HOUSE OF COMMONS

Business, Energy and Industrial Strategy Committee

Oral evidence: Businesses and Brexit preparedness, HC 1001

Tuesday 23 February 2021

Ordered by the House of Commons to be published on 23 February 2021.

Watch the meeting

Members present: Darren Jones (Chair); Alan Brown; Judith Cummins; Ms Nusrat Ghani; Paul Howell; Mark Jenkinson; Charlotte Nichols; Sarah Owen; Mark Pawsey; Alexander Stafford.

Questions 52 - 94

Witnesses

I: Mike Hawes, Chief Executive, The Society of Motor Manufacturers and Traders Limited; Ian Howells, Senior Vice President, Honda Motor Europe; Paul Everitt, Chief Executive, ADS Group; and Simon Peckham, Chief Executive, Melrose PLC.

II: Duncan Buchanan, Policy Director, Road Haulage Association; Joe Marshall, Senior Researcher, Institute for Government; Jessica Sargeant, Senior Researcher, Institute for Government; and Fergus McReynolds, Director of EU Affairs, Make UK.

Written evidence from witnesses:

[ADS (BBP0014), Institute for Government (BBP0020), Melrose PLC (BBP0022)]

Examination of Witnesses

Witnesses: Mike Hawes, Ian Howells, Paul Everitt and Simon Peckham

Q52 **Chair:** Welcome to this morning's session of the Business, Energy and Industrial Strategy Select Committee. It is the second hearing in our inquiry trying to understand the impact of and preparedness for Brexit on British businesses. The last session we had was before the UK-EU trade deal was agreed at the end of December. This is a subsequent session to understand what is happening now in some of the key sectors this Committee is interested in, primarily automotive and aerospace as well as some other sectors, including haulage and logistics.

On the first panel today, I am delighted to welcome: Mike Hawes, who is the CEO of the Society of Motor Manufacturers and Traders; Ian Howells, who is a senior vice president for Honda Motor Europe; Simon Peckham, who is the CEO of Melrose PLC, which owns GKN Aerospace and GKN Automotive; and Paul Everitt, who is the CEO of the ADS Group, representing the aerospace and defence sectors.

Welcome to all of you this morning, and welcome back to some of our usual suspects. We are delighted to have you back before the Committee. You heard in the opening that the purpose of today's session is to check in and see how things are going in your respective sectors now the UK-EU trade deal has been agreed. The opening question for each of you today is about what the immediate impact has been since the agreement at the end of December. How have the organisations or sectors you represent had to adjust to be able to operate within the context of that trade deal in the first few months of the year? Mike, I will come to you first from an SMMT perspective, please.

Mike Hawes: The first way to characterise where we are now is that there is still a pervading sense of relief that we got a deal. It is the one thing we absolutely needed for the future of the industry. We knew the scope of the deal had narrowed over the course of the last four or five years. We ended up with a deal that in many ways works for the sector, most obviously in the avoidance of tariffs and quotas, which would have been a severe brake on the industry. However, that does not mean zero cost.

Where are we now? The industry is trying to manage its supply chains. As you would know, we are integrated within the European if not the global industry, so the supply chains stretch far and wide. I would characterise all the industry as paddling furiously below the water to keep things going. There have been a couple of stoppages, but that has primarily been because of the global issue around semiconductor supply. In terms of general day-to-day operations, moving parts in and out, it is difficult. The administration is significant, and I believe we were a sector that was as well prepared as any for this change. This is the new normal; we accept that. Ensuring the entire complexity of the supply chain can continue to operate is a major challenge, and it is a challenge for which we had, to a certain extent, little preparation time.

We certainly think we probably would have benefited from some sort of longer implementation period. With the withdrawal agreement, there was supposed to be up to 21 months of implementation period. We ended up with, effectively, seven days over the Christmas shutdown from the publication of the deal to when it took effect, so it is understandable that all businesses were struggling to understand what they now had to do.

The deal does have some benefits, which I am sure we will talk about later, but one of the most immediate ones was the grace period around rules of origin and the fact that we do not have to demonstrate rules of origin for automotive products to qualify for automotive trade. Given the complexity, that is a significant issue. As I say, I would probably characterise it by saying that businesses are managing, but just managing, at the moment.

Q53 **Chair:** Mike, when you gave evidence to our Committee before Christmas, you set out a number of things that you were hoping the Government would do to be particularly helpful to the automotive sector around those supply chains. Is there anything outstanding that you think could still be done to be helpful, or is everything being done that could be done?

Mike Hawes: The Government certainly tried to keep everyone communicated and informed. How much it resonated with businesses was variable, but in all the preparation, until you actually saw the deal, you were not sure exactly what you were preparing for in terms of rules of origin and other arrangements.

Yes, we could have all done with more preparation time. That is being revealed in the pressures on certain parts of the system. We are getting a lot of inquiries from our members about what it is you have to do, how it is working and indeed some issues. The issues often relate to a lack of consistency in application. There was one supplier, for instance, who sent away two trucks with pretty much identical loads. They went out into Europe and arrived into two different ports. One went straight through; the other was held up. Again, there is this sort of uncertainty.

In terms of where we are at the moment, it is not the full application of the rules for import, which come in in July. Making sure we have everyone fully informed, aware and prepared for that particular deadline is still a challenge that is before us.

Q54 **Chair:** Paul, from an ADS Group perspective, in terms of aerospace and defence, have you had similar problems to the automotive sector, or has it been different from your perspective?

Paul Everitt: My characterisation would be the same. Again, we were pleased that there was a deal. That was a step forward. By and large, companies were well prepared, but, none the less, I would characterise it as a day-to-day battle to make the new arrangements work and to find their way through this.

Effectively, there are four key areas for us that are problematic. As Mike has already said, the reintroduction of borders and the paperwork associated with shipping goods is a problem. I am sure you will have others talk about this a bit later, but both the availability and cost of transport is being flagged as an issue. During the first couple of weeks of January, part of our preparations had been to ensure that some of our businesses were not using some of the key crossings during those times. As they have begun to use those crossings, they are having to plan for additional delays. They are having to fight to get the transport and, in some cases, they are having to pay additional costs for that transport. It is a cost pressure. Whether that is longer term or not is something we cannot say.

The second key area for us is around regulation. We have a separate aviation safety regime in the UK. Some of that works okay. Some of the detail of how the UK regime interacts with the European regime is not yet fixed, and that is subject to an ongoing level of discussion and, indeed, negotiation. In the absence of those details, there are key parts of the industry that are not able to do business, and some of them are actually losing business as a consequence of those details not being available. I can go into more details on the regulatory side if you want, but it is a complex area.

Third for us is specifically around Northern Ireland. Again, we have a very significant sector in Northern Ireland. Like many sectors, shipping goods from the UK to Northern Ireland is a problem, again, in terms of transport, but also companies operating in Northern Ireland are faced with new tariffs associated with what are termed goods at risk. If they wish to avoid those tariffs, they have to put in place quite difficult and complex mitigating measures, which, particularly for the smaller businesses operating in Northern Ireland, is very new territory. Many of them are having to both adapt and learn quite quickly within what is already a pressurised situation.

The final area for us is around chemicals. Whilst we are not chemical producers, the UK aerospace and defence industry are significant users of chemicals. Again, we have established in the UK, or are establishing, a separate chemicals regulatory regime. The details of that are not yet fixed and there are issues around costs and availability for some of the chemicals that are part and parcel of our businesses.

I would say that we are managing. It is a stressed environment. There are issues for us in making the system work, but there are also some bigger issues around what will happen next in the relationship between the UK and the EU. We had anticipated that a deal would provide the basis for further development of those arrangements. It is a bit early in the day, perhaps, to be launching those, but clearly the longer-term development of the deal to make it as good as it could be is an important issue for the longer-term competitiveness of the industry in the UK.

Q55 **Chair:** Maybe you could write to us about those regulatory issues and the timescales you are working to. It sounds like we probably need to make progress on that as quickly as possible.

Ian Howells from Honda, you are clearly a key customer for components in the UK, with just-in-time manufacturing. What has it been like on the shop floor since the deal was concluded in December?

Ian Howells: We very much welcome the trade deal, as the previous two witnesses said. We went into that with a degree of uncertainty; no deal was certainly something we wanted to avoid. We had actually planned for no deal in our preparations, and I have to say that has proved to be the right approach in many respects. We are now at 23 February, and we are only just finalising our systems in terms of their ability to communicate effectively with HMRC.

From that perspective, it has taken time for things to settle down. It has not disrupted our production. Mike mentioned earlier that there had been some suspension of production—our own factory was part of that—but those have been largely driven by Covid-related issues, particularly in terms of deep sea port issues. Just generally in terms of logistics, it has been very, very difficult. Those have, as I said, primarily been around deep sea and our sourcing from elsewhere other than Europe.

Our preparation was well founded. As I mentioned earlier, we now have the systems up and running and in place. There are still some open points for us, particularly around data and, as Paul mentioned, in terms of regulation. We will wait to see how that develops. In overall terms, we have demonstrated so far that we have been able to produce. We put buffers in place in terms of componentry in particular to begin with. Again, we are still working our way through those, so we have not yet seen the full impact of any delays at the border.

As Mike described, we have seen some inconsistency in the way the border is operating, but, in overall terms, the flow is working. From our perspective, just-in-time means that those flows need to work very effectively. We are still taking precautions in terms of adding additional inventory and additional flows, just to make sure things are arriving on time. Quite clearly, if a lorry or some sort of transport gets in the wrong order, that will impact us very quickly in terms of our production.

