Brexit preparedness

Understanding Cornwall and the Isles of Scilly's international trade

Introduction

With this analysis Cornwall Council seeks to establish a better understanding of Cornwall and the Isles of Scilly (CIoS) trade patterns in order to prepare for a new UK/EU trade relationship that will follow Brexit.

The UK's future trade relationship with the EU is under intense negotiations, and much uncertainty surrounds it. The work outlined here analyses new trade data available for the first time at a CIoS footprint[1] and draws on existing regional and national research to identify the likely impact on CIoS of a new UK/EU trading relationship. Particular attention is given to a no-deal WTO scenario, not because this is the most likely outcome, but because preparing for that scenario will hold Cornish business in good stead for any future UK-EU trade relationship (see annexe A for an overview of the WTO scenario).

By developing a baseline understanding of Cornwall and Isles of Scilly's strengths, future opportunities and potential vulnerabilities in terms of trade, we hope to support individual businesses, business organisations, CIoS LEP, Cornwall Council and Isles of Scilly Council to better prepare for Brexit.

Summary and Key findings

- **CIoS exports significantly less than most other UK regions and improving our export performance is vital**
  With exports accounting for 5.7% of the total economy this places CIoS as the third lowest NUTS 2 areas out of 40.

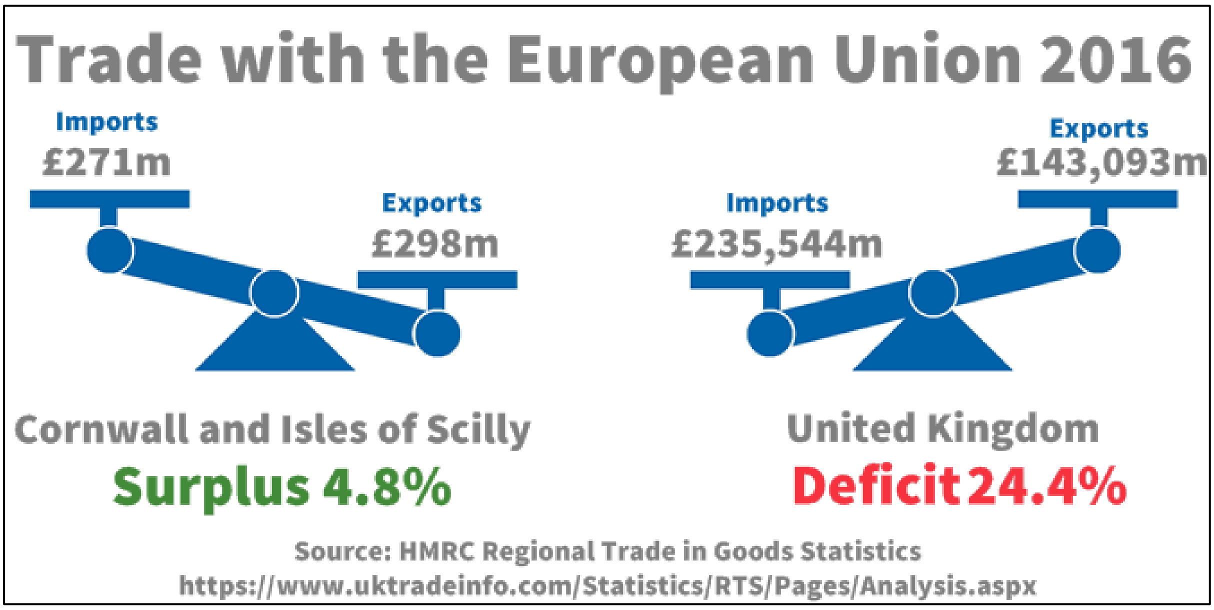
Improving export performance is important and reaffirms the key ambition within CIoS Vision2030 to increase the share of employment in

[1] Dataset and methodology is available from https://www.uktradeinfo.com/Statistics/RTS/Pages/Analysis.aspx

export intensive industries. Firms that export are more productive than firms that sell exclusively to the domestic market and this is a key part of increasing the overall productivity of CIoS.

There is significant scope for improving CIoS's export performance and therefore a strong case for continuing and potentially expanding on the local export promotion offer in order to address CIoS weak export performance.

