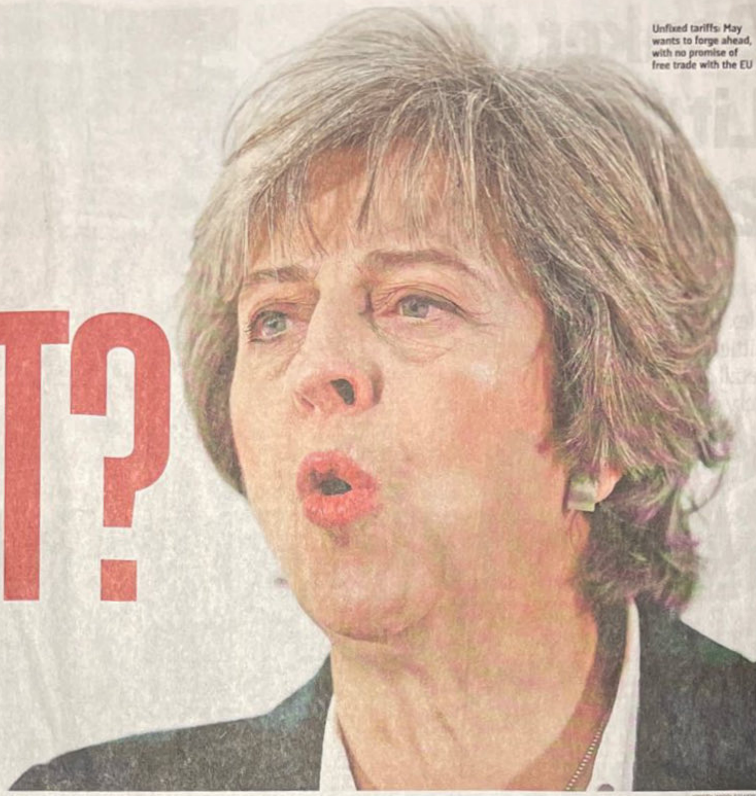
HARD BREXIT?



Unfixed tariffs: May wants to forge ahead, with no promise of free trade with the EU

KIRSTY WIGGLESWORTH

The prime minister will trigger article 50 this week — with no trade agreement on the table. Would 'no deal' be a 'bad deal' for British firms, asks **Tommy Stubbington**

James Cooper has his eye on the farm next door. The cluster of warehouses at Immingham docks on the south side of the Humber estuary are surrounded by open fields. Cooper, the chief executive of Associated British Ports (ABP), will probably need to buy out his neighbours to sustain the flow of trade through the vast import terminal.

Once Britain leaves the European Union, a larger proportion of the 55m tons of goods pouring into Immingham each year is likely to be subject to customs checks, slowing its passage through the port. Cooper is preparing to build extra facilities for additional inspection areas, and the backlog of goods that is likely.

"We have the capacity to deal with it and we are ready," Cooper said. "Will we see lower volumes? We might, but we might be able to do more storage. Most North Sea-facing ports have got plenty of land. In spite of a challenge, I see an opportunity."

ABP and other businesses up and down the country are preparing for the possibility of a "hard" Brexit — a departure from the EU, with little or no continuing free trade deal with 27 of our closest partners. With Theresa May set to invoke article 50 on Wednesday, beginning the two-year exit process, the possibility of departing without an agreement on trade has become an increasingly ominous prospect.

"No deal is better than a bad deal," May said in January. Ever since, "no deal" has been the base-case assumption, for planning purposes, of many British businesses.

Not everyone is as optimistic as Cooper. While many companies feel they could cope with new tariffs on exports to the EU, they are more nervous about less obvious, "behind the border" barriers that could spring up if Britain quits the EU without a trade deal. The result, some experts say, would be a sharp drop in the flow of goods and services across the channel.

Foreign secretary Boris Johnson, meanwhile, has declared that Britain would be "perfectly OK" if we are forced to fall back on World Trade Organisation (WTO) rules.

The WTO regime already governs the majority of world trade, including nearly half of Britain's business dealings outside the EU. Trade at Southampton, another big ABP port, is booming. British-made Land Rovers, Minis and Hondas line the quays destined for America, the Middle East, or beyond. "90% of what Southampton does is not with the EU: it's a WTO port to all intents and purposes," said Cooper.

The WTO's rulebook means the EU could not hit the UK with punitive tariffs. If it did, it would have to apply the same penalties uniformly to every other WTO country it deals with. The average tariff imposed by the EU on imports from beyond its borders is just 2.7%, according to think tank Policy Exchange — much less than the 10% figure (which relates to cars) that has stuck in the public consciousness.

For British exporters, the hit to their competitiveness would be more than offset by the 11% fall in the pound against the euro since June's EU referendum.

On the surface, that makes much of the hand-wringing by big businesses look odd. The CBI has long since abandoned hope of retaining membership of the single market, yet is now firing off warnings of the dangers of losing preferential access to EU consumers. Earlier this month it warned that hard Brexit would open a "Pandora's Box of economic consequences". There is a reason, however, why businesses are still so desperate to avoid a hard Brexit: not because the end point is so calamitous, but because the starting point is so appealing to them.

