

**INITIAL ANALYSIS**

# **The Impact of Brexit on Birmingham and the West Midlands**

## The Mutual Understanding

Britain and the EU, on November 14th, published both the Draft Agreement on the withdrawal from the EU and Euratom, termed the Mutual Understanding, as well as secondly the Outline Political Declaration on the Future Relationship.

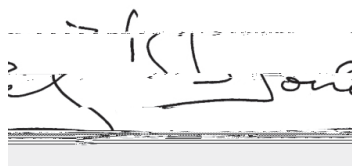
The Mutual Understanding details the legal and procedural complexities of Britain's withdrawal and is currently expected to be ratified by the European Council of Ministers on Sunday, November 25th, and then subsequently by the British Parliament and the European Parliament. The Mutual Understanding forms the conclusion of the negotiating process, and, following legal verification and ratification, will become the legally enforceable Withdrawal Agreement. Should ratification fail at any stage, then currently Britain would still leave the EU on March 29th, 2019 but without any agreement in place. In summary, the Mutual Understanding encompasses the following aspects of the withdrawal process:

- the objective of the overall process is to secure an orderly withdrawal;
- Britain will cease to be a member of Euratom;
- reciprocal protection of EU citizens and British nationals, who have exercised free movement before a date to be set by the agreement;
- prevent disruption and provide legal certainty;
- determine the parameters and length of a transition or implementation period;
- EU law will be applicable to Britain during the transition, although Britain can prepare for new international arrangements post-transition during the transition phase;
- the EU and Britain agree to honour the mutual financial commitments;
- establish a joint dispute resolution process given Britain's third country status;
- establish separate protocols to address the Republic of Ireland/Northern Ireland, Cyprus Sovereign Base Areas and Gibraltar issues during transition;
- agreement founded on overall balance of benefits, rights and obligations for Britain and EU.

## Political Declaration

During the transition period the EU and Britain will commence formal negotiations to conclude the framework for the future relationship outlined in the Political Declaration. These will focus on:

- shared values and approach to rights and data protection;
- a close relationship on services and investment, including on financial services;
- wide-ranging sectoral cooperation, for instance on transport and energy;
- requirements for open and fair competition to underpin the future economic relationship;
- broad and deep partnership on foreign policy, security and defence;
- comprehensive arrangements toward creating a free trade area, combining deep regulatory and customs cooperation, building on the Withdrawal Agreement single customs territory;
- on internal security, the need for comprehensive law enforcement and judicial cooperation in criminal matters, identifying ways of delivering strong and important operational capabilities.
- the process that will follow the conclusion of the Article 50 negotiations.

A handwritten signature in black ink, appearing to read "S. Jones", is written over a horizontal line. The signature is somewhat stylized and cursive.

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referendum. A more long-term option, if Brexit proves to be more economically debilitating than anticipated, could be an application to join the EU via Article 49, after March 29th exit.

Any change to the deep and extensive relationship between Britain and the EU will inevitably provide new opportunities as well as precipitate fresh barriers, some of which can be identified, others unexpected and will only emerge later. The challenge to Birmingham, and the wider region, is to identify these and develop appropriate responses to both capitalise on any advantages and minimise the negative impacts.

Nevertheless, until the final settlement(s) are agreed and ratified, it is difficult to calculate with any confidence the impact of leaving the EU on the local and regional economies. However, considerable research has been undertaken examining the potential range of overall economic impacts, and in terms of sectoral impacts it is possible to identify which sectors are most exposed to more constrained access to the markets of the EU. Furthermore, until the precise nature of any WTO trading arrangements are confirmed, it is similarly problematic to calculate the economic prospects resulting from

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levels of job creation, and a consequent sharp uptick in inflation as Moody's warn that a lower pound would lead to higher inflation and a squeeze on real wages. Optimistically, it would take 2-3 years for the economy to adjust to a WTO context, but again with slightly weaker growth than could currently be achieved and inflation remaining above previous trends.