Total CIoS exports were £539 million in 2016. Involved in exports were 743 CIoS businesses that exported to non-EU countries, which constitutes 2.7 % of CIoS's total business count, and 1,064 businesses that exported to EU countries (3.8% of total businesses)[2]. As point of comparison, in neighbouring Devon 1,625 businesses (3.0% of total businesses) exported to non-EU countries and 2,200 businesses (4.0%) exported to EU-countries. Comparing to Cumbria, which similarly to Cornwall is a large rural county, shows that 738 businesses (2.6%) exported to non-EU countries and 921 businesses (3.3%) exported to EU-countries.



CIoS exports less than it imports and has a trade deficit of £70 million or 6.1% when calculated as a percentage of total trade. This compares to a UK trade deficit of 18.7% when calculated as a percentage of total trade. However CIoS has a trade surplus (£ 27 million) towards the EU, while the UK as a whole has a trade deficit (£ 92, 451) vis-à-vis the EU.

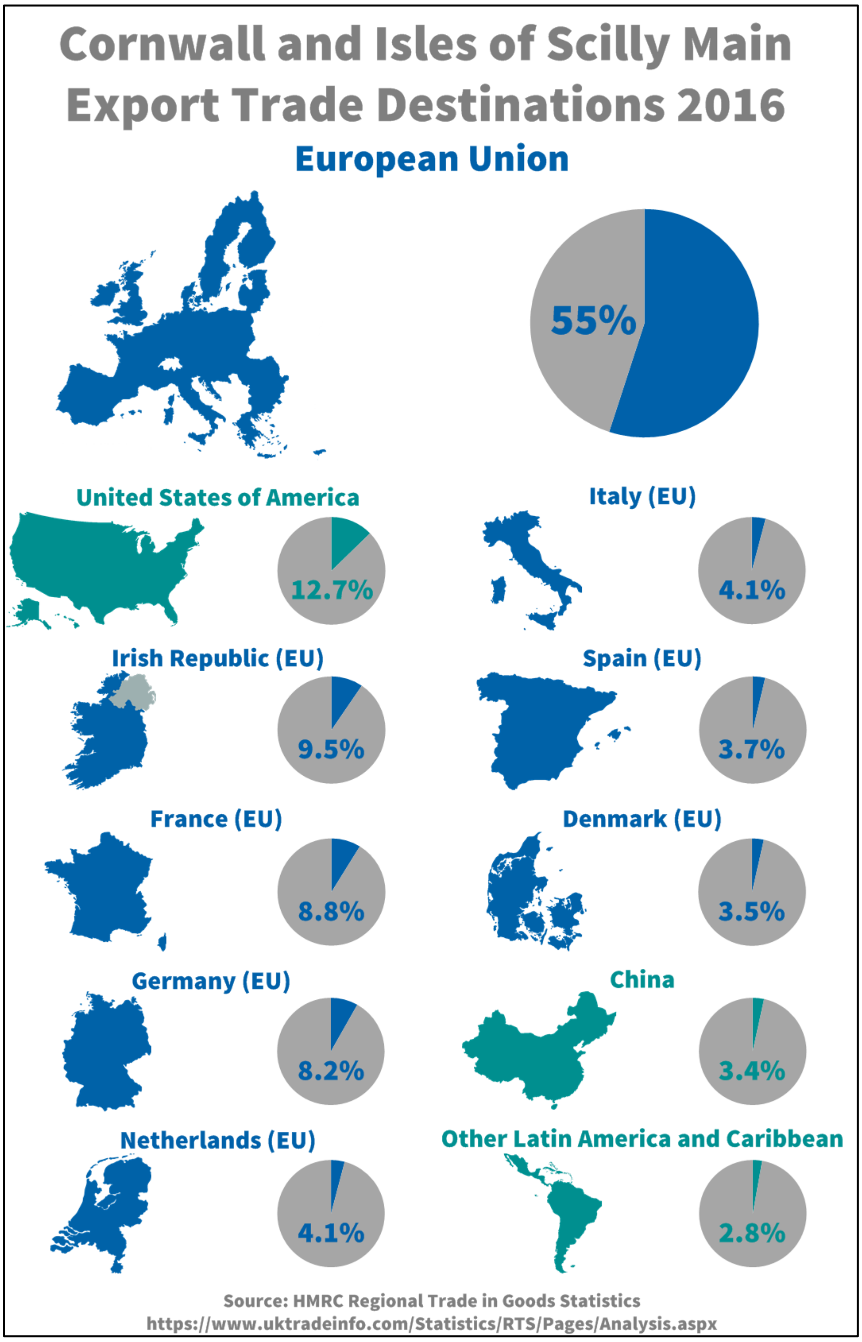
[2] The number of businesses that export to non-EU and EU countries cannot be summed as many businesses will be engaged in export to both non-EU and EU countries.

