

Brexit: Risk and resilience for business

A report by The Economist Intelligence Unit



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Brexit is done, and a free-trade agreement is in place. So what are the implications for UK business?

It was a last-minute Christmas present, but when the UK finally left the EU on January 1st it did so with a zero-tariff, zero-quota trade deal to fall back on. The EU-UK Trade and Co-operation Agreement (TCA), approved on December 24th 2020 and ratified by the UK parliament on December 30th, removes much of the uncertainty about the future of the relationship between the UK and the EU. However, as details of the TCA have become clear, so have its implications for various industry sectors.

In this paper, The Economist Intelligence Unit looks at the medium-term impact that Brexit could have on nine sectors, bearing in mind the terms of the TCA. Those sectors are: automotive, life sciences, financial services, technology, consumer goods, food & agriculture, travel & tourism, aerospace, and other services. By weighing risk factors against the potential resilience of each sector (see methodology below), we then assess which businesses are likely to be hardest hit by Brexit and which are in the best position to ride it out.

Our key findings

- The food & agriculture sector faces the biggest risks from Brexit, followed by automotive and financial services. This assessment reflects the UK's reliance on EU supply chains and EU workers in these sectors, as well as the limited benefits to be gained from regulatory divergence.
- The life sciences sector is likely to prove the most resilient over the next five years, given its export potential outside the EU as well as the possible benefits from regulatory divergence, particularly for innovation. Technology is another area that could survive relatively unscathed, for similar reasons.
- The TCA explicitly gives the EU and the UK the right to impose tariffs if the other party introduces too much regulatory divergence. The UK-EU trading relationship is likely to evolve into a far more complex system, and will probably be informed by many of the tradeoffs we explore in this paper.
- The TCA focuses on trade in goods, which account for 58% of UK exports, with relatively modest provisions for the 42% from services. Some decisions around these sectors, including the UK's important financial services industry, are either limited or deferred to future negotiations, along with other issues such as whether the UK's data protection regime is sufficient to transfer data freely to the EU.
- The TCA allows either party to reopen the entire trade chapter after four years, although the appetite for yet more negotiations may be limited.

Despite its limitations, the TCA did achieve its short-term goal of limiting disruption at the UK borders on January 1st. In the event, the chaos occurred in the preceding two weeks, when France barred

travellers feared to be carrying the new, more infectious version of the coronavirus (Covid-19). By the time a testing regime had been put in place, hauliers had reined back their schedules, queues were down sharply and Brexit day passed with little disruption. However, we do expect some loss of trade to occur over the next few months as exporters adjust to the new rules.

In the longer term, the TCA provides the UK and EU with a zero-tariff, zero-quota regime to start their new post-Brexit relationship. It also resolves some of the more contentious issues that have dogged negotiations over the past nine months or more, as set out below.

Fishing quotas were a final sticking point, not because of the significance of the industry but because of the symbolic importance of the UK's sea borders. The TCA was struck after the EU agreed to cut its fishing quotas in UK waters by 25% (far less than the UK wanted) until June 2026, followed by an annual renegotiation.

