Select Committee on the European Union

External Affairs Sub-Committee

Corrected oral evidence: Brexit: Future trade between the UK and the EU in goods

Thursday 3 November October 2016

10.05 am

[Watch the meeting]

Members Present: Baroness Verma (Chairman); Baroness Armstrong of Hill Top; Lord Balfe; Baroness Brown of Cambridge; Lord Dubs; Lord Horam; Earl of Oxford and Asquith; Lord Risby; Lord Stirrup; Baroness Suttie; Baroness Symons of Vernham Dean; Lord Triesman.

Evidence Session No. 5 Heard in Public Questions 64 - 84

Witness

I: Mr Mike Hawes, Chief Executive Officer, Society of Motor Manufacturers and Traders.

Examination of witness

Mr Mike Hawes.

Q64 **The Chairman:** We welcome Mr Hawes to this evidence session, which is being broadcast. We will have a transcript sent to you after the session so you can see whether it needs any corrections. We look forward to hearing evidence from you. You will have had the questions pre-circulated to you. They may not be the questions put to you by the Committee; they may be variants of them. When the questions are posed to you I would like you to respond, if you will, with a shorter and a longer-term view. I say that so that your responses reflect that.

I start by asking you to give us a quick overview of the importance to your industry of trade with the EU and if you think there will be significant differences to trading with the EU in UK-made car parts, compared with UK-assembled cars.

Mike Hawes: Thank you very much for this opportunity. This is a critical issue for our industry. We are very much part of a European, if not a global, automotive sector that is very highly integrated. Your question is getting at that level of integration that we have, especially around the supply chain. In terms of scale, to set the scene a little, we are the third-largest manufacturer of vehicles in Europe. We are the second-largest new car market in Europe. On the supply chain, we have some 19 of the top 20 European suppliers with facilities here in the UK.

In terms of the importance of trade, we represent about 12% of all UK exports. Looking more specifically at vehicles and parts, we export 80% of what we produce. We produce about 1.6 million vehicles, which means that about 1.2 million are exported. Over half—57.5% to be precise—go to the rest of the EU. Similarly with parts, we export about £4.8 billion of parts in total. We have a trade deficit in vehicles and parts with the EU and globally. It is a huge part of the industry and we are very much part and parcel of the European automotive network.

The Chairman: Thank you. You spoke about the supply chain. It would be interesting to know the responses you have had since the referendum, particularly from the small and medium-sized suppliers, on, first, how they are preparing to exit from Europe and, secondly, what you as an association are doing to support the transition.

Mike Hawes: It is important to note that, going into the referendum, we surveyed our members. The view was consistent among large vehicle manufacturers, the supply chain and the aftermarket that they would have rather that the referendum had resulted in the UK remaining in Europe. Clearly that will not happen, so all the industry is now looking at the likely scenarios that may result. It is difficult to gauge the immediate effect, other than effects that have been driven by foreign exchange rate shifts.

Perhaps I can explain the nature of the industry. There was never going to be an immediate effect, where you wake up on 24 June and plants were shutting or contracts were going to move differently. We tend to operate on a three to four-year model cycle. For the supply chain in particular, every three or four years they reapply for those contracts. Where a contract is coming up for a new model in the next three or four months, this is a challenge because you are trying to understand what your future costs will be, but you have to make that decision now in pitching. You are in competition with other suppliers around Europe, or indeed around the world.

The immediate challenge for them is, first and foremost, what effect the exchange rate is having. Again, the contracts tend to be fixed-price, so the impact will not be seen immediately but will be seen in time. Large companies, such as vehicle manufacturers, hedge as well. Those hedging agreements take a while to unwind. The effect of the foreign exchange shift is not seen immediately, but it will be seen in due course and certainly into 2017.

We are working with the supply chain as best we can to make sure, first and foremost, that they understand the current situation, as far as anyone understands what will happen next. Equally, we make sure as best we can that the Government understand the nature and importance of the industry, and how different parts, whatever future relationship we have with Europe, will impact the sector, not just the large vehicle manufacturers or the small-volume vehicle manufacturers, but the supply chain and across the whole sector, because the SMMT represents the entire sector.

Q65 **Lord Stirrup:** Mr Hawes, Nissan has been much in the news recently, but Nissan is just one of several large UK car manufacturers that are foreign-owned, such as Toyota, Honda, Vauxhall and Jaguar Land Rover. What impact do you think Brexit will have on the location of international and European companies' headquarters, and on their investment in the UK? I would be very interested if you could take us through the timing of such investment decisions and what the Government could do to increase investor confidence. There has clearly been a conversation between the Government and Nissan. We do not know what it was and perhaps you do not know either, but clearly some reassurance has been issued. Would you expect that to be spread across the whole UK car sector?

