Time for Clarity:
The Views of British Business on The Path to Brexit

Ed Balls, Peter Sands

Eleanor Hallam, Sebastian Leape, Mehek Sethi, Nyasha Weinberg

HARVARD Kennedy School
MOSSAVAR-RAHMANI CENTER
for Business and Government

KING'S College LONDON

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Abstract

Brexit presents profound changes for British businesses: from how they trade, to how they are regulated and how they employ people. This paper represents the second phase of a research project exploring the challenges and opportunities from the perspective of mid-sized British businesses. Based on interviews with over 120 individual businesses, trade associations and experts, our research seeks to identify and discuss the issues and priorities of mid-sized British businesses as the UK progresses towards exiting the European Union. Highlights from this second phase of research include: most businesses want to remain in the Single Market, and if that proves impossible, to stay in the Customs Union; most businesses fear Brexit will result in more regulation, not less; and almost all British businesses want to maintain flexible access to EU labour. The key conclusion from these interviews is unambiguous: most British business leaders are concerned that the current path of Brexit could well cause significant damage to business, both because the end-point will inevitably mean more barriers to trade, most likely more regulation, and almost certainly less influence; and because the process of leaving the EU is creating huge uncertainties and diverting management efforts.

Acknowledgements

We would like to thank all the companies, trade associations, and experts we interviewed for this research for making the time to share their perspectives with us. These are listed in Appendix 1. We would also like to thank the Members of Parliament who helped us during this research project, not least by helping identify companies to interview, as well as the individuals from various academic institutions and think tanks who gave us their insights. These are listed in Appendix 2. Finally, we would like to thank those who took the time to review the draft report and provide us with comments. The authors take full responsibility for the content and conclusions of this report, including any errors and omissions.

Affiliations

Ed Balls – Research Fellow – Mossavar-Rahmani Center for Business and Government – Harvard Kennedy School and Visiting Professor, King's College, London
Peter Sands – Research Fellow – Mossavar-Rahmani Center for Business and Government – Harvard Kennedy School

Eleanor Hallam – PhD Candidate – King's College London
Sebastian Leape – MPP Candidate – Harvard Kennedy School
Mehek Sethi – MPP Candidate – Harvard Kennedy School
Nyasha Weinberg – MPP – Harvard Kennedy School Alumni

Summary

It has now been over eighteen months since the UK held a referendum on leaving the EU, nine months since the UK Government (hereafter, the "Government") triggered Article 50, and over six months since negotiations began on the terms of Brexit and the UK's general election.[1]

Our first paper highlighted four key themes that emerged from our interviews as being priorities for British businesses: first, making sure Brexit enables trade rather than stifles it; second, ensuring Brexit streamlines regulation rather than inadvertently expanding it; third, helping industry sectors adapt to the specific challenges many face as a result of Brexit; and fourth, implementing Brexit in a way that ensures a smooth transition, avoiding a disruptive cliff edge, and ensuring that critical policies and processes, such as customs and immigration, are made fit for purpose for a post-Brexit world.

Since this first paper, the realities of Brexit have become much more visible to British businesses. They have been inundated with a flood of proposals, reports and papers from the Government, their trade associations, think tanks and universities. Many have already seen the impact of Brexit on their ability to hire talent, win contracts, establish partnerships, or secure financing and investment. For some, Brexit is already having a significant effect, while others have experienced little direct impact thus far.

Despite several rounds of negotiation and a profusion of policy statements, huge uncertainties remain about both the end-state and the process. Companies have to deal with the fact that everything from near Single Market status to a "Hard Brexit" relying on World Trade Organisation ("WTO") rules still appear possible as outcomes. Even the Government's acceptance of the concept of a transitional period, while broadly welcomed by business leaders, raises its own questions: will the transition period be a continuation of the status quo, or some kind of intermediate step between the current situation and the Brexit end-state? Likewise, the Government's commitment to protect the Good Friday Agreement through maintaining regulatory alignment between Northern Ireland and the Republic of Ireland, thus avoiding the need for a "hard border", raises significant questions about the scope for regulatory divergence between the UK and the EU.[2]

To deepen our understanding of the perspectives of small and medium sized British businesses on Brexit, and to explore how their views and priorities might have evolved over the last six months, we conducted a further round of interviews from August 2017 onwards with an even broader range of mid-sized companies, including businesses from every region of the UK and all the major sectors. In total, we have now conducted interviews with over 90 businesses, 30 trade associations, and 20 international trade policy experts from the UK, US, and Europe.

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[1] Sands, Balls, Leape and Weinberg, *Making Brexit Work for British Business*, M-RCBG Associate Working Paper Series | No. 77, 2017

[2] TF50 (2017) 19, *Joint report from the negotiators of the European Union and the United Kingdom Government on progress during phase 1 of negotiations under Article 50*, 8 December 2017

The focus of the Brexit process has now shifted from the terms of departure to the framework for the UK's new relationship with the EU after the European Council's determination that "sufficient progress" had been made on Phase 1 in December 2017. As the serious negotiations on the UK's trading relationship with the EU begin – which will define the scope for changing Britain's relationships with its other trading partners – it is timely to take stock of how the owners and managers of the small and medium sized businesses that drive much of Britain's economy view the opportunities and challenges.

Main Findings

Our second round of interviews confirmed the key findings about mid-sized businesses' priorities for the Brexit end-state from the first set of interviews. An indication of these priorities is given in Figure 1, which is based on surveying the businesses we interviewed, and which shows the average importance given by these businesses to different aspects of Brexit. At the top of their concerns is continued access to EU labour and skills. While accepting that some controls on unskilled immigration are now inevitable, almost all British businesses want an immigration system that enables continued flexible access to EU workers. Second most important is the trading relationship with the EU. The vast majority of British businesses would like to remain in the Single Market and the Customs Union. If full or even tailored Single Market membership is impossible, they would like to remain in the Customs Union and see the Government secure an FTA with the EU that replicates the Single Market as far as possible. Regulation was also seen as an important issue by most businesses. A clear majority of British businesses would like UK regulation to remain equivalent or closely aligned with EU regulations and want the UK to continue to be actively engaged with EU regulatory agencies. By contrast, the potential upsides from Brexit – striking trade deals with other markets, including the US, or changing regulations to align more closely with the needs of British businesses – were seen as less important.

