EY DKM

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Brexit watch

Monthly briefing on Brexit developments

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It's been quite a month since our last update. So where are we now? A sequence of votes will be put to the House of Commons in the second week of March. The first, scheduled for 12 March (or before), will be a vote on what Theresa May hopes will be a revised Withdrawal Agreement. If the vote on 12 March fails, they will vote on leaving the EU without a deal on 13 March, which would see the UK adopt World Trade Organisation conditions. If the House of Commons votes against leaving the EU without a deal, on 14 March there will be a vote to extend Article 50 no further than June of 2019. The three votes will not ensure a no-deal is permanently off the table, as only revoking Article 50 or agreeing a new deal could ensure the avoidance of no-deal.

Jeremy Corbyn has said that even if the current Brexit deal is passed by the Commons, it should still go to a vote by the 'people'. Earlier this week, Labour finally took a position, pushing a second referendum or 'people's vote' on the final deal. It may well be that this move helps to push some Tory MPs toward backing the deal as they fear the potential result of a 2nd referendum.

Wednesday of this week saw MPs vote on a number of amendments. Five amendments in total were debated and voted on with just two being accepted and one withdrawn. Yvette Cooper's amendment reiterates Theresa May's recent commitment to allow votes on a no-deal Brexit and a delay to Brexit if her Withdrawal Agreement is rejected again. Conservative MP Alberto Costa's amendment was also passed which outlines that safeguards for EU citizens which have already been agreed with Brussels will apply whether the UK leave with a deal or not.

Taoiseach Leo Varadkar supports an extension of Article 50, but this option has divided senior UK politicians. At the European level, it appears they are currently assessing an extension. Given that European elections are due to take place in May, this would mean that the UK would take part in the elections. Dutch PM Mark Rutte appears to be the voice of reason on the extension debate, asking 'what do you want with it? We don't want to go round in circles for the next couple of months. What will be achieved by it?' This question will certainly resonate with Brexit commentators and stakeholders alike. If the extension goes ahead, all interested parties would have to ensure that it would not be a repeat of the last three years.

1 Political Developments

United Kingdom

What happens next?

Theresa May has stated that she will not get a Brexit deal in time to put it to Parliament for a meaningful vote this week. She then outlined that a series of votes will take place on 12, 13 and 14 March. More Common's votes took place on Wednesday 27 February with two of the five debated amendments being accepted. Both the Labour Party and SNP had amendments rejected which moved that the government should adopt Labour's Brexit plans and the government should rule out leaving the EU without a deal. Guy Verhofstadt, the European Parliament's Brexit chief, branded the postponement of the Commons ballot as one of the most reckless he has ever seen and accused Theresa May of kicking the can down the road. The latest delay of the meaningful vote resulted in the British Labour leader stating that his party would support a second referendum if Labour's proposals were rejected by Parliament this week. In an official statement the Labour Party has outlined they will put forward or support an amendment in favour of a public vote to prevent a damaging Brexit.

United States urges UK to uphold Belfast Agreement

Earlier this month, senior United States officials said if the UK would like to reach a trade deal with them, they must ensure to maintain the integrity of the Belfast Agreement. Congressman Peter King said that 'if the British want to consider any type of trade agreement with the United States, it is important that a soft border is maintained.' This appears to be smart politics from the Irish/EU teams to remind the UK that favourable trade deals are not a foregone conclusion.

The current state of car manufacturing in the UK

Honda has outlined plans to close its Swindon-based manufacturing plant. Initially citing that it had nothing to do with Brexit, when pushed on the issue, the Japanese manufacturer stated that it was not due to one single reason, but an accumulation of various issues. This comes two weeks after Nissan stated they do not intend to build their X-Trail SUV in Sunderland. Last year, the Honda plant was running at 65% capacity and producing 160,000 vehicles, with half of these exported to the US. Willy Shih, of Harvard Business School, advised that with capacity issues and the increased challenge of their market share in Europe, it made no sense for Honda to keep the factory open.

Countdown to Brexit

28Days

Ireland (NI & ROI)

Irish businesses urged to register for customs registration number

Businesses are being informed of the requirement to register for an Economic Operations Registration and Identification (EORI) number if they trade with the UK. The EORI number is common procedure for companies trading with non-EU countries. To avoid any potential delays and disruption, affected businesses should apply as soon as possible.

Varadkar backs extension

Speaking at an EU summit in Egypt, Leo Varadkar backed a 'long extension' to Article 50. While Mr. Varadkar's statement lacked any clarity in relation to the desired outcome of an extension, Dutch PM Mark Rutte employed a more direct approach and appears less than convinced that an extension would achieve very much without a business case for it. An extension to Article 50 does appear to be a divisive topic among British MPs, with the Defence Minister outlining that he would be tempted to vote for a delay, while the Education Secretary stood firm on his stance that Brexit would go ahead on 29 March.

