

Position Paper

Brexit

Major Economic Impacts

Brexit means Brexit

No Deal vs. Bad Deal
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Brexodus

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Remain/Leave

POSITIONS

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Brexit - Major Economic Impacts

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Single Market Access vs. EU Membership

The UK declared to leave the EU and set the legally fixed exit process in motion. The aim of this paper is to point out the major negative economic consequences for UK production sites, supply chains and trade without EU membership and with no access to the single market.

The below pointed out negative consequences come in force even so when there will be a single market access or a 2-years-period of transition or the smoothest way of a „soft Brexit“. The consequences start in the moment the UK leaves the EU.

UK Exports

Goods from the UK lose duty-free access to 66 countries

UK goods are no longer considered as EU goods and therefore will no longer be imported to the EU without customs duties. Also to 39 other countries UK goods are no longer considered as duty free goods and therefore will no longer be imported also to these countries without customs duties. Duty-free import to 66 countries ends with Brexit. After Brexit UK goods will become more expensive if exported to these 66 countries.

27 EU Member States	Honduras	Panama
Albania	Iceland	Peru
Algeria	Israel	San Marino
Andorra	Japan	Serbia
Bosnia Herzegovina	Jordan	Singapore
Canada	Kosovo	South Africa
Chile	Lebanon	South Korea
Columbia	Liechtenstein	Switzerland
Costa Rica	Macedonia	Syria
Ecuador	Mexico	Tunisia
Egypt	Montenegro	Turkey
El Salvador	Morocco	Ukraine
Faroe Islands	Nicaragua	West Jordan
Guatemala	Norway	and Gaza Strip

Production Sites

Goods from British production sites lose duty-free access to 39 free trade zones the EU has established with other countries

UK goods are no longer considered EU goods and therefore will no longer qualify for preferential treatment when entering these partner countries. This means, they enter on WTO terms with full payment of customs duties. Goods from EU production sites, however, still get preferential treatment and enter duty-free. Therefore, many companies now located in the UK will - or more precisely: will be forced to relocate production lines to the EU in order to retain EU origin, necessary for preferential treatment, i. e. duty-free import to 66 countries (39 with EU/UK-FTA). The loss of thousands of jobs in the UK will be the consequence.

Supply Chains

UK goods will be sorted out from EU supply chains and are replaced by goods from other EU countries

The rules of origin of free trade agreements require imported products to contain a certain amount of EU origin to be eligible for preferential treatment. As goods from UK are no longer regarded as EU goods they reduce this preferential origin if entered into EU production processes. As a precautionary measure EU producers will sort out UK products from their supply chains. This is necessary in order not to lose duty-free access to 66 countries. According to our calculations, up to one third of UK supplies to the EU could be threatened thereby.

Trade

Global trade (globalised industries and trading companies) will avoid the UK when the end destination of the product is in the EU (end consumers and industry)

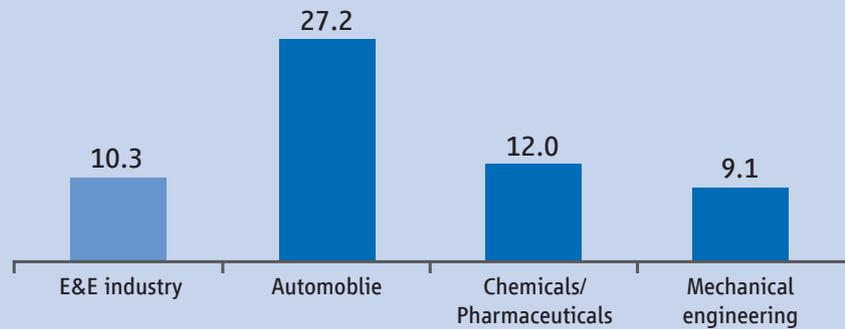
The UK has established itself as a major gateway to the single market. The loss of this easy access to the single market will lead to a re-routing of trade out of the UK and a movement of warehousing sites directly to the EU. Otherwise, products that are destined for the EU would have to undergo customs clearance twice, first at the UK border and then again at the EU border. Even in case of a future free trade agreement between the UK and the EU, customs procedures are necessary as third country deliveries must always be singled out for duty payments. Therefore, many warehousing and retailing companies will have to leave the UK and relocate to the market they serve: the EU. Again, the loss of thousands of jobs in the UK will be the consequence.

Imports, Exports, FDI Costs

The United Kingdom is the fifth biggest economy in the world and the second biggest in Europe. For Germany's export industry the country ranks third among its customer nations. About one fifth of the total German export surplus is generated by the trade with UK alone.