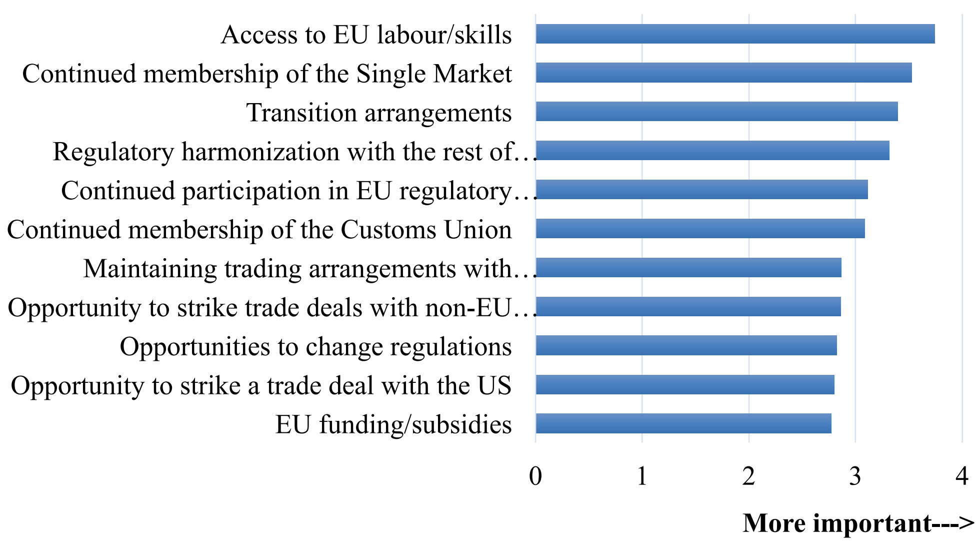
The transition arrangements were also seen as critically important by business leaders. Indeed, this second round of interviews revealed much sharper views on the process of implementing Brexit. While in our earlier interviews we typically heard generalised concerns about the possibility of a "cliff edge" and the debilitating effects of uncertainty, in our most recent interviews we heard specific concerns about the need to get clarity on granular points of policy and regulation in order for businesses to be able to make decisions. With the Article 50 deadline of 29 March 2019 firmly in their sights, business leaders are getting much more focused on the need to prepare for different potential outcomes.

Some interviewees suggested that early 2018 will be the watershed, leading to a marked shift in mindset; from now onwards, managers will be looking more concretely at 2019, which means they will have to form a view on what will happen when the Article 50 process expires in March 2019. Both pro-Brexit and anti-Brexit business leaders expressed frustration at the slow pace of negotiations and the lack of clarity on both process and eventual outcome. As many pointed out, the greater the uncertainties, the more businesses will need to plan for worst case scenarios.

We were struck by how many business leaders talked about seeing a shift in psychology or sentiment towards Europe. They talked about sensing a “retreat from Europe” in both their own companies and amongst suppliers and customers. Some mentioned that this disengagement was being reciprocated by EU counterparts. To some extent, such a trend would seem both inevitable and rational in the light of the degree of uncertainty around future rules of engagement. Yet those we interviewed also pointed to a change in sentiment on both sides of the Channel fuelled by the rhetoric around the negotiations.

However, it would be misleading to suggest that the businesses we spoke to were invariably gloomy about the future. Whilst almost all see Brexit as creating significantly more challenges than opportunities, many expressed confidence in their ability to adapt in response to the outcome, as long as they are given sufficient warning as to what the changes will be. However, this pragmatic “can do” stance does not equate to complacency. Britain’s mid-sized businesses know they will have to change to make the best of Brexit, and see urgency in identifying what these changes will need to be.

Figure 1: The ranked importance of key aspects of Brexit (1= lowest, 5=highest)



Source: We asked each business to give each of a series of issues a score from 1 to 5 based on the importance of that issue for their business (1 = not important, 5 = very important (Detailed in Appendix 2)

Summary of Specific Findings

Our specific findings from the second round of interviews puncture some of the abiding myths about Brexit. Most business leaders are now extremely sceptical about many of the claims about the potential benefits of Brexit and are deeply concerned about the practicalities of implementation.

Trade

British companies recognise that securing an FTA giving access to the Single Market is significantly inferior to being a member of the Single Market. Even an FTA of the scope of the EU-Canada Comprehensive Economic and Trade Agreement ("CETA") would exclude services, require rules of origin checks and mean that British companies exporting to Europe would have to conform to regulations the UK has had no involvement in shaping. Moreover, negotiating an FTA more favourable or comprehensive than CETA would be extremely difficult since its benefits would have to be extended to Canada and other countries that have negotiated FTAs with the EU (given WTO Most Favoured Nation ("MFN") clauses). For companies relying on tightly integrated supply chains, such as those in the automotive, aerospace, plastics and chemicals industries – in fact, most advanced manufacturing sectors, plus those in the packaged food industry – the distinction between Single Market membership and an FTA would require fundamental changes to the way they do business. The difference between an FTA and the Single Market is even more profound for companies in the service sectors. Whilst the Single Market in services is far from complete, the degree of regulatory harmonisation, mutual recognition of credentials, and focus on removing non-tariff barriers far exceeds what an FTA would provide. Moreover, the Single Market provides a framework for further progress in the removal of non-tariff barriers to trade in services, through initiatives such as the Digital Single Market or the Payments Services Directives. Given the UK's strengths across many service sectors, including finance, consulting, the creative industries and law, many UK businesses believe they have more to gain from the expansion of the Single Market into services than their counterparts in any other EU state.

For these reasons – the costs of leaving the Single Market for some, and the advantages of staying in a deepening Single Market for others – many of the businesses we have spoken to would support the kind of hybrid Single Market arrangements advocated recently by both the Institute for Government ("IFG") and the Institute for Public Private Research ("IPPR"). The IFG suggested four options including an "EU-UK regulatory partnership"[3] while the IPPR proposed a "shared market" model.[4] All these options attempt to create a solution somewhere between a Norway-style adoption of Single Market and an FTA like CETA – offering greater integration with the Single Market than an FTA, but with more scope for regulatory divergence and greater room to constrain migration. The attractions of such models in terms of outcomes for UK business are easily apparent, but negotiating any of them looks very difficult. To start with, any of these models would require both the UK and EU to make significant compromises on previously asserted red lines.