Overall, it is working okay. We are looking forward to July to see what happens when those full customs checks come into place, but so far it has not impacted us in terms of production.

Q56 **Chair:** We will come back to some of those points in further questions. Specifically on your point around data, again maybe you could write to us about the data point so we can understand it in a bit more detail. That would be helpful.

Moving to Simon Peckham from Melrose, I should probably declare a constituency interest in that a number of my constituents work at GKN Aerospace just north of my constituency, but GKN Aerospace and GKN Automotive are key components of the supply chain. What has your experience been like since the start of the new year?

Simon Peckham: I am chief executive of Melrose, which is one of the UK's largest engineering businesses. We turned over £11 billion in 2019. We are not seeing any significant effect from Brexit whatsoever. We are very pleased with and welcome the Government's deal, and we congratulate them on achieving it.

Q57 **Judith Cummins:** My questions are really about the future benefits, first of all. I am going to take this in two parts, and it is a question to you all. Much of the analysis of the TCA has focused on the disruption and instability it has caused, but, before we come on to that, are there any material benefits to the new arrangements as set out in the TCA for your sector or organisation? If there are not any at the moment, do you anticipate future benefits from the new arrangement? If so, when would you expect to see a tangible impact?

Mike Hawes: It is too early to say whether there are going to be any tangible benefits. At the moment, most of the industry is focused on making the new systems work. You can look at the Brexit deal, but let us not also lose sight of the fact that a number of other deals have been agreed with other international markets. These are rollover deals, by and large. For most of the industry, that is essentially about damage limitation.

The question you are getting at, though, is whether there will be future benefits. At the moment, as I said, we are focused on the initial operations. For many companies, the additional paperwork friction that is involved can add the equivalent of a couple of percentage points in terms of additional costs.

The TCA does provide a basis for the future, and that is very important. In particular, the TCA provides in the short term some very encouraging arrangements, certainly in terms of battery and electrified vehicles. Those rules get tougher as time goes on, and the UK Government were very successful in negotiating a more flexible approach to these vehicles to ensure they were not going to be subject to tariffs and that batteries and components in the short term were not going to be subject to additional tariffs.

What this does is gives the UK a window of opportunity, and that window must be about attracting inward investment, for example the gigafactory production and the associated supply chain that goes with it. If there is a benefit that goes with it, it should be that it is viewed as concentrating minds on the importance of inward investment. To be able to do that, we have to make sure the UK retains its inherent strengths and its competitiveness.

We have always said about Brexit in general that it has been about damage limitation. Nothing is going to replace the way you trade under the terms of the single market, so you need to say, "Okay, let us try to minimise the additional costs of that. What are the benefits more globally?" That is too early to call.

Ian Howells: I would reiterate what Mike has said. Quite clearly, the auto annex was extremely helpful in terms of offsetting some of the dynamics we are having to deal with. Batteries are key to that. Certainly, the environmental changes are starting to gather some pace; we are starting to see this with the Road to Zero, but probably more so on the European side in terms of the green deal. Therefore, the electrification of the supply chain is increasingly important. At the moment, batteries sit very much at the heart of that. In terms of overall benefit, very much as Mike has said, we did not see any direct benefit to our business from the agreement or from what has happened so far.

Going forward, quite clearly the ability to define rules and regulations under which we are operating does provide some opportunities, but equally there is a risk side to that. If we have that regulatory divergence from what Europe are doing, that adds cost and complexity to our production. It is a double-edged sword in that respect, and it is something we need to watch very carefully.

Looking at it from a UK plc point of view, it releases some elements of those standards that Europe are setting and the rules and regulations they have, but equally we will need our own rules and regulations around that. As I said, the greater the divergence, the more difficult that becomes in terms of cost and, probably more importantly, the competitiveness of our products in Europe.

Simon Peckham: To a degree, in terms of the success or otherwise of Brexit, it is down to industry, Government and the people of the UK to seize the opportunities that are available to them. Apart from that, I would not have anything to add to what my fellow panellists have said. They have covered the subject very well.

Paul Everitt: I would say, like many, that the deal was limited in its nature, and most of it adds additional costs to where we were before Brexit. The opportunities, if you like, are around how much of an improvement we can make to that deal over the longer term. Particularly for the aerospace industry, that is around the relationship between the newly created UK Civil Aviation Authority and the existing European Union Aviation Safety Agency.

If we can develop the deal that is currently in place, which for us means a maintenance annex, some changes to the relationship around design, certification and approvals, then we can improve the deal. The second stream, as others have mentioned, is really about the choices the UK makes in determining its future competitiveness and what its strategy is going to be to strengthen key industries and the productivity and competitiveness of the nation.

If we do that, we can make the deal work as well as we can, and hopefully over time we will improve the effectiveness of the administrative and bureaucratic burdens that have been imposed. With goodwill on both sides, we can make improvements that make it a much more effective and beneficial relationship for both the UK and our European partners.

Q58 **Judith Cummins:** I will now move away from the future benefits, because what most people seem to be saying is that it is too early to tell yet, because we are months into the TCA, rather than years. I will move on to the teething problems. In your assessment, are these teething issues that we have now more longer-term or systemic issues arising from the fundamental change in the trading relationship between the UK and the EU post Brexit? Specifically on teething issues, are there specific things you think the Government should be doing right now to alleviate these problems? For example, I am thinking about the shortage of customs agents and poor trader readiness. I wonder whether you think the Government still need to do more in those areas.

Paul Everitt: Unquestionably, there are a range of teething problems. I have mentioned a few, and I can go into some detail around making things work and making sure there is a good international understanding of the new arrangements. As an example, the new UK CAA certifications and approvals are not always immediately recognised by countries with whom we do not have a bilateral aviation safety agreement. That is something that can be easily overcome, but it takes time and effort.

There is a second area where we think there is an opportunity for government to do things differently. We have established a new regulatory arrangement. At the moment, UK industry is paying 100% of the price and the cost of the administration of that new regulatory arrangement compared with our European colleagues, who are only having to pay 70% of the cost of the equivalent to the European Aviation Safety Agency. If you go to the US, most of our competitors in the US are not having to pay the costs associated with the US equivalent.

For us, there is definitely an opportunity for Government to help fund to a greater extent the new regulatory arrangements they have put into place. Similarly, as the relationships develop and the new relationship settles down, there will be changes in the way in which businesses organise their supply chains to optimise the costs associated with moving goods across borders. There is definitely an opportunity for the UK to optimise more work in the UK, but one of the big costs associated with that from an aerospace point of view is that—

Q59 **Judith Cummins:** I am sorry. Do you see these as more systemic issues or teething issues? That is the nub of the question.

Paul Everitt: The majority are systemic issues that are bound to the terms of the deal.

Simon Peckham: Part of the reason why we do not have a significant effect from Brexit is that we do not move that much across borders as a company, either in GKN Aerospace, where we primarily supply Airbus in the UK, or GKN Automotive, where we primarily supply into UK automotive manufacturers. We are not moving huge amounts cross-border. Government can clearly do everything they can—indeed, the European Governments have a responsibility to do that as well—to try to make that process as seamless as possible.

I am sure that can be improved, but we are not seeing any major teething problems in our business, as I said earlier, and we are not seeing a significant effect from Brexit.

Ian Howells: Broadly, I would describe them as non-systemic so far. Certainly from our point of view, we have had some annoyances along the way, some noise if you like, as I mentioned, over logistics, but one that did pop out at us, for example, was banks suddenly charging cross-border for cash transactions. In effect, we had to move it to Amsterdam to avoid that. This is also in terms of the CAS system, which is the underlying customs system that HMRC has been implementing. That is still not fully operational and it still needs to be put into place.

Again, these are more in the nature of teething issues. I would come back to the point Paul was making, though. The systemic issues could come later, and that will be as a result of regulation and the different direction the UK might decide to take or otherwise. That is where we see the systemic issues starting to arise.

Mike Hawes: Just to add to that, in terms of the teething problems, yes, there is a lot of pressure on freight forwarders and brokers. There is a shortage of them. As I am sure you will hear from subsequent witnesses, we are seeing freight costs go up sometimes fourfold. We have a number of members either undertaking or considering having to use air freight, which is a last resort given how expensive it is. It is still cheaper than stopping production. Those are the teething problems while the system beds down.

As I said, the systemic issue is that this adds cost. It is a lot more complicated to move stuff across borders than it used to be. Throughout the negotiations and their different iterations, there was a lot of talk about the application of IT to ease the process. That needs to be developed and implemented as soon as possible, because, in the modern world we are in, having to provide a stack of paperwork is not congruent with effective and efficient movement of goods and services.

Q60 **Charlotte Nichols:** My question is for the whole panel. What cumulative impact has the uncertainty surrounding the end of the transition period, Covid-19 and the implementation of TCA had on your sector or organisation?

Mike Hawes: Undoubtedly, the big challenge for a lot of the industry last year had to be Covid. We had manufacturing shuttered for a number of months. We had and still have showrooms closed, and that is affecting demand. The way the industry managed Covid sucked a huge amount of resource. That resource had to be taken away from preparations for Brexit and the change of planning. Across the industry, manufacturing was down just under 30% last year. That was a product of demand and also concerns about supply at the beginning of the pandemic. Undoubtedly, the bandwidth was only so great.