Brexit analysis

Our ambition to support more Cornish firms to export may be negatively impacted by Brexit as it is likely that it will become harder to access the EU market. This is particularly the case under a WTO scenario where both tariff and non-tariff barriers[3] would be applied to UK exports to the EU market. Leaving the EU customs union opens up the possibility for the UK to negotiate better trade access to markets across the world than the current EU trade framework affords the UK. However, given that it is not unusual for Free Trade Agreement (FTA) negotiations to take 3-5 years, it is unlikely that the UK will be able to have alternative FTAs in place in the short run.

- **The EU is a key market for Cornwall and the Isles of Scilly and we are more dependent on access to the EU than the UK overall**
  55% of total exports (£298 million) are destined for the EU market. While the US is the biggest single country destination with 12.7% (£68 million) of our exports going to this market, 7 of CIoS's 10 main export markets are in the EU. Of these Ireland is the most important with 9.5% (£51 million) of exports going to this market, followed by France, Germany, the Netherlands, Italy, Spain and Denmark.

[3] Non-tariff barriers include health and safety checks, checks to establish compliance with standards, VAT clearance and rules of origin checks.



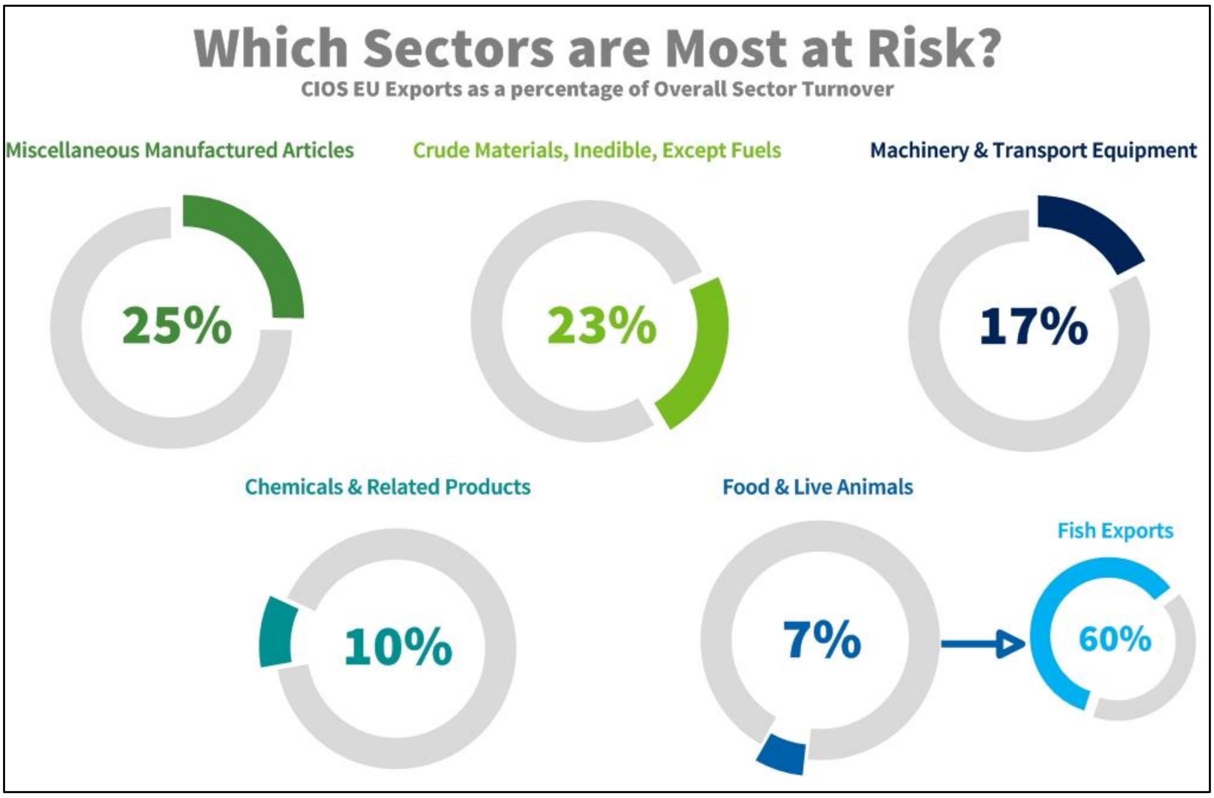
CIoS is more dependent on being able to sell our goods on the EU market than the UK overall. Of total UK exports 49.2% go to the EU market and 50.8% goes to non-EU countries. This is also the case for individual sectors. CIoS is more reliant on the EU than the UK overall for all sectors with the exception of 'machinery & transport equipment' where CIoS only exports 38% to the EU market compared to 43% of total UK exports in this sector going to the EU. The importance of this different export profile cannot be understated. Having a different export profile from the overall UK export profile means that we may have interests that are different to those pursued at a national level. This highlights the importance of ensuring that the UK pursues a trade policy that is sensitive to and informed by regional differences in trade patterns.