Mike Hawes: First, Nissan's decision to allocate replacement Qashqai and X-Trail is a fantastic result. It is a very, very efficient plant. It is world-leading. The decision was clearly taken in some degree of uncertainty because we do not know what our future relationship will be. Nissan, ourselves and the rest of the industry should take encouragement from the comments of the Prime Minister and the Secretary of State for Business that they understand the industry, that they want to safeguard its competitiveness in future negotiations and that they recognise that the automotive industry is a major player and major contributor to exports. It is highly competitive at the moment. As far as we are concerned, we need to safeguard that. That is the answer to your question about the process behind a decision.

As I said, most volume models operate on a four-year product cycle. The more-premium, small-volume models, such as the Bentleys, the Rolls-Royces and the Aston Martins, will have a longer product cycle of maybe seven to eight years. The majority, certainly the majority of the products produced by Toyota or Nissan, will have four years. You have to step back about four years from when you are starting production to when you begin the process of deciding where the next model will be allocated. A decision taken today, as you saw last week, will not start production until 2019 or 2020. The UK industry is on track to have an all-time record in new car production, but that is the result of investment decisions taken over the past three or four years and will not be realised in volume terms over the next three or four years.

The process is first that the company will decide they will want a replacement model four years hence—it has been very successful and we want to replace it. Clearly, it will have new technology, new design and so forth. Then you look at which region it is targeted at, because all manufacturers have the inherent principle of building close to where they sell. That makes sense for logistic reasons. Then you look at the options you have in that region: do you have the existing capacity? Do you need to put additional capacity in? Is it a like-for-like replacement or a new model? Then you look at the business capabilities—the competitiveness—of the locations you have. Different manufacturers will have different options. No two will be alike because of the nature of their investment. Some may have only one European plant; some may have 10 that they can choose from. They will look at the cost and the ability to sustain the development of that model in terms of the supply chain and people, in case they need to recruit additional people. They will also look at the intangibles, which are sometimes overlooked in the decision-making process.

We tend to be a foreign-owned industry—not entirely, but to a large extent. You'll be looking at the UK and asking, "Do I feel welcome? We have a long-term commitment to the industry there". That is where, to answer the third part of your question, the Government can be helpful. What has been notable during the past six or seven years is the shift in attitude of government towards the automotive sector. It may have taken a financial crisis to remind people that it is still important to make things; we happen to be very good at making cars and parts. Successive Governments, from Labour through the coalition to the current Government, have recognised the industry and supported it, helping wave the flag internationally and trying to ensure that we remain competitive. The conditions are right for the UK to be competitive. You see that that is certainly bearing fruit when you look at the level of investment that has gone in. It is a long-term decision, but it takes into account a number of different factors. We have been very successful in recent years, as will be borne out by future product capacity.

Lord Stirrup: Do I infer from that that whatever happened between the Government and Nissan will be taken by the entire industry as a vote of confidence in its future, or will companies look for individual reassurances?

Mike Hawes: Certainly, in the statements which the Prime Minister, the Secretary of State for Business and other Ministers have made, they have been at pains to reiterate the point that the Government are trying to ensure that the UK automotive sector, not just Nissan, remains competitive. Invariably, different manufacturer locations have different challenges, but across the board, they are trying to maintain that competitiveness. I do not expect the Government to offer any guarantees, because they are going into negotiations and there is uncertainty. For the present, we remain within Europe, so we are subject to state-aid rules. Whatever future relationship we have, there will be trading terms which constrain the ability of government to provide more support. But we are competitive; we are not looking for support.

Q66 **Baroness Brown of Cambridge:** To follow that up, the UK has far more than its fair share of Formula 1 development companies, which are both good for stimulating innovation in our automotive industry and great PR for the UK as an advanced manufacturing country. Will Brexit affect their decision, as many of them are not UK-owned, whether to stay here, or will they move to Germany and other places?

Mike Hawes: I cannot speak with too much authority on that sector—it is not something that we are responsible to. My view is that it is a global industry and the UK's undoubted success in that field, with eight out of the 11 teams based here, is something that we want to ensure continues. They will scour the world for the best engineering talent, and clearly they will be very desirable places to go and work if you are a top engineer. They will certainly be concerned about any change in their ability to continue to recruit that top talent, be it from Europe or elsewhere. It is a globally successful industry that we need to continue to help grow because of the transition of technological developments from Formula 1 to production vehicles. The reverse is equally true, so it is important that both are seen as facing similar issues.

Lord Horam: Following Lord Stirrup's question, is capacity an issue? We are always being told that there is overcapacity and that there is a lot of extra capacity in France and Spain, for example. Will that have an effect on the decisions made about location of companies in the UK?

