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 2016

11.15 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 Stirrup; Baroness Suttie; Baroness Symons of Vernham Dean; Lord Triesman.

Evidence Session No. 6 Heard in Public Questions 85 - 95

Witnesses

I: Mr Simon Whalley, Head of External Affairs, Royal Aeronautical Society; Mr Paul Everitt, Chief Executive Officer, ADS Group.

Examination of witnesses

Mr Simon Whalley and Mr Paul Everitt.

Q85 **The Chairman:** Good morning, Mr Whalley and Mr Everitt. Thank you very much for coming before the Committee this morning. I remind the Committee and yourselves that we are broadcasting; it is in public. We will send you uncorrected versions of the transcripts after the evidence sessions. If there is anything that needs correcting, please feel free to do so and send the corrections back to us. You will have had sight of the questions that were circulated. Colleagues may come back with supplementaries or may just completely ignore the questions on the papers. I would also ask you to give us a short-term and long-term view on the questions that are put to you. I would like to start by asking for an overview of the importance of trade and collaboration with the EU to your particular industry.

Paul Everitt: The aerospace, defence, space and security sector has a very deep and significant relationship with the EU. In broad-number terms, the UK in our sector exports about £35 billion of goods, 10 billion—30%[1] of which will be heading into the EU. A certain amount of trade goes the other way as well. We have some key European research and development relationships that are of strategic importance.

Also, when we start to look at the products and programmes that we as a sector are engaged in, perhaps some of the deeper and more strategic importance of our European Union relationships becomes clear. If we are talking about civil aircraft, programmes such as the A320, A380, A330 and A350, are major products that dominate 50% of the global market. We are a significant supporter of those products. Companies such as Rolls-Royce, which competes and provides products both to Airbus and others, are clearly involved in an integrated European operation.

If we look at the defence sector, there are projects such as Typhoon, which is a consortium which involves the UK, Spain, Italy and Germany. Clearly that is an integrated product. Similarly, our defence exports are, significantly, air-dominated and complex weapons. The relationships we have with key EU states are part of the way in which we are able to develop that sector. There are economic and industrial implications for the strategic relationships that hold the wider European Union together.

Simon Whalley: I will not repeat what Mr Everitt said but I will also highlight the fact that we enjoy a very good regulatory environment with the rest of the European Union that has underpinned the success of the Single Market and makes it very easy for UK industry to be able to trade, at the minimal cost possible, with the rest of the European Union. In terms of research and development, beyond the industry and also including higher education, collaborative projects across Europe have

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[1] Statistic corrected by the witness.

meant a higher quality of outcome than necessarily achievable within only national programmes, especially with the limited amount of funding available from national government compared with what is available from the European Union.

It is also important to highlight, on the engineering side of aerospace, the importance of mobility and the freedom of movement of people—that is, skilled workers—across the European Union to not only work within companies but to work on projects in other countries according to the demands of the customer.

The Chairman: Following up on your concerns about free movement of people, how are preparations going to meet the challenges if there is a complete shift in how we approach people coming in and going out?

Simon Whalley: There is a difference between controlled migration and anybody being able to come for whatever reason. Firms with integrated supply chains, distributed across Europe are dependent on the movement of highly skilled individuals within firms to be able to progress in their careers and work on different programmes at different times. There is a difference between immigration, migration and mobility. The Government understand the importance of mobility for the success of the sector and for other advanced manufacturing sectors. That distinction must be clear and well understood.

Q86 **Lord Horam:** You stressed—particularly Mr Everitt—the integration of the UK and contact with Europe in the various industries that we are talking about. How would you expect Brexit to affect investment? Will there be the likelihood or capacity to switch around investment between different countries if we exit the European Union?

Paul Everitt: There are short-term and long-term issues that we need to address. Short term, obviously during the period when we are in the process of trying to extract ourselves from the current relationship and renegotiate a new one, there is huge uncertainty in the business community, which has a negative impact on investment. We are pushing the Government and the Chancellor very hard. In his Autumn Statement and the Budget over the course of the next six to eight months there are big opportunities to restate and signal clearly the kind of business environment that the UK wishes to create, particularly for some of its strategic industries. We need to make it a very attractive place to invest in terms of the skills that we need, the research and development on which we depend and efforts to improve our long-term competitiveness. There is an uncertainty which, in some respects, the Government cannot resolve, but there are ways in which they can make it easier for companies to make the right kinds of decisions.