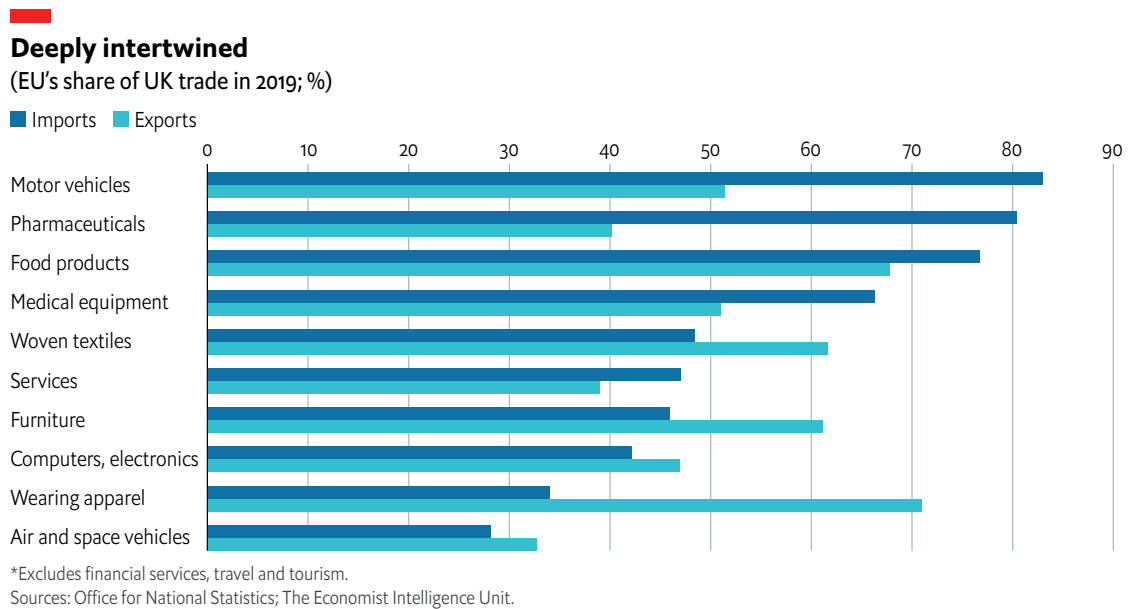
On the issue of **regulatory sovereignty** the TCA sets limits to the UK's ability to rewrite legislation while still enjoying tariff-free trade. Level playing field provisions on labour, environmental and subsidy regulations give both the EU and the UK the right to impose temporary tariffs if they believe the other party has changed its regulations to gain an unfair competitive advantage. A joint EU-UK arbitration panel will then decide whether the tariffs can stand. This means that the current no-tariff deal may eventually evolve into something far more complex.

The EU "rules of origin" restrictions—which require products to have a certain percentage of their inputs sourced from the EU—were another contentious issue. The UK will now be subject to these rules of origin, giving companies that want to sell to EU markets less leeway to globalise their supply chains. For example, in the automotive sector 50-55% of vehicle components must be made in the EU or UK. Although the UK did negotiate a six-year phase-in for electric vehicle (EV) components, many vehicle makers, as well as other consumer goods companies, will struggle to meet these requirements.

The deal also provides for **co-operation and co-ordination** in certain areas. This includes a simplified process for UK citizens to maintain their healthcare and pension rights in the EU and vice versa. The UK will also pay into and remain eligible for many scientific and technological co-operation programmes organised by the EU, although it will leave the Erasmus student-exchange scheme and replace it with a domestic programme.

The UK and EU have agreed a six-month bridging provision to allow the UK continued access to EU data until the EU data regulator reaches a final ruling on the UK's **data adequacy** regime. This certification is not guaranteed—a previous ruling by the European Court of Justice found that UK security laws did not sufficiently respect data privacy. Nevertheless, the TCA prevents a cliff edge whereby UK users would not be able to access EU data.

Finally, the TCA creates simplified rules around **public procurement**, allowing UK and EU companies to bid on government tenders on an equal basis.