Mike Hawes: It could do, but each manufacturer will be in a different position. Some manufacturers do not have excess capacity. Jaguar Land Rover is building a new plant in Slovakia because it is on a massive growth curve. It depends on how particular brands and companies are doing. Perhaps it is simplistic to say that if there is additional capacity there that will undermine it. UK companies tend to operate quite successfully. Some operate in two shifts, some operate in three shifts and so are at maximum capacity; others have a bit more flexibility. It depends where they are in their cycle.

Lord Horam: It was thought that, with Nissan-Renault, Renault had a lot of excess capacity. I do not know whether that was the case. That is the worry.

Mike Hawes: While Nissan is clearly an independent company, Renault has a stake in it. I am not privy to its exact strategies. I am sure that it will look at putting any vehicle in the most productive place possible. That would have been a major driver for why it has ended up in Sunderland.

Q67 **Lord Triesman:** Good morning. You have already emphasised the importance of the supply chain—incidentally, we understand that last year the figure was that about 41% of the components of British-built cars came from the UK; I do not know whether there is a more recent figure than that.

Mike Hawes: That is the one from the last survey.

Lord Triesman: That is helpful, thank you. What would tariffs imposed on UK-EU trade do to the industry? I appreciate that there will be some speculation about the character of the agreements that are finally struck. What would the impact be if import tariffs on components were abolished by the UK? There may be one or two supplementary matters to come to.

Mike Hawes: You are right; the average UK-built car has about 41% UK components. In other words, 59-60% come from abroad—the majority come from the EU. We are part of the Single Market, so there are currently no tariffs on parts or vehicles. That is very important for the industry because of the nature of it. As you develop a model, parts will be developed in one country; they will cross a border into another to end up in a sub-assembly. They might then end up in an engine made in a third country and then be assembled in a finished vehicle in a fourth country. To a certain extent, that will happen between the UK and the rest of Europe for certain components. Any tariff will add cost. As I hope people recognise, we are an incredibly lean and efficient industry, constantly striving to reduce costs. The margins that the industry operates on are wafer-thin. It is a common rule of thumb that return on investment is around 4%. Any tariff will immediately be a critical challenge to a company, especially when their competitors may not be subject to those tariffs.

Lord Triesman: You have already commented on the exchange rate and the degree to which you were speculating—incidentally, if you have found a good way of hedging for four years, I would love to know what it is, as would probably all of us; it would be an interesting piece of commercial information. I want to turn to rules of origin and the impact they might have given the movement of vehicles and parts of vehicles in the way that you described. Is there a way to structure the rules of origin that would support the UK automotive manufacturing system without making the final product uncompetitive?

Mike Hawes: The rules of origin as they apply now are part and parcel of why we have such an integrated automotive industry, because the UK qualifies as Europe. Anything that changes that could have a very negative effect on the industry. Your question is whether that could be turned into a benefit to the UK. I think we would struggle to see any scenario where it would be a benefit. I would not want the rules to be used as a mechanism to force local sourcing—there are other ways in which we can do that, by the UK remaining competitive. You mentioned the 41% figure. That is an increase, albeit a relatively modest one, on where we were, at 36%. We are trying turn around a battleship here. The supply chain was eroded over many years because the industry as a whole was uncompetitive, and we saw production plants leaving in the 1980s, 1990s and early 2000s.

We have stemmed that. Production is growing, the supply chain is also growing, and as a result the mood music around UK automotive is very positive. That means that plenty of international companies are looking at the UK. If we continue on this incline, it will become a very attractive place to invest, because the volumes are there, and that is what will drive the decision rather than rules of origin. We see rules of origin as a threat rather than a tool to encourage that.

Lord Triesman: I know that we are short of time, Chair, but I have one other quick question. Outside the EU, do you believe that inspections, customs and delayed shipment issues will have an impact, or should we be relaxed about that?

Mike Hawes: By no means be relaxed. The term 'scaremongering' has been used a lot, but I am not seeking to do that. However, various studies that we have looked at have suggested that the non-tariff barriers could be as punitive in cost as the tariff barriers. We are a very lean industry; some manufacturers do not do any warehousing. In other words, the part comes from a part manufacturer; it is on a truck, and goes straight to lineside, even if it comes from abroad. The introduction of any customs is a significant concern, given that interaction of parts, in particular. Anything that involves a customs check involves administration, so you need additional heads. If it passes borders, you need a customs validation, that creates some delay, and anything that delays creates cost. Either you will have to warehouse it to act as a buffer, because you can never be sure how long the delay is going to take, or you will have to increase the logistic capability because you are going to take the part to dockside. The truck may have to wait there for however long it is going to take before moving on, so you will potentially have to double up the transport costs, too. So a figure of at least 6% increase in cost has been mooted by the CBI. Certainly, we have plenty of companies as concerned about the effect of customs as the introduction of tariffs, but tariffs are probably the number one.