Longer term will depend on our ability to negotiate a successful new relationship with the EU. If we are not able to do that, we will face significant competitive pressures. If we can address some of what we would see as core issues around freedom of movement and the regulatory environment, research and development as well as ensuring that we do not attract additional costs of trading, we have every opportunity of sustaining a strong and vibrant economy. From an aerospace perspective, we are the second major player in the world, so we will not suddenly diminish. The opportunity is that we can strengthen our position. The danger is that we see a slow and steady erosion of our competitiveness if we do not address the challenges in front of us.

Lord Horam: Taking Airbus as an example, is it easy to move capacity around between the manufacturing of different parts of the aeroplane, or is that a difficult thing to do because people get specialised expertise? Is it in practical terms quite difficult?

Paul Everitt: We see ourselves as a long-term sector. Currently Airbus is making almost all the wings for its products in Broughton in the UK. It is unlikely that it would suddenly be able to switch to somewhere else.

Lord Horam: It would take years.

Paul Everitt: Probably a number of years, but we should be conscious of the fact that it now has two other global final assembly lines where effectively we kit all the parts here in the UK and they are shipped out and then assembled in other locations. The threat there, which is the same for all the major players operating in the UK is that, over time, yes they can move. If we do not sustain the incremental investments that happen year on year when big decisions come, such as whether an all-new aircraft or a major new investment is required, we would be in a disadvantaged position. The challenge for us is to be competitive today, tomorrow and every day. If we do that, then we will attract the incremental investment that will make it very difficult or very costly to reallocate investment elsewhere.

Dealing with smaller businesses further down the supply chain, is a much more mobile situation, and today we already face major threats from various parts of the world. Some of that is down to trading relationships. In order to sell a product in China, say, there is an implicit request to produce something in China—and similarly in other parts of the world. Equally, there is a broader competitiveness challenge that our customers—airlines—are placing on us. They want our new product but they do not want to pay quite as much as we would like, so there is a downward push to find competitive places to manufacture.

Lord Horam: Is there anything you would like to add to that, Mr Whalley?

Simon Whalley: In relation to research and development, for example, in the short term the Chancellor has guaranteed Government investment after Brexit for projects currently funded through multiannual frameworks up to 2020, which is very helpful in the short term. But there need to be more guarantees beyond that; for the longer term. The industry works on very long cycles—over decades rather than years or parliamentary terms—and the stability of European Union research funding over and beyond parliamentary cycles has made it less susceptible to political influence. It is a concern in the longer term that we are either going to have to try to negotiate access to some of that funding and pay into it or replicate it with national funding.

Lord Horam: We saw what the Government did for Nissan. Is there anything of a similar character that you are looking for? Obviously, you hope the Government will eventually negotiate a good deal with the European Union and we will have that certainty but is there anything in particular that you are looking for now?

Simon Whalley: It is a matter for individual companies, as it was for Nissan, to be able to discuss and negotiate with the Government what kind of terms they would find favourable in future negotiations, so I will not comment on that. But the Government's promise of a revamped industrial strategy is a welcome and important development, and we look forward to seeing more details, potentially in the Autumn Statement, to find out how the Government can continue to work in partnership with industry, as well as with the higher education sector and research community, to maximise the value of the sector to the economy and to society, and to maintain its competitiveness—which they already have done well through the Aerospace Growth Partnership.

Paul Everitt: We are probably a bit more forward-leaning. There are two key issues that we have addressed directly to the Chancellor relating to the aerospace industrial strategy. One is the Aerospace Technology Institute, which is managing joint funding into key research and development and technology investments. It is very successful. We have far more high-quality bids than we have resources available. We have asked the Chancellor to increase the funding available to the ATI, which would have to be matched by industry. Increasing the funding by £50 million should bring £200 million of public and £200 million of private sector investment over a long period of time, which we think would help us attract and sustain the, if you like, sticky technologies and developments that will, irrespective of the outcome, want to remain here in the UK.