2.7%

the average EU import tariff under WTO rules, according to Policy Exchange

59%

estimated reduction in UK-EU trade under hard Brexit, according to NIESR

For all its failings, the EU single market has gone much further in harmonising regulations and tearing down barriers than other bilateral trade agreements across the globe. The less friction, the quicker the wheels of international trade can whirr.

For example, cosmetics manufactured in the UK are automatically certified for sale across the Continent. And international banks that have set up shop in London can freely sell their services to customers anywhere in the EU. A recent survey by the Institute of Directors showed that 62% of firms believe a new agreement with the EU should be the priority in trade negotiations. Just 13% said seeking new deals around the world is more pressing.

The desire for a quick and wide-ranging agreement with the EU underlines an important truth in international commerce: distance matters. Every one of the world's top 10 economies benefits from trade agreements with its regional neighbours. Without an EU deal in place, Britain would be the odd one out.

"Hard Brexit will be disastrous for business," said Baroness Wheatcroft, a Conservative peer who has sought to put the brakes on Brexit in the Lords. "I struggle to see a best-case scenario for Brexit other than full access to the single market."

As Britain's divorce negotiations get under way, Jan Ward isn't waiting to see which way the wind is blowing. The boss of Corrotherm International, a Southampton company that makes industrial pipes and valves, is preparing to move some of its manufacturing to a new factory near Carcassonne, France. "I can't be paralysed until we know how things are going to turn out, I have to act now," Ward said.

She isn't worried about tariffs on Corrotherm's products. Most are tariff-free under the EU's schedules with the WTO — detailed lists of the duties levied on thousands of different categories of imports. But the nickel alloys the company imports from the EU would attract tariffs of 5%-8%, eating into margins.

"Some of our European customers are reluctant to buy from outside the EU. Coupled with the extra costs, this could make us uncompetitive," Ward said. "It might force us to move." Ward's fears offer just one example of how hard Brexit could disrupt supply chains. For many firms, like Corrotherm, that is not a matter of life and death. It does, however, underline that any loss of competitiveness is likely to chip away at UK-EU trade.

Some industries are even more tightly interwoven into European supply chains. Birmingham-based Brandauer imports rolls of precious metals such as gold and silver from Europe and runs them through precision presses to make electrical connectors that end up in power-steering units in Fiats and Volkswagens. The cars then roll off the production lines in Germany and Italy, and some of those vehicles are sold back into the UK market.

Where materials are imported and re-exported, companies can generally claim back duties. However, doing so means keeping track of exactly where all components come from — meaning a mountain of paperwork.

"It would create a whole set of red tape for us to understand and work our way through," said Brandauer boss Rowan Crozier. "That's a challenge that a smaller company like us could do without."

There are further traps lurking for exporters in a post-Brexit world. For example, European car makers that sell to Korea under its free-trade agreement with the EU are obliged to use no more than 45% of components made outside the EU or South Korea. British components would become part of that total, which could make the European car industry less inclined to use parts manufactured in the UK. Forecasting the impact of all this on UK-EU trade is difficult, but most economists reckon it would fall.

Monique Ebell, a trade expert at the National Institute of Economic and Social Research (NIESR), estimates that membership of the EU more than doubles a country's trade with the rest of the bloc. However, she stresses that the impact of leaving is highly uncertain, given no economy of a reasonable size has ever left the EU before. (The economy of Greenland, which quit in 1985, is almost entirely based on fishing, and is not considered a good model for the UK.) Even so, she estimates that Britain's trade with the EU would tumble by 59% under a hard Brexit.

"It's hard to see how it could be positive for the economy," Ebell said. "You're looking at a big reduction in overall trade, and a long period of adapting to the new arrangements."

> **"IT'S HARD TO SEE HOW IT COULD BE POSITIVE. YOU'RE LOOKING AT A BIG REDUCTION IN OVERALL TRADE, AND A LONG PERIOD OF ADAPTING TO THE NEW ARRANGEMENTS**

Should we trust the much-maligned "experts" who said the economy would grind to a halt after a Brexit vote and have so far been proved spectacularly wrong? Gerard Lyons, former economic adviser to Boris Johnson and a prominent pro-Brexit economist, thinks such forecasts are flawed. "They don't take account of how our business model will change," said Lyons, chief economic adviser at Policy Exchange. "The EU was set up to protect French agriculture and the German car industry — that's why tariffs in those areas are so high."

Any lost trade in Europe, Lyons argues, will eventually be replaced farther afield — particularly as Brexit frees up Britain to strike new trade deals. Trade minister Liam Fox has already mooted agreements with the US, China, Australia and New Zealand.

In the meantime, WTO rules are a "strong foundation" for Britain's future relationship with the EU and beyond, Lyons believes.

The EU is a protectionist bloc that has prevented Britain enjoying the fruits of unfettered trade, according to economist Patrick Minford, who campaigned for Brexit and has now shifted his focus to global free trade. Minford argues that outside the EU's external tariff, Britons would see benefits such as cheaper food, while increased competition from Asia for our manufacturers would be offset by the decline in sterling.