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[3] Institute for Government, *Trade After Brexit – Options for the UK's Relationship with the EU*, 18 December 2017
[4] Institute for Public Policy Research, *The Shared Market: A New Proposal for a future partnership between the UK and EU*, 18 December 2017

From a UK perspective, some degree of European Court of Justice ("ECJ") and an ongoing budgetary contribution would be almost inevitable, as well as a negotiated compromise on migration. From a EU perspective, on the other hand, these options might look like variants of the UK "having a cake and eating it". Second, ensuring any sectoral differentiation is enforceable and consistent with WTO MFN rules would be far from trivial. Third, the novelty of the "regulatory partnerships' and "shared market" approaches suggest these would take even more time to negotiate than options based on existing models.

In contrast to the recent Government statement that departure from the Customs Union was "in order to strengthen opportunities for UK exporters",[5] **most British companies - and the overwhelming majority of British companies who expressed a view to us - want to stay in the Customs Union, believing that the potential gains from the UK negotiating its own trade deals with other parts of the world do not offset the substantial disadvantages of leaving the Customs Union.** While many companies are enthusiastic about the prospects of doing more business with other parts of the world, most are sceptical that the UK can secure trade deals more effectively than the EU, and that the upside from such deals would offset the downside from greater friction in trade with the EU. Already an average of 62% of UK goods and services exports go to the EU or to countries with which the EU has already negotiated FTAs.[6]

Most British firms believe that the UK lacks the negotiating capability or clout to secure more advantageous trade deals with the most significant markets in the rest of the world. Moreover, many companies believe the barriers to greater export success in these markets are more to do with productivity or focus than the lack of trade deals. They point to the fact that Germany exports far more than the UK to growth markets like China and India despite being in the EU. Companies also highlight the advantages of being part of the Customs Union when trade disputes arise, given the scale and negotiating power of the EU as a whole.

Business leaders also point out leaving the Customs Union would mean that customs checks on trade with the EU would be required, regardless of whether the UK remained in the Single Market or secured an FTA. Since the UK would have its own tariffs, UK exports to the EU would have to undergo rules of origin checks to ensure the UK was not being used to circumvent the EU's Common External Tariff. Some also queried as to whether it would be possible to maintain the commitment to an open border between North and South in Ireland if the UK left the Customs Union, a point the European Commission has also made.[7]

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[5] Laura Hughes, *Downing Street rules out EU customs union to placate Brexiters*, The Financial Times, 4 February 2018]

[6] House of Lords European Union Committee, *Brexit: Trade in Goods*, The UK Trade Policy Observatory (UKTPO)- Written evidence (TAS0085), 14 March 2017

[7] Daniel Boffey, *Brexit plan to keep Northern Ireland in Customs Union Triggers Row*, The Guardian, 9 February 2018

Many British companies regard the US market as enormously important, but believe that an FTA with the US would offer UK companies only limited benefits and are somewhat sceptical about the likelihood of an advantageous deal being achieved. The US is a very significant market for UK companies, taking 19% of UK goods and services exports in 2016/17.[8] However, an FTA would appear to offer limited upside. On goods, tariffs average 2.5%, with the highest rates in food and agriculture. Removing tariffs would largely benefit US companies in these sectors given their relative scale and competitiveness. UK consumers could also potentially benefit from lower prices providing concerns about differential standards on food safety and the environment were addressed. In the auto sector, EU tariffs on US imports are 10%, while US tariffs on EU imports are 2.5%: so removing these tariffs would benefit US companies. For companies with highly integrated intra-European supply chains, such as car manufacturers, having tariffs with the US that were different from the EU's Common External Tariff would add considerable complexity and cost, since it would result in rules of origin and other customs checks needing to be introduced. In the service sectors, such as finance and the creative industries, where there may be significant upside to reductions in non-tariff barriers for British companies, firms were sceptical about the UK being able to negotiate significant concessions. In most service sectors, the US political context suggests changes to accommodate UK priorities look improbable (eg Dodd-Frank in banking). Moreover, the degree to which services regulation is delegated to states (eg in insurance) creates a further impediment.

Almost all companies believe that "Hard Brexit", leaving the EU without an agreement and relying on WTO rules, would be a disaster. The clear majority of companies dismissed this option as unacceptably risky and damaging. The few that suggested this might be practical appeared to misunderstand what it meant (ie suggesting that it would lead to UK exporters facing reduced tariffs elsewhere).

Regulation

Most British companies believe that **the upside from the UK being able to make its own regulations outside the Single Market is small, and outweighed by the considerable risk of an increased regulatory burden and costs.** While some business leaders, particularly the small minority in favour of Brexit speak in general terms about the potential benefits of reducing the regulatory burden, very few could point to specific regulations emanating from the EU that they want to see removed or modified (and sometimes these were wrongly attributed to the EU). Most firms want UK regulations in their own industries to continue to be aligned with EU regulations to avoid the incremental costs of having to comply with multiple regulatory standards, even if the UK no longer has a voice in shaping these regulations. British companies are concerned that regulatory divergence will lead to an increased regulatory burden and that the need to set up new regulatory agencies to develop and administer regulations at a sector level will lead to increased costs.

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[8] Office of National Statistics, *BoP: Current Account: Goods & Services: Exports: United States of America*, 22 December 2017

Most British companies would like the UK to continue to be engaged in the specialised EU regulatory agencies administering and developing the regulatory frameworks for their industries. Firms are worried that withdrawal from these agencies will mean that they are subject to rules they have no opportunity to influence. They are also concerned that the costs of the UK creating equivalent agencies will be borne by them.

Companies believe the Government's commitments on the relationship between Northern Ireland and the Republic reinforce the uncertainty about the shape of the UK's eventual end-state relationship with the EU. Whilst those who commented on this topic recognised the importance of protecting the Good Friday Agreement, the commitments to "regulatory alignment" and to preserving the Common Travel Area raise significant questions about the degree to which the UK as a whole will be able to diverge from EU standards, even if this means the UK becomes largely a "rule-taker". And the Government's apparent belief that it can maintain borderless trade between with the North and South while leaving the Customs Union only adds to the current confusion and uncertainty, not least because the European Commission has made clear that it does not share this view.

Skills and Talent

Almost all the companies we interviewed believe that devising a workable immigration scheme is one of the most difficult and important challenges for the Government in implementing Brexit. Continued flexible access to EU labour is a key priority for business leaders in almost every company in most sectors. Given their experience with immigration procedures for non-EU citizens, they are concerned that the Government will introduce overly cumbersome immigration mechanisms that will fail to reflect the needs of specific sectors and be particularly burdensome for smaller companies. The delayed publication of the Government's promised White Paper and reluctance to provide any substantive details of what the new system will look like is a growing concern for many businesses.