The Chairman: We have two quick very quick supplementaries, one from Lady Armstrong.

Baroness Armstrong of Hill Top: Do you have any indication of large-scale companies that are not based in this country but use and manufacture some product in this country? I am thinking of BMW, which manufactures engines in County Durham. I know that it does that largely because the whole of our economy in the north-east has been geared towards making it straightforward for people such as Nissan to be very efficient, and they benefit from that.

Mike Hawes: Absolutely.

Baroness Armstrong of Hill Top: But that is a different aspect to what we have been discussing.

Mike Hawes: I said before that we make about 1.6 million vehicles. We also make 2.5 million engines. Ford, BMW, Toyota and Bentley all make engines—we make many more engines than we do cars—and those engines go into Europe and beyond, so it is a very valid point not to view the sector just as cars or a supply chain. There are diesel and petrol engines—and, on the R&D side, you can see the development that is taking place. Jaguar Land Rover has just opened a brand new engine plant in Wolverhampton, which will feed its UK production and its overseas production as well. That is typical of the industry.

Baroness Brown of Cambridge: Can I bring you back to your answer to the last question and your description of the problems of borders if we are outside the EU? I believe that Jaguar Land Rover is now saying that its vehicle entertainment systems cost more than the rest of the vehicle these days, because they are so sophisticated. I assume that all that comes from outside the EU—from China, Korea, Singapore and places like that. How do they manage that, and does that cause them serious problems? Is that not what a model might look like for how we might interact with part supply chains outside the EU?

Mike Hawes: As I said, if you look at the total part content of a vehicle, there are 6,000 parts, and the majority come from the EU, but certain products will come from further afield. The entertainment systems will come from abroad—but obviously there is an additional price associated with that. We want to see especially those new technologies developed in the UK and Europe.

Baroness Brown of Cambridge: But presumably we have ways of overcoming these problems that you describe—for example, on vehicle entertainment systems.

Mike Hawes: We export to more than 100 countries, so the industry faces tariffs and non-tariff barriers in other markets. But in Europe we do not, and the industry really benefits from that free flow. In an industry that is consistently trying to drive down costs, it would be perverse to say that we were prepared to move away from a system that has free flow and has no additional costs to one that would have. Undoubtedly, globally you face those challenges and they can be significant in different markets, way beyond the 10% currently mooted in terms of WTO in Europe. So it varies.

Q68 **Lord Balfe:** I think you have answered my question about non-tariff barriers. To what extent are procurement regulations of concern, in a post-Brexit world? I know they have been of some concern previously, but how do you see that development?

Mike Hawes: In being part of the single market, any procurement contract has to be open to all member states. UK manufacturers have the opportunity to tender for any large public procurement contracts wherever they are in Europe. It has always been an issue of some debate, because invariably, with any public procurement, any Government want to balance the impact on the public purse while having the intent or desire to support local industry jobs, and so forth. If we are not going to be eligible to apply for those contracts, UK manufacturers will clearly be at a disadvantage.

Lord Balfe: Could I ask another question? Would you regard it as a legitimate negotiating tactic for us to say that, if the right is withdrawn from UK firms, we should take a similar step in restricting our public procurement?

Mike Hawes: I think we would always advocate free trade and the maximum opportunity for UK manufacturers to compete globally. I do not think that that will be one of the most important issues. Our principle will be to try to maximise the global opportunities for UK companies.

Q69 **Baroness Brown of Cambridge:** Can I bring you on to the significance of standards? Clearly, being part of setting EU standards for things such as fuel consumption and CO_2 emissions as well as other emissions is important. I could throw in whole vehicle type approval and international technical harmonisation. Will it be essential for us to stay in line with all these things post-Brexit, or will there be advantages for us in coming out of some of those things?

Mike Hawes: As I said, we operate in at least a European if not a global industry. Ideally, we would like global technical standards, and to a certain extent there is a move towards that; the pace may be glacial, but there are a number of areas where there are global technical regulations. They start in the UNECE, and the UK is and will remain part of that process, which sets the direction. Invariably, if you are looking at different standards, you are looking at additional cost. When you develop a car for Europe, the beauty is that you produce it to a single standard, and then you can sell that car across a market of 550 million. If the UK was to come outside that and set its own standards, that would obviously have an additional cost and you would also then have to look at the effects on the consumer.

For a manufacturer that currently makes a huge range of cars—there are about 350 models on the market, so the consumer has a massive amount of choice, because there is that economy of scale and you can make a particular car for a particular niche—if the UK were to set its own standards, the manufacturer would say, “I can’t make the sums add up to give you that range of vehicles to a UK standard”.