For the German electrical and electronic industry (in short: E&E industry) UK is of very great economic importance, too. In 2016 the sector's exports to the country amounted to euro 10.3 billion. With it, UK is the fourth largest foreign customer of the overall German E&E industry and the second largest from Europe. For some sub-sectors the country ranks even higher. For instance, both the energy technology line of business and the electric railway vehicles sector send most of their exports to UK, respectively. For the ICT sub-sector the country ranks second in the list of the biggest export destinations, for domestic appliances third and for the sector of vehicle electrics fourth.

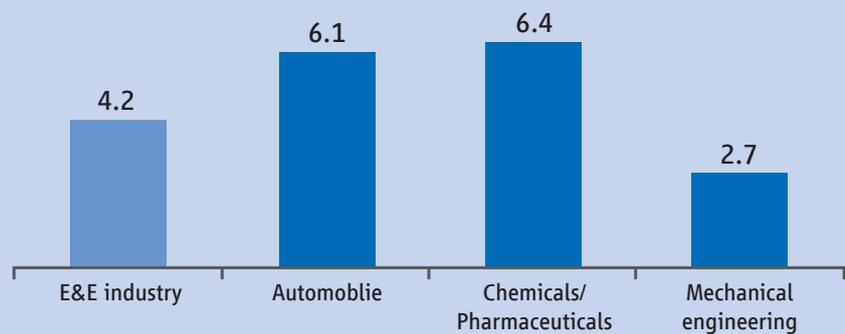
Exports to UK, 2016, bn €



Source: Deutsche Bundesbank

Total German imports of electrical and electronic products from UK came to euro 4.2 billion in 2016. Here the most important items are electronic components and systems, automation technology, ICT and electro-medical equipment. Among the biggest suppliers for the German market of electrical and electronic goods UK ranks 15th globally and eleventh in Europe.

Imports from UK, 2016, bn €

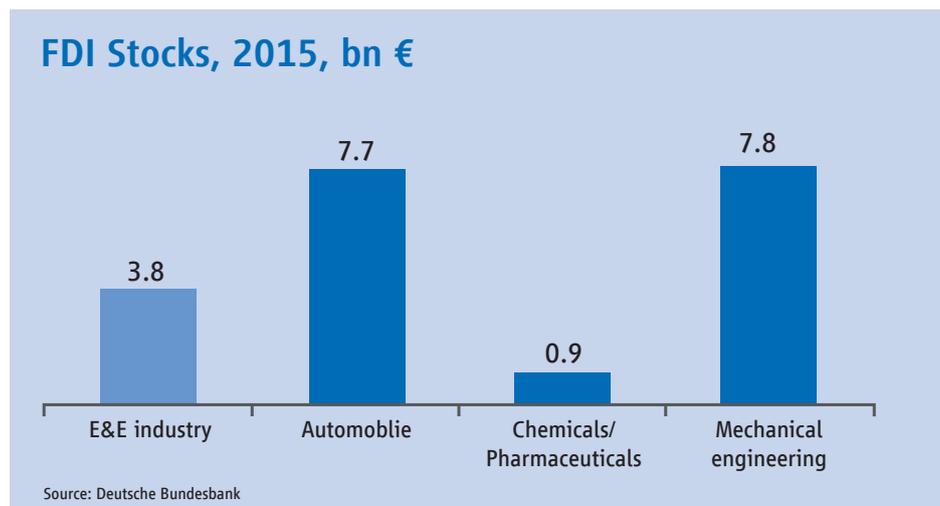


Source: Deutsche Bundesbank

Aggregating exports and imports to an overall trading volume of euro 14.5 billion in 2016 (compared with euro 33.3 billion in the automobile sector, euro 18.4 billion in the chemicals and pharmaceuticals sector and euro 11.8 in the mechanical engineering sector), in the charts of Germany's major trading partners in electrical and electronic products and systems UK holds the seventh place worldwide and the fifth in Europe. Germany's export surplus towards UK in the field of electrical and electronic wares reached at euro 6.1 billion in 2016. It is only topped by the sector's surplus vis-à-vis France.

By the way, the entire trade volume in electrical and electronic products between UK and the European Union (EU) amounted to euro 63.2 billion in 2016. Here EU exports to UK of euro 42.1 billion and EU imports from UK of euro 21.1 billion face each other. Hence, the EU is by far the most important trading partner of the country, and a big chunk of the trade takes place in intermediate goods.

Besides exporting, the German E&E industry is also serving the British market by producing locally. Its stock of foreign direct investment (FDI) came to euro 3.8 billion at last. The country is therefore the sector's third biggest production site abroad – behind China and the USA.



Gradually spoiling prospects quite likely

Meanwhile the German E&E Industry's prospects of its businesses with Great Britain might spoil gradually due to the looming Brexit. Indeed, from January through November 2017 the sector's exports to Great Britain have still grown by 6.6 percent (year over year) to EUR 9.6 billion. However, total exports of the German E&E Industry increased markedly more dynamically in the same period of time – namely by 10.1 percent to EUR 183.3 billion. Moreover, in each individual month of the third quarter the sector's deliveries to Great Britain were on the decline.

