

Head to head:

Brexit – Economic Disaster Or Opportunity?

"Discuss the likely positive and negative effects of Brexit on the motor industry in the short, medium and long term"

The argument about Brexit has certainly raised the political temperature in Britain, so I hope you'll forgive me if I begin my talk with a couple of facts about my background which might shield me, as an unapologetic Leaver, from some flak.

I worked for Reuters as a reporter in Brussels from 1971 to 1973 which of course you will know coincided with Britain's negotiations to join what was then the Common Market. I spent 8 of the next 10 years working for Reuters in New York in particular and North America in general. And in the nineties and early noughties I travelled all over Europe as Reuters Science and Technology Correspondent and then European Auto Correspondent. I'm hoping that might insure me against Bigoted Narrow Minded Little Englander taunts as I lambast the European Union, but it's only a hope.

Secondly, I can see there are a few people in the audience who attended Professor Bailey's seminar over at the Aston Business School before the Brexit referendum, where I argued that all would be well for the auto industry if we left the European Union. I still hold to that view, but the fact that late in 2019 we are still unsure of the future is a shameful scandal, no doubt about that. The auto industry has every right to be incandescent as its future is held in limbo.

So I understand and sympathise with the industry's pain and outrage that the issue still isn't settled. But some of the cries of pain have been counter-productive not to say hysterical from those who should really know better. Jaguar Land Rover has toned down its comments of late and is trying to look at the future constructively, but the SMMT shows no signs of calming down using words like "catastrophic". And don't get me going on the CBI. Many supporters of Remain have taken up the mantra that leaving without a deal would not only be disastrous, but was a policy actively being sought by the British government and had to be shot down. The fact that this would eliminate a perfectly legitimate tactic in any negotiation didn't seem to register. Has anyone in this audience ever started a negotiation this way? Isn't it tantamount to throwing in the towel before you start? The SMMT doesn't seem to think so, and I quote Chief Executive Mike Hawes.

"As the Brexit clock ticks ever closer to midnight, this survey reveals the bleak future that awaits this vital sector in the event of 'no-deal'. Hawes rightly said investment was haemorrhaging, competitiveness

being undermined, and U.K. jobs cut but then said vast sums were being wasted on preparing for 'no-deal'.

PSA Group CEO Carlos Tavares wasn't worried about raising the temperature either with these choice remarks, after telling the BBC, failure to agree a deal between the EU and Britain would be like a train-wreck.

A week later Tavares said this to Standard and Poors in an interview, and I quote.

"(U.K. Prime Minister Boris) Johnson and (EU chief negotiator Michel) Barnier, they have to find a solution and that's all. There is no other way. Anything else will be a disaster for everybody as much for the U.K., as much for my employees, as much for continental Europe. With a no-deal (Brexit) you are going to destroy the lives of the next generation of people in the U.K. and that's not fair, so a deal is a must," Tavares said.

If the Conservatives win the election next month with a workable majority, and Britain officially leaves the EU on January 31, there is still a free trade agreement (FTA) to be negotiated with a deadline at the end of 2020. If there is no agreement, the dreaded no-deal scenario will kick in with World Trade Organisation tariffs of 10% on our vehicle exports.

Michael Burrage, from Economists for Free Trade and a senior research fellow at Civitas, thinks this will present no real problem to the auto industry, and has some interesting data from the Office of National Statistics to back this up.

Burrage says despite being in the EU's Customs Union and Single Market, U.K. goods exports to the EU grew just 0.3% in real terms over the past 20 years. But exports to non-EU countries have grown over 10 times faster by 3.2% per year. Meanwhile EU imports have surged with the U.K.'s trade deficit jumping from £7.9 billion in 1999 to £93.5 billion in 2018. Burrage points out that U.S. exports to the EU, trading from the outside, grew at 1.9% between 1993 and 2015.

In the automotive industry, the compound annual rate of Britain's export growth to the EU since 1999 was just 0.7% while imports rose 3.2% for a 2018 deficit of £28.5 billion. Exports outside of the EU mainly on WTO terms and mostly luxury vehicles rose from £7.9 billion 20 years ago more than 10 times faster than exports to the EU, producing a surplus of £15.9 billion. Burrage describes this as the great British success story of the past two decades.

Burrage quotes the SMMT saying 57% of British car exports go to the EU, but because this refers to unit sales and not value it hides a steep decline in the EU as a market for our auto makers. In 1999 the EU took

75% of the value of U.K. car and parts exports, but during the 20 years when intra-EU trade was said to be intensifying, it fell to 42% in 2018.

Burrage also criticised the Treasury and the Bank of England for overlooking the risk of an unsustainable trade deficit with the EU if the U.K. continued its current trading relationship for a transition period and indeterminate period beyond that. And he rails against them for sticking with outdated and wrong assumptions about how UK trade with the EU would develop from outside.

"Leaving with no trade deal would provide an opportunity – and the strongest possible incentive – for the government to devise and implement trade and fiscal policies that build on the UK's remarkable success when trading under WTO rules. It would also encourage policy-makers to understand and address the U.K.'s chronic failure in EU goods markets before resuming EU trade talks," Burrage said.

Professor Patrick Minford, Professor of Applied Economics at Cardiff Business School, doesn't doubt there will be big challenges for the auto industry outside of the EU, but expects it to survive and thrive.

Minford expects there will no problems negotiating a free trade deal with the EU because it really amounts to simply consolidating what already exists. The idea this will take from 5 to 12 years, as some Remainers have insisted, is ridiculous according to Minford, and it will include Japan.

The industry will have to raise productivity because it will no longer be able to hide behind the 10% tariff barrier provided by the EU, but Minford is pretty sure it can do that. The industry won't welcome having to improve efficiency but the likes of Jaguar Land Rover already manage to do this very successfully, but now they will be able to source components not just from the EU but also the rest of the world.