Given the timeframes currently involved in the Brexit process, this could create difficulties in having the infrastructure required for WTO trading regime in place by March 2019. Moreover, some 20 countries, including USA, China, Australia and New Zealand, have rejected the initial schedules proposed by the UK and the EU meaning that the UK's accession to the WTO will likely involve a lengthy negotiation process. In this context, it seems increasingly unlikely that the UK will be able to adopt WTO status in time for March 2019. This could lead to a fourth potential outcome, a unilateral trading position (4) where the UK leaves the EU and has no other trading regime to fall back on. This would obviously be a significant negative shock to the economy, with the possibility of a recession in 2019 as well as high inflation from currency pressures. The economy would take a significant amount of time to recover from this shock, as the UK would need to determine its status in the short term, in order to allow trade to continue, as well as negotiate its membership of the WTO in the longer term.

These forecasts are based with the significant caveat that the British government does not pursue accommodative policies and local government is constrained in its ability to facilitate a positive response.

The parameters of the final trade settlement between the EU and Britain will obviously have an impact on Birmingham and the wider region, both in terms of domestic funding and policies as well as how the region sustains economic ties internationally and with the EU. Furthermore, how Central Government proposes to develop economic and trading ties with Non-EU economies will impact on future growth prospects for the region. Undoubtedly, more constrained access to the region's single largest export market will compress these growth prospects; however, whether this leads to an actual contraction of performance will be heavily dependent on what policy responses can be and are adopted locally. An increase in demand for local authority services, coupled with the loss of a significant source of funding could lead to considerable pressure being placed on local government. Most immediately, these trade negotiations are obviously a discussion within which Birmingham and the region needs to articulate its aspirations.

### EU-Britain Possible Framework for Future Partnership Discussions



Source: EU & WMEF

If indeed Withdrawal phase of negotiations do conclude amicably and an orderly Brexit is achieved, the European Commission has already mapped out a proposed framework for Future Partnership Discussions and this effectively provides a roadmap for future local government interventions to influence the expected further negotiations.



## 4. The Brexit Context

The EU reaction to the June 2016 British Referendum result has remained consistent since the immediate hours after the result was declared through to the content of the November 2018 Mutual Understanding document. This EU negotiating stance had been best summed up by President Macron, quoted in the FT, as “Brexit shows us one thing: it’s not easy to leave the EU, it is not without cost, it is not without consequence”. Some of the key consequences apparent from the negotiating process is that, for the European Commission at least, that leaving the EU means leaving its constituent institutional frameworks, most notably leaving both the Single Market and the Customs Union. However, such a rupture could be offset by the more qualified membership of the EEA or EFTA. Above all, collectively the EU-27 are concerned that if there are no adverse consequences from leaving the bloc, then its longer-term viability will be seriously jeopardised.

In contrast, the British position would appear to be a member currently enjoying a range of opt-outs, such as from the Euro, Schengen and the Charter of Fundamental Rights, wanting to become a non-member but with a series of significant opt-ins, namely preferential access to the Single Market, the Customs Union and the Erasmus Programme.

Despite the seeming incompatibility of these positions, progress has reportedly been made on a number of issues since Article 50 was triggered with the publication of the draft Withdrawal Agreement, the so-called Mutual Understanding published in November 2018. Although, under the original formal negotiating schedule agreed once Article 50 was triggered, the timeline for concluding the negotiations has expired in October 2018, now the period between November 2018 and March 2019 will be used to secure respective member ratifications, thereby enabling an orderly Brexit. Nevertheless, at this extremely late stage, less than five months before Britain is actually scheduled to leave on March 29th, it still remains unclear what the final form of this exit will take. EU-27 members are continuing to prepare the ground to introduce emergency measures to accommodate the severe disruption anticipated should no final agreement be reached.