Brexit analysis

Cornish and Isles of Scilly businesses are currently more dependent on market access to the EU markets than is the case for overall UK trade. A move to trading with the EU based on WTO-rules would impact negatively on these businesses ability to sell their goods and services. Under this scenario EU tariffs would be imposed on CIoS exports to the EU making our products less competitive. In addition non-tariff barriers would cause costly delays in terms of bringing products to the EU market.

While all businesses will be impacted by a change to the UK/EU trading relationship, the firms likely to be most vulnerable are the ones currently only exporting to the EU or indeed businesses that don't trade internationally but are considering venturing into exporting. Businesses that already export to non-EU counties are likely to already have the skills and capacity to adapt to a new way of trading with the EU. In light of current uncertainty regarding the future UK/EU trading relationship it is recommended that all CIoS businesses make Brexit preparations –a useful checklist has been published by Cornwall Chamber of Commerce. Planning for a WTO scenario will hold CIoS businesses in good stead for all eventual UK/EU trade scenarios.

- **The Cornwall and Isles of Scilly sectors most vulnerable to changes to the UK/EU trading relationship have been identified**
  By looking at exports to the EU as a share of total turnover we have been able to identify the sectors for which exports to the EU are most important and therefore are the sectors that would be most vulnerable to change:



While the importance of exports to the EU as a percentage of turnover for the 'food & live animals' sector overall is relatively low at 6.6%, there is significant variance within this sector, for example fish exports where it is estimated that of fish landed in 2017, £27.5 million or 59.5% was exported to EU countries.

Brexit analysis

The above identified sectors are likely to be most vulnerable to any significant change to the UK/EU trading relationship caused by Brexit as their export exposure to the EU market is highest. The data indicates that businesses within these sectors rely heavily on being able to sell their products on EU markets as an element of their business model.

Furthermore, the 'food and live animals' sector is estimated to be particularly hard hit by a WTO scenario[4]. This is due to higher EU tariffs on these products compared to other sectors and the perishable nature of produce within these sectors (e.g. fresh fish or vegetables) making any delays in getting products to market due to customs or regulatory checks particularly harmful. These sectors are also currently more dependent on access to EU labour than the UK economy in general and Cornwall Council commissioned research has shown that changes to access to EU labour markets could lead to multi-million pound losses for the Cornish and Isles of Scilly economy[5].

- **The EU is an important import market for Cornwall and the Isles of Scilly with up to 80% of our imports sourced from the EU for some sectors**
  Imports from the EU are significant with 44 % of CIoS imports originating from the EU. Total imports from the EU were worth £271 million in 2016 with the following import categories being what we spend most on: 'Food & live animals' £102 million (38%), 'Machinery & transport equipment' £57 million (21%) and 'Miscellaneous manufactured articles' £38 million (14%).

  The EU is the biggest source for 'Food and live animals' with 80 % of these imports arriving from the EU, 'Beverages and tobacco' (78%) and 'Chemicals and related products' (63%).

  While the main single country that CIoS sources its imports from is China (17.6%), 6 of 10 of its biggest import markets are EU countries with Germany being our biggest EU import market (10.8%) followed by Denmark (6.6%), the Netherlands (5.6%), France (4.9%), Italy (3.8%) and Ireland (3.1%).

[4] "The impact of Brexit on the processed food and drink sectors", Business, Energy and Industrial Strategy Committee

[5] Economic and Social Impacts of EEA Area workers in Cornwall and the Isles of Scilly [Link no longer available], Cornwall Council and the Cornwall and Isles of Scilly Local Enterprise Partnership, Research Report October 2017

There were 1,074 CIoS businesses that imported from non-EU countries, which constitutes 3.9 % of total CIoS's business count, and 1,785 businesses (6.4%) that imported from EU countries in 2016[6]. As point of comparison in neighbouring Devon 2,245 businesses (4.1%) imported from non-EU countries and 3,485 businesses (6.3%) imported from EU-countries. Comparing to Cumbria, which similarly to Cornwall is a large rural county, shows that 945 businesses (3.4%) imported from non-EU countries and 1,578 businesses (5.6%) imported from EU-countries.