Minford put it this way, and I quote -

"Prices will come down in the home market as we sign free trade agreements; that's the key point. How firms react to that is up to the market place and their decisions. I can't predict what they will do. Whoever stays will have to be more productive," Minford said.

The future will be clouded by the fact the EU negotiated a free trade deal with Japan, which he calls the joker in the pact, but doesn't expect Toyota or Nissan to up sticks and go.

This free trade deal with Japan raises the question about whether Toyota and Nissan would want to remain in the U.K. even if it were firmly in the EU for the long-term, but it's unlikely in the short term that these companies would want to shut down very efficient factories because big global manufacturers need to insure themselves against

things like exchange rate fluctuations and perhaps tariff wars too. Having an alternative makes good business sense.

The free trade deal with Japan would bring us full circle from Britain's so-called transplant factories, which former Peugeot chairman Jacques Calvet described at the end of last century as a Japanese aircraft carrier moored off the northwest coast of Europe.

Given my experience with Reuters, I feel obligated to present at least one opinion contrary to mine, and Professor Peter Wells, Professor of Business and Sustainability at Cardiff Business School (must make for some interesting chats in the staff room) doesn't view the future outside of the EU with much enthusiasm.

"The future of the U.K. automotive industry is particularly bleak because the decision to leave the EU, with all the economic uncertainty and probable added cost entailed, comes at a time of massive and rapid technological and business convulsions sweeping through the industry," according to Wells.

Wells said even before the exit decision it was becoming clear that the U.K. was becoming too expensive to compete in the lower margin segments despite good quality and productivity. Britain's auto industry may return to pre-EU conditions where, as imports become more expensive and as exports become more difficult, U.K. output may focus on the home market. This might work if cars become more of a commodity and less of a status symbol.

The long-term future for the industry is more likely to be a smaller domestic industry producing high-margin vehicles, when we will see the end of what he called the Thatcherite vision of the "great car economy". As constraints on car use accumulate, individual car ownership will be eroded.

Wells' negative long-term predictions seem also to include the mass market auto industry globally, not just the U.K., so we will all be sinking together.

And of course the ability of the auto industry to succeed depends on the EU's ability to provide a positive economic environment, while the political conditions are important too.

In a recent column in the Daily Telegraph, Liam Halligan said the EU has been in perpetual crisis for the last 8 years, locked in a slump, beset with chronic social and political tensions, not least because of successive waves of illegal immigration and in some nations, sky-high unemployment. Leaving the EU and setting in motion the mountain of pent-up investment could trigger a boom here. Europe's banking sector

is being undermined by bad debt and a fresh Eurozone crisis is looming, which could be worse than in 2011, according to Halligan. And I quote.

"We hear so much about the dangers of leaving the EU – and almost nothing about the dangers of staying in," Halligan said.

The politics are important too and unavoidable.

Historian and Daily Telegraph columnist Robert Tombs says the next election will show whether Britain is a true or sham democracy. Across the democratic world, power has shifted from elected national governments to non-elected bodies. Tombs describes the process like this.

"This has gone further in EU member states. A void has been created between rulers and ruled. Two networks of power, influence and patronage have grown up; one based on domestic politics, the other based on EU institutions," Tombs said.

Britain is trying to prise them apart and take back control, Tombs says. France and Holland already tried and failed in 2005 when they voted against the EU draft constitution. The Greeks also tried and failed. The Italians are still trying.

There might seem to be no grounds for agreement between Remainers and Leavers, but I have an idea that might go some way towards achieving this. The first part of my plan might be hard for you to tolerate because it could seem too radical. But here goes. The trouble with the EU is that its founding fathers, unlike their American counterparts all those years ago, never had the confidence they could convince their fellow Europeans to give up sovereignty, so they deliberately tried to disguise their long-term plans. Institutions grew by subterfuge. The British were lured in with promises that it was only a Common Market. Commerce was the only point. But after we joined it slowly but surely morphed into the EU, which now unashamedly calls for ever closer union, their own army etc. But the institutions have never been up to the task of providing democratic accountability and transparency. It has shown itself incapable of reform.

So here's my plan.

The failure of the EU has to be admitted and its institutions laid to rest. It really is broken beyond repair. A proper constitution has to be designed along the lines of the U.S., but not necessarily a mirror image. This will entail much deep and serious study. If something similar to the U.S. constitution emerges, with state's rights, and an electoral college which beefs up the power of smaller states, I would go for that. But I'd bite off the hand of the politician who suggested we returned to an EU

which had eschewed grandiose federal ambitions and simply wanted free trade.

So to sum up, I think the auto industry's understandable reluctance to change a successful formula has hidden the possibility of great achievements in the future outside of the EU. Civitas's Burrage points out with his data from the Office of National Statistics that in fact the experience of Britain's auto industry in the EU has been far from the success story painted by the conventional wisdom. It has been overtaken by competitors in Europe operating outside of the system and despite the tariff barriers. Professor Minford says a Free Trade Agreement will be negotiated quickly, and agrees that initially, the industry will have to up its efficiency, but is confident it can quickly do well. His colleague Professor Wells sounds a warning note, but said negative influences had already started to build before the Leave referendum.

Think about this. If Britain was now outside of the European Union, would it want to join? The EU is a sclerotic, centralised, opaque organisation gradually accounting for less and less of the world's trade, generating an avalanche of anti-business regulation, massive youth unemployment, and a burgeoning Gilets Jaunes movement. It has proven immune to reform. If the EU could restore what Britain thought was its original intention – free trade – period, then by all means. If not, we're better off with a friendly, mutually beneficial deal, but out.