SMMT DRIVING THE MOTOR INDUSTRY

Rt Hon Liam Byrne MP
Chair
Business and Trade Select Committee
House of Commons
London
SW1A 0AA

16 February 2024

Dear Mr. Byrne,

SUSPENSION OF NEGOTIATIONS WITH CANADA – IMPACTS ON THE UK AUTOMOTIVE SECTOR

Thank you for your letter of 6 February, seeking SMMT feedback on the potential impacts on the UK automotive sector of the suspension of negotiations for a modernised trade agreement with Canada.

The automotive industry is a vital part of the UK economy and integral to our economic growth, high skilled employment, net zero and global trade. Automotive-related manufacturing contributes £78 billion turnover and £16 billion value added to the UK economy each year, and typically invests around £3 billion in research and development (R&D). We remain an export-led industry, accounting for 10% of total UK exports of manufactured goods and generated more than £94 billion of trade in 2022.

With almost eight out of ten cars produced in the UK destined to markets overseas, UK free trade agreements (FTAs) represent a key enabler of competitive advantage for our automotive exports. The conclusion of continuity agreements (CAs) in 2021 with all the UK's largest preferential trading partners was a major achievement, avoiding the reintroduction of tariffs on automotive trade with more than sixty countries following the UK's withdrawal from the EU.

In this context, the entry into force in April 2021 of the CA between the UK and Canada was of particular importance. Canada has consistently ranked among the top ten export destinations for UK-built passenger cars. Last year, Canada was the eighth largest export market for UK-assembled vehicles, with 9,079 cars shipped across the Atlantic, representing 1.3% of UK exported cars. In 2023, car export volumes to Canada rose by 11.5% compared to the previous year. Canada is also an important destination for UK engines, parts and components, with exports of these products worth more than £53 million last year.

The entry into force of the UK-Canada CA allowed the progressive phase-out of our respective import tariffs on automotive goods in continuity with the schedule agreed under the EU-Canada Comprehensive Economic and Trade Agreement (CETA). After more than seven years since the provisional application of CETA, UK-built passenger cars have finally been able to enter Canada tariff-free from January 2024.

This tariff-free trade, however, risks being short-lived. The suspension of negotiations for an upgraded deal and the expiry of key provisions in the CA will ultimately result in the reapplication of tariffs on UK automotive products incorporating a large proportion of EU materials. Most important for our sector was the inclusion in the UK-Canada CA of specific clauses allowing the use of EU content to meet origin requirements. As the CA fully replicated CETA origin rules, the deal sets value-added thresholds requiring at least 50% of the value of a car to be originating in the territory of the parties. In consideration of the UK's high levels of integration with EU supply chains at the time of withdrawal, the parties agreed that EU materials and processing operations could be considered as originating in the UK and Canada.

This crucial facilitation will expire on 1 April 2024. From this date onwards, a UK-assembled passenger car cannot incorporate more than 50% of materials originating outside of the UK and Canada if it is to be tariff-free. With the expiry of the clause, all EU inputs will be considered as non-originating. In September 2024, the possibility to incorporate non-originating materials will be further restricted, with the threshold decreasing from 50% to 45%, effectively demanding 55% of the value of a vehicle be added in the UK and Canada.

Given the very limited integration of British and Canadian automotive supply chains, rules of origin under the CA will become unattainable for the overwhelming majority of exporters. Failing to comply with origin rules will result in the introduction of a 6.1% tariff on imports of finished vehicles into Canada.

Without an agreement to extend EU cumulation until an upgraded deal enters into force, the potential tariff liabilities will be significant. According to estimates provided by AutoAnalysis, UK car exports would face £28 million in duties per year if no UK-built model can meet origin requirements. The reintroduction of import tariffs would result in an average price hike of more than £3,000 per car. The estimate is based on 2023 export volumes, the average domestic (UK) price of models exported to Canada last year, a deduction of UK VAT and company specific assumptions on margins for dealers and distributors. AutoAnalysis is available should further explanation on these calculations be required.

While the sector ships only premium and luxury vehicles to Canada, with no exports from UK-based volume manufacturers, impacts might vary significantly between different models. Potentially, tariffs charged on lower-priced premium vehicles exported to Canada would likely see their profitability and competitive position in the market significantly undermined, although higher range vehicles could better absorb additional duties. However, high-range premium vehicles and luxury vehicles are already affected by a luxury tax, introduced at the Federal level in September 2022, on cars priced more than $100,000 (CAD) – equivalent to less than £60,000 at today's exchange rate. In some cases, an additional provincial luxury tax is also charged.

Although the continuity agreement with Canada offers more modern trading terms than similar CAs, it set unattainable thresholds for electric vehicles, even with the possibility to cumulate EU content. With the expiry of the EU cumulation clause, virtually all UK-made vehicles will be subject to tariffs or luxury taxes or a combination of both. In sum, even if the CA will continue to apply despite the suspension in negotiations on an upgraded deal, it will effectively be devoid of any value in less than 50 days.

Many of our member companies are looking to export to Canada and the current position could be interpreted negatively. In response to the suspension of trade talks, the SMMT issued the following statement on 26 January:

"Canada is an important market for UK car exports and, given the close ties between our two countries, the suspension of trade talks is especially disappointing and sends a signal that the UK's world-class automotive products are not welcome in Canada. If UK car exports can't use EU parts and components to avoid additional duties it creates a risk that tariffs, potentially charged on top of luxury goods taxes, could be reintroduced. This would benefit no one, not least Canadian consumers, and we urge all parties to get back around the negotiating table."

Our sector believes in free and fair trade, so a balanced deal needs to be struck – one that seeks to improve reciprocal market access, but also recognises the UK sector's integration within the European automotive industry, so we urge all parties to get back around the negotiating table to extend EU cumulation provisions and continue progress discussions on a modernised agreement.

An upgraded UK-Canada FTA could achieve enhanced market access for EVs and batteries, deliver additional flexibilities to meet origin requirements and strengthen cooperation on supply chains, including critical minerals. However, even in the event negotiations for a new deal are resumed promptly, it is crucial for the parties to ensure continuity of trade by extending existing cumulation clauses allowing businesses to account EU materials to meet origin requirements.

Please do not hesitate to contact me if you would like to discuss the matter further.

Yours sincerely,

Mike Hawes
Chief Executive