However, on the more positive side, do not underestimate the importance of getting that deal and what that deal says in terms of the UK and its future. By that, I mean that there was huge uncertainty hanging over our industry. That was significant. It was the uncertainty that was the barrier to investment. I am not saying that having a deal means the cork is suddenly out of the bottle and that investment is going to flow like it is coming out of a champagne bottle, but it helps put the UK back on global agendas. While there was uncertainty, you did not know what your future trading arrangements were going to be. People still recognised the UK, but they were not going to go there because of that uncertainty. Now we at least know what the future will be.

Covid is a global issue. We have a pathway out of it, and our vaccinations are potentially ahead of most other countries in the world. We need to use those advantages and overcome that issue while, at the same time, managing these changing trading conditions especially with that July deadline still hanging over the industry.

Ian Howells: I will pick up on a number of points that have been mentioned, just to bring them together. Mike mentioned the cost of shipping and movement to air freight. That has certainly been very significant. For us, that was not generated by Brexit but by Covid, as we had shipping delays and ships ending up in the wrong place. There were the well-reported issues at Felixstowe, for example. In terms of cost as well, as Mike was saying, a shipping container is costing four to five times as much as it was pre-Covid, so there is a very significant cost in terms of shipping componentry in particular, which we tend to do by container. In that respect, there has been quite a sharp impact from Covid. Dealers have been closed, of course, and that has hit the demand side of the business.

In terms of a knock-on effect from Brexit, Covid also absorbed some of our Brexit contingencies. In other words, componentry and finished product were absorbed significantly by having to cover off Covid as well as Brexit, so there was a double impact there.

The other area I would pick up on is slightly outside the immediate European agreement, in terms of the side agreements that were also put in place. I call them side agreements, but the Turkish agreement was very significant for us, and we very much welcome that development in terms of maintaining the pre-Brexit arrangements in relation to trade with Turkey. Of course, we also very much welcome the Japanese trade agreement. As a Japanese business, that was very welcome.

Coming back to the point about confidence, certainly among my peers in Japanese companies, that was very much welcome. It probably settled a good number of nerves in terms of their trading prospects in the UK going forward.

Simon Peckham: Last year was really much more the story of Covid. We did not see any particular Brexit effect, but the impact of Covid was huge. At one stage, we had all of our European car plants closed. Some of our aerospace factories were open. We had to make a number of difficult decisions. Thankfully, we are starting to see a worldwide recovery in auto. At the moment, we are not seeing that in aero. Obviously, that is to do with the lockdown procedures that are in place. However long they last, they will definitely have an effect on the aerospace industry. Any effect last year has to be about Covid rather than Brexit.

Q61 **Charlotte Nichols:** Before I come to Paul, I had a supplementary question for ADS. I am just conscious of time, so I will ask that and you can answer both together. Obviously, Covid-19 has had a detrimental impact on the aerospace sector in 2020, but will the provisions in the TCA help or hinder your recovery?

Paul Everitt: Like everyone has said, the pandemic has had a very negative impact on the sector. As a comparator, production in 2020 was probably 30% to 40% below what it was in 2019. We continue to be impacted by international travel restrictions, which limit our ability to have a clear path to recovery.

There is nothing in the agreement that particularly either facilitates or undermines recovery. What we have seen is that, since 2016, the rate of growth that we saw in the UK aerospace industry was lower compared to the market as a whole. The market itself was growing strongly, but it was not growing as strongly in the UK. We feel that is very clearly because there was some uncertainty about what the future relationship was going to be, which prevented people from investing perhaps as readily as they might have done. Where they were having to invest in additional capacity, they were preferring to do that in regimes where there was more clarity on what the overall business environment would be.

There are some challenges for us as we go forward, but the immediate ones are getting the recovery going and getting international travel up and running. Over the slightly longer term, it is about how we ensure the UK business environment is as competitive as possible.

Simon Peckham: I would agree entirely with what was just said. There will not be a big difference one way or the other in terms of the EU trade deal in the short run for aerospace. The most important thing for aerospace is getting people back on planes and getting people travelling again. I appreciate that is to do with wider issues around Covid.

Q62 **Mark Pawsey:** I have some questions to ask about rules of origin, but I just want to pick up on a point that Mike made. Mike, you spoke about the need for us to have a gigafactory. As a Warwickshire MP, would Coventry be a good location for that?

Mike Hawes: I am sure it is, but you will understand if I am diplomatic and say that there are a number of good locations across the UK. The important thing is that we need more than one. We need four or five. Everyone should be a winner.

Q63 **Mark Pawsey:** It links in to the issue around rules of origin, because, Mike, when you were with us before, you told us that it could take several months for manufacturers with complex supply chains to get their procedures in place in respect of rules of origin. Particularly if you go down to tier 2, tier 3 or even further down the supply chain, we know that often people are not entirely confident about the origin of a small component. You said that you have a short-term relaxation of the rules. How are businesses getting ready for that?

Mike Hawes: It is an incredibly difficult issue given the complexity of demonstrating and calculating the origin in tier 4, tier 5 and so forth. The grace period that we have is not on compliance; it is about proof. We will still ultimately have to prove that origin; we just have 12 months to be able to gather the evidence to demonstrate it, and then you can do it retrospectively.

Most manufacturers are choosing to do that. Some are perhaps more wary about it and are still paying the rules of origin, and they are subsequently going to claim a duty draw-back on demonstration. That is where that facilitation has been incredibly helpful. The challenge is not just on what you are doing now but also what you are doing in the future. You are trying to attract investment; you are trying to develop new parts and new components, especially with the shift to electrification. The importance of UK content is going to increase significantly as the technology changes and, in doing so, your sourcing issue is going to become that much more critical.

The importance of battery supply, either in the UK or Europe, given the cumulation, is going to be critically important. That goes for the entire supply chain. Being able to trace that is incredibly complicated, but it is part and parcel of doing international trade, I am afraid.

Q64 **Mark Pawsey:** Mike, if it is complicated and takes a lot of time and effort, are there some businesses that will not bother and will instead choose to pay a tariff? What impact is that going to have on the price of the finished product?

Mike Hawes: It is hard to talk about the price of the finished product, because it depends on how many companies will be subject to that tariff or choose to pay it. It is too early to say in that regard. We are aware that some are sceptical of being able to demonstrate it and will pay it up front, and, when they have in place the methodology to demonstrate that they qualify as tariff-free, they will then claim that under a duty draw-back approach. It is probably too early to give you any impact on cost, but we are an industry built on high volume and small margins. Every piece of margin has to be addressed. If this adds cost, you will cease to be competitive in the marketplace. You have to find other ways of overcoming that cost increase.

Q65 **Mark Pawsey:** I wonder whether I might turn to Simon Peckham, as somebody running a business with a very broad range of suppliers. Simon, you are presumably very comfortable with rules of origin on the products you are manufacturing in-house, but you will have a supply chain going down to tier 2, tier 3 and tier 4. How confident are you that those small businesses that are supplying your business know exactly where they need to be on rules of origin?

Simon Peckham: We have spent a lot of time on this. It is not Simon Peckham who does this; it is our procurement teams in each of our businesses. One of the things we have actually done as part of the GKN takeover is improved those teams and made them more proactive about talking to our supplier base. A huge amount of work goes into that.

We believe we will be alright. That does not mean there will not be hiccups from time to time. There is currently a hiccup on chips because it has all been diverted somewhere else and there was a fire in a factory. There are going to be problems from time to time, but an enormous amount of work goes on. In fairness to the other trade bodies I am with today, they do an enormous amount of work to try to get the best we can. There are going to be problems, but we are doing our best to solve them and we are trying to be part of that solution process with our suppliers.

Q66 **Paul Howell:** I will continue with some of the points my colleague Mr Pawsey has just been talking about. In terms of rules of origin in this space, are we seeing that there are going to be really fundamental changes in the supply chain in terms of the need to have more UK manufacturing as a result? Could I come to Mike first? Is it radically different from one part of your supply chain to another? I guess it is.

Mike Hawes: On the second part of that question, no, not yet. I will come back to that. When OEMs are sourcing componentry, they are looking for a number of factors: obviously cost competitiveness, but also quality, reliability of supply and innovation. There are a number of particular issues. The tariff on parts and components is normally somewhere between 2% and 4%. In a high-volume, low-margin business, that is still significant, but it is probably not insurmountable. You just have to drive down costs in other areas. That is where we need to make sure, as a country, we have an approach, a strategy, a set of policies and a framework that makes manufacturing competitive to overcome some of these additional costs.

In the medium-to-longer term, as I said before, the need for a shift in supply chain from producing internal combustion engines to battery-based vehicles is going to lead to a change in supply chain, and we want the supply chain to make that transition. Always remember, however, that a vehicle will still have a lot of common parts, whether it is powered by an internal combustion engine or whether it is powered by a battery. For some businesses it will not so much be business as usual, but it will be about making that transition as quickly as possible to different types of vehicles; for others, it is a more fundamental change.

That is both an opportunity and a threat, as always. The way automotive works is that every two or three years you are trying to re-pitch for the business anyway. You have to be constantly on your mettle in terms of competitiveness.

Q67 **Paul Howell:** Just before I move on to the other witnesses, can I go a little further on that? As part of the TCA, there has been a lot of discussion about batteries into cars. Even for somebody who does not have a great deal of awareness of the motor industry—the motor business but not the motor industry—there has to be a complex supply chain that sits behind that. It is not just the battery; it has to be the other electrics and things. It has to be a much broader supply chain. Do you want to comment on that, Mike, and then I will jump over to the other witnesses?