Funding and Subsidies

Most British companies believe the Government will need to maintain the level of subsidies and grants to particular sectors following Brexit, limiting the potential savings in public expenditure. While views vary on the desirability of reducing agricultural subsidies, few believe the Government will want to make significant reductions, given the potential impact on food security, rural communities and the environment. Companies in innovative sectors, such as the technology, advanced manufacturing and life sciences sectors, as well as the creative industries, stressed the need for continued government support of research and development. In fact, some suggested the Government would have to invest more to offset the disadvantages of losing access to EU funding schemes and collaboration mechanisms, which UK institutions have benefited from disproportionally.

Transition

Most business leaders welcome the prospect of a transition period, but are frustrated by the lack of clarity about how it will work. To the extent that they have focused on it, most companies believe that a transition period will have to be an extension of the status quo rather than some intermediate stage between full EU membership and the ultimate status quo. Most mid-sized British companies are struggling to understand the proposed transition period and what it means for them. Conflicting signals from the Government have contributed to their anxiety. The UK could leave the EU on 29 March 2019 but agree with the EU to maintain conformance with all EU rules including Freedom of Movement and the Customs Union. However, in addition to the reality that the UK would have no influence over new directives directly affecting British companies during this transitional phase, such an agreement would not be binding on non-EU parties, so – absent specific bilateral deals – the UK's access to EU FTA deals with other countries; plus several hundred other agreements around regulatory harmonisation, mutual recognition, etc. would fall away.[9] This creates massive uncertainty for any company trading with non-EU countries. An alternative would be to extend the Article 50 process, so that the UK does not legally leave the EU until the end of the transition process. However, as of now, this option appears politically unacceptable to the Government.

Our conclusion

Our key conclusion from these interviews is unambiguous: most British business leaders believe the current path of Brexit could cause significant damage to business, both because the end-point will inevitably mean more barriers to trade, most likely more regulation, and almost certainly less influence; and because the process of leaving the EU is creating huge uncertainties and diverting management efforts. While it is possible to debate the magnitude of the economic impact, the fact that Brexit will have a negative impact, and that this impact may be significant, seems unarguable.[10] While our interviews revealed multiple concrete reasons why British businesses fear Brexit will hurt their businesses, we heard almost no specific reasons, or even good arguments, to back up the rhetoric about how and why Brexit might help British business.

[9] Financial Times, *After Brexit: The UK Will Need to Renegotiate at Least 759 Treaties*, 30 May 2017
[10] That was certainly the conclusion of the recently leaked economic impact scenarios produced by the Government itself – see Alberto Nardelli, *This Leaked Government Brexit Analysis Says The UK Will Be Worse Off In Every Scenario*, Buzzfeed, 29 January 2018

It is difficult to reconcile the notion that Brexit will liberate British business from the grip of a "protectionist EU" with the facts. The EU's Single Market is by far the largest and most successful initiative to create a truly frictionless cross-border market for goods and services in the world. The EU continues to be successful in securing FTAs with major trading counterparties around the world, most recently with Canada and Japan. This means that some 48% of UK goods and services exports go to the Single Market, plus another 12% to markets with which the EU has established or agreed FTAs[11]. Given the composition of the UK's goods and services exports, leaving the EU's Single Market and Customs Union will inevitably mean that UK businesses will face more tariff and non-tariff barriers. Despite claims to the contrary,[12] there seems no remotely realistic scenario in which a Brexit which requires exit from the Single Market and Customs Union will result in British businesses finding it easier to sell their goods and services abroad.

The idea that Brexit will free British business from "overly burdensome EU regulation" is also difficult to support. Whilst we did hear some general complaints about the level of regulation, this was as often directed at UK-originated rules as at those emanating from the EU. Mostly what we heard was that companies are broadly satisfied with the EU regulations directly affecting their own sector; that they fear Brexit will lead to more, not less regulation by imposing a dual burden; and that they want the UK to continue to be engaged in the specialised EU regulatory agencies.

Confusion and uncertainty about the Government's current approach to Brexit is exacerbating the negative impact on British business. The businesses we spoke to repeatedly emphasised their need for clarity about "the rules of the game" to enable them to make investment decisions, hire employees and strike deals. Yet British businesses are now faced with the double uncertainty of not knowing what the end-point is likely to be, nor how it will be reached. Some companies pointed out that some Government ministers have repeatedly asserted "have cake and eat it" positions, then retreated when EU negotiators point out these are unacceptable or infeasible (eg on payments to the EU, or on Ireland). Other firms highlighted that Government positions on one aspect of Brexit (eg Ireland) appear incompatible with their positions on others (eg status of EU citizens, Customs Union). Perhaps the greatest source of frustration to the companies and trade associations we interviewed is when important issues currently seem to be glossed over or dismissed as insignificant (eg third-party arrangements during the transition, rules-of-origin checks, the impact of reduced access to specialist skills).

Having witnessed the Government assert unsustainable positions about the terms of the UK's departure from the EU, before conceding on all three main issues (Northern Ireland, payment of existing obligations and the status of EU citizens), businesses are anxious that the Government should not now do the same on both the end-state relationship with the EU and the transition arrangements. They see a real prospect that the UK "crashes out of the EU" without a deal – a "Hard Brexit". It is true that some enthusiasts for Brexit welcome the prospect of such an outcome as a "clean Brexit", but most British businesses we spoke to believe that such an outcome would be anything but clean. An abrupt switch to WTO terms, and a loss of the multitude of other regulatory arrangements that underpin trade in goods and services with both the EU and elsewhere, would result in disruption to supply chains and significant loss of competitiveness.

[11] Office for National Statistics, *Geographical breakdown of the current account*, The Pink Book, 2016

[12] Chris Hope, *David Davis, Boris Johnson tell CBI chief she is wrong on remaining in customs union after Brexit,* The Telegraph, 21 January 2018

Having asserted unrealistic positions about the terms of the UK's departure from the EU, before conceding on all three main issues (Northern Ireland, payment of existing obligations and the status of EU citizens), businesses are anxious that the Government should not now do the same on both the end-state relationship with the EU and the transition arrangements. For the end-state, the Government, or at least individual ministers, have been suggesting tailored solutions (eg "CETA plus, plus, plus" or "a partial Customs Union"), which EU negotiators currently make clear they cannot (due to MFN or other WTO rules) or will not (due to their broader impact on the integrity of the Single Market) accept. It is of, course, possible – and highly desirable from the perspective of British business – that the EU will budge on some of these issues eventually, perhaps allowing a hybrid version of Single Market membership alongside restrictions on Free Movement. Yet so far there has been little indication of their willingness to do so.