At this stage there remain a number of probable outcomes for what form the Future Relationship could take, after the 29th March 2019 exit, based on the parameters established under the Mutual Understanding agreement:

- a settled agreement, such as temporary reversion to European Economic Area status;
- an as yet undefined transition programme;
- adoption of a WTO-based trading regime;
- without an actual deal, and with no recourse to other trading regimes;
- unanimous agreement to an extension of the Article 50 process, pending a Second Referendum of the decision to leave;
- UK application to re-join EU via Article 49, after March 29th exit.

In consideration of the most appropriate of these options, a number of factors have had to be considered, requiring concessions from both sides.

Firstly, membership of the Single Market is based on acceptance of the so-called “Four Freedoms”, namely freedom of movement for capital, goods, services and labour. These are defined in the Treaty of Lisbon, which superseded the founding Treaty of Rome, a key difference between them, is that the former details the free movement of labour, whereas the latter talked of the free movement of people. Although various EU members adopt distinctive and more restrictive labour market policies, the EU insistence that Britain, which

currently operates one of the most open labour market policies, fully accepts the free movement of labour is critical if it is to have unfettered access to the Single Market. The attitude of the British government seems to suggest that immigration is assumed to have been a key factor precipitating the vote to leave.

A European Parliament study 'Future relations between the UK and the EU: options after Brexit' finds that there are only two possible outcomes for the future trading environment which preserve the integrity of the Single Market. These are continued membership of the Single Market through the EEA or another similar organisation, or a customs union/FTA which abandons the continued integration of the UK and EU markets.

Secondly, a major stumbling block is the status of the United Kingdom-Republic of Ireland border. The 1998 Good Friday Agreement, which brought a seemingly fragile form of resolution to the long-running "Troubles" in Northern Ireland, was achieved in part because of the respective memberships by the Republic of Ireland and the United



simply yet a further novel initiative on the part of President Trump, but more an extension of previous administrations voiced concerns regarding the WTO assumption of legislative functions that the Americans consider beyond its remit. This has led to the United States effectively delaying judicial appointments to the WTO appellate body and as a result it could soon be rendered inquorate and unable to adjudicate on trade disputes. Thus, by the time Britain leaves the EU, the WTO option may prove to be valueless, and with President Trump intensifying his anti-WTO rhetoric, there are considerable doubts that it will be able to survive as an effective trade arbiter. Accordingly, as Britain develops its post-Brexit trading relations, rather than an environment within which multinational trade arrangements are the norm, bilateral ties between nation-states could become much more significant.

It is in this context that the British Government is negotiating the UK's exit from the EU. Previously, in the White Paper 'The Future Relationship Between the United Kingdom and the European Union' (otherwise known as the Chequers Proposal), the Government set out its aims for Brexit, including the formation of a free trade area for goods as well as the UK following a common rulebook. This arrangement would, in theory, continue to enable the free movement of goods across borders with no need for customs checks. However, this would not cover services, an important component of the British economy, and

## 5. Executive Summary



### Birmingham Export Position (2016)

	World	UK	West Midlands	Birmingham
Value of EU Exports (£m)	3,414,200	139,975	12,871	1,657
EU Exports % of GVA		8.01	10.17	6.44
% of Total EU Imports	100.00	4.10	0.38	0.05
Value of Non-EU Exports		147,905	16,862	2,489
Non-EU Exports % of GVA		8.46	13.32	9.68