The other is around global competitiveness. Over the past five or six years many of the schemes and funding sources that were available to help particularly small businesses improve their competitiveness have been removed. We believe that if we are going to be successful, we need to accelerate the rate of our productivity and competitiveness improvement but also widen the base of companies that are on that journey. We have a specific proposal that has been developed with a number of other key sectors—automotive, rail, nuclear—which we believe would help us to ensure that we are competitive in the long term; again, irrespective of the outcome of the negotiations.

The Chairman: Lord Balfe, did you want to come in?

Lord Balfe: I was going to come in with my question.

The Chairman: Before you do, I have one small supplementary. How is the sector calming down fears from the supply chains? As a sector, there will be big impacts on a lot of businesses of various sizes. How are you working with them to ensure that the discussions include their fears?

Paul Everitt: There are two elements. From an industrial perspective, obviously the vote was a shock to many. As I said earlier, we are a long-term business. Most of the businesses will have long-term contracts in place and the challenge, certainly in the civil sector, is about a ramp-up in production rates. Those businesses' day-to-day concerns are about, "Are we meeting the targets and requirements being set by our customer?" While they are unquestionably concerned about the implications of the decision to leave the EU, their day-to-day focus is on delivering the job that they need to do for their customers. Currently that is quite difficult because they are increasing output but reducing their costs. Their focus is very much on the day to day. As an organisation, we have just over 1,000 members. Most of those are small and medium-sized enterprises so we are very much engaged in talking to them about their immediate concerns. But if we are honest, their immediate concerns are where will their customer be, will they have access to their customer and will they be able to deliver a cost-effective product and service to them?

Q87 **Lord Balfe:** Britain's joining of the EU started at almost the same time as currency fluctuations began on the international market. Since then, to an extent, the British currency has gently depreciated. In recent weeks there has been quite a strong depreciation, which may well correct itself. I am interested in, first, to what extent the industry hedges forward so that it can safeguard itself against depreciation, and, secondly, there is a school of thought that says that a depreciated currency would be good for exports. To what extent do you think what I would call a long-term resetting of rates, probably in a downward direction, would benefit or not benefit the industry? It is a dollar-dominated industry. Some would say that this industry is probably less affected by Brexit than some others because of the security considerations involving a lot of the exported product.

Paul Everitt: In the very short term there may be some benefit for the margins of businesses because they have contracts already fixed with margins in them, so the currency fluctuation at the moment is probably marginally beneficial. When you move out beyond the immediate few months, it is a more difficult equation because your cost base will also start to increase. We are importing raw material and part-finished products in dollars or euros so the costs of those will begin to increase. As you move out beyond the immediate, it begins to balance itself out.

The worry is that if we see a significant increase in wage inflation in the UK as a consequence of the depreciation, that will begin to hit the longer-term competiveness of the sector. Larger companies are able to hedge and do hedge. Some of that is a natural hedge. That is why businesses in mainland Europe have dollar-denominated, euro-denominated and pound-denominated businesses. They are a bit more sophisticated in the way they manage it. But hedging becomes more expensive the greater the level of volatility so no one particularly likes it. Smaller businesses are less capable of hedging; that is not to say they cannot, but it is a more sophisticated game and some prefer not to get too far into that.

Our big message is that long-term global competitiveness is not based on exchange-rate fluctuations. If you want to win for the long term, it is because you are the best that is available, both in the technology and the quality of what you can produce. To a certain extent, what businesses want is a stable exchange rate, whatever it is—obviously, a competitive rate would be good—but in a position on which they can play with certainty.

Simon Whalley: On that point, there are two other aspects that are worth highlighting. If inflation in this country rises, it reduces discretionary spend, which makes it much more expensive for people to go on holidays, which would potentially dampen the demand among airline customers for products in the longer term. Also, the long-term price of fuel will have a significant effect, so it is not just sterling. If the price of fuel falls considerably around the world, that could reduce demand for new aircraft, because it is cheaper in the long run—it is of more value—to keep older aircraft going for much longer than to buy a new one.