For the transition period, the Government has proposed an approach that has attracted fierce criticism from all sides, since it creates enormous complexity for businesses, whilst putting the UK into the position – as both a prominent Brexiteer and the pro-Remain former Deputy Prime Minister have described it – of a "vassal state", forced to implement rules it has no hand in determining.[13]

Even if the Government soon sets out a clear strategy and is then united in making it happen, it is getting very late to resolve all the outstanding issues. Given this situation, the prospect of a smooth transition to a sensible end-state is far from assured. Many businesses are fearful that they will end up experiencing an increasingly shambolic progression towards a highly undesirable end-state, with the political discourse becoming ever more heated as the real world consequences become ever more evident.

This paper does not attempt to reopen or reassess the 2016 Referendum decision. We have not looked at the wider sovereignty, political or social arguments that were raised at that time and are thus not presuming to make an assessment of Brexit as a whole. Our focus is solely on the challenges and opportunities Brexit creates for the small and medium sized British business that underpin livelihoods and job creation across the UK. However, based on our interviews and other research, we are confident in asserting that Brexit could end up having a significant negative impact on British business, and that the way Brexit is currently being implemented is exacerbating this impact. Indeed, some of the businesses we have spoken to already report a palpable shift in mindset among both UK companies and their international counterparts away from international trade and partnerships. Far from being a step towards a more "Global Britain", many of the businesses we have spoken to fear that Brexit currently risks creating a more insular and less prosperous Britain.

[13] Jacob Rees-Mogg, Brexit Select Committee, 24 January 2018; Nick Clegg, *On Brexit, Jacob Rees-Mogg is right: Britain risks vassal status*, Financial Times, January 27 2018

1. Introduction

In this introductory section, we set out: our objectives in researching and writing this second research paper; our approach; and the structure of the rest of the paper.

Objectives

As with the first paper, our objectives for this second paper were to explore the implications of Brexit for British businesses through the perspectives of the people who own and run mid-sized companies across the country. Our goal is to highlight what this critical part of the UK economy sees as the priorities for how Brexit is implemented, and to distil from this discussion the policy implications. With this second paper, we wanted to deepen our understanding of the issues identified in the first paper, identify any important issues we might have missed the first time around, and reveal how businesses' views have evolved over the last six months.

Approach

Consistent with our approach in the first paper, we focused our research on interviews with small and medium sized companies and their trade associations across a broad range of sectors and all parts of the country. We actively sought to interview companies holding both pro-Brexit and pro-Remain points of view. Whilst our interviews were designed to follow a broadly common format, we took a flexible approach, enabling those we interviewed to dictate the balance and flow of the discussion. Where companies were receptive, we asked them to complete a survey, indicating the importance they attached to various issues arising from Brexit (see Appendix 3 for details). We do not claim that the findings of these interviews or the results of the survey have statistical significance, nor that our sample is necessarily perfectly representative of the business community as a whole. On many issues, we encountered a wide range of views. On some topics, those we interviewed held different perspectives when talking about the priorities for the UK as a whole than when talking about the priorities for their own company. However, there were also many issues where there was strong consensus among the vast majority of the companies.

In addition to the interviews, we reviewed the ever expanding literature on Brexit. However, we do not claim to have conducted an exhaustive review of the profusion of papers, reports and proposals that emerge on an almost daily basis. This paper, like the first, does not attempt to analyse or derive economic projections on any aspect of Brexit.

Structure of the Paper

The rest of this paper is divided into six broad sections:

- Chapter 2 provides brief **recap of the deal options** and how these have evolved since the first paper.
- Chapter 3 offers a discussion of how the findings from this second round of interviews confirms or modifies our findings from the first paper about the **implications of Brexit for trade**
- Chapter 4 provides an equivalent discussion about the **impact of Brexit for regulation**
- Chapter 5 does the same for the **issues arising from Brexit around skills and talent**
- Chapter 6 highlights the specific concerns about **funding issues arising from Brexit**
- Chapter 7 explores how business views about the **process of implementing Brexit** have evolved in the six months since we published the first paper

We provide a conclusion of the key findings from our paper in Chapter 8 and the Summary above.

2. Recap of the Deal Options

In our first paper, we laid out the spectrum of deal options, from remaining in the Single Market at one end, to relying on WTO rules, at the other. The basic attributes of these options from a business perspective are shown in Figure 2, which we repeat from the first paper.

Figure 2: Existing Models of EU Trade Relationships

Feature	Single Market			Customs Union Turkey	FTA Canada	WTO MFN Status
	Full EU Membership	EFTA (EEA)	EFTA Switzer-land			
Duty-Free access to the Single Market for Goods	Yes	Yes	Yes	Yes	Yes	No
Duty-Free access to the Single Market for Services	Yes	Yes	Some	No	Some	No
Free movement of capital	Some	Some	Some	No	No	No
Free movement of people	Yes	Yes	Some	No	No	No
Acceptance of Single Market Rules	Yes	Yes	Some	No	No	No
Input to Single Market Rulemaking	Yes	No	No	No	No	No
Bound by ECJ decisions	Yes	Yes	Some	No	No	No
Bound by Common Commercial Policy	Yes	No	No	Yes	No	No
Bound by Common Agricultural Policy	Yes	No	No	No	No	No
Contribution to EU Budget	Yes	Yes	Yes	No	No	No
Participation in Regulatory Agencies	Yes	Yes	Yes	Some	Some	No
Member of the EU VAT area	Yes	Yes	Yes	No	No	No

This basic set of options has not changed fundamentally over the last six months. However, in mid-December the EU leaders confirmed that “sufficient progress” has been made over the Brexit negotiations for the talks to move onto the second phase. This followed a tense week of negotiations leading up to agreement on the three key issues: Northern Ireland; the settlement of the UK’s financial obligations; and the status of EU citizens. Of particular significance to the broader trade relationship between the UK and the EU was the UK’s commitment to maintaining an open border between Northern Ireland and the Republic of Ireland to protect the Good Friday Agreement.