Four Scenarios and their Impacts on Trade

The United Kingdom will end its membership to the European Union on 29 March, 2019. Regardless of what the transitional period will look like, in the long run politicians must choose a scenario for the future UK-EU relationship.

Continued EU membership and indefinite single-market access are ruled out by UK and the customs union is highly questionable. Therefore, it is necessary to assess the potential economic consequences.

What does "end of EU membership" mean?

- Preferential (duty-free) treatment within all 39 EU free trade zones ends for UK goods.
- UK goods do no longer count as EU goods in free trade calculations and therefore may be sorted out from European supply chains.

What does "loss of single market access" mean?

- Customs officers are back at the border as simplified customs procedures become necessary (50-60 million declarations per year). This will cause delays at the border and harm the supply chain reliability.
- In the event of a UK-EU customs union, the 39 EU free trade partners retain preferential access to the customs union and the UK market. This, however, will not be reciprocal as the UK is no longer member of the EU and therefore not a party to these free trade agreements.

What does "no customs union" mean?

- Full customs procedures are necessary for bilateral UK-EU trade as third country deliveries must be singled out for duty payments.

- Proof of origin of goods becomes necessary for trade between the UK and EU creating a new type of bureaucracy such as documentation of input to production lines according to a list of rules of origin.
- Duty payments are levied on third-country goods and goods that fail to achieve preferential origin. This is especially unwelcome news for shipments that enter from third countries and are to be delivered to the EU via the UK or the other way round. Without additional bureaucratic measures in the transit country, customs duties must be paid twice.

Just to mention the worst case: What does “no free trade agreement” mean?

- Customs duties are to be paid on all goods at every movement across the border. Even with additional bureaucratic measures, these payments can only be reduced but not avoided. Supply chains that require products to cross the border several times are no longer economically viable.

Brexit - Major Impacts

On March 29, 2017, the United Kingdom has officially declared that it will end its membership to the European Union. This has triggered a period of two years to negotiate an exit agreement, possibly a transitional agreement, and eventually an agreement on the future relationship. As far as trade and customs is regarded, these have the following implications.

Four possible scenarios and their impact on production sites and supply chains

- 1 End of EU membership
- 2 No single market access
- 3 No customs union
- 4 No free trade agreement

In order to understand the difficulties that arise from the end of EU-membership and the disassembly of the single market and the customs union, it is helpful to explain this process step by step. It has to be kept in mind that the scenarios 1 and 2 (and eventually scenario 3) may all occur at the same time on the date the United Kingdom leaves the European Union (29/3/2019). If no transitional agreement can be achieved in time, the so-called cliff edge will set in and all four scenarios happen at once.

Brexit - Scenario 1: End of EU membership - but single market access continues

It has to be kept in mind that the consequences of the following scenarios add up. Major consequences of this scenario:

- 1.1 Preferential (duty-free) treatment within all 39 EU free trade zones continues for EU goods, but ends for UK goods.

Impact: UK production sites fall back in competitiveness, as they are no longer member of these 39 free zones, e.g. UK exports to South Korea face an average of 8% customs duty whereas EU goods enter duty-free under the free trade agreement.

- 1.2 UK goods no longer count as EU goods in free trade calculations

Impact: UK suppliers may be sorted out from European supply chains to avoid the loss of preferential origin. This will happen if the next step of manufacturing lies within the EU-27 and requires the application of origin rules, e.g. for export into another free trade zone.

- 1.3 EU regulations such as the union customs code (UCC) or the dual use regulation, are no longer legally valid and binding in the UK. A bill is necessary to transfer these EU regulations in part or completely into national law to establish a level playing field.
- 1.4 In this first scenario, the single market for goods continues to exist and is supervised by the Court of Justice of the EU. This is necessary to keep a close eye on the elimination of non-tariff trade barriers. Important rulings in this respect are the "Cassis de Dijon" and "German purity law on beer". These rulings established that a good that is rightfully placed on the market of one member state can be sold in every member state. Additionally, the alignment of VAT and excise duties is necessary to avoid tax tourism.
- 1.5 As long as the single market stays in place there is no need for customs officers at the border.

Brexit - Scenario 2: No single market access - but a customs union is agreed

The consequences of scenario 2 arise in addition to the problems that result from the loss of EU-membership. Major additional consequences of this scenario:

- 2.1 Preferential (duty-free) treatment within all 39 EU free trade zones continues for EU goods, but ends for UK goods and UK goods no longer count as EU goods.
- 2.2 Customs procedures are necessary for bilateral UK-EU trade.