Q88 **Lord Stirrup:** I would like to ask an omnibus question about barriers to trade that might be introduced and the effect they could have on the sector and on its supply chain. There are three key areas. One is tariffs, which are not applied at the moment to aerospace components but could be in future. The second, of course, is the introduction of more stringent requirements on rules of origin and the impact that these might have. The third is the whole issue of customs requirements, the bureaucracy around that and the effect that that might have on speed of movement in the supply chain, and so forth. Will you comment on each of those and, in doing so, indicate how they might affect different parts of the industry? In one of your earlier answers you made clear that some things would have a much greater impact on SMEs than on the large firms. That may, of course, be equally true in this context.

Paul Everitt: We are very clear that we would prefer to stay within the single market and the customs union, because that would be the best way of minimising any future concerns.

Lord Stirrup: Understood, but—

Paul Everitt: For the aerospace sector there is a pre-existing WTO plurilateral agreement on the trade in civil aircraft, which means that both aircraft and complete parts are tariff free. That is a pre-existing arrangement, so we as a sector, as long as we get the transition right, would not face tariffs on complete goods. A small ripple around that is that it does not cover some of the raw materials and part-finished goods that we import and export as part of the development of our larger products.

Lord Stirrup: Sorry, can you tell us broadly where that boundary lies?

Paul Everitt: There is a very long schedule to define what is a complete part.

Lord Stirrup: Wings are complete parts?

Paul Everitt: Yes; we are reasonably comfortable that systems and sub-systems would be included. As you move down the scale and into machine parts, raw materials and a whole variety of other bits and pieces, it is less clear. However, there is effectively a tariff relief available in the current regime which, assuming that we were able to replicate it within our WTO status, would mean that we could also, basically, offset. It means that if you are importing something that is going to be exported, you would not face tariffs. The tariff barrier issue is one that we think, with some care and attention around civil businesses, is doable. However, the non-tariff barriers—which is, I guess, in your second and third brackets—are considerable. As an example, we are shipping hundreds and hundreds of thousands of parts both into and out of Europe over the course of any year. So any customs process that requires additional paperwork and occasional checks would immediately add cost to our businesses.

The rules of origin are a particular challenge; it is not something that we, as a sector, have had to track. Having to track it would, again, add significantly to the administrative burden of shipping goods. More importantly, as the volumes in our business rise, any delay would be a major problem. At the moment, if you are shipping a wing from Broughton to Toulouse for final assembly, it is no different. There is a logistical challenge but there is no customs issue or border for us to cross. In a world in which there was a border for us to cross and customs procedures in place, that could add momentary delays. I am reminded of the A380, as an example—roads are closed, it is shipped in a very specialist way; if you miss your slot that aircraft is just not going to be built, possibly for another week, which has a very significant implication.

The challenge for us, we believe, is more about the administration of new or different customs procedures. Again, larger businesses fear the cost but they do have the resource to manage. For smaller businesses this would be a wholly new activity, certainly of a scale that they would not have had to deal with before, and both acquiring the expertise as well as the cost itself would be significant burdens for them in a market where there are already very significant cost down-pressures.

Lord Stirrup: Could I ask about the defence sector in particular, which is, of course, a very large export market for us? On the rules of origin, there are some requirements in this regard anyway, I assume, because of the export of technology issues. Are we already, as it were, tracking the origin of various components in the defence sector?

Paul Everitt: The defence sector is, first, of a different order of magnitude. If we are looking at £10 billion of exports from the UK to

Europe, something in the region of £8 billion is civil aircraft and around £700 million is defence, and that is a relatively small part of our overall defence market. So most of our defence exports are not destined to Europe but to other markets and because there are already export licensing, export controls, a whole range of other procedures, we are less alarmed about the impacts from a European perspective around defence.

Baroness Brown of Cambridge: Could I ask a quick follow-up on that? I just want to ask whether you are perhaps overstating the case a little. Given that aerospace is a safety-critical industry and that pretty much every part has a number and you have to know what day it was made on, what batch of material it was made from, which factory it was made in, et cetera, all that data, in terms of rules of origin, already exists, usually in quite sophisticated systems. Is it really as huge an extra administrative burden as you make it sound?