None of the existing models depicted in Figure 2 appear to meet the Government's objectives for Brexit. Remaining in the Single Market through joining the European Free Trade Area ("EFTA") would – as currently constituted – entail conceding Freedom of Movement, making significant payments to the EU, becoming a "rule-taker" on regulation (since the UK would have to abide by Single Market rules without being at the table to devise and administer them), and accepting at least some degree of jurisdiction. Leaving the Single Market, but remaining in the Customs Union would enable tariff-free trade with the EU for goods, but would still require some customs checks for regulatory compliance, would result in new impediments in trade with the EU in services and would prevent the UK negotiating its own trade deals with other countries. Leaving the Customs Union and securing a free-trade deal along the lines of CETA would ensure tariff-free access to the Single Market for goods, but would be a significant step backwards for services and would require customs checks to ensure compliance with both EU regulations and rules of origin requirements. It is difficult to see how leaving the Customs Union can be fully reconciled with the commitment to maintain an open border between the North and South in Ireland.

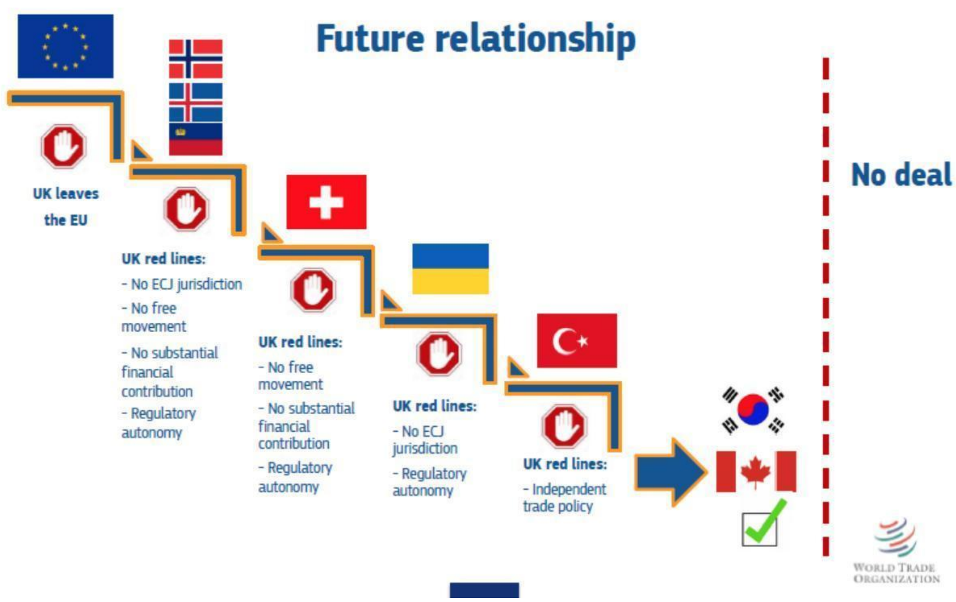
The effort to devise solutions that achieve the UK's objectives without conceding on any of the Government's "red lines" has led to considerable discussion of variants of the existing options, from "Norway minus", where greater limits on participation in the Single Market would be accepted in exchange for greater constraints on Freedom of Movement, to "CETA plus" (or even "CETA plus, plus, plus"),[14] an FTA that is much broader and deeper in scope – extending to cover services – than the FTA with Canada. Detailed proposals for such hybrid or "a la carte" arrangements have been recently put forward by both the IFG and the IPPR. The IFG proposed four options: i) "bespoke Norway", which is essentially a "Norway minus" or EEA membership tailored to the UK's specific needs; ii) "Deep and Comprehensive FTA", which builds on the Ukraine model of sector-specific participation in the Single Market based on regulatory alignment; iii) "Canada plus", which fleshes out the "CETA plus" concept; and most ambitiously iv) a "EU-UK regulatory partnership", which is a radically different, more evolutionary approach using regulatory alignment as the determinant of Single Market participation.[15] The IPPR proposed a "shared market" model, which has similarities to the IFGs "regulatory partnership" approach.[16] The objective of all these options is to devise to a solution somewhere between Norway's adoption of Single Market and an FTA like CETA – offering greater integration with the Single Market than an FTA, but with more scope for regulatory divergence and greater room to manage and constrain labour migration.

[14] BBC News, *Brexit: David Davis wants a 'Canada plus plus plus' trade deal*, 10 December 2017
[15] Institute for Government, *Trade After Brexit – Options for the UK's Relationship with the EU*, 18 December 2017
[16] Institute for Public Policy Research, *The Shared Market: A New Proposal for a future partnership between the UK and EU*, 18 December 2017

The attractions of such models in terms of outcomes for UK business are easily apparent, but negotiating any of them looks very difficult. To start with, any of these models would require both the UK and EU to make significant compromises on previously asserted red lines. From a UK perspective, some degree of ECJ oversight and an ongoing budgetary contribution would be almost inevitable, as well as a negotiated compromise on migration. From a EU perspective, on the other hand, these options might look like variants of the UK “having a cake and eating it”. Second, ensuring any sectoral differentiation is enforceable and consistent with WTO MFN rules would be far from trivial. Third, the novelty of the “regulatory partnerships’ and “shared market” approaches suggest these would take even more time to negotiate than options based on existing models.

The EU’s current perspective is set out in Figure 3: EU negotiators believe the UK’s “red lines” will drive negotiations towards an FTA like CETA (although the European Commission has itself questioned how this would be reconciled with the agreement on Ireland).

Figure 3: Options for Future Relationships with the EU



Source: European Commission

Given the lack of an obvious solution that meets the requirements of both the UK and the EU, plus the complications arising from the agreement on Northern Ireland, there is huge uncertainty as to what the eventual outcome will be, and this in turn appears to have made negotiations on the transition period more difficult. Businesses therefore face the full spectrum of potential outcomes for March 2019, from continued full membership of the Single Market, if the proposed transition period equates to maintaining the status quo, to an abrupt return to WTO rules if negotiations collapse and a “Hard Brexit” ensues.