The issues you raise about CO_2 and air quality—and I will come to type approval—are very challenging. The UK is part of the European regulation that, as you will be well aware, is trying both to set a reduction in CO_2 and address the air quality issue. Those new regulations, which come in next year, will apply to UK manufacturing and we would expect, and indeed want, those to continue post leaving the EU.

Turning to type approval, again one of the advantages of having a type approval authority in the UK is that it helps with R&D, which then helps with the production, and you can then get it type approved for anywhere in Europe. An immediate concern of ours is that the type approval authority in the UK is the Vehicle Certification Agency. It can authorise for a number of different standards but certainly it can certify for whole-vehicle type approval. We have a concern about the validity of a type approval certificate issued by the VCA post-2019 or whenever we leave Europe. Will it still be in force, or not? We do not have a clear legal opinion and so that means that manufacturers may be forced to immediately look to type approve their vehicles with a different agency—a German one or a French one for example; there are a number out there—to ensure that the vehicle remains certified for the life of the vehicle, which could be beyond 2019.

Baroness Brown of Cambridge: Given that we have quite a strong luxury car manufacturing base in the UK, is there an importance in being part of negotiating the detail of the CO_2 requirements for vehicles?

Mike Hawes: Absolutely. The CO_2 legislation sets a fleet average for all manufacturers across Europe. They all have to achieve an average of 95 grams by 2020/2021. There are certain derogations for niche and small manufacturers, of which the UK has more than any other Member State and arguably more than many other countries. That is something that we should be very proud of. It is important that the likes of Aston Martin, McLaren, Morgan and Lotus are able to influence the legislation so that their particular circumstances are taken into account. They cannot produce small city cars to offset their type of vehicle. This is where the UK played a very strong role in being able to negotiate a derogation under which they still have a CO_2 target that is broadly equivalent, but, instead of getting down to an average of 95 grams, it is the equivalent 25% reduction. It is still there, but it recognises that, unlike for a large manufacturer with a multitude of models and segments, you can deliver CO_2 benefits and still sell in Europe. If we did not have that derogation, it would be very hard for those companies to continue to sell in Europe.

Q70 **Lord Stirrup:** A number of industries bundle together the export of goods with the export of associate services through the so-called servitisation contracts. Does that happen in your industry, and if it does, does that introduce any special considerations in terms of negotiating Brexit?

Mike Hawes: The way vehicles are sold these days has changed considerably. Finance packages are involved in the sale of most new cars, certainly in the UK. That is fairly typical of European sales, although perhaps Brits are more predisposed to credit than some other European countries and we take it a bit further. Finance is an important part of the industry. Ford in particular has its European bank, Ford Credit, based in the UK. It would be particularly interested in what is happening to the financial services as a result of us leaving the EU. Often, due to servitisation, when you buy a car you can buy a service package and other bits and pieces. That tends to be done more locally. What we are focused on here is essentially the product, but we would like to see the free movement of goods and services in that regard.

Q71 **Baroness Symons of Vernham Dean:** We have touched on Formula 1 and the sale of luxury cars. Clearly, there is in this country a great strength in research and development. Do you see any opportunities, or is it only challenges that you face, in terms of intellectual property law if we leave the European Union?

Mike Hawes: That is a very good question. It is an area that we are looking at. We do not at a firm position yet. We want to ensure that we maintain a compelling case for investment in R&D in the UK. I think we currently have that. There are areas that could be improved but we have fantastic universities and good collaboration between the industry and universities. You do need to have the right framework in place to protect IP. One of the most exciting areas of the automotive industry is the technology that is being developed at the moment. We are going to see significant leaps in technology both in terms of the power train—how cars are propelled and the use of alternative fuels and electricity and so forth—and in the connected nature of the vehicle, potentially leading to autonomous vehicles. There has been huge investment by the industry, in the UK and abroad. To go back to the earlier question about standards, we need to make sure that these vehicles are interoperable. In other words, if a vehicle is autonomous in the UK, you can go through the Channel Tunnel and it will be equally autonomous in France.

There is a huge opportunity in the development of these technologies. Last year, we did a study with KPMG, and it quantified the benefit of connected and autonomous vehicles at around £51 billion to UK GDP. About £1 billion of that will naturally accrue to the industry and the other £50 billion is up for grabs. We need to make sure that the development of these technologies, and ultimately the monetisation of that, is safeguarded so that UK companies can benefit. We are looking at IP, but I do not have a firm idea of what the potential opportunities are, other than the importance of maintaining it.

Baroness Symons of Vernham Dean: But are there identifiable restrictions at the moment that you would be very glad to be rid of?

Mike Hawes: Not that I am immediately aware of. I can write to you with some further consideration, if I may.