Paul Everitt: I discussed with a large, well-known company that you may be familiar with. They were clear that they could do this, but that their existing information systems and software management could not do it. So for them, it would be an expensive change management process. As you move down the supply chain, their systems and processes will not be as sophisticated and their resources available to dedicate to this topic will not be as large. I am not suggesting that it is insuperable, I am just saying that it would add significant additional administrative burden to a sector—certainly from the UK point of view—that is already having to fight very hard to sustain the work that it already has.

The Chairman: Mr Whalley, would you like to add anything to that?

Simon Whalley: I think that larger companies would be able to absorb additional costs if they had to, whereas it would be much more difficult for smaller businesses. They will generally look at where the value-added is in their operation, across national boundaries, and where value-added cannot easily be replicated elsewhere. It might be a cost that could be absorbed, but only if added value can be maintained. These would be unhelpful burdens on the industry but adaptable, perhaps, in certain areas.

Q89 **Baroness Brown of Cambridge:** If you take, for example, a large aero engine company, a lot of the increase in profitability in the past 10 years has been down to the move towards a servitisation model of power-by-hour rather than having to wait for spares revenues 15 years or so down the line. It is interesting that parts of the industry have become very dependent for their profitability on this kind of combined service and product model. Are you getting any messages that Brexit might cause particular problems for that kind of business model?

Paul Everitt: To date, we have not. We have not had as many in-depth conversations around servitisation because in our initial work we have focused on products and the flow of goods. It is an area that we recognise has potential, but it certainly has not been raised with us directly and we have not had sufficient time to look at it in depth.

Baroness Brown of Cambridge: That suggests that it may not be as high on people's risk registers as the specific product issues. Is it significantly easier to export services to the EU than to third countries at present?

Paul Everitt: Again, in general this is not a topic or an issue that has been raised. By and large, it is the product that leads the service in the sector. There is a service that is wrapped around the product, so to speak, but it is the product that leads in terms of what people want to buy.

Baroness Brown of Cambridge: Are there are any implications for repair and overhaul services? Will we see those moving out of the UK?

Paul Everitt: Again, this is a pretty challenging area for us anyway. Airlines make global decisions about some of that, and increasingly so, and labour costs tend to be more significant in that particular activity, which I guess is why it has been an area under pressure. It is about those who supply into that market. Quite a lot of specialist equipment is needed for the maintenance, repair and operations market, not just the parts for the original equipment but the infrastructure that helps to support it. That is obviously an area in which the UK has been traditionally strong.

Q90 **Baroness Armstrong of Hill Top:** One of you mentioned in your opening statement the importance of the regulatory regime in this industry. We would be interested if you would explore that a little more. Would the industry look to have a regime where this country complied with the EU regulatory regime? Do you see advantages in being outside it and developing a different regulatory regime?

Simon Whalley: The regulation of the aerospace industry has gradually been migrated over to the European level through the European Aviation Safety Agency, which has created common standards and common requirements. It has enabled concurrent certification with the Federal Aviation Administration which has made it much easier to get aircraft certified in the US via the European Union. The UK has been very positively influential within EASA, particularly by advocating and championing a much more pragmatic, risk-based approach to advances in technology, which is not always shared among other more risk-averse nation states. If we were to withdraw from EASA, and there really is not a good case for doing so, not only will we lose that influence but the opportunities to become more innovative outside would not necessarily translate into benefits if we needed to trade with the European Union, and if the products we make did not meet their more stringent safety requirements. There is clearly a benefit to remaining within EASA. In the longer term it is possible for the Civil Aviation Authority to repatriate some of those powers, but it would need considerable manpower to do so given that it has gradually run down its resources as it has transferred over to Europe. So it is possible, but not necessarily desirable, and we should try to maintain our position within EASA and retain as much influence as possible.

Paul Everitt: From an industry perspective, our number one ask of the UK Government is that we retain membership of the European Aviation Safety Agency. It is our route to market. For any new development or new technology that we create, we need a set of rules to be able to sell it to the rest of the world, and it is through EASA that we gain access to all of our major markets, whether that is the US, China, Japan or elsewhere. The equivalence debate that they can have is one that we do not believe there is any need for us to change. There are existing examples of countries outside the EU which are part of EASA and we would like to ensure that as an industry we have the same level of influence as we have currently, so membership is absolutely essential to our future.