Mike Hawes: Yes, absolutely. It is not just the batteries, although the battery will probably end up being the single highest-value component of the vehicle. An electric vehicle will have fewer moving parts, by definition. There are more parts in an internal combustion engine than there is in a battery and an electric motor. As I say, you need the associated supply chain of power control technologies, electronics, motors and so forth, all of which the UK has some advantage in, which we need to nurture.

As I said, it goes back to having an approach, a framework, that incentivises investment, innovation and good links with the R&D capability that the UK has. The commercialisation of some of those technologies will be fundamentally important. It would be a mistake just to look at the battery; we need to look at both.

Q68 **Paul Howell:** I want to broaden the conversation a little as I move around the witnesses. You touched on the relative advantages or disadvantages that we may see, particularly during the six-year transition period, but what are the things that the Government and others should be doing to help position things so that, as you go through that period, you come out the other end with the advantages maximised and the disadvantages minimised?

Ian Howells: In that respect, picking up a couple of the points Mike has already made, quality, cost and delivery are always going to be key. It is always going to be that balance to make sure you have the right components at the right cost coming in at the right time. From that point of view, clearly, if you can near-shore quite often it is going to be more effective in terms of robustness in your supply chain.

At the end of the day, our vehicles and similar vehicles made by our peers will have something in the region of 30,000 different parts and 2,000 or 2,500 subcomponents. Monitoring and keeping on top of the origination for rules of origin is a key part of the systems and processes we have put in place.

Coming back to the point that was made earlier, that takes a significant amount of time and effort to put into place. We were fortunate, in that we were already operating rules of origin so we therefore already had a good idea of where our products and components were coming from. Clearly, that was a result of a very specific project a number of years ago when we started to export to America. It takes a good six to 12 months with quite a large project team to put that type of capability into place.

Picking up on another point, we look product by product as to whether we apply rules of origin. In some cases, it is not worth the system changes that are required for us to move in that direction, so we do vary that quite a bit.

In terms of the actual impact going forward, yes, if we can get the product at the right price, that is always going to be an important consideration. The issue the UK supply chain has is that it is relatively small. Therefore, it has struggled historically to keep pace in terms of the economies of scale that are so critical in making sure the cost of a product is right. It has struggled. If we go back in time, trying to build a car from UK componentry was physically not possible. It is a relatively low percentage volume of the total vehicle.

Mike made reference to cumulation. That becomes such an important part of qualification for rules of origin going forward. We have the Japanese agreement in place; we have the European content; we have UK content. For example, wiring that together and having that as an accumulation certainly makes rules of origin a lot easier to deal with. That is certainly something we should be looking at moving to. Overall, rules of origin are unfortunately here to stay. Nevertheless, there is an opportunity, as Mike said, as the supply chain starts to switch towards electrification, to take advantage of that in a new environment with new suppliers.

Paul Everitt: From an aerospace point of view, rules of origin are probably not as significant as they are in the auto sector. By and large, there is a pre-existing plurilateral agreement, which, in the major cases, is what the sector uses. There are exceptions to that, but that is where we are.

The challenges are clear for us. Quality, cost and delivery are normal things for a supply chain. Aerospace is a highly regulated sector, and therefore companies will not choose to move things easily or unnecessarily. That means there is a degree of stickiness in the aerospace supply chain that is perhaps greater than in the automotive one. Over the longer term, we too are facing very dramatic changes in technology. To ensure we come out on the right side of any technological changes or optimisation of the supply chain, it is really about the focus on how the UK Government will choose to ensure and support UK manufacturing.

For us, it is all about increased investment in R&D to ensure we are leading the change to net-zero aviation. It is also about ensuring that we have a business environment in the UK that encourages people to invest here, both companies that are already here but also those that want to come and invest here. That is particularly true of our UK supply chain.

We need to ensure that, having come through a very difficult period because of the pandemic, we put in place longer-term financial support for that supply chain so it can both invest in the technology to ensure they are part of the future as well as being able to continue to deliver a high degree of the existing demand.

Q69 **Paul Howell:** Mike, let me just throw one question back at you that I failed to ask earlier. You talked about how some firms will be self-declaring the situation as opposed to using the Customs Declaration Service. Do you have a sense as to what proportion of businesses are doing it each way?

Mike Hawes: This is obviously just about the rules of origin certification. Most are choosing not to pay the respective duty in the belief they will meet the qualifying criteria. It will be a minority, and you could understand that in terms of cash flow and so forth.

Paul Howell: Yes, that is what I expected. I just wanted to hear you say it.

Q70 **Alexander Stafford:** On the importing of goods, the UK Government have allowed firms importing most goods into Britain from the EU to defer submitting a customs declaration for up to six months at the point of import. We have had concerns expressed to us that many firms are deferring these customs declarations without keeping the records necessary for future declarations, which creates a risk for firms around building up administrative and financial liabilities that they will later find hard to discharge, or, frankly, they are just not declaring them.

Are your members or firms aware of this risk? What steps are you taking to help them mitigate against it?

Paul Everitt: I have to say that it is not one of the ones that is high on our risk register. We are certainly wary of the new administrative procedures that will come in later in the year in terms of imports, but, by and large, companies are familiar with the processes. From our perspective, these are not the biggest issues we are facing. They are certainly not ones that are being raised on a regular basis with us.

Q71 **Alexander Stafford:** Mike, is that true for you?

Mike Hawes: Yes, increasingly our members are focused on what happens in six months' time. We know some automotive companies and their customs brokers are making use of the phased approach to customs controls and submitting monthly declarations, but increasingly the focus is on what happens in six months, in July—it is less than that now; it is four months—when the full import controls are introduced. People are taking a cautious approach. Given the pressures on brokers and so forth, you can anticipate that there could well be a peak in demand for them in and around that six-month period. In terms of risk mitigation, you do not want to be exposed to any shortage of capacity at that time.

Ian Howells: As a company, we have kept on top of our paperwork. Again, some very rigorous work was done by the business in the run-up to Brexit and subsequently, as I was explaining.

Our risk is with our supply chain. From that point of view we have been working with them through our procurement team to make sure they are complying and they have the right paperwork in place. As Mike said, looking forward to July, they are going to have to have it, so it is better that they get it in nice and early rather than accumulating a potential issue. From a business point of view, we are fine, but we are working closely with our supply chain.

Q72 **Chair:** Mike, if I could come to you next, as a Committee, we are conscious that there are various announcements going on in the automotive markets, with positive announcements around investment in car production in the UK. For example, there is the decision about the Vauxhall plant at Ellesmere Port that we are waiting to fully understand, and the announcement from Jaguar Land Rover recently.

I am just interested in your view on what you think automotive is going to look like in five years in the UK. It is such a major employer, especially in some communities where there are often not alternative sites for the workers to go to. Are we going to end up being a country that produces a smaller number of vehicles but leads in R&D, or do you think we are going to continue having the high level of manufacturing that we have now?

Mike Hawes: It is crystal ball time. It is a very difficult question to answer. In answering that question, you have to look back a few years and forward a few years. If you look back, a lot of the investment was increasingly put on hold. We were running at annual investment rates of about £2.5 billion for the sector over the last seven or eight years, but over the last three or four years that dropped right down. There is some stored-up investment, and you are beginning to see some of that with some of the announcements that have been made. A lot of companies have been holding on to make their decisions. I put Ellesmere Port into that as well. They were delaying that decision as long as possible until there was clarity.

On top of that, we have the Government announcement about the end of sale of petrol and diesel engines in only nine years. That is compounding the pressure on the industry to ensure it is effectively fit for purpose for the future of automotive industry. We have some inherent advantages in terms of workforce flexibility, R&D capability and good links to the universities. Essentially, it is a fundamentally productive and good place to invest in automotive, but we need to attract some significant investments soon around, as we said before, batteries and the supporting supply chain to be able to take advantage of the change that is going to happen very quickly in terms of the market.

In terms of the future of the industry, a few years ago we had ambitions to make 2 million units a year. That is not going to happen for the foreseeable, for some very clear reasons. That said, if you look at the diversity of the UK industry in particular, we are still, I would suggest, one of the most attractive and envied automotive sectors, when you look, particularly, at the diversity here, and especially when you look at luxury and premium brands as well as the inherent productivity of our volume manufacturers as well.

Q73 **Chair:** Simon, we have heard today how important it is to maintain UK-based manufacturing capacity, whether it is about borders or concerns around rules of origin. As a Committee, we are conscious of the announcement to close, potentially, the GKN Automotive site in Birmingham. Will you be continuing to make those products in a different way in the UK or will you perhaps be offshoring them to somewhere in Europe or elsewhere?

Simon Peckham: Thank you very much for that question. I much appreciate the chance to talk to the Committee about this. We saw some articles in the press a couple of weeks ago: I got invited to this meeting without knowing about it, and I actually refused without knowing about it too. It is a pleasure to be able to come and correct the record on some of the inaccuracies that have been going on.

As part of my preparation for this meeting, I went back and looked at what we said to the last Committee—I appreciate that the members have changed a bit—and also what we said in our offer document. What we said then was that GKN was a troubled business that was not performing to its potential and that something had to be done about it. Thankfully, the shareholders agreed. That is why they sold to us. When we bought it, we said that we were going to put the divisional management in charge of the business, and that is what we have done. We also said we were going to improve the businesses, and that is also what we have done. We have sorted out some of their customer relations; we have improved their procurement; we have improved the operational side.