Baroness Symons of Vernham Dean: That might be helpful. It is a big question.

Q72 **Baroness Brown of Cambridge:** Considering life outside the EU, what should the Government be thinking about when it comes to anti-dumping, countervailing duties and import tariffs? Would we want a regime that looks very much like the current EU one, or would we want to see some differences?

Mike Hawes: Essentially we want the UK to remain competitive. Individual companies will always look at alternative suppliers to try to ensure that there is competition for a particular part or material, because that will ensure that the price is low. Certainly on anti-dumping we want to be sure that competition is maintained, and maintained in Europe. I would not like to see anything that undermined the European attempts to ensure that competition is assured.

Q73 **Baroness Armstrong of Hill Top:** Very quickly, we have not talked at all about people, although it was in the ether of Baroness Symons's question. How important are European nationals, as opposed to British nationals, to the industry?

Mike Hawes: Very, very important. We currently have around 5,000 vacancies in the UK automotive sector. These are critical vacancies, often production engineers, design engineers and so forth. These are vacancies that we cannot fill. Most of our members who I talk to have non-UK nationals working for them. They will scour not just the UK but Europe and beyond to get these people. There is something of a global shortage of production engineers in particular.

The ability to attract and retain talent is very important, not just to larger manufacturers but to the supply chain in particular. For the likes of Nissan and Jaguar Land Rover—household names—it is probably easier for them to recruit. However, within the supply chain, they have as much need for some of these skills as large original equipment manufacturers, but it is much harder to recruit. Certainly they will need assurances that the non-UK nationals they currently have can remain and that they can continue to attract talent from abroad.

Q74 **Baroness Suttie:** Can you say a little more about the UK's unique strengths in the automotive industry compared to our competitors? Are there currently any parts made in the UK that you feel could not be made in those competitors' countries, which, post-Brexit, we could hold on to as a unique selling point?

Mike Hawes: The UK industry is unique. It is a mixture of major global companies which have invested in production plants here. It has some very strong domestic brands, for want of a better expression. It has some premium very small vehicle manufacturers which do not necessarily have the ability to go elsewhere but will be subject to the nature of the future trading arrangements. We have a strong engine production element, and we have incredibly good R&D development programmes in some leading areas in terms of new propulsion and new technologies. One other thing that we really want to do is develop the connected and autonomous vehicle technologies, not just test them here but develop some of the technologies. Certainly, if you look outside our sector at some of the work that is done in both the telecoms and tech sectors, there is going to be an overlap there with automotive. Anything that we can do to encourage that we will try to do. These are major investments and what you see among the larger companies is increasing collaboration between companies that might normally be, certainly on the forecourt, absolute competitors, but they will collaborate on R&D because it is hugely expensive.

The UK is competitive. Work was undertaken by the Automotive Council last year which looked at some of the key areas—I will not read out the list, but items are marked as being red, green or amber—that make the UK competitive. We are very strong in terms of labour productivity. We are arguably the most productive place in Europe for making cars. Workforce flexibility is very strong. University and industry collaboration is very strong. We are not as strong as others in terms of labour cost, as you would expect. Availability of engineers, as I said earlier, is a major challenge. The R&D system is reasonable but is not as competitive as in some other countries. So anything that the Government can do—it is encouraging that there is an industrial strategy already in place for our sector but that is of greater importance now to this Administration—to turn those weaknesses into strengths would present an opportunity.

Baroness Suttie: Following on from Lady Armstrong's question, as regards the 5,000 vacancies, would you imagine being able to recruit these people uniquely from the European Union or from beyond the European Union?

Mike Hawes: It would be both, wherever the best talent is we would want them here.

Q75 **The Chairman:** May I follow up with a small supplementary as well? Are suppliers exporting to the same extent as car manufacturers?

Mike Hawes: Probably not. I think you would characterise the UK supply chain as follows. As I said, 19 of the top 20 suppliers have facilities here and you have some large companies—GKN is obviously the outstanding one, as the largest UK company—but a lot of it is SME. As the major manufacturers have grown, they have attracted inward investment. There have also been opportunities for the UK supply chain. We want to see the supply chain grow, not just on the back of increasing volumes in the UK but also increasing exports. Obviously, we want to encourage them to export to Europe and beyond, so anything that would facilitate increasing exports we would very much support.

Q76 **Lord Stirrup:** You mentioned that there is a global shortage of engineers. Could you expand on the subject of capacity, not just for engineers but in total? Clearly, we have parts of our supply chain in the rest of Europe, and the rest of Europe has parts of its supply chain in the UK. What capacity is there for people practically to shift that: in other words, were terms of trade to worsen, is there capacity for car producers in the rest of Europe to be able to shift their supply chain out of the UK, or are the capacity constraints such that they simply have to make it work?