3. Findings on the Brexit end-state for trade

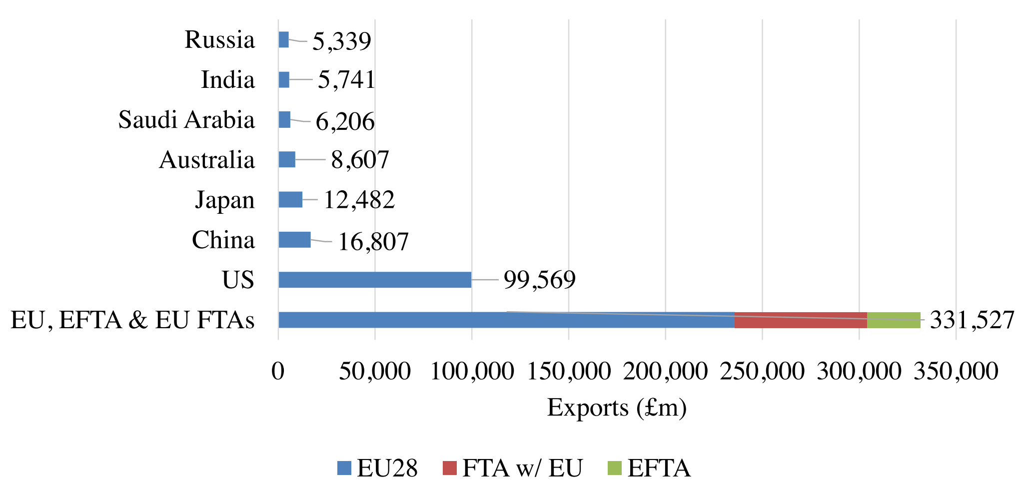
Our initial findings

In our first round of interviews, we found that Britain's businesses want a Brexit that enables trade, not stifles it. The top priority for almost every business was getting the right trade deal with the EU. Almost all businesses we interviewed expressed a preference for remaining in the Single Market and Customs Union. If these options were unavailable, firms expressed a strong preference for an FTA that replicates, as far as possible, the Single Market's relatively frictionless trading arrangements for goods and services.

Most of the companies we spoke to expressed concern about the potential impact of increased tariffs, non-tariff barriers and customs controls on their costs and competitiveness should the UK leave the Single Market. Many were particularly worried at the prospect of the UK leaving without a deal and thus defaulting to the WTO MFN status since for many this would lead to a sharp increase in tariffs and non-tariff barriers when exporting to their largest market.

Companies recognise that leaving the Single Market and Customs Union would give the UK the opportunity to negotiate new trade deals that more closely reflect British priorities and that focus on the fastest growing economies in the world. However, the businesses we spoke to were highly sceptical about the potential to replace unfettered access to the EU market with growth elsewhere. As Figure 4 clearly shows, the mathematics of Britain's export destinations supports this view.

Figure 4: The UK's top goods and service destinations, 2016



Source: Office of National Statistics Pink Book 2017 (Geographical breakdown of the Current Account)

However, many of the firms we spoke to thought Brexit could potentially have some positive impact by focusing policy attention on other impediments to trade, particularly non-tariff barriers in services, and on broader shortcomings in British companies' competitiveness. They highlighted the importance of harmonising standards and regulation, of mutual recognition of credentials and of enhancing support to smaller companies seeking to enter new markets. Companies acknowledged that while most of these impediments to increased export success could in theory have been addressed without leaving the EU, Brexit gives a new urgency to tackling them.

Our new findings

Our second round of interviews confirmed that the vast majority of British businesses would like to remain in the Single Market and the Customs Union or, failing that, to secure an FTA with the EU that replicates the Single Market as far as possible while keeping the UK in the Customs Union. However, most companies recognise that, following the referendum, changing UK immigration rules to ensure at least a degree of control over immigration from the EU is a political imperative. Since the EU has so far held steadfast to the notion that membership of the Single Market requires Freedom of Movement, the reconciliation of greater control of immigration while remaining in the Single Market remains difficult. Yet finding such a solution may not be impossible. For example, the way Switzerland has implemented Freedom of Movement gives the Swiss considerably more control over who remains in Switzerland than the UK currently has.[17] Belgium requires EU nationals seeking work to register with the local police within eight days of arrival.[18] The challenge for the UK has been that enforcing restrictions on residency and eligibility for benefits in a way that is consistent with Freedom of Movement requires an ID card or equivalent system that enables residence and employment to be systematically tracked.

If remaining in the Single Market equates to maintaining Freedom of Movement as currently interpreted, and that proves politically impossible as currently seems likely, most firms would like to see the UK stay within the Customs Union, and agree an FTA with the EU that achieves as close to full Single Market access as possible. Most stress the importance of preserving the trade arrangements secured through the EU with countries outside Europe. Few see new trade deals with other countries as likely to offset the potential downsides from increasing impediments to trade with Europe, or losing existing trade deals with other countries, even if an FTA with the US could be secured.

In this round of interviews, we heard much more about trade in services, as opposed to trade in goods, but also much more disagreement about the potential impact on service sectors. Firms that trade in goods tend to have highly consistent priorities, almost always expressing a strong preference for remaining in the Single Market and for preserving the trade deals elsewhere secured by the EU through continued membership of the Customs Union. For many of these companies, Brexit will result in increased production costs, which will either be passed on to the consumer, or reduce profitability. The relatively few exceptions tend to be where an individual firm has a business model that gains little advantage from the EU, or is even disadvantaged by it.
For example, companies that export to the EU from outside Europe (eg Dyson), which manufactures in Asia, already face the EU's external tariffs.

[17] Swiss Confederation (ch.ch), *Entry and stay in Switzerland,* February 2018
[18] UK Government, *Guidance for British citizens living in Belgium*, 19 July 2013

Also, companies for which the EU is a less important market for their products (eg JCB) are likely to see greater opportunities in trade deals with markets elsewhere. Finally, there are a small minority of companies that believe the structure of the EU's external tariffs create a disadvantage for them versus EU competitors (eg Tate & Lyle) or where the firm anticipates that reduced competition from the EU may provide an opportunity to expand market share.

By contrast, firms that trade in services hold a much more diverse range of views, depending on the nature of the services they produce, the degree to which these services are tradeable and the extent of regulatory harmonisation across the EU in their sector. Some of the firms we spoke to pointed out that the Single Market was far from complete in services, so leaving it would make less difference (although others observed this was less an argument for Brexit than for completing the Single Market in services). Other service firms pointed to the importance of common regulatory standards (eg on data privacy) as an enabler of trade in services, and the efficiencies offered by mechanisms like "passporting" in financial services.

One notable change from the first round of interviews is that companies now seem far better informed about these topics. In our first round, we found it difficult to get companies to make any distinction between the Single Market and the Customs Union, and relatively few were aware of the extent to which their exports to non-EU countries were dependent on EU arrangements. This time round we found most companies were far better informed, although pervasive misunderstandings remain about the scope and nature of WTO rules, particularly amongst business leaders more inclined towards "Hard Brexit".

