such provisions, the business case for locating volume manufacturing of vehicles for export in the UK would be flimsy at best and non-existent at worst. (Paragraph 44)

Certainty and transition

12. Whatever choice the Government makes regarding the future UK-EU relationship, it should make it quickly. The wait-and-see approach to the future direction of regulation may be a convenient compromise for the short term, but it would not provide the certainty needed by the sector and would undoubtedly lead to a shift in jobs and investment from the UK to the rest of the EU in the period up to exit. *We recommend that the Government clarifies its intention at the earliest opportunity to seek continued regulatory alignment with the EU in the automotive sector.* (Paragraph 48)

Skills

13. *In determining its negotiating objectives on freedom of movement and subsequent immigration policy, the Government should prioritise ensuring that our key manufacturing sectors such as automotive retain sufficient access to essential skills to ensure that gaps can be filled adequately with UK workers.* (Paragraph 51)

14. We welcome the investment the Government is making in Research and Development activities, particularly in low-carbon technologies, and *we recommend that the Government reviews its investment strategy once our future relationship with the EU becomes clearer, with a view to enhancing existing incentives to locate automotive R&D in the UK.* (Paragraph 54)

Conclusion

15. There are no advantages to be gained from Brexit for the automotive industry for the foreseeable future. The negotiations are an exercise in damage limitation. The Government should acknowledge this and be pragmatic in seeking for the sector as close as possible a relationship with the existing EU regulatory and trading framework to provide for volume car making—one of our great manufacturing success stories—a hopeful future. (Paragraph 56)

Formal minutes

Tuesday 27 February 2018

Members present:

Rachel Reeves, in the Chair

Vernon Coaker	Albert Owen
Drew Hendry	Mark Pawsey
Stephen Kerr	Antoinette Sandbach
Peter Kyle	

Draft Report (*The impact of Brexit on the automotive sector*), proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 56 read and agreed to.

Summary agreed to.

Resolved, That the Report be the Fifth Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

[Adjourned till Wednesday 28 February at 9.45 am

Witnesses

The following witnesses gave evidence. Transcripts can be viewed on the inquiry publications page of the Committee's website.

Tuesday 14 November 2017

Question number

Mike Hawes, Chief Executive, Society for Motor Manufacturers and Traders; **Patrick Keating**, Government Affairs Manager, Honda Motor Europe; **Mark Wilson**, Chief Financial Officer, Aston Martin — Q1–90

Chris Saunders, Director of Group External Relations, GKN plc; **Dermot Sterne**, Chief Executive, Applied Component Technology — Q91–132

Published written evidence

The following written evidence was received and can be viewed on the inquiry publications page of the Committee's website.

BRA numbers are generated by the evidence processing system and so may not be complete.

1 Association of British Insurers (BRA0009)

2 Construction Equipment Association (BRA0007)

3 Department of Business Energy and Industrial Strategy (BRA0012)

4 EEF (BRA0013)

5 Enterprise Rent-A-Car (BRA0002)

6 Ford Motor Company (BRA0011)

7 Honda Motor Europe (BRA0008)

8 London EV Company (BRA0001)

9 National Franchised Dealers Association (NFDA) (BRA0010)

10 Professor David Bailey (BRA0003)

11 The Society of Motor Manufacturers and Traders (BRA0005)

12 Trades Union Congress (BRA0006)

13 UK Trade Policy Observatory (BRA0015)

14 Unite the Union (BRA0004)

15 Vauxhall Motors (BRA0016)

List of Reports from the Committee during the current Parliament

All publications from the Committee are available on the publications page of the Committee's website. The reference number of the Government's response to each Report is printed in brackets after the HC printing number.

Session 2017–19

First Report	A framework for modern employment	HC 352
Second Report	Leaving the EU: implications for the civil nuclear sector	HC 378
Third Report	The safety of Electrical Goods in the UK	HC 503
Fourth Report	Pre-legislative scrutiny of the draft Domestic Gas and Electricity (Tariff Cap) Bill	HC 517
First Special Report	Industrial Strategy: First Review: Government Response to the Committee's Second Report of Session 2016–17	HC 337
Second Special Report	Corporate governance: Government Response to the Committee's Third Report of Session 2016–17	HC 338
Third Special Report	Apprenticeships: Government Response to the Second Joint Report of Session 2016–17	HC 450
Fourth Special Report	Leaving the EU: negotiation priorities for energy and climate change policy: Government Response to the Committee's Fourth Report of Session 2016–17	HC 550