Remaining issues

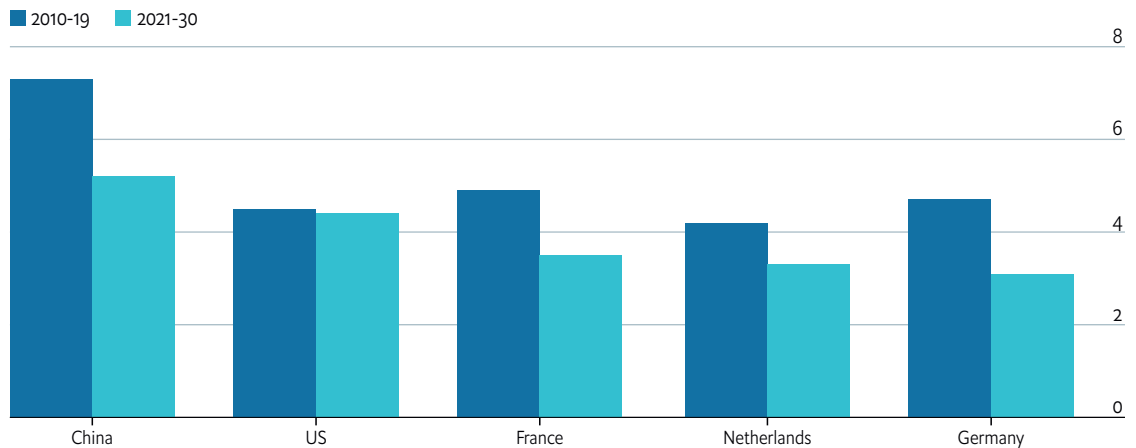
Despite the zero-tariff regime, UK exporters will still encounter **more customs barriers**. The UK and the EU have agreed to waive some declaration requirements around rules of origin for the first year of operation, but companies will need to ensure that they can prove compliance in the longer term. This will be tested as hauliers ramp up their schedules over coming months.

The UK's decision to diverge in the regulation of agricultural products means that plant and animal exports will have to be certified under both UK and EU standards. Similarly, the deal did not include any provisions for the cross-recognition of product standards (so-called conformity assessments). As a result, manufactured goods for sale in the UK and EU market will have to be **certified separately** by product regulators in each jurisdiction. This includes, for example, pharmaceutical products.

Most importantly, the UK **services industry** remains in flux, with the TCA significantly curtailing the UK's access to the single market. For financial services, for example, UK banks no longer have passporting rights, which allow them to operate freely across the EU. The TCA does commit the two sides to work towards a framework for mutual recognition of professional qualifications, as well as improving market access. However, UK professionals may find it harder to practise in EU countries, with arrangements likely to differ between EU member states and, while the deal does allow for short-term business travel, they may need a visa in some circumstances. The UK is likely to push for greater services liberalisation, given its competitive advantage in that area, but it could be a decades-long process.

Non-EU exports outpace EU

(UK export growth by destination; % average per year)



*2020 data are omitted.
Sources: Office for National Statistics; The Economist Intelligence Unit.

Sector by sector

Under the terms of the TCA, the UK faces a series of tradeoffs. The UK retains tariff-free, quota-free access to EU markets post-Brexit only insofar as it remains aligned to EU regulations in those sectors. Many sectors in the UK are highly integrated with the EU and risk losing significantly from existing and further divergence. Conversely, in other sectors, the combination of the UK’s comparative advantage and opportunities beyond the EU give them greater resilience and potential opportunity to thrive under a more divergent regime. This process has already begun under the TCA, and may continue, albeit unevenly across sectors.

To assess the impact of Brexit under the TCA, we scored nine UK sectors on the risks they now face, and their sources of resilience, which should help them to ride out difficulties.

Methodology:

Scores were given on the basis of both qualitative and quantitative factors, and ranged from -3 to 0 for risks and from 0 to +3 for resilience. Averaging the scores for the risk and resilience gives an overall estimate of each sector’s ability to thrive outside the EU over the next five years.

The five risk factors for each UK sector were:

1. its reliance on exports to the EU as a proportion of trade;
2. its reliance on EU imports, including into its supply chain;
3. the tariff barriers that it could encounter (most sectors scored at or near zero under the TCA);

4. the non-tariff and regulatory barriers that it could encounter when trading with the EU;
5. and its reliance on recruiting EU workers who may not meet the UK’s new salary requirements. Sectors that are highly integrated with EU supply chains will face additional challenges despite the TCA, given that tariffs and regulatory barriers may increase over time.

The five resilience factors were:

1. the sector’s ability to grow trade outside the EU;
2. the potential benefits of regulatory divergence in terms of the business environment (eg, cutting red tape or labour costs);

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3. The potential benefits of regulatory divergence in terms of innovation, research and product development;

4. the international influence of the sector;

5. and the national influence of the sector.