Most businesses involved in the import and export of physical goods emphasised the importance of maintaining "frictionless" trade with the EU, without the impediments of tariffs or burdensome customs controls and procedures. Put simply, to preserve truly "frictionless" trade in goods would require continued membership of both the Single Market and the Customs Union. Leaving the Single Market would imply that UK exports to the UK would need to be checked to ensure they comply with EU regulations (including any applicable taxes). Leaving the Customs Union would mean that UK exports to the EU would need to be checked for compliance with rules of origin requirements (to ensure the UK is not used as a route to circumvent EU tariffs) and for the imposition of any relevant tariffs. In our interviews, firms often lumped these two aspects together.

The Importance of the Single Market

The vast majority of the companies we interviewed would like to stay in the Single Market. The essence of the Single Market is a set of common rules and a shared jurisdiction under the ECJ that establishes a level playing field across the EU, and thus enables goods produced in one member state to be sold in another without facing non-tariff barriers, such as customs checks or the need to meet differing regulatory standards. In services, the Single Market can be described as work in progress: it allows the right of establishment across the EU and in some areas, such as financial services, the cross-border provision of services; yet in other areas, non-tariff barriers persist.

Businesses integrated into European cross-border supply chains emphasised the need for full participation in the Single Market to enable the frictionless movement of goods and services across the EU. For many businesses the best Brexit option is one that minimises divergence from the Single Market status quo.

> **Johnnie Ball – representing a fintech company providing automated cash flow analysis and forecast generation using machine learning, based in London**
> "We plan to expand globally and having the Single Market would make this easier. Any friction between Europe and the UK that hits small businesses would be negative for our business – it's an unnecessary complication."

> **Izaak Watson and Adam Hooper, Martin's Rubber – a rubber manufacturer who specialise in the production and supply of elastomeric products, based in Southampton**
> "Frictionless trading is the key thing. Anything that provides more of a barrier than there is at the moment is clearly going to be a disincentive to use a UK supplier."

> **Tony Walker, Toyota Motor Europe – manufactures and sells Toyota and Lexus vehicles, parts, and accessories. Toyota has two UK manufacturing operations in the UK based in Deeside and Burnaston**
> "The majority of the parts we use come from outside the UK. And the vast majority of our products go outside the UK to Europe using cross-Channel ferries or the tunnel… so not only free but also frictionless trade remains essential. We have supply chains that operate just in time, that are highly complex and developed overtime. We want to avoid disrupting them."

Since the creation of the Single Market, British companies have become progressively more accustomed to operating in a way that involves the frictionless movement of goods across EU borders. As a result, the EU content of UK exports has increased across all sectors as the Single Market has enabled supply chains to become pan-European.[19]

> **James Walton, The Institute of Grocery Distribution -global food and grocery researchers, based in Watford**
> "All of our members, across the whole of the supply chain, everyone from the boardroom down to the new starter has been used to operating within the Single Market. As a consequence, we have supply chains that span the entire European continent as centralised production of products like confectionary bars allow us to minimise production costs. If the UK were to reverse course and become detached this would have a significant impact."

[19] Stojanovich and Rutter, *Frictionless Trade? What Brexit means for cross border trade in goods*, Institute for Government, 2017

Laura Cohen, Ceramfed – the UK's Ceramics Association, based in Stoke-on-Trent
"The four sectors within ceramics that export most are tableware and giftware, refractories, (technical ceramics like artificial hips), material supplies (such as kaolin) and high quality minerals used in ceramic, pharmaceutical and paper production. Each of these sectors rely on pan-European supply chains."

Tim Hames, British Venture Capital Association ("BVCA") – the industry body and public policy advocate for private equity and venture capital industry in the UK, based in London
"Venture Capital firms that deal in sectors that involve complex manufacturing processes, where bits go back and forth across borders will be affected if we leave the Single Market."

The extent to which companies emphasised the importance and benefits of the Single Market in our interviews depended largely on the extent to which their business models depend on pan-European supply chains. For example, companies in the automotive, aerospace, chemical and plastics sectors are very focused on the downsides from leaving the Single Market. By contrast, businesses manufacturing outside the EU or producing in the UK for the UK market are far less exposed to the risks resulting from leaving the Single Market.

Tony Walker, Toyota Motor Europe – manufactures and sells Toyota and Lexus vehicles, parts, and accessories. Toyota has two UK manufacturing operations in the UK based in Deeside and Burnaston
The company's basic direction is to support a policy of localisation – this means building products and operating services close to our customers. We also believe that for wider economic, social and political reasons it is right to make products where we sell them and this will remain our basic philosophy. Brexit won't change this overall strategic approach"

Mike McDonald, Serlby – a diversified holding company, based in Yorkshire
Membership of the single market is less relevant for some of the businesses in our portfolio. If they don't manufacture, they don't have to meet manufacturing standards. If they don't export or import much to or from the EU, they don't rely on the reduced barriers to trade."

For some firms, their reliance on EU inputs in their supply chains reflects deficiencies in the resources, both human and physical, available in the UK.

Tom Shutes, Wakefield Ltd – Property Developers, based in London
"There are holes in manufacturing skills and industries in UK, which will have to be built or sourced elsewhere if we lose EU access. We source lots of prefab – cross laminated timber. They've got better expertise. There aren't any engineered timbers in the UK, as there's no history."

> **Herwig Vennekens, Haribo – a German confectionery company with its UK headquarters in Pontefract, Castleford**
> "The issue is that a lot of the raw materials we need are not available in the UK, so we will have to bring them in, and at the minute we bring them in mostly from EU member states. A lot of the machinery we use is also coming from outside the UK, neither which is because we don't want to source in the UK but we cannot."

Many firms believe that staying within the Single Market would require a reversal of the Government's current strategy, since even EEA membership would currently appear to require acceptance of Freedom of Movement (however this is interpreted) and an element of de facto ECJ jurisdiction via the EFTA court, neither of which the Government appears willing to countenance. If retaining full Single Market membership is not feasible, most businesses want a broad and deep FTA that mirrors the advantages of the Single Market as far as possible with the UK remaining in the Customs Union. This echoes the Government's commitment in October to make trade with the EU "freest and most frictionless trade possible",[20] and underpins the focus on hybrid options in the space between "Norway minus" (offering something less than full Single Market access) versus "CETA plus" (an FTA of unprecedented scope and depth).

The issue of customs controls

In this round of interviews we heard much greater concern about the