Brexit analysis

Any change to the UK/EU trade relationship that makes imports from EU countries more costly for Cornish businesses and consumers would have a negative impact on the CIoS economy. While import data is harder to interpret in terms of pinpointing which sectors are using imports as part of the supply-chain, and while we don't know the details of the future UK/EU trade relationship, we do know that the sectors that generally meet the highest tariffs under WTO-rules are sectors that are important to Cornwall. This includes the agri-food sector which accounts for 5.3% of CIoS GVA.

Conversely a scenario where the UK unilaterally decides to impose zero tariffs on imports would be beneficial for UK consumers and importers (who wouldn't be faced with higher prices due to import tariffs), but likely to detrimental to CIoS producers who would be competing for the UK market directly with e.g. agricultural imports from low wage countries such as Kenya.

[6] The number of businesses that import from non-EU and EU countries cannot be summed as many businesses will be engaged in imports from both non-EU and EU countries.

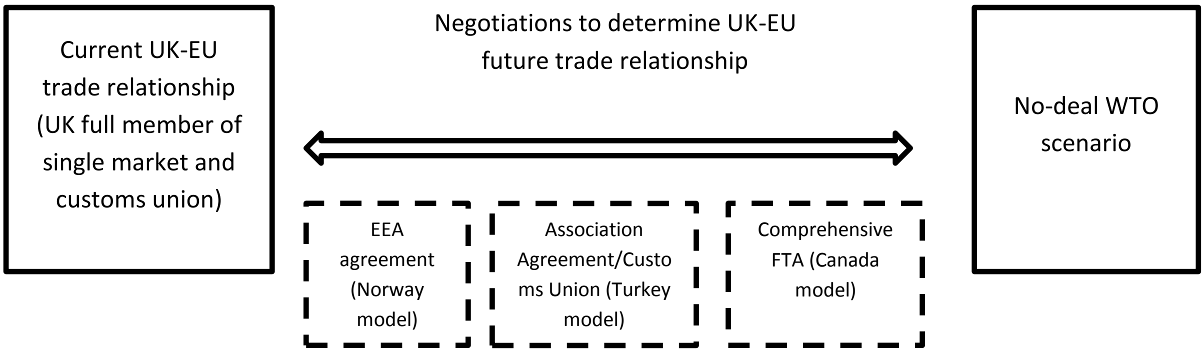
Annexe A:

A “no-deal” WTO scenario

The UK’s future trade relationship with the EU is under intense negotiations. While it is difficult to predict what the exact outcome of these negotiations will be, we know that the future trade relationship will land somewhere in between the current situation where the UK as a full EU member is part of the EU single market and the customs union and the no-deal scenario where trade relations between the UK and the EU will be governed by World Trade Organisation (WTO) rules.

This note outlines what a no-deal WTO scenario would entail, not because this is the most likely outcome, but as a way of setting the outer perimeters within which the future UK-EU trade relationship will land (see figure 1).

Figure 1: illustration of options for future UK-EU trade relationship



<u>WTO scenario and implications for the UK economy</u>

If no deal is reached on the future UK-EU trade relationship WTO rules will apply by default from the end of March 2019 when the UK exits the EU. At the core of WTO rules is the ‘most favoured nation’ (MFN) principle, which obliges a country/trading block to grant the same access to all WTO member countries as they grant to their most favoured nation. The only exception to the MFN principle is to enter into a Free Trade Agreement (FTA) with another country or trading block[7].

This would mean that the EU will need to treat imports from the UK in the same way it treats imports from other third countries such as the US, and subject UK goods and services to the same customs checks, tariffs and regulatory barriers that the EU currently charge on trade with other countries with which is does not have a FTA with. The UK would similarly be able to impose tariffs on imports to

[7] There are exceptions for the worlds least developed and developing countries, but these are not relevant to the UK.

the UK. The UK would need to treat imports from the EU in the same way it treats imports from other third counties.