We have also invested in these businesses. In 2019, we invested £227 million in auto, of which £114 million is supporting new programmes and £75 million was into the exciting new EV powertrain. I will come back to that.

In your constituency, in aero we have tried to redirect investment in technology into the UK. In 2017, it was about £7 million. We have managed to get up to about £19 million now. The culmination of that—I would like to congratulate the Government for doing this, because they put up half the money—was the new global technology centre, which we would love to invite you and your Committee to come to. You will be able to walk into the global technology centre and see a wing of tomorrow, the most advanced wings in the world. You will be able to see one of the world's first electrically powered planes being constructed by GKN. You will also be able to see world-leading technology in titanium. That is before we even talk about what I know is one of your interests, hydrogen-powered planes, where we are the UK leader and we have committed to that.

We have made those commitments—

Q74 **Chair:** I am sorry to interrupt. I am a big champion of your aerospace work in north Bristol, because it is great work and it employs many of my constituents, but the purpose of the session today is just about the Brexit scenario, so I would like to focus your mind on the question I asked, which was on the issue we have heard today in evidence to the Committee, about how important it is to manufacture automotive components here in the UK. My question was merely about whether you plan to continue to make automotive components in the UK with the proposed closure of the Birmingham site, or whether you plan to offshore them into the European Union.

Simon Peckham: Let us be entirely clear: Brexit has no influence over the Erdington decision. Erdington is one of the difficult decisions that we were presented with. As well as the good stuff we do, when we inherited GKN it was basically a troubled business. Your Committee spent quite a long time talking to them about that and the profit warning they did at the time. As a business, it needed improvement.

When we inherited this from GKN, in the auto space in particular, there were actually only two factories in the UK out of about 40. We have a relatively small, admittedly, factory in Abingdon, which is to do with new technologies that we are investing in to grow. We also have Erdington.

Let me turn to Erdington, because it is a difficult position. It is one of the difficult things. We have complied with the spirit and the word of every undertaking we gave, but we also said we would make difficult decisions from time to time. Unfortunately, Erdington is one of those. If I look at the situation it is in—I can now share this with you, because we wanted to talk to our employees in the consultation process first, because it is quite right that they should hear this information first—it may be a shock for you to know that, over the last 10 years, Erdington has lost money every single year. Those losses now total over £100 million. Over that time, people have tried to improve the business but they have failed to do so.

Unfortunately, between 2016 and 2019, about a quarter of its marketplace has gone. The UK marketplace it is supplying into has unfortunately disappeared. Then we have a further problem as well, which is that about 40% of its current sales are to do with a product that will disappear after electrification. Unfortunately, electrification is a threat to jobs as well as an opportunity to grow jobs. For GKN Automotive as a whole, electrification is an opportunity; unfortunately, for Erdington it is not.

If you put all that together, we have done the best we can to look at it. We have complied with the spirit and the word of what we said. I would be very happy to run you through the undertakings; we gave your Committee a briefing note as to what they are. Unfortunately, GKN Automotive management took the very difficult decision that they had to go into a consultation process and explain all this to the employees. Unfortunately, that is what is happening right now.

Q75 **Chair:** Thank you, Simon. As I said, this session is not about the broader decisions in your businesses; it is really just about the Brexit impact. I am going to try to ask the question for a third time, but then maybe I will leave it. You have said that electrification means there will be a decline in the need for components made at the Birmingham site. Does that mean, though, that you are not going to continue to make those components, or will you make them in the UK in a different way or will you make them somewhere else?

Simon Peckham: Unfortunately, Erdington is not a manufacturing site. It is purely an assembly plant. It does not have a manufacturing process; it does not have manufacturing equipment. The past management chose to put the manufacturing site for EV manufacture in Bruneck in Italy. We did not make that choice; they did. We have capacity in that plant and we have an existing plant doing the manufacturing there. Unfortunately, there is nothing we can do about it. It is a legacy we inherited.

Q76 **Chair:** Thank you for that. I assume that, in the normal way, you will commit to consulting with the employees and the unions to try to find alternatives to closure.

Simon Peckham: There is a consultation meeting happening today and there was one last week. Of course we will. I would like to say that we are sorry. We do understand. This is difficult for the employees at Erdington, and we do understand the effect we are having on them. We are sorry about that, but we have done everything we said we would do in the context of the takeover. Unfortunately, this is one of the difficult things we have to do to make GKN a better business in the long run.

Q77 **Mark Jenkinson:** I had some questions for Simon, but many of the points were covered in the previous answers. We have heard that the agreement does not really have a material impact on your business, Simon. Very quickly, in the wider context of Brexit, what can the UK Government do to help the UK maintain some competitiveness? What advantages and opportunities do you see for your company from Brexit, given that you have plants in Italy and the UK?

Simon Peckham: We acquired those plants. I would love to put more manufacturing in the UK. I have the legacy I was given to do that. Equally, we have a competitive plant in the Abingdon plant, which we are trying to build up. We have big plants in aerospace, some of which are in the Chair's constituency. I would like to say again that we have upped investment in technology in those plants from £7 million, when we bought this business, up to £19 million. We have just spent £32 million, half of which came from the Government—this is part of the answer to your question about the Government—to invest in world-leading technology in wings, which is going to be very important in making planes more efficient. On engines, we are trying to look at hydrogen engines. We are the UK leader for that. If you go there, on that site we are constructing a very large part of the world's first—if it is not the first, it is one of the first—electrically powered planes.

We are also investing a huge amount of money in titanium additive manufacturing. I am sorry if you already know this, but, just to explain, that is essentially about the printing of parts. Instead of all the waste that goes with forging or, indeed, machining parts, we would print more intricate, lighter parts. It is all about reducing weight on planes, which boosts efficiency whichever power system you are using.

We are very committed to trying to make GKN, and indeed Melrose, a better business. I am British. We are very committed to trying to build the best possible plants here, but unfortunately we have to take difficult decisions from time to time. One thing I did get cross about was reading in the paper that we had breached the spirit or the commitments we gave. We have not, in any way, shape or form, breached any single commitment we have ever given. In fact, we have done exactly what we said we were going to do.

Mark Jenkinson: I look forward to the Committee's visit to the site.

Simon Peckham: I appreciate that the Covid environment means it might take a little while to get there, unfortunately, but we would be delighted to have you and your Committee. We would be delighted for you to see what a great British company is doing at the forefront of technology in aerospace.

Chair: Thank you to our four witnesses on the first panel today: Mike Hawes from SMMT; Ian Howells from Honda; Simon Peckham from Melrose; and Paul Everitt from ADS. We are grateful for your contributions this morning.

Examination of Witnesses

Witnesses: Duncan Buchanan, Joe Marshall, Jessica Sargeant and Fergus McReynolds.

Q78 **Chair:** We are now moving on to the second half of our session today, with Fergus McReynolds from Make UK, Duncan Buchanan from the Road Haulage Association and Joe Marshall and Jess Sargeant from the Institute for Government. Welcome to all four of you, and welcome back to the Committee again.

Opening the questions today, I have a question that is primarily for Fergus and Duncan. It is the same question you probably heard on the first panel. With the trade deal now having been agreed, what does the world look like for the sectors you represent? Fergus, one of your colleagues referred to it being Dante's fifth circle of hell, which sounds pretty bad. From your perspective, has it improved since the start of the year?

Fergus McReynolds: Thank you for the opportunity to talk to you today about our experiences. I would echo some of the comments that have been made by the previous panellists around the importance of finishing last year with a deal. That should not be underestimated. A lot of what we have seen, to some extent, comes from the inherent challenges of leaving the single market and the customs union. Those were decisions that were made and were known. That introduces a great deal of friction across the border. I suspect the comments my colleague was making were in relation to that friction.

The TCA recognises that we are not in the single market and the customs union, and it tries to build a relationship based on a free trade relationship. The picture is mixed. It is not black and white. For some businesses, it has been a considerable challenge. Certainly, when we surveyed our members some two weeks ago, 61% of the members who said they had been prepared were still experiencing disruptions. We are genuinely seeing a lot of disruption within the sector. Some of that is around systems and some of it is structural.

There are other businesses that have made this work and that will make the new relationship work. In fact, one in five of the companies we surveyed said they had not seen any disruption. For our sector, it is not as simple as saying it is all bad or saying there is no problem. For a lot of businesses, this is a mixed picture at the moment. There are certainly challenges today, and I am very happy to share some of our experiences with you later in the session.

Q79 **Chair:** Duncan, you have been very busy representing the Road Haulage Association. Have things started to get better? Are these teething problems or are they causing you longer-term issues?

Duncan Buchanan: I would like to echo some of the things Fergus said there. It is very important to understand that different markets are experiencing different problems. You have just been listening to the automotive and aerospace industry. If I was going to characterise the automotive industry, I would say they were probably among the best prepared with the highest levels of skills and capability to deal with the problems. That is not the case universally across all sectors. Some sectors have coped relatively well and have dealt with the challenges better than others.

The other thing to bear in mind is that we are now on only the second day of the eighth week of this. Your direct question is really important. I had already prepared to say that we are seeing improvements and we will see improvements. They will happen over time. It is what the logistics industry does. It deals with the problems that are presented to us, and we find ways through it.

January in particular was incredibly challenging, and we still have major issues around the availability of customs agents and the processing of paperwork, particularly in some sectors. It is a very challenging circumstance, but things are improving. The impacts are as we expected. We see big issues coming down the road in July and in April around SPS, but, as I said, our focus is on making things work.