Sectors scoring highly on influence have a stronger starting point from which to build international trade, and may have the ability to shape the industry and regulations to the UK's advantage. However, the room for regulatory divergence will be limited by the TCA, given that the EU can respond by imposing tariffs (subject to arbitration). The full set of scores is provided in the annex to this paper.

Sector	Risk score (out of 15)	why?	Resilience score (out of 15)	why?	Total score
Food & agriculture	-11.5	Nearly two-thirds of trade is with the EU, with highly integrated supply chains. Tariffs may be applied on re-exports. Non-tariff barriers (NTBs) are fairly high, given the need for complex customs declarations. Around 13% of workers in food processing and 20% in agriculture (seasonal) come from the EU and will not meet UK salary requirements.	4.5	Growth potential for exporters is low outside the EU, except in niche areas. Regulatory divergence is possible, for example in environmental standards, animal welfare, labour, but would not give great competitive advantages.	-7
Automotive	-10	The UK automotive sector is highly integrated with EU supply chains. Much of automotive production is based in the UK as a gateway to EU markets. Local content requirements will be onerous, requiring a shift in supply chains. 10% of employees in the sector are from the EU.	4.5	Volume vehicle-makers and their suppliers need to operate internationally to be viable, so there is little scope for UK-only regulatory divergence. Divergence will also be limited by the threat of new tariffs. However, growth potential is high outside the EU.	-5.5
Financial services	-8	Financial services gain little benefit from the TCA. UK banks have lost passporting rights, and other financial businesses, from insurance to derivatives, now face trading barriers. Around 20% of FS business in the UK is related to its role as an EU gateway. Despite a high share of EU employees, however, salaries are generally high enough to meet new UK visa requirements.	5.5	Although much of the potential non-EU growth has already been exploited, the UK has enough influence to carve out new business in areas such as green finance and fintech. Regulatory divergence could enhance competitiveness, particularly in the development of novel financing tools, while the UK may decide to opt out of Solvency II requirements for insurers. However, the UK faces a tradeoff between divergence and retaining more access to EU markets.	-2.5

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Sector	Risk score (out of 15)	why?	Resilience score (out of 15)	why?	Total score
Other services	-7	Services are largely ignored in the TCA. The UK will now face NTBs in areas such as mutual recognition of qualifications, as well as certification of standards. Data regulation will be another area of uncertainty. Most, but not all, EU employees will meet UK salary requirements.	5	Potential growth ex-EU is strong, particularly for services that can be offered remotely. The sector can benefit from regulatory divergence in areas such as competition and digital taxes. Influence varies but is high in areas such as education.	-2
Consumer goods, eg clothing & textiles	-7.5	Trade links are generally high, particularly on the export side, but supply chains in sectors such as textiles are more reliant on Asia, as is staffing. NTBs include rules of origin, which may result in tariffs being applied to some goods. Tariffs may also impact re-exports.	5.5	Potential growth ex-EU is moderate-to-high, with the UK's luxury sector particularly strong. There is also a moderate opportunity to benefit from regulatory divergence (at the risk of EU tariffs) in areas such as labour laws and digital taxes. Influence is not high, other than in niche businesses.	-2
Travel & tourism	-7	Barriers to travel will be only partial. Travellers must have six months left on passports, while business travellers to the EU (other than short-term ones) may need visas in some circumstances. Managing cross-border travel businesses may be complex, particularly in terms of data regulations.	5.5	The UK is the world's tenth biggest tourism destination, so will retain international clout. Once the pandemic wanes, growth in non-EU travel is likely to outpace that in the EU, while the sector could benefit from some regulatory divergence, for example over labour, taxation and refunds.	-1.5
Aerospace	-7	The industry is highly integrated with the EU. Among the biggest UK producers is Airbus, which employs around 15,000 UK workers and operates across the EU. Just-in-time supply chains could be disrupted by increased NTBs and local content requirements.	6	Given high integration with the EU, scope for regulatory divergence will be limited by the TCA but may cover emissions trading, competition and innovation. The industry has been badly affected by the pandemic, but should see a strong recovery from 2022, with non-EU opportunities high.	-1