The average EU tariff rate is low - around 1.5% -however, tariffs on individual goods and sectors vary significantly and the impacts for some sectors would be much larger[8]. For example the processed food and beverage sector would face significant tariffs:

Box 1: The EU's Most Favoured Nation tariffs on processed food and drink imports to the EU[9]:
- animal products is 16 per cent on average, with peaks for individual products at 104 percent; - dairy products is 35 per cent on average, with peaks at 96 per cent; - sugars and confectionery is 24 per cent on average with peaks at 127 per cent; - beverages and tobacco is 20 per cent on average with peaks at 152 per cent.

In addition to tariffs UK exports to the EU would also face non-tariff barriers such as regulatory and custom checks. Tariff and non-tariff barriers will increase costs for UK businesses that export as well as for businesses that import components as part of their production process. UK business may also incur additional costs if access to EU-labour is restricted and it becomes harder for them to recruit to fill vacancies and attract skills. UK consumers will experience price increases as UK business past on these higher costs to consumers and as imported goods from the EU will become more expensive if the UK choses to introduce import tariffs.

Outside of the EU customs union the UK will have greater flexibility to enter into FTAs with third counties. This opens up the possibility for the UK to negotiate better trade access to markets across the world than the current EU trade framework affords the UK. However, given that it is not unusual for FTA negotiations to take 3-5 years[10], it is unlikely that the UK will be able to have alternative FTAs in place by the end of the transition period. On the 1st January 2021 when the transition period comes to a close the UK will cease to be party to the FTAs that the EU currently has with a number of countries (Canada, South Korea, Japan, etc.[11]) and while it will be relatively uncomplicated for the UK to

[8] Brexit factsheet: "No Deal: the WTO option", The UK in a changing Europe
[9] "The impact of Brexit on the processed food and drink sectors", Business, Energy and Industrial Strategy Committee
[10] As an example the negotiations re. the EU's latest successful FTA with Canada started in in 2009 and were only concluded in February 2016.
[11] See full list of EU trade agreements with third counties here: http://ec.europa.eu/trade/policy/countries-and-regions/negotiations-and-agreements/

'grandfather' these FTAs this would simply replicate existing EU market access to these counties.

Various research institutions and government departments have analysed the economic impact of a non-deal scenario for the UK economy. While their estimates of impact vary, there is near consensus that moving from trading with the EU as a Member State to trading with the EU on WTO terms would have a significant negative impact on the UK economy[12].

The Centre for Economic Performance estimates that a "No Deal WTO rules only" scenario would reduce the UK's trade with the EU by 40% over ten years[13]. This reduced trade would mean a fall in income per head of 2.6% per year (net of the savings from no membership fees). There would also be longer-term negative effects from lower investment and slower productivity growth, which are estimated to be another 3.5% of GDP. Adopting a policy of unilateral free trade would mitigate part of these costs. But the savings from unilateral tariff cuts are estimated to be just 0.35% of GDP. The short-term disruption resulting from the sudden imposition of these WTO rules could exacerbate these negative effects[14].

The UK Treasury analysis of the long-run consequences of leaving the EU for the UK economy suggests that after 15 years, the UK is estimated to be between 5.4% and 9.5% of GDP better off inside the EU than adopting WTO rules. In 2015 terms, leaving the EU and relying on the WTO rules would mean a long-term loss of GDP of £5,200 a year for each household in the UK[15].

There is a general consensus that the economic impact of a no-deal scenario for the UK economy i.e. moving from trading with the EU as a Member State to trading with the EU on WTO terms would be significant and negative. Analysis of which sectors would be impacted the most at a UK-wide level tends to point towards ***vehicles, food and agricultural industries*** as the main losers due to high tariff and high export volumes[16]. Other research shows that while high-skilled industries and areas will be impacted the most in the short term, these areas will also have better adaptation potential, and ***lower-skilled sectors and areas in the long term will struggle the most in terms of adapting*** to the new trade framework between the UK and the EU[17].

12 "The future UK-EU relationship", House of Commons Exiting the European Union Committee,

13 The Costs and Benefits of Leaving the EU: Trade Effects, CEP Discussion Paper No 1478, April 2017

14 Brexit factsheet: "No Deal: the WTO option", The UK in a changing Europe

15 UK Treasury analysis of the long-run consequences of leaving the European Union (EU) for the UK economy 2016

16 CIVITAS, Potential post-Brexit tariff costs for EU-UK trade, October 2016

17 **Brexit, trade and the economic impacts on UK cities,** Naomi Clayton and Professor Henry G. Overman July 2017