Source: UNCTAD, HMRC, OECD & WMEF

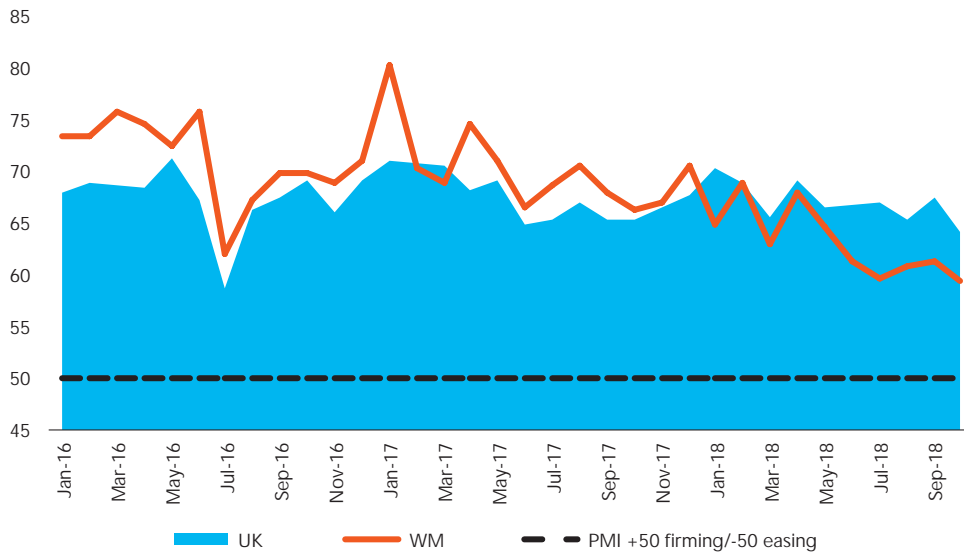
Regardless of the Brexit option pursued, geography will ensure that the EU will remain a key market for Birmingham and the wider region. Enhancing the connectivity to this market, through improvements in regional infrastructure provision should be part of any effort to mitigate the negative impacts of leaving the EU. This could include improving direct access via air, road, rail and sea as well as boosting internet capacity and provision. Indeed, the actual depth of the current relationship is certainly much deeper than the gross trade data indicates, and critical is the exposure of intensely integrated EU-wide supply-chains to Brexit. These EU supply-chains, however, extend beyond the borders of the Single Market and of the Customs Union, encompassing many manufacturers and service providers located in economies without formal trade agreements in place and operating under WTO rules. These supply-chains are not simply the progressive assemblage of products but incorporate associated services sector deliveries, such as design and software provision. Until a trade agreement is in place, the resilience of these supply-chains will be severely tested when, and if, WTO-style tariffs and rules of origin are rapidly and rigorously applied. In the interim it seems more probable that a transition period will be agreed until the end of 2020.

Having a formal input into future trade negotiations will be essential if regional institutions are to provide effective support to the local economy. Furthermore, regional comprehension of the implication of future trade agreements, and the necessary requirements to observe any new arrangements, such as documentation, certification, rules of origin and tax procedures, will be essential to fill current business information gaps. Consideration of free trade zones to support export capacity, whilst dynamic engagement with regional export markets will need to be deepened and expanded, such as the active engagement programme proposed with the Free State of Saxony (see detailed exposition in the Research Findings). With some 60% of regional exports currently to Non-EU destinations, the West Midlands already has a proven track record in succeeding in exporting on WTO and Non-FTA terms.

## 5.2 Business

Regional business confidence on future prospects has, until recently, held up relatively strongly, despite the continued ambiguity surrounding the final Brexit proposals. However, as the potential for a Brexit without an agreement has increased, this confidence has been eroded. Restoring such confidence will require demonstration by regional institutions that there is a credible strategy to address both the opportunities and risks that arise from any exit from the EU locally. Key to this will be the articulation of a regional focus to the National Industry Strategy. Paradoxically, if Brexit does not include continued membership of the Single Market, this may permit a more activist role to be pursued by public sector institutions and programmes in a less restrictive environment for state aid.

**West Midlands Future Business Activity**



Source: NatWest Regional PMI & WMEF



The region, and indeed Birmingham, has been very successful in attracting inward foreign direct investment (FDI) over the past decade, and its growth model is based on continuing to attract such flows. Brexit will change the value proposition of the WMCA. However, it is not just Brexit that will influence future FDI inward flows but the future structure of the global economy. With the increasing technological sophistication of the economy likely to alter investment objectives, the region needs to be sufficiently agile to respond to the new requirements. In terms of Greenfield FDI the region has been identified as one of the strongest performers in western Europe over the five-year period ending in 2016.