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Sector	Risk score (out of 15)	why?	Resilience score (out of 15)	why?	Total score
Technology	-6.5	EU trade links are moderate, given increasing reliance on Asian suppliers. EU employees are likely to meet UK salary requirements. NTBs include data adequacy rules.	7	Potential growth ex-EU is strong, particularly for technology services that can be offered remotely. The sector can benefit from regulatory divergence, eg in areas such as competition and digital taxes. Influence is not particularly high.	0.5
Life sciences	-7.5	Trade links with the EU are strong, while potential NTBs include new-drug authorisation and approval of medical equipment. Most EU employees will meet UK salary requirements, while mutual recognition agreements in the TCA will ensure that, for example, good manufacturing practice approval will be transferable.	9.5	The life sciences sector scores highly on non-EU growth potential, the potential benefits from regulatory divergence (especially in innovation), as well as its ability to influence the shape of future regulation. The UK's relatively homogeneous national health service gives it an edge in research involving patient data, such as cell and gene therapies.	2

Source: The Economist Intelligence Unit. The full set of scores is provided in the annex to this paper.

Conclusion

Overall, most sectors scored higher on risks, with Brexit bringing significant non-tariff barriers (NTBs) for trade, as well as employment implications. The food & agriculture, automotive and financial services sectors are at particular risk, given their current level of EU integration. On the other hand, sectors such as life sciences do have considerable opportunities to benefit from divergence, using their influence to reshape regulations to their advantage, within the limits of the TCA. In nearly all sectors, non-EU trade is growing faster than EU trade, although most of the resulting opportunities were already available when the UK was an EU member.

The balance between risk and resilience will affect the investment and operational strategies of domestic companies. Many companies have delayed investment decisions, in some cases for years, until there was more clarity over Brexit. This balance will also affect the amount of foreign direct investment that comes into the UK in the wake of Brexit. EU companies are the biggest investors in the UK in terms of the direct parent company, although the biggest ultimate parent country is the US. Meanwhile some companies, particularly those from Japan, have previously invested in the UK as an EU base—a role it may no longer fulfil adequately.

Data suggest that Brexit has already cut both the inflow and outflow of foreign direct investment, particularly in 2017 and 2020. The greater certainty provided by the TCA may stem the decline. For the moment, however, the impact of Brexit is being masked by the far bigger impact of the coronavirus pandemic, and will only become clearer as that recedes.

Annex

Annex: Risk factors

	EU exports	EU import reliance	Tariff barriers	Non-tariff barriers	EU worker reliance	Total risk score
Food & agriculture	-3	-3	-0.5	-2	-3	-11.5
Automotive	-3	-3	-0.5	-2	-1.5	-10
Financial services	-2	-2	0	-3	-1	-8
Consumer goods	-3	-2	-0.5	-1.5	-0.5	-7.5
Life sciences	-2	-3	0	-1.5	-1	-7.5
Other services	-2	-2	0	-2	-1	-7
Travel & tourism	-1.5	-1.5	0	-2	-2	-7
Aerospace	-2	-1	0	-2	-2	-7
Technology	-2	-2	0	-1.5	-1	-6.5

Source: The Economist Intelligence Unit

Annex: Resilience factors

	Divergence: business environment	Divergence: innovation	Non-EU growth potential	International influence	National influence	Total resilience
Food & agriculture	0.5	1	1	0.5	1.5	+4.5
Automotive	0.5	0.5	1	1	1.5	+4.5
Other Services	1	1	1	1	1	+5
Financial services	0.5	1	1	2	1	+5.5
Consumer goods	2	1	1	0.5	1	+5.5
Travel & tourism	1	1	1	1	1.5	+5.5
Aerospace	1	1	1.5	1	1.5	+6
Technology	1	1.5	1.5	1	2	+7
Life sciences	2	2	2	1.5	2	+9.5

Source: The Economist Intelligence Unit

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