Europe

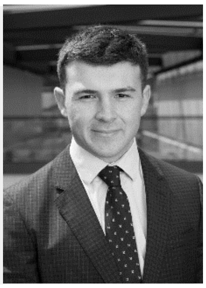
EU prepares for delay

The EU's most senior officials are exploring plans that could delay Brexit until 2021. A two-year extension to the negotiating agreement is gaining traction at the EU level. In the event of the Commons continuing to reject Theresa May's deals, the extension would allow the UK to remain a member state of the EU for a further two years which would give more time to tackle issues such as the Irish backstop. Given that the Brexit vote took place almost three years ago, little has been achieved since then, the question is whether a further two years would be any different.

Germans remain relaxed about Brexit

The Chief Executive of the German-Irish Chamber of Industry and Commerce advised that Brexit is not among German companies top 10 political concerns. This is despite the fact that just a quarter of German SMEs state they are well prepared for Brexit.

2 Brexit and Rules of Origin



Alwyn Hopkins

Alwyn is part of our Brexit team and has advised businesses across a diverse range of industries on the issues facing them when trading internationally post-Brexit.

Claiming preference

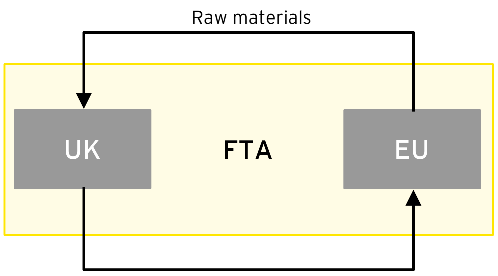
Rules of Origin (RoO) govern whether an importer can access reduced customs duty rates under a Free Trade Agreement (FTA). Taking advantage of this reduced rate is called 'claiming preference'. Currently, this is not needed for movement of goods within the EU.

If the final outcome between the EU and UK is an FTA, these RoO will prove a key issue for businesses. When hoping to claim preference, businesses will have to prove that the goods 'originate' from the country with which the import country holds an FTA. For example, a RoO might require that the goods are manufactured from a minimum of 60% originating materials. As part of this, materials from non-FTA countries may be considered originating, depending on the 'cumulation' clause of the FTA.

Bilateral cumulation

We anticipate any future EU-UK FTA to allow for 'bilateral cumulation'. This means that, for trade between the EU and UK, any good originating in the EU can be treated as originating from the UK, and vice versa.

Figure 1: Example of bilateral cumulation post-Brexit



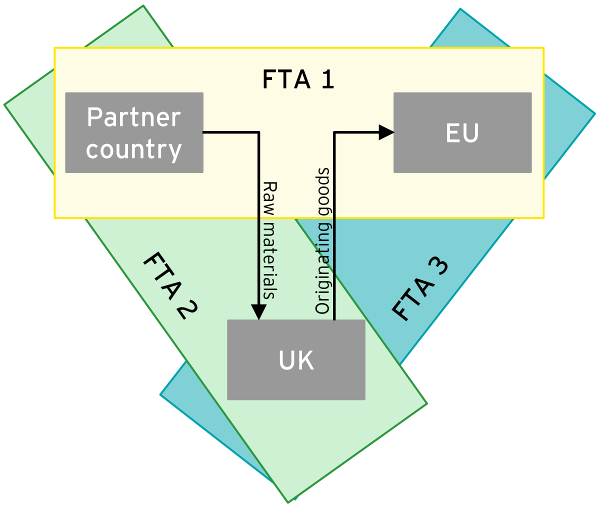
For businesses, this means that they would be able to source their raw materials from any combination of EU and/or UK origin, manufacture the finished good in the UK, and meet the RoO for that product when claiming preference on import in the EU (or vice versa). In the context of the RoO in this case, bilateral cumulation would mean that materials originating from the other party in the FTA would count towards the requisite 60% originating materials.

Diagonal cumulation

Some recent trade deals involving both the EU and UK have provided for diagonal cumulation. These include CETA (the EU-Canada Comprehensive Economic and Trade Agreement) and the recent UK-Switzerland trade continuity agreement presented to UK Parliament.

In an EU-UK deal, diagonal cumulation would be between a specific 'partner country', the EU, and the UK. This would mean that inputs originating from the partner country (which must hold an FTA with both the EU and UK) would count as originating from the UK when importing from the UK into the EU (or vice versa) provided that identical RoO and provision for cumulation exist in these FTAs.