We are not interested in whether Brexit is good, bad or indifferent. That is landscape to us. What we have to do is work with the environment we are given and do the best we can to make sure the services we provide to Fergus's members and everyone else work for the future. We have very bad issues in some areas, but things are not so bad in others.

Q80 **Charlotte Nichols:** My question, similarly, is primarily for Duncan and Fergus. What cumulative impact has the uncertainty surrounding the end of the transition period, Covid-19 and the implementation of the TCA had on your sector to date?

Duncan Buchanan: Mike Hawes from SMMT mentioned earlier that settling the TCA one week before the deadline was not enough time. We are dealing with tens of thousands, or even hundreds of thousands, of businesses and individuals who are having to make decisions, and they did not have sufficient time to assimilate the information that was coming towards them. That was a serious timing issue.

We advocated an implementation period; we did not have one. People had prepared as much as they could, but there were huge gaps because so many things had not been settled. Even in the road haulage industry directly, the rules that were going to apply from 1 January were only settled a few days before Christmas, right in the middle of a Covid pandemic, right in the middle of dealing with new rules regarding Covid testing. Everyone was working flat out. There was that period just before Christmas where we had the queues in Kent. It just filled everyone's minds. There was no space to deal with Brexit in the two weeks before Christmas, really. We were dealing with Covid.

Fergus McReynolds: The point you are getting to here is about the cumulative impact. As you heard from the witnesses on the previous panel, 2020 was a year that was, for many manufacturers, about getting to the end of the year and coping with the pandemic, which was right in front of them and having a real impact on their business.

Again, there is a mixed picture in the manufacturing sector. Some sectors are particularly challenged by some of the measures last year. The aerospace and automotive industries obviously are. There are then different issues in other sectors. The food and drink sector may have had a slightly better year in terms of output, but they have had other challenges.

The point that Duncan makes is absolutely valid. Something we called for was an introductory phase. Learning what the black and white of the text of the agreement said on Christmas Eve, with eight days to go until it was implemented, was a challenge for many businesses. That was particularly true for some of the detail of the agreement. While we could probably have, relatively accurately, prepared our companies for about 90% of what we anticipated, you could never have been 100% ready for the end of the transition period. We would have liked to have seen an introductory phase.

How much of that is impacting today? Duncan is absolutely right. A lot of companies had challenges at the end of the year around the disruptions caused by the Covid restrictions and the travel restrictions implemented in that week in the run-up to Christmas. That is still being felt in the sector. Things are out of place. That was a challenge. Some of that is following its way through. We are starting now to get into more of the issues around the actual application of the TCA.

The cumulative issue is the real issue. That is at the root of your question, and it is absolutely correct. The impact of both not knowing, the uncertainty, and having reduced capacity because of managing Covid has been a challenge to the start of this year.

Charlotte Nichols: Thank you, both. That was very instructive.

Q81 **Alan Brown:** Fergus, we have already heard about a mixed picture in terms of some sectors being more ready and able to adapt. Are you now in a position to identify what have been termed the teething problems arising from moving into the TCA and what is more systemic? More importantly, for systemic issues arising from the TCA and the new relationship, are there key issues that the Government are going to have to address going forward?

Fergus McReynolds: Yes, we are starting to see some of that. It is still relatively early days, but what we do know is around what types of supply chains and structures of business simply will not work in the future relationship. That is becoming increasingly known.

What I am referring to there is that, while on the face of it the agreement delivers tariff-free and quota-free trade between the UK and the EU, the devil is in the detail around understanding the rules of origin component of that. That will decide whether it is tariff free. There will be a lot of transits of goods that will have a tariff associated with them. The issue here is around trying to understand how much of this is preparation, knowledge gap and systems being in place versus simply business models that will find it more challenging to exist in the future relationship.

We are starting to get there. Certainly, if your business is orientated around bringing goods from outside either the UK or the EU into the UK, not processing them and then sending them to Europe to service the European market, in the classic FTA relationship that we have with only bilateral cumulation, it is a very significant challenge for businesses to continue that model. That is one area where we know there will be a long-term structural change, if you have the impact on that model.

In terms of some of the other issues, this is still bedding itself in. There is a knowledge gap. We tried to address that. There is an issue about understanding the systems and an inconsistency of application. That is not just in the UK; that is a picture across the board. While we are facing the challenge of coming to terms with a new system that we did not see the details of until the last two weeks of the year, that is equally true of customs authorities across the EU, and we are still seeing inconsistency in the system there.

There are some really acute problems today that I can see will right themselves in time, but I am not underestimating at all that the new structure of the relationship means that some business models will not work or will be challenged in the future.

Q82 **Alan Brown:** Do you have confidence that the UK Government are taking enough action to rectify these anomalies and making sure they are working with other Governments? You say that customs clarifications are required there as well.

Fergus McReynolds: As Make UK, we are talking to the UK Government on a weekly basis, if not considerably more often than that. We are alerting them to many of these issues. We are working with the Government to try to address some of these challenges.

There are some things that can be addressed—some of this is about addressing the knowledge gap—but, equally, there are some things that, with the best will in the world, simply will not work in the new relationship. It is important for us to recognise that.

As far as addressing those issues is concerned, I do not see that there is an appetite on the EU side particularly for renegotiation. It has made that extremely clear. For us, what we need to do is find the sweet spot to work with the Government on addressing those issues that can be addressed, addressing the issue of improving the knowledge gap and working to find pragmatic solutions with the EU to keep goods flowing.

Q83 **Alan Brown:** Duncan, I have a similar question about teething problems versus systemic problems. You also said earlier that things are improving. Are things going to continue to improve or are there further hurdles? For example, we know that full customs checks for incoming goods are to be implemented in July. Is that going to cause further setbacks, or are there sufficient Government preparations in place to deal with this?

Duncan Buchanan: I will build on what Fergus was saying, in terms of the complexity we are seeing around the EU side. There is a misunderstanding, to some extent. We are not dealing with a single customs body on the other side of the Channel; we are dealing with 27 individual member states. From the haulage industry's point of view, we really see that the inconsistency is because, if you go into Belgium, the Belgian authorities will do it one way; if you go into Holland, the Dutch will do it a slightly different way; the Spanish and the French will do it differently. People have tended to think of the EU as a cohesive single customs area, which it is, but each individual authority behaves in its own ways and has its own culture and rules. That is adding complexity.

We are seeing people start to realise, as Fergus said, that some goods will no longer be able to take the additional friction that is coming, and that is going to be permanent. That is not transitional or teething. There are some goods where the friction will add too much cost for those goods to continue moving. It will affect SME businesses more than large businesses, and it will affect and impact food and agricultural businesses more than, say, the manufacturing sector.

For many in the SME sector—certainly, this is the feedback I have had—the rules of origin problems caught a number of people by surprise. They are not used to dealing with rules of origin in a lot of sectors. In automotive and aerospace they are, but a lot of sectors are not used to dealing with it, so it caught a lot of people out.

We are in the eighth week. To answer your question about whether things will get better, yes, they will get better, because we are learning. Everyone is learning: the customers are learning; the customs agents are learning. Thousands are needing to be employed to do the customs processes here and in the EU. They are new customs process. There are new people. Every time you have new people involved, it will cause issues. It will get better, but the problems are serious and in some cases permanent.

Q84 **Alan Brown:** On the customs agents, the UK Government—I think it was in response to yourselves—said that the estimate of 50,000 new customs agents being required was an arbitrary industry number. Is there an accurate estimate for how many customs brokers are going to be required? Is there any evidence that there are enough agents being put in place to manage the workload going forward?

Duncan Buchanan: There is evidence that there is an insufficient number of customs agents now. As regards the number not being recognised, the 50,000 number was broadly accepted by the Government, by officials and what-have-you, and they have never come up with an alternative number. I would throw that challenge back to the Government. If you are going to criticise the industry's accepted numbers, numbers that you accepted previously, if you are saying they are wrong, what is the right number?

The truth is that what we are seeing is customs agents and hauliers cherry-picking the business that they want to do at the moment. If something is complicated, if it involves groupage, SPS, complicated rules of origin, complicated customs procedures with drawbacks or anything like that, the agents are turning it away.

We are also seeing price increases. One of the earlier witnesses talked about increased prices in the container industry. We are seeing increasing prices in the road haulage sector as well. We are seeing people choosing to leave empty rather than deal with the complexity of the problems, and that is pushing up prices.

Yes, we are seeing the impacts. They will get better. We will get more people trained. There are more people still to be trained. The Government have accepted that there is still a need for many more people to be trained.

Q85 **Alan Brown:** Duncan, written evidence to the House of Lords Committee's inquiry identified the serious problems arising from limited cabotage rights, with only two drop-offs being allowed in Europe. It was suggested that that the biggest impact is going to be in the culture and entertainment sector. I have a logistics company in my constituency, FMX Events. It usually goes on EU-wide tours with bands. Half of that business is currently at risk. What steps have the Government taken to recognise this situation and to recognise how major an issue this is as regards cabotage rights?

Duncan Buchanan: They have not taken any serious measures in relation to the issues around concert tours. It is quite difficult. They have just done an agreement with the EU. The TCA has put in place arrangements. This is really important. Fergus and some of the other witnesses talked about this earlier. When you set up a completely new arrangement like the TCA has done with the European Union, it is a bit like Microsoft issuing Windows 95 back in the day: when you issue it, you put it into the real world, it starts getting play-tested and you find all sorts of bugs, things that do not work.