**Location of Greenfield Manufacturing FDI**



The deepening of the relationship between business and academia has continued apace, with regional institutions particularly successful. EU collaborative funding flows for academic institutions, such as Horizon 2020 which was worth €4.98bn to the UK in 2015, has provided crucial support for the links with businesses. There needs to be an urgent response to secure future equivalent funding after 2019 and facilitate continued participation by City institutions in EU research programmes.

### 5.3 Jobs

It is not clear what migration policy will be developed post Brexit(n)-9(d)-8(s)-27(t B)-5.(x)- TmT10 1 Tf-3(o)-12(n 6(l21(r)-4(r w)-17(h)-20

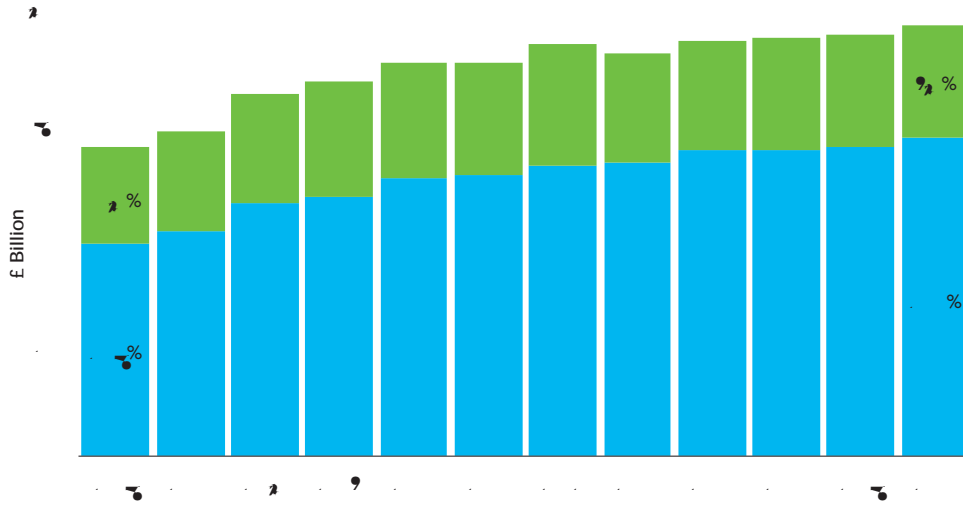
The formal regional labour market is close to historic employment highs, with over 60% of the 16-64 age cohort in employment. However there remain pockets of endemic long-term under-employment and unemployment, with registered unemployment at 7.1% in the WMCA – the highest of all the UK combined authorities. Nevert Tf-0.025 Tch(i)-hall t(UK -9(025 Tc)-15v183.703 0 (i)-40 Tc 37

of 16-64-year-olds with no formal qualifications is 13.1% in the WMCA, compared to 10.4% in the West Midlands and 7.7% in the UK overall. This highlights the need for local skills strategies to tackle structural issues within regional and local economies, especially with regard to the Shared Prosperity Fund.

Much of the workforce is, however, located in low-paid, low-value-creation sectors, increasingly staffed by people on temporary and zero-hour-contracts. A skills strategy needs to be sufficiently adroit to accommodate these aspects, with simple supply-side solutions unlikely to be sufficient.

Given the tightness of the labour market, demand for skilled migrant staff will remain robust for the foreseeable future, indeed, as can be seen from recent PMI data, it has remained robust in the region despite the headwinds from Brexit. The skills strategy adopted by government, and critically devolved to local government and/or the English regions, Brexit also needs to understand the nuances of different types of workers and people coming to the UK. Sectors in the West Midlands where a significant number of EU nationals make up the workforce, such as health and social care where 4.2% workers are from the EU, rising to 10% of registered nurses, will also come under considerable strain. As another example, an EU-based HGV driver may come to the UK for 24-36 hours at a time, bringing in goods and components and taking out exports, but returning as many as

### Aggregate Government Expenditure



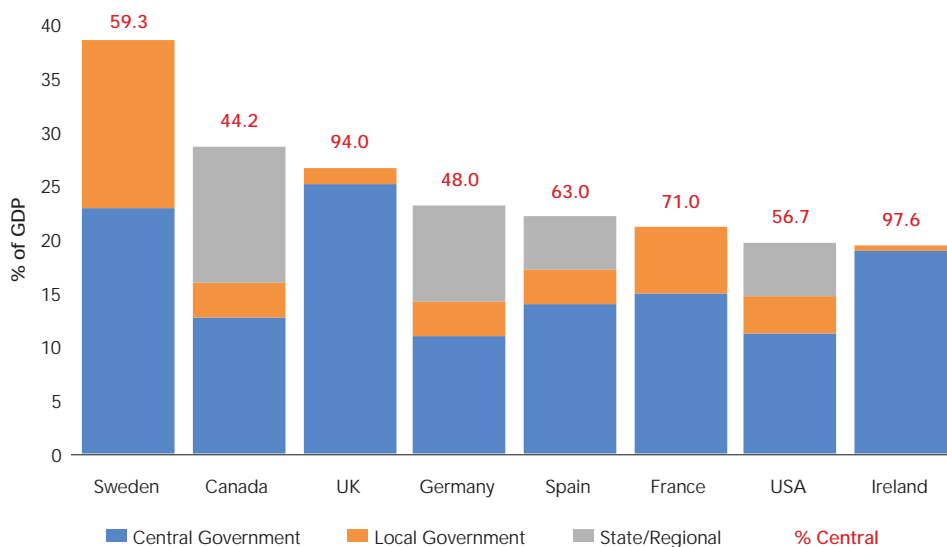
## 5.5 Public Services

Membership of the EU has had a significant influence on the way public services are delivered. The EU's ambitions for an integrated Europe with a harmonised Single Market have led to a raft of EU legal instruments having relevance on a wide range of areas affecting public service delivery. This comprises trading standards, including health and environmental concerns; regulation and legal issues such as procurement and state aid. A cornerstone of EU citizenship has been the right to freedom of movement across borders within the EU. The workforce has been a net beneficiary of this with many non-UK EU nationals working in critical areas of public service delivery, such as social care and health. Public service delivery also encompasses resilience and security issues, including police and security co-operation, the effect of Brexit upon this is still unclear. In addition, local government has a role in supporting business and responding to economic impacts in our areas, including trade and travel, regulation and potential impacts on infrastructure projects. Furthermore, the EU has developed an extensive regional framework in an attempt to promote growth and expansion across the EU, albeit one that is mediated by differing and distinct approaches adopted by member-states. As a result, EU funding streams, as well as best-practice knowledge diffusion, have been heavily integrated into British local authority strategies. Birmingham alone has been a net benefactor of over £1bn of funding and is currently delivering £103m of EU funded programmes.

Regardless of the final form of disengagement, the net impact on public services, across sectors is expected to be appreciable. Currently many core services such as employment and skills and business support are resourced through EU funding. A withdrawal of this funding would threaten the delivery of such services.

Although not within the purview of this report, perhaps a more fundamental review of both the funding of devolution and of the funding of local government needs to be undertaken, possibly by a Royal Commission. Not only does the current Barnett formula effectively curb English regional capital and current expenditure, but London continues to receive a disproportionate level of public sector provision with some 34% of regional GVA in the capital derived from it. Indeed, the United Kingdom government administration continues to be a grossly over-centralised process, especially when considering revenue harvests compared to comparable economies.