Lord Stirrup: That was my question and it has been answered. Perhaps I may follow up by asking one more. Boeing sells a lot of aircraft into Europe but is not a member of EASA.

Paul Everitt: The way it works is that Boeing will have its products certified in the US, but the US through the FAA has a mutual recognition agreement with EASA.

Lord Stirrup: Presumably there are global standards that are recognised by everyone.

Paul Everitt: We are genuinely a global industry. We would prefer to have one set of global standards which we can all meet, and by and large that is what is happening. If you like, the big blocs of the US and Europe are the ones that are leading the way.

Lord Stirrup: So we could have our own standards and be part of the same arrangement but it would be much simpler just to remain in EASA.

Paul Everitt: And we would add significant costs. EASA is already 70% funded by industry. The cost to the UK is something in the region of £1 million per annum. To recreate the capability within the CAA to do a similar job would cost tens if not hundreds of millions.

Q91 **Baroness Suttie:** Could you say a bit about your view of future access to European Space Agency programmes like Galileo and Copernicus? Will it be possible to maintain access to these agencies post-Brexit, and do you think we should?

Paul Everitt: It is important to understand that the European Space Agency is not an EU institution. However, it uses EU-funded programmes, particularly Horizon 2020 or the framework R&D programmes, to fund much of its work, particularly Galileo and Copernicus. From our industry point of view, the UK retaining access to those European Union R&D framework programmes is really important because of the collaboration aspect, but particularly in space there is a direct benefit from participation. We as a nation have invested very significantly in both

Galileo and Copernicus. There are some important decisions coming up about the future allocation of work which, from the UK point of view, we would very much want to see being allocated to UK businesses. But in the longer term we have to stay in those European framework programmes in order to ensure that we continue to be at the heart of the work that the European Space Agency is doing. Does that answer your question?

Baroness Suttie: It is a separate question that one of my colleagues put earlier. Do you see that being possible?

Paul Everitt: Yes. Again, there are examples of non-EU nations which are part of the Horizon programme. There are some which are traditionally on the edges, but in this case both Canada and Israel access the programmes. They do not receive funding from the European Union. Their Governments have to pay to play in order to support their businesses. That is at the outer extreme. For our sectors, while the money and collaboration are important, it also about having the influence to direct where that money is spent. The UK and France have strong interests in aerospace. My colleagues in France are very worried because 26 other nations are probably not quite so interested, and without the UK's influence, they fear that some of the funding that has been traditionally available, both for space and aerospace, might not be quite so high up the priority list.

Baroness Symons of Vernham Dean: Surely that is an enormously important point, because we are one of the minority countries that are net contributors to the EU. I do not know whether the figures exist for how much the UK pays into Galileo and Copernicus, but presumably, when we leave, that contribution will come out of the EU budget, so there will be a gap in the funding.

Paul Everitt: Potentially, yes. There are a couple of issues, including the work that flows from those programmes. We have already invested in something—Galileo is a good example—that is going to be of strategic national importance. If we do not retain access to the service and capabilities that both Galileo and Copernicus offer, we will be worse off from a UK national security point of view.

Lord Balfe: Surely there are many precedents of EU projects and programmes which do have countries in them that are not in the EU. There is no reason at all why we should be forced out of either of these two programmes. We do not have to leave them—we can leave the EU without ending our participation in those programmes.

Baroness Suttie: We would have to negotiate that.

Lord Balfe: Of course we would have to negotiate, but it does seem to me on occasions—I voted for remain—that the people who are on the remain side cannot accept that there is a life outside and that there are circumstances where we can have a reasonable solution.

Paul Everitt: Our starting position is very much that there has been a vote and we accept it. What we are about is saying what we need. To your point, it is perfectly possible to be outside of the EU and access those programmes.

Lord Balfe: And contribute to them financially.

Paul Everitt: Yes. There has to be some contribution. I guess that is the challenge in terms of the negotiations that will come: how you ensure that you get the right kind of approach.

Baroness Brown of Cambridge: I am now a bit confused. The European Space Agency is not a European Union agency, so there is no question that we should have to come out of Galileo and Copernicus, even if we were outside the EU anyway, is there?

Paul Everitt: No, but those are EU-funded programmes.