Mike Hawes: There is always capacity to move, to a greater or lesser extent. Certainly, as regards the majority of the supply chain here in the UK, we have identified that about 80% of the parts that go into a car are not actually made here and there is no UK supplier so, in other words, there are plenty of suppliers in other parts of Europe or beyond. Other countries are growing their automotive capability rapidly. I think of Slovakia, in particular, Hungary and eastern European countries. Romania's capability is growing. As those vehicle manufacturing volumes grow, they attract suppliers in there. The supply chain is mobile. You obviously want to try to minimise your logistic costs. That said, if you spoke to most UK suppliers, I think they would immediately point to one, two or three different competitors that they are always up against whenever a new model is being developed and they are trying to get that contract.

Q77 **Lord Dubs:** Can I slip in a question that might not follow in sequence? I am still puzzled about Nissan. Do your other members push you to find out whether the Nissan arrangement can apply to them? It seems to be a most dramatic thing that has happened and yet everybody is being very secretive about it. There is no point my asking any more than that but I am trying to couch my question in terms that you can answer. Are not your members all saying, "We want the same thing"?

Mike Hawes: All our members were surprised by the speed of that announcement, given some of the comments that were made in the previous few weeks. I think they would say that obviously it is good for the UK. They will have taken comfort from the comments made by the Secretary of State, Greg Clark, and the Prime Minister, that this is a deal for the industry. Certainly, we are reminding them all of that. But, invariably, let us face it, these are competitors, so the others will always be looking to see the exact nature of the detail. I am sure that some elements will be commercially confidential. However, from what has been described, the deal has the support of the Government. I take it they are saying that they want to ensure the competitiveness of the UK automotive sector. That is what needs to be borne in mind: it is not just Nissan, it is the sector as a whole. That will be one of their priorities and we very much welcome that commitment.

Lord Dubs: I congratulate you on your diplomatic skills. The Foreign Office could use you.

Q78 **Lord Triesman:** Let me return to the shortfall of 5,000 specialist site production engineers. I understand the point that there is probably a global shortage of engineers. But if you were, for example, giving evidence in front of a German committee considering the car trade, would it have the same problem to the same extent that we have it?

Mike Hawes: There was a quote from about two years ago that says Germany has a skills problem, the UK has a skills crisis, especially around engineers. Germany has a larger engineering sector. It has a bigger automotive industry, which is very successful and very international, but it, too, needs to recruit and attract more engineers. As the industry expands, and we look at the global demand for mobility and car sales, China is the obvious market. It is now the biggest market; 10 years ago it was not. As you spread your production and so forth, this demand will continue for some considerable time. It is right that countries and individuals who did not previously have that mobility option potentially can have it.

Q79 **The Chairman:** If I may, I will follow up on a thought I have just had about production decisions. You said that they are taken quite a number of years ahead, before production actually starts. How agile is the sector in changing if circumstances change?

Mike Hawes: It is never going to be immediate, which is why I said before that you would not wake up on 24 June and say something like, "That's the end of Sunderland". You would likely see a gradual reduction. If a decision was taken that we would not build the next model of X in that particular plant, or it was potentially going to be split between two sites, then production capacity would go down. If you are currently working on two or three models, you would be down to two. Your competitiveness may be affected and then the next decision is taken. It would be more like death from a thousand cuts than just shutting the gates overnight. As I said before, different companies are in different positions. It is a fantastic result for Nissan and Sunderland, but you cannot say that that template will immediately apply to another company, because they will be in a different situation. You are always looking at the alternatives, but most companies will have alternatives. I hope we can ensure that those alternatives are not as attractive as here, but that is a constant battle.

Q80 **The Chairman:** So do you think the debate that we have had in this country about immigration has been helpful?

Mike Hawes: I do not think it has been helpful, to be perfectly honest. That is a personal view, given that we have got vacancies and are an industry which depends to a certain extent on non-UK nationals. In addition, people who work in the UK industry really benefit from going abroad to get international experience. It is an international industry and we need people with that experience. We need to make sure that this country still says that we are a great country to live and work in and that we want talent. All the companies will invariably try to recruit locally; it makes eminent sense to do so, and that will continue. However, you cannot always recruit locally. All our companies have had long-term commitments to apprenticeships—growing your own engineers, effectively—but that takes time. I would endorse anything we can do to say that this is a good place which is open for business and wants the best.

Q81 **Lord Horam:** That was a very interesting and passionate response. So far, we have talked mainly about trade inside the European Union, as opposed to exporting to other continental countries and the world. But, thinking again about third countries outside Europe, we have a big trade out there. As you said earlier, almost half our exports go to non-EU countries. How important are the free trade agreements which the European Union already has with third countries?