Impact: This leads to a sharp rise in bureaucracy as an additional 50-60 million customs declarations per year are necessary (roughly a quarter million per working day). These declarations are simplified because no duty payments are involved. Nevertheless, delays at the border are to be expected, potentially harming the supply chain reliability. According to the port authority of Dover 2.6 million commercial ("road haulage") vehicles enter or leave the UK mainly from and to France, Belgium and the Netherlands per year. On the other side, Holyhead, the main port for deliveries between Wales (UK) and Ireland (EU-27) may not be as famous but still handles the astonishing number of 400,000 trucks per year.

- 2.3 A UK-EU customs union, if kept in place, will face serious difficulties because goods from 39 free trade areas (where the EU-27 is still member but UK is no more) can enter the customs union duty-free and then be transported to the UK without further duty payments. After losing its EU-membership, however, UK exporters are no longer entitled to send their products duty-free to those 39 countries. This leaves the United Kingdom in a detrimental trade position as free trade is applied in one direction only (imports to UK).

Brexit - Scenario 3: No customs union - but a free trade agreement is agreed

Further customs requirements, in addition to those mentioned above, must be met if efforts to agree on a customs union also fail. Major consequences:

- 3.1 Preferential (duty-free) treatment within all 39 EU free trade zones continues for EU goods, but ends for UK goods and UK goods no longer count as EU goods
- 3.2 Full customs procedures are necessary for bilateral UK-EU trade

Impact: As third-country deliveries must be singled out for duty payments, more customs bureaucracy and further delays at the border will be the direct consequence. Now, goods must be controlled by customs officers in order to avoid smuggling (on average 2-5% of all deliveries). A de-facto control of goods by customs officers leads to a sharply reduced reliability of delivery times. This is especially burdensome for just-in-time shipments.

3.3 Proof of origin becomes necessary for trade between UK and EU

Impact: A completely new type of bureaucracy is started when rules of origin are to be respected. This involves pre-shipment calculations of origin and the burdensome requirement of documentation of input to production lines. This documentation is to be made according to a list of so-called rules of origin and is necessary for controls by UK and EU customs officers until up to three years after the date of delivery.

3.4 Duty payments on third-country goods and goods that fail to achieve preferential origin

Impact: In this scenario customs-duty payments on a big part of EU-UK trade re-arise. This is especially unwelcome news for shipments that enter from third countries and are to be delivered to the EU via UK or the other way round. These goods must be declared, controlled and customs duties paid for twice. Only via additional bureaucratic measures in the transit country these double-payments can be avoided.

3.5 As the customs union currently comprises the EU and Turkey, upon leaving this customs union the UK must negotiate two separate free trade agreements, one with the EU and another with Turkey.

Brexit - Scenario 4: No free trade agreement - but WTO status ("cliff edge")

Major additional consequences:

4.1 Preferential (duty-free) treatment within all 39 EU free trade zones continues for EU goods, but ends for UK goods and UK goods no longer count as EU goods and full customs procedures are necessary for bilateral UK-EU trade. Additionally preferential (duty-free) access ends for UK goods in the EU customs union increasing the number of countries where UK goods face customs duties to 66 countries.

4.2 Customs duty payments on all goods

Impact: Supply chains that require products to cross the border several times are not economically viable any longer as every crossing of the border results in full custom payments. Unless burdensome bureaucratic measures are taken to limit the customs payments to the value added at every step of production, this will result in prohibitive costs.

Conclusion

In every scenario UK goods no longer count as EU goods. This leads to the following direct impacts:

- After Brexit UK goods will become more expensive if exported to 66 countries. Duty-free import to 66 countries ends with Brexit
- UK goods will be sorted out from EU supply chains and will be replaced with EU goods
- UK suppliers will be sorted out from EU supply chains and will be replaced with EU suppliers
- Warehouses and retailing companies will leave or will be forced to leave the UK
- Nearly one third of the EU export value (supplies) is in danger of getting lost
- Brexit damages UK trade especially the export of UK goods to 66 countries
- European companies are losing the chance to handle their subsidiaries in UK as before because of the massive negative consequences after Brexit.
- Instead European companies will not establish new subsidiaries in UK because of the massive negative consequences after Brexit.
- In a depressing way, European and international companies have to calculate the massive negative consequences after Brexit and have to decide what to do with their subsidiaries:
 - Let them "die"
 - Transfer them to the EU
 - Let them work in future only for the UK market with reduced production and employees
- The above pointed out negative consequences come into force even so when there will be a 2-years-period of transition or the smoothest way of a „soft Brexit“. The disastrous consequences start in the moment the UK leaves the EU.
- The resulting consequences for the UK economy are difficult to estimate. They may lead to a massive economic crisis in the UK that may become clear in its full proportion once it is already too late, i. e. 2 - 5 years after Brexit without the chance to turn back.