Some firms are certainly relishing the prospect of life outside the walled garden of the EU customs union. At Tate & Lyle Sugars' refinery in Silvertown, east London, shipments of raw sugar cane arriving from former colonies are subject to EU tariffs designed to protect European sugar beet producers. The company says these tariffs cost it £34m in 2015 alone and threaten the survival of the only refining facility in Britain.

Nevertheless, such companies probably remain a minority. A recent survey of 600 large companies in Europe by investment bank UBS showed that 31% plan to remove a "large" part of their operations from the UK. The research, by NIESR, suggests benefits of new trade deals will be much smaller than the losses from a hard Brexit. According to Ebell, trade deals with the US, Australia, New Zealand and Canada would lead to just a 12% increase in trade.

That is partly because trade in goods with these countries is already remarkably easy — as the cheerleaders for WTO rules point out — so there is relatively little to gain. More importantly, even enhanced free-trade deals — such as the EU-Korea deal — have so far done little to boost services trade. Services are generally even more susceptible to behind-the-border barriers: if two governments cannot agree on the qualifications a lawyer, accountant or architect needs, it is hard to sell these services into each other's markets.

Of course, Britain could break new ground by negotiating free-trade agreements with deeper provisions for services. Those deals, however, are likely to take years to complete, as various vested interests on both sides are placated.

In the meantime, the containers will be piling up in a field by the Humber.

Making a drama is becoming a crisis

TV and film producers could among the big losers if Britain leaves the European Union without a free trade deal.

The impact would reverberate far beyond the creative sphere. Overseas sales of movies and TV shows, along with other creative work, brought in £13.9bn in 2015, accounting for 9% of non-financial services exports that year.

A large chunk of that income would be cast into doubt by a hard Brexit. Under the current system, European broadcasters are obliged to buy 50% of their programmes from EU-based producers.

This quota regime has created a hugely vibrant TV industry on these shores, as the BBC, ITV and a host of independent production houses have been able to sell their formats and programmes across the single market.

"The quota system has been very valuable to Britain's TV production industry," said Alice Enders at Enders Analysis. "Exports are becoming more important due to pressures on the licence fee and the budgets of commercial free-to-air broadcasters."

Outside the EU, British producers would have to scrap with rivals from America and elsewhere for the portion of airtime that can be filled with non-EU shows. That would make it harder for the BBC and other broadcasters to find backers for high-end dramas, such as War and Peace, right, which can cost more than £1m an hour to shoot. They rely on pre-production deals with stations overseas before giving the green light to glossy hit shows.

British producers hope that their position will be protected in a future free trade deal between the UK and the EU. However, TV and film have been excluded from all but a handful of trade agreements struck by the EU; member states, notably France, have fought hard to protect their native film industries.

Who has most to lose?

Banks
The prospect of a hard Brexit has created a big headache for the City's investment banks. Their chief concern is the potential loss of the "passporting" rights that enable them to sell financial products across the European Union from their bases in London.

The City's hopes rest on an EU legal concept called "equivalence", which would potentially maintain access to the single market provided that Britain's regulatory standards do not diverge from Europe's. However, it is not certain that London and Brussels can thrash out an equivalence deal by 2019. For this reason, Goldman Sachs and Morgan Stanley last week stated they would soon begin moving jobs to other EU financial centres from London.

Insurance
Insurers that sell products across Europe are in a similar predicament; they may need to set up operations in the EU, potentially reducing their UK workforces. Lloyd's of London has already announced it will set up a hub in the EU.

Pharmaceuticals
For British drugs giants such as Astra Zeneca and Glaxo Smith Kline, a hard Brexit could significantly increase the cost of getting new treatments approved by regulators. Currently, developers can sell drugs across the single market after getting the go-ahead from the European Medicines Agency. Unless a common drug-approval system is agreed, Britain will have to set up its own watchdog, meaning more red tape for the sector.

Science funding is one of the few areas where Britain is a net beneficiary of EU membership. Between 2007 and 2013, the UK contributed €5.4bn to the bloc's research and development budget, yet received €8.8bn from Brussels, according to the Royal Society.

Technology
Britain's tech entrepreneurs have two chief concerns over a hard Brexit. First, hi-tech companies rely more than most industries on attracting the brightest and best talent from across the world. A hard Brexit that makes it more difficult to bring in highly skilled workers from the EU would be a blow.

Second, tech start-ups receive much of their early stage funding from venture capital firms. A key source of the VCs' cash is the European Investment Fund — which is backed by the UK and other EU governments.

Telecoms
Telecoms companies want to be able to continue transferring data freely between their server farms across Europe. A new set of EU-mandated rules — called the General Data Protection Regulation — comes into force next year, which should enshrine this freedom in UK law. But Britain's internet privacy rules would have to remain in lockstep with Europe if data transfer rights are to be preserved. Data transfers are crucial for many other businesses, including insurers.