The cultural transport issue is one of those areas where the cabotage rules and the restrictions on international haulage, both in the UK and in the EU, do not work for cultural tours. We would like to see serious action from the Government, the European Commission and EU member states in recognising that cultural events need to have arrangements around them that allow them to take place. The haulage and the specialised haulage needed to do the cultural events need to be properly looked after.

We cannot have a situation where you cannot do a complete tour in Germany or across the EU for an orchestra because the haulage is limited to two journeys within the EU. It just does not work as it is, and I would suggest that the Commission, the European member states and the UK Government need to look at this issue. They need to look at the bugs and improve them. Make things easier for people to do work that is really predictable but was overlooked in the negotiations.

Q86 **Alan Brown:** Do you see any indications that there is an appetite to get these bugs resolved, and resolved quickly?

Duncan Buchanan: There is an understanding in Government that these are serious problems. I am not sure at the moment that, in the eighth week in, they have the systems in place to do it. I am hopeful that, with David Frost joining and the talk of the committee being established to deal with the future relationship, these things will get dealt with as a priority, so that we have arrangements that allow concert tours, orchestras, Formula 1, major sporting events and bands. All of these cultural events need to be looked after, allowed and facilitated, as well as circuses, museum tours and art tours. All these things can be severely limited by the current restrictions.

Q87 **Alan Brown:** Can one of the IfG representatives answer this? In your written submission to the Committee, you distinguished between short-term and long-term impacts of the TCA, but you also indicated it is going to be quite hard to distinguish. From what you have heard from witnesses, does that reinforce or challenge your analysis?

Joe Marshall: Thank you very much for having us. We have covered a lot of ground and the witnesses have definitely covered a lot of the material that we are very aware of. Many of the things we have said about distinguishing between the short term and long term do still stand. That is in large part because of some of the stuff that various witnesses have said about how we are still very much in a state of flux, how things are still becoming clear and how in some areas we are still seeing the full impact play out, whether that is because firms are still adjusting and looking at things or because the costs of some of the third-party operatives that firms rely on, such as the customs agents or the transport sector, are still in flux there; the customs agents sector particularly has not yet met demand, really. Some of those things mean it is hard to tell.

For instance, there are some things that could be called teething problems in the supply chain, if you have some delays caused by firms or actors not being aware of certain requirements or not quite having the right paperwork. There might be some of the hiccups with IT systems that played out earlier. These are some of the things that cause short-term disruption. Over time we would expect things like that, and hopefully things like the shortage of customs agents as well, to be resolved and to improve.

In the short term, many firms are able to deal with those problems and adapt, whether that is by having to pay more to transport goods and absorb costs for a while, by looking for alternative supply routes or by avoiding GB distribution hubs, for instance, to ensure that they do not fall foul of the rules of origin reimportation issue. Over time, there should be more certainty and predictability built into those things, as those issues are resolved.

Ultimately, the supply chain you are left with, as a result of the kind of Brexit deal that we have, is likely to be costlier, slower and have more points in the supply chain that are subject to vulnerability and could be subject to disruption. Therefore, businesses will be looking at that and thinking, "We have dealt with this for a while, but going forward, in the long term, is this sustainable? Can we absorb these costs?"

I have a couple of points I would quickly make, which have not been raised today but are really important. We have talked a lot about goods and movement of goods, but services and the service sector is another huge area where the TCA is relatively thin. There are lots of new restrictions for firms on how they can provide services in the EU, on short-term business trips and things like a lack of mutual recognition of professional qualifications, and also in terms of the fact that many of those rules are complicated by the fact they differ across different member states.

One of the big issues there is that, while firms are adjusting and are dealing with those—we have seen lots of impact in the services sector already around financial services, in particular, and business moving elsewhere—in many areas the full impact has not quite been seen yet, particularly on those business trips and business travel, because Covid is suppressing that business travel. Some firms are looking at that. Many large, sophisticated businesses will have been preparing for that and are used to those sorts of requirements for rest-of-the-world trade, but many other firms may find that comes as a surprise. It is one of those issues that will come to the fore in future.

Another issue that Duncan mentioned earlier but that has not been raised hugely in this session is the fact that we have so much distinction between sectors and between firms within sectors. Automotive, aerospace and large manufacturing firms were broadly well prepared and also able to make use of stockpiling, for instance, but some of the most immediate early disruption we saw was particularly in the agrifood sector and particularly in the seafood sector, for a constellation of reasons, one being the perishable nature of the products meaning they could not be stockpiled. They were more vulnerable to disruption and delays, and we also have particularly onerous requirements and new SPS requirements that firms have to deal with at very short notice.

Then there is also the fact that there is a plethora of smaller businesses in that sector, often exporting small volumes, where increased transport costs, customs and frictions involved in the TCA have a bigger impact and are harder to adjust. Broadly, smaller firms are also generally less prepared than larger firms for the end of the transition period.

Overall, there are still lots of moving parts. We have lots of stories and lots of evidence of things that have happened, with disruption and firms adjusting. It differs broadly between sectors and between firms. We are going to be looking forward and seeing what happens next. There are lots of changes still to come and the full impact of many changes has not yet been seen.

Q88 **Sarah Owen:** These questions are for Fergus, but they lead on nicely from what Joe has just mentioned, so if anybody else from the panel would like to join in, please do. We have seen a lot of coverage about pro formas and work visas, but in your report on the impact of the EU-UK agreement, you note that almost 61% of manufacturers regularly send employees to the EU for business, yet three in 10 companies are unaware of the new rules. What immediate and long-term disruption is this likely to cause your members and UK manufacturers?

Fergus McReynolds: There are two forms of transit for us. There are the day-to-day business trips, which allow for business to flow between the UK and relevant markets, but there is also the provision of services. The points that Joe made are very valid in this. It is important for us to get that right. There are some flexibilities that are provided for in the business travel provisions under the TCA. It is going to be interesting to see how they actually work in practice. Right now the disruption we are seeing is related to Covid travel restrictions, so we have not seen the true impact on that. We have seen people turned away at the border, but that has predominantly been because of the travel restrictions associated with Covid right now. Getting these things right is going to be vital for our sector.

Joe picked up on a couple of the other issues around the mutual recognition of professional qualifications. That will be key for our sector as well, making sure that engineers and qualified technicians are able to continue to practise under the qualifications that they have already gained.

It is going to be important to understand how each member state is going to apply the rules. When it comes to working as a third-country national within the EU, that is a member-state competence. The TCA provides the framework to allow that to happen, but ultimately it will be down to the individual member state to determine how that process is legislated in their market. It draws on from what Duncan said earlier and what Joe has highlighted. Increasingly, outside of the single market and customs union, it does not look so singular for a third country, because, when it comes to the movement of people, you are dealing with 26 different markets; in all other areas of regulation, you are potentially dealing with 27 markets.

Certainly, when it comes to this issue of business travel, you will have to know what the specific requirements are in each member state before you travel. What is really vital for businesses to understand is that you will have to do that before you go. The assumption of entry is what has been removed. At the point that you are checked by a border guard, it will be at their discretion whether you are granted entry. You will have to fulfil a large number of requirements before you even get to that point to know whether you should be granted entry. It will always be at their discretion; there is no automaticity any longer.

Q89 **Sarah Owen:** Fergus, we have talked about existing workers, but I wanted to touch on changes that could affect workers and skills within the manufacturing industries. Are work visa rules around the minimum £20,480 wage and the RQF 3 requirements having an impact on the industry already? If so, are there any specific sectors that are more affected than others? We heard from the automotive witnesses before that they were not so affected, but I know that is not necessarily the case for all of manufacturing.

Fergus McReynolds: Right now, because of the travel restrictions, a lot of companies have made the decision not to engage in movement of people. We are seeing people delaying decisions on doing that, so right now the evidence base is not as high as we would want it to be. There are specific challenges in some elements of the sector. I would be very happy to follow up in writing with our views in terms of the impact of the points-based immigration system requirements. Right now, the issue is much more acute around corona travel restrictions, and that is stopping transits from really testing the new system; that is in both directions. This is an issue that we are not going to understand until those travel restrictions start to be lifted later on in the year.

Q90 **Paul Howell:** I know we have dominated this with Duncan and Fergus, and I am sorry, but I am staying with them at this point. Just in terms of what we have talked about on the frustrations of Brexit and around the TCA and other things, we have had a number of years of uncertainty for business, so therefore there was no investment or no changes. They did not know where to go. You are now coming through into this new world. We have talked about whether things are systemic and about the impacts. Is anything going to arise in terms of fundamental changes to operating models for businesses, now that they know where they are going? They have had four or five years of almost stagnation in terms of decisions. Are there going to be step changes now that they know where they are going?

Fergus McReynolds: There will be long-term changes in structures for those businesses where the new relationship does not work. It is important to say that right now there are genuine challenges for businesses: there are increases in cost; there are increases in time; it is becoming increasingly difficult to fulfil the expectations of either suppliers or customers. There are real issues today that need to be highlighted, and we need to find solutions for them.

Paul, in answer to your question about the long term, yes, there are, unfortunately, inevitable consequences of the decisions that have been made around the relationship. Much of the manufacturing ecosystem across Europe has grown up in the environment of being inside a customs union and inside a single market. There are business models that have been developed to take full advantage of that.