Mike Hawes: Very important. We would like to see some sort of grandfathering continuation of those trade agreements. A significant example is the FTA with South Korea, which is a big market. I believe there are about 40 free trade agreements currently in existence, providing a £15 trillion market. We clearly want to make sure we maintain access to that. As it is, UK exports go to over 100 different markets and this will continue. When you see the opportunity to develop a new market, you want to take advantage of it. However, there are two points. First, as I said, 57.5% go to the rest of the EU. The next nearest market, the US, is less than 10%, so it is a variety of different markets. Some of them—especially emerging ones—can be quite volatile. In terms of exports, China, Russia and Brazil were down last year for different reasons, political, economic and so forth. But the bottom line is that we have a massive market on our doorstep and we want to make sure we continue to be part of that.

Lord Horam: Do the EU FTAs cover most of the big markets, like the USA and so forth?

Mike Hawes: No. There is obviously the potential for TTIP, the Transatlantic Trade and Investment Partnership, which we see as a huge opportunity for the industry on both sides of the Atlantic, offering a real benefit to UK companies. To go back to one of the comments about regulation, there are small-volume UK companies—familiar brands—that do not export their model range to the US because the costs of meeting US regulation, as well as European regulation, are prohibitive. So they just sell in Europe. We would have been very much in favour of TTIP and clearly we welcome the CETA arrangements, but there are other markets which we would like to reach.

Lord Horam: Which non-EU countries export a lot to the UK?

Mike Hawes: In automotive terms, obviously Japan is probably one of the most important and the US is increasingly so. South Korea has had an FTA for the last three or four years.

Lord Horam: Those are the two big ones?

Mike Hawes: Yes.

Q82 **The Chairman:** Because I am slightly irked about the skills gap, I have to come back to you on a small question about the percentage of non-UK people, who are predominantly from the EU, working within the sector here. How do you feel they must be feeling with the uncertainty of the outcome of negotiations? While you have production planning for years ahead, getting people to be certain about their certainty is not going to be done in the same frame. It would be useful to know what conversations are going on internally within your sector.

Mike Hawes: This is purely anecdotal, but speaking to a lot of our members, one of the first things that many of them did in late June was to reassure their workforce of their own future as a business, irrespective of their nationality, and subsequently they have been reassuring their workforce, which may be non-UK national, that they have a job for as long as they want it and that they would provide support. They have encouraged us to make sure that they are reassured about their long-term future. I understand that going into negotiations, the Government cannot offer cast-iron assurances, but I hope that everyone within our industry recognises our dependence on non-UK nationals and will endeavour to convince the Government of the importance of keeping them. I think the Government will be amenable to that.

Q83 **Baroness Brown of Cambridge:** On dumping, a couple of years ago I visited the Australian Government to talk to them about reducing emissions from vehicles. One of their frustrations is that a lot of old models are imported into Australia. If we do not have the right anti-dumping regulations in place, is there any danger that we might see that kind of thing?

Mike Hawes: I have a little experience of the Australian market, although not a lot, and it was as a consumer. Australia may be a salutary tale. The Australian automotive industry was for many years quite protected, so manufacturing developed and the type of vehicle bought there was, compared to their neighbours, unique. They were large vehicles—V6s and V8s are an Australian institution—whereas Asia, on its doorstep, is more of a small car market. The cars they were making for Australia were less attractive for exports. Basically, the industry ceased to be competitive. As those import protections were lifted, more cars came in. That has been a major challenge to all the manufacturers such that as from next year, I think, there will be no domestic automotive manufacturing.

We are in a very different place. We are competitive. We produce vehicles that consumers want in the UK and around the world. There are currently no restrictions. If you want to bring a car in from abroad, you can do so. Equally, people internationally want UK cars, be they brand new or classics. I understand that the classic car market has been the best investment that you could have over the past five years, and I would clearly like to see that continue—not that I have one. I do not see us as being at risk of getting old bangers in, if you will.

Q84 **The Chairman:** Mr Hawes, we are approaching the end of the session. Will you quantify to us in writing or put to the Government directly the impact of the various trade barriers you see coming and the short-term and long-term impact on the sector? It would be useful for all of us to be able to explore how that will impact on other sectors, too.

Mike Hawes: That is a good challenge and exactly what we are trying to do. As you will appreciate, it is complex and difficult, and we clearly have to abide by competition compliance issues in accessing what would be confidential information, but we are certainly looking to provide robust, quantifiable evidence that would support the case.

The Chairman: On behalf of the committee, I thank you very much for coming in and being very frank and passionate about your sector and the impact negotiations that Brexit will have. I remind you that the uncorrected transcript will be sent to you; please feel free to send it back corrected if you feel that corrections are necessary.