### Comparative Government Revenue Structures (2016)



Source: OECD & WMEF



The public sector interface with the business community (shared services) is an area of concern, with agreements and operating practices bound up within EU legal frameworks. Until the effective transfer and repatriation of necessary legislative frameworks are undertaken by Britain, shared services are another sector which it still remains problematic to determine. Future taxation variances from EU norms and current British tax concessions continuity could also have a considerable impact. Nevertheless, current business









## 7. Glossary

2011 Census	UK Census undertaken by the ONS in 2011
APPG	All-party parliamentary group
APS	Annual Population Survey
Article 49	Refers to Article 49 of the Treaty of Lisbon which outlines the process by which a nation state can become a member of the EU
Article 50	Refers to Article 50 of the Treaty of Lisbon which outlines the process by which a nation state can leave the EU
Barnett Formula	The mechanism by which funding is allocated to the four constituent nations of the UK
BASL	Business activity size and location
BCU	Birmingham City University
BFPG	British Foreign Policy Group
Brexit	The exit of the UK from the EU
Brexit Referendum	The United Kingdom European Union membership referendum in June 2016
Budget Cycle	The EU multilateral financial framework covering the period 2014-2020 with the new period coming into force in 2021-2027
Business Rates	A tax on non-domestic properties
CBR	Centre for Business Research, Cambridge University
CBS	Centre for Brexit Studies, Birmingham City University
Chequers Agreement	Proposed future relationship between the UK and the EU by the British Government
City REDI	City Region Economic and Development Institute
Core Cities	An advocacy group of 10 key urban areas of the UK excluding London, comprising Birmingham, Bristol, Cardiff, Glasgow, Leeds, Liverpool, Manchester, Newcastle, Nottingham and Sheffield
Customs Union	The EU Customs Union which means that the 28-member states of the EU, as well as Turkey, Monaco, Guernsey, Isle of Man, Jersey, Akrotiri and Dhekelia, Andorra and San Marino, form a single territory for customs purposes
EC	European Commission
ECJ	Court of Justice of the European Union
Economic Operator	Authorised Economic Operator
EEA	European Economic Area
EFTA	European Free Trade Area
ERDF	European Regional Development Fund
ESF	European Structural Fund
EU	European Union
EUROCITIES	Network of Major European Cities
FDI	Foreign Direct Investment
Fitch	Fitch Ratings
FTA	Free Trade Agreement
FTZ	Free Trade Zone

<b>Future Partnership</b>	The negotiations of the future arrangement between the EU and the UK will begin after the implementations of the Withdrawal Agreement.
<b>GDHI</b>	Gross Domestic Household Income
<b>GDP</b>	Gross Domestic Product
<b>GVA</b>	Gross Value Added
<b>HGV</b>	Heavy Goods Vehicle
<b>HMRC</b>	Her Majesty's Revenue and Customs
<b>Horizon 2020</b>	EU research and innovation funding programme covering 2014-2020
<b>IMF</b>	International Monetary Fund
<b>Intermediate bodies</b>	The Core Cities plus London and Cornwall
<b>Key Cities</b>	A group of mid-sized UK cities, including Coventry and Wolverhampton.
<b>LA</b>	Local Authority
<b>LEP</b>	Local Enterprise Partnership
<b>LGA</b>	Local Government Association
<b>Nomis</b>	ONS Source of Labour Market Statistics
<b>NVQ</b>	National Vocational Qualification
<b>OECD</b>	Organisation for Economic Co-operation and Development

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# Brexit Commission Membership

1. Birmingham City Council
2. Greater Birmingham Chamber of Commerce
3. West Midlands Combined Authority
4. Aston University
5. Birmingham City University
6. University of Birmingham
7. University of Warwick
8. Black Country Local Enterprise Partnership
9. Coventry and Warwickshire Local Enterprise Partnership
10. Greater Birmingham and Solihull Local Enterprise Partnership
11. Coventry City Council
12. Dudley Metropolitan Borough Council
13. Sandwell Metropolitan Borough Council
14. Solihull Metropolitan Borough Council
15. Walsall Metropolitan Borough Council
16. Wolverhampton Council
17. West Midlands Economic Forum

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The West Midlands Economic Forum is a neutral, independent forum bringing together representatives of the public, private and voluntary sectors to evaluate real trends in the local economy.

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