I am confident that our sector, as innovative as it is, will take advantage of the new relationship in the future, but that is not to underestimate that there will be structural changes and there will be some businesses for which the new relationship just will not work. It will be particularly in those areas where you have narrow profit margins, and particularly in the areas where you have a large amount of the supply chain crossing borders without any substantial change to the product.

It is an anomaly of international trade that you see working very sensibly in markets that are distant from each other and are not as integrated as our markets are, but the transit of a product from one market into the other market, then losing its identity because it is not processed and then coming back out of that market, is a challenge. That will make things more difficult. Using the UK as a base to service multiple European markets could be something that might, for some businesses in some sectors, become increasingly challenging.

I hope that answers your question. Yes, there are acute problems right now. Some of those can be improved but it will be a complete change to our relationship, and for some businesses it will mean the end of how they operate today.

Q91 **Paul Howell:** I know it is not really the focus of where we are today, but is there a build-up question on that in terms of the position that we are in now? Some of those businesses may just pivot from the EU to the rest of the world.

Fergus McReynolds: It is still too early to say at the moment exactly how they will do that. What is going to be interesting is bringing a set of businesses that have only ever traded inside the single market and customs union into an environment exposed to the trappings of international trade. We have often talked about exporting to Europe, and really we have not done that for the last 40 years. We have been trading on a single market inside a customs envelope; that is not really export. The delta change between sending something to a European customer and sending something to a customer from the rest of the world has been quite a substantial difference.

Perhaps one of the potential benefits is that that difference will be reduced. Sending something further afield is not as much of a change in terms of how your business is set up, because you will need customs knowledge inside your business to service your European market. You will need to understand how international trade rules work. There is a potential, as you said, to get an advantage in understanding how to trade globally as fully export-orientated businesses, because we are being forced to do that with our closest market. That is a potential benefit. In terms of the reorientation of supply chains, it is still too early to say.

Paul Howell: Thanks for that, Fergus. I appreciate where you are coming from. Duncan, do you have anything to add?

Duncan Buchanan: I would like to make a couple of comments, if I may. First, in advance of 1 January, substantial investment of time and effort was put in place preparing for this. Do not think that people were just sitting on their hands. It would not have gone as smoothly as it did; I am saying that very advisedly. It went as well as could possibly be expected in the circumstances. It is a real credit to the logistics industry that it went as well as it did. I really think that. People take logistics for granted.

In terms of what is going to change, there are going to be fundamental changes in supply chains around the border issue that Fergus was just talking about. You will not be importing from the far east and distributing from the UK into the whole of the Europe. It just becomes a nightmare to do that. You will not be doing that in Europe either. There will be people in Europe who are going to have to change. The logical explanation is going to be to have individual distribution centres in the UK separate from your EU distribution centres, which allows you to deal with rest of the world.

People need to simplify their supply chains as much as possible. That is going to be the real change. Some business models are incompatible with the border arrangements that are being put in place. That is just an inevitable consequence of not being in the single market and customs union. People will adjust and change. We have heard about problems with parcels, Amazon parcels, people being charged duties and stuff like that. That will disappear, because people will just work in a different way. They will slice the salami in a different way.

Paul Howell: Spending the last seven years of my pre-MP working life as a logistics director, I absolutely endorse the work that you guys have done to get to where you are. Well done.

Q92 **Chair:** I am sorry to our colleagues that we are running over. Before we finish, Jess, would you be able to give us an update on the GB-NI situation? You were very helpful in calling out some of the issues before the end of December. How is that looking now?

Jessica Sargeant: Yes, absolutely. Thank you for having me back. Understandably, this session has focused on the GB-EU aspects, but it is important also to consider the GB-NI issue. It is important not to overstate the extent of disruption, given some of the political sensitivities around the protocol at the moment. The recent ONS survey that looked at GB-NI trade found that, of businesses that would usually trade between Northern Ireland and Great Britain in those two weeks, only 1% had ceased deliveries altogether, so most trade is still continuing, but, none the less, there are issues.

Some of those are around the new customs processes that have been introduced that just mean, as we spoke about in respect to GB-EU trade, some of the existing business models or ways of doing things just are not appropriate anymore on that crossing. There are particular issues around groupage and mixed loads, although I know the Government are looking at solutions to those. We have also seen some areas, particularly around SPS, where certain products are now prohibited under EU law. We have seen that particularly in the horticultural sector. Certain seeds and plants can no longer be transported between Great Britain and Northern Ireland.

We are also potentially going to see more of those issues come down the line with the end of the grace periods. There is a three-month grace period for export health certificates. That is the particular piece of paperwork that agrifood movements need to be accompanied by. If that comes into force in April, as it will do unless there is another decision or agreement in the joint committee, it is possible that we will see more disruption. There is also that six-month grace period for chilled meats, sausages and other restricted products. Again, if there is no solution to that, it will mean that trade in those particular products will have to cease between Great Britain and Northern Ireland.

A key point is just to emphasise how important those ongoing discussions in the joint committee will be and the need for a quick resolution to provide certainty to businesses, which need to know whether they will be required to produce this new paperwork at the beginning of April, which is just over a month away. It is really important that there is swift resolution. It is probably going to require a bit of movement from both sides in order to find a long-term solution to that, but hopefully we will hear more about that in the coming weeks and months.

Q93 **Chair:** Do you have any particular insight, Jess, as to progress on those issues in advance of the three-month and six-month deadlines? Presumably the negotiations are happening right now and we are just waiting for confirmation from Ministers as to what that will look like.

Jessica Sargeant: Yes, absolutely. I have heard from some business groups in Northern Ireland that their meeting with the co-chair of the joint committee last week was perhaps more promising than they were expecting, so that is a good sign. From what I have heard and from what I have seen around those discussions, we are more likely to be able to find a long-term solution to the issue of restricted products, so that sausage and chilled meat issue, than we are to the issue of export health certificates, because the integrity of the SPS health of the single market is a real priority for the EU. However, an extension to the grace period on that issue is likely.

We have been recommending more time to implement the protocol since last year. The reason for that is that the facilities to conduct those checks in Northern Ireland were not ready at the end of the year, and I have not seen much evidence that they are likely to be ready for April. That is, again, partially because of some of the political sensitivities around those. The fact that the Northern Ireland Executive is responsible for making those preparations has somewhat delayed it, as well as the practical challenges.

In that area an extension to the grace period might be likely. Whether it is until 2023, as Michael Gove suggested would be the preference, or whether it is a bit shorter is what will be up for negotiation. Finding a long-term solution to that issue around agrifood paperwork is going to be much more difficult, and it is difficult to see how we could find one unless the UK Government are willing to commit, to some extent, to some form of alignment on mutual recognition on those EU SPS rules. It is not clear that that is something the UK Government would be willing to give at this point.

Q94 **Chair:** That is very useful. Thank you, Jess. Lastly, Joe, we have heard in the session today that there are lots of issues where we need to resolve problems but also maybe build on what was agreed in December to improve things for British industry. We have now had Lord Frost appointed to his capacity in the Cabinet Office. What more do we have to do to get the machinery of the UK-EU trade relationship up and running, so that we can start to make progress on these things?

Joe Marshall: Definitely, it is good news that we have seen the UK appoint Lord Frost as joint chair and that we are seeing movement there. We know from discussions that officials have had publicly in other committees that Lord Frost is taking part in those conversations, establishing other committees and working out how they are going to be staffed and led out of Government.

The TCA and the governance structure of the TCA is immensely complicated, covering cross-cutting issues across Government and many different specialist areas as well. That will require some sort of central Government co-ordination, which Lord Frost and hopefully the Cabinet Office team will be able to lead on. It is a cross-Government piece of work.

Some of this will take a bit of time. It is good that the partnership council can get going on these things, but some of the other committees may take time to get up to speed. We know the TCA puts in place some formal structures to have conversations about development, whether that is on mutual recognition of professional qualifications or whether it is some of the other sub-committee structures on things like aviation or customs. We might see movement and discussions there. There are various other deadlines to review certain bits of the agreement that could provide opportunities to revisit some of the issues.

The general point I would make is the wider political one: the TCA was subject to fraught political negotiations right up until the wire, and while we know that the TCA will not work for some sectors and some businesses in the way they would like, and that it does not resolve some of those issues and creates new frictions, it is unlikely there is going to be the political appetite on either side to fundamentally reopen large bits of the agreement, particularly at this stage. Many of those non-tariff barriers and issues that have arisen so far are the necessary consequence, as Fergus was saying, of leaving the single market and the customs union. They are the consequence of the kind of Brexit deal the Government pursued.

One thing that was not that helpful last year, and unfortunately continued a bit as the TCA came out, is, at a political level, about making clear that there are trade-offs involved in that kind of Brexit deal. Saying there are no new non-tariff barriers, for instance, is not helpful when we know there are and we knew there were going to be as part of the agreement.

The TCA will evolve over time. There are lots of structures in place for it to do so. It is good we have seen progress in setting those up. Lots of discussions need to carry on, on things like financial services equivalence decisions and getting those memorandums of understanding on financial services under way. Lots of these things need to start happening, and time is ticking along quite quickly, but we will not know the full impact and see all of these changes for quite some time.

Chair: There is still a lot to do, by the sounds of it. I am afraid I am going to have to call this session to an end now, because we have run over. I am grateful to Fergus McReynolds from Make UK, Duncan Buchanan from the Road Haulage Association and Joe Marshall and Jess Sargeant from the Institute for Government for your contributions today and for sticking with us as we ran over. Thank you, as always, to colleagues and Clerks for the session today.