Baroness Brown of Cambridge: In terms of the allocation of work to UK companies, I realise that other nations might feel we were not good sports and did not deserve it—but, surely, being outside the EU should not mean that we do not get work allocated to us.

Paul Everitt: No, it should not. Where the European Space Agency is the lead in allocating resources, it has a *juste retour* kind of approach, but where it is using European funds—

Baroness Brown of Cambridge: Horizon-type funding.

Paul Everitt: Our concern at the moment is a short-term one. The Chancellor made some helpful comments around carrying on playing our part, but none the less there is a great deal of nervousness within industry and academia that decisions that six months ago might have been very straightforward are now not so straightforward.

Baroness Suttie: I am further showing my ignorance on this, but what sort of numbers of people are currently employed in the UK under these funding programmes?

Paul Everitt: It is quite difficult to say how many are directly employed as a consequence. We estimate that, on an annual basis across our sectors, we access about £100 million of funding. In terms of the specifics around Copernicus and Galileo, we think it is somewhere in the region of 600 to 1,000 jobs in the UK.

Simon Whalley: A further point about ESA is that, yes, it is not a European Union organisation, but there clearly are overlaps with the EU, in the sense that the EU is a research funder, a customer of space systems and it is also a legislator and a regulator.[2] We must maintain access to Galileo and Copernicus, as important and vital national security

[2] Addition from witness: The implementation of EU space programmes is delegated to ESA

and infrastructure assets. We should also maintain, as other non EU countries are able, access to EU space programmes for UK firms to be able to tender for future space programmes. However, they [non-EU countries] are not always able to tender for all projects because, even though there are WTO rules that say that all countries can tender for European Union space projects, there are exclusions for non-Member States due to certain research and security clauses. So companies within the UK that are currently able to tender and are heavily involved in EU-funded space programmes would not necessarily be able to enjoy the same benefits in the future. That is worth highlighting.

Q92 **Baroness Symons of Vernham Dean**: How important is continuing current access, or equivalent access, to the EU's free trade agreements with third countries in your sector?

Paul Everitt: Because civil aerospace is regulated more on a global basis, the key for us is the one we mentioned earlier: the European Aviation Safety Agency. The route to market is having our products certified and approved so that we can sell them in markets around the world.

Baroness Symons of Vernham Dean: That is the key point for you.

Paul Everitt: For us, yes.

Baroness Symons of Vernham Dean: Are there particular barriers that you think the Government could overcome in respect of dealing with that?

Paul Everitt: Yes, we want to stay a member of the European Aviation Safety Agency and, if we do, we will not have a problem. From our point of view, it is relatively straightforward.

Baroness Brown of Cambridge: Is the European Aviation Safety Agency an EU organisation or is it like the European Space Agency?

Paul Everitt: It is an EU institution, but through treaty, other countries can access and participate in its work.

Simon Whalley: To follow up on that point, the European Aviation Safety Agency is sometimes limited to making recommendations to the European Commission and other European Union institutions with regard to new regulation and legislation. Consequently, the UK could lose policy influence outside the EU—but it is still important to retain membership of EASA.

Q93 **Earl of Oxford and Asquith:** In the context of Brexit, in answer to an earlier question from Lord Horam, you referred to the possibility of significant competitive pressures on the UK industry. What would you say were the unique UK strengths in the whole sector that will play a significant role in negotiations? I know this is always a hypothetical question. Secondly, and perhaps more provocatively, do you see any particular resistance or co-operation from our main EU trading partners or competitors, such as Germany, Italy, Spain or France?

Paul Everitt: I will start with the second half. We would be fooling ourselves to think that everyone is not looking and saying, "There are some opportunities for us here because of changes". However, by and large, from an industrial point of view, the current arrangement works very well. As an industry, we are closely integrated. We are competing very hard for a place in a tough global market, so there is certainly a sense from my colleagues in key parts of Europe that we want to try to achieve the best industrial outcome. From an industrial point of view, we all recognise that there is a bit of work that we can all do to better inform those who will actually be participating in the negotiations, so that the outcomes do not create major problems.