Figure 2: Example of diagonal cumulation post-Brexit



In the context of this RoO, materials originating from the partner country would also count towards the 60% requirement.

Next steps for businesses

While an EU-UK FTA seems some way off, businesses who will trade between the UK and EU post-Brexit must be aware of the type of cumulation allowed in any future agreement. Procurement decisions may be impacted, as well as the importer's ability to claim preference.

Businesses will also want to consider whether they have sufficient data to prove origin if required, as well as the potential duty/cost impacts of lost preference.

3 Business developments

Cautious awareness affects business investment

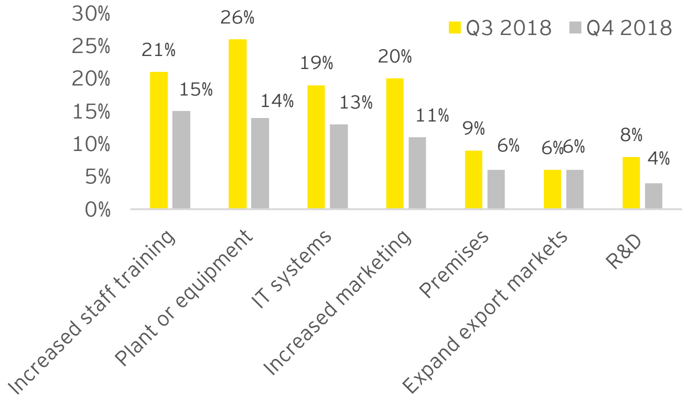
Unsurprisingly, the current business environment is anxious and observant. The only certainty which businesses can rely on, and the one which they must plan for in earnest, is that the UK will leave the EU on 29 March unless and until an alternative measure is decided. We have decreased our probability of a no-deal to 20%, owing largely to the amendments accepted this week and Theresa May's promise to deliver the three votes outlined.

Table 1: Brexit Strategy team – February outlook		
	Likelihood	Change since last issue
WTO (no-deal)	20%	Less likely
FTA	15%	Unchanged
Customs Union	5%	Unchanged
Hybrid arrangement	50%	More likely
Remain in EU/EEA	10%	More likely

Source: EY Brexit Strategy team

The lack of Brexit progress is already having tangible, damaging results. InterTradeIreland's Q4 2018 All-island Business Monitor reveals the low levels of investment which businesses plan to undertake in the next 12 months. Figure 3 shows the broad sectoral view, but certain sectors are particularly worrying: for example, only 3% of manufacturing and production businesses planned to increase staff training in the next 12 months, falling from 20% in Q3. This may represent a redirection of resources to Brexit mitigation strategies, or may be due to firms implementing a 'wait and see' strategy and building cash reserves.

Figure 3: Over the next 12 months do you have to undertake any of the following investments for your business?



Source: InterTradeIreland Q4 2018 All-island Business Monitor

The case for extending Article 50

With time running out, the consensus is one of panic that a cliff-edge departure will be the 'accidental' outcome of months of stasis and red lines. However, there is a very real possibility that such an outcome will be delayed, if not avoided completely based on Labour's recent support of a second referendum. This may be to afford more time to prepare, but it may also be owing to logistical hurdles which have until now been overshadowed by political manoeuvrings.

One such concern is that the UK has much progress to make in such a small amount of time to agree rollover arrangements with the countries which are currently covered within the EU. It was reported this month that only seven out of 69 such agreements had been rolled over, representing just £16bn out of £117bn worth of deals. This figure will have increased since the Israeli trade agreement was reached, but shows the scale of the work ahead.

Leaked Treasury documents show a traffic light system for indicating the likelihood of deal completion by exit day: only a handful were green, with some major trading partners, like Turkey and Japan, coloured black. The Department for International Trade also publicly released a progress update, with Table 2 showing the five largest deals in terms of share of UK trade which have not yet been agreed. This is a stark reminder that the approaching deadline will have tangible economic consequences; for businesses this is more reason than ever to action contingency plans.

Table 2: UK trading partners, total value trade		
Agreement	Status	Value of trade with partner*
EEA (Norway, Iceland, Liechtenstein)	Engagement ongoing	£7.5bn
Canada	Engagement ongoing	£4.9bn
Turkey	Will not transition for exit day	£4.6bn
South Korea	Engagement ongoing	£4.1bn
Southern Africa Customs Union and Mozambique	Engagement ongoing	£2.5bn

Source: Department for International Trade, ONS

*Year to Q3 2018, absolute total of imports and exports

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