Clearly, the UK is the leading aerospace economy in Europe. If things do not go well here it is likely they are not going to go so well for some of our partners in the rest of Europe. Getting a good outcome is to everybody's benefit. However, we should not underestimate the competitive pressures from the US, China, India, Singapore, which is another good example, and the Middle East. They are trying to create their own aerospace economies. They are already building their capability and capacity, mainly on the back of the ability to require investment into those countries to secure sales. Things that undermine the UK will be seized on in those places. They will say, "These are the reasons why you should be investing here, because we can offer you a great environment and you'll be closer to your major customers".

Baroness Symons of Vernham Dean: You said we were the leading aerospace economy in Europe. This is probably an invidious question, but how do you rank the others? Is it France and Italy next?

Paul Everitt: The UK is marginally ahead. France would be very close behind us. There is then a gap, with Germany and Italy after.

Q94 **Baroness Brown of Cambridge:** I want to ask Mr Everitt a question. We have been taking evidence from the automotive and aerospace sectors today. I know that before your current role you were chief executive of the SMMT, so you have a view over both sectors. Looking at the situation for aerospace, with only 10 billion of exports going to the EU and with zero tariffs agreed internationally on components, it seems to be in a much easier position in the context of Brexit than the automotive industry could find itself. I would be interested in your relative view of where the two sectors find themselves.

Paul Everitt: You have encapsulated it pretty well. As a global industry in aerospace, I reiterate that we would prefer to stay part of the Single Market and the customs union because that would be the least damaging to our long-term future. However, we can see some routes through, whereby we can sustain a reasonably competitive position. We are still a longer-term business. Wholly new aircraft do not come along very often. We have a market where long-term contracts tend to be the norm. If you have the best technology you will be well positioned, irrespective of a range of other things.

The automotive industry is much more challenging because they do not have the reassurance around tariffs and tariff barriers. Also, the speed of product development means that there are more opportunities for significant decisions to be made. Again, that means they have to work on a shorter timeframe, which means that if important decisions go wrong, they can have significant impacts in a relatively short period of time.

Lord Horam: Is the whole market for all these products expanding?

Paul Everitt: Yes, it is.

Lord Horam: Secondly, you mentioned the competitiveness of China, India, America, the Middle East and so forth. The market is expanding quite well. In that, is the UK well placed to get a reasonable market share, or is the UK and Europe share declining as others expand?

Paul Everitt: The global market for aerospace products is growing and most of our other sectors are growing too. The UK is extremely well positioned. From an aerospace point of view we are number one in Europe. In defence we are number one. We could probably do a bit better in security, where we are fourth or fifth. For space, we are probably number one or number two. We are incredibly well placed, but there is competition. Certainly in aerospace we have been growing year on year in the UK but not quite at the same rate as the overall market.

Lord Horam: We have a declining market share?

Paul Everitt: Yes. It is not hugely significant at the moment, but we know there are pressures. As I alluded to earlier, if you wish to sell into some of our major markets there will be pressure to put and allocate some activity into those markets. In the main, at the commoditised end of the marketplace our strategy is to make sure we move as far away from that commoditised position as we can, but none the less, it is still important to the overall economy. We are in a good place. The decisions we make in the course of the next two years will determine whether we have as much opportunity available to us over the longer term.

Simon Whalley: The demand for civil aviation and civil aircraft looks very healthy into the longer term. With the strength of the UK aerospace industry as it is there is huge market potential, but those customers will equally be competitors. It is key that the Government work with the industry to maintain the current level of competitiveness so we can still provide products at competitive prices, otherwise, we will lose market share. So long as we maintain investment and funding for research into hi-tech systems, engineering design and materials that we are well known for around the world, we have every opportunity to take advantage of the opportunities that Brexit presents.

Q95 **The Chairman:** To clarify, do you as an industry still have to comply with the rules of origin when trading with other parties to that agreement?

Paul Everitt: Currently we do not have to comply with any rules of origin. If we were outside the customs union or unable to negotiate a customs relationship with the EU, we would have to comply with rules of origin, which would create some significant challenges.

The Chairman: Thank you very much, Mr Whalley and Mr Everitt, for coming in this morning and giving us evidence. It has been a very useful and helpful session to us. I remind you, as I did at the beginning, that there will be a transcript. We will send it to you. If corrections need to be made, please send them back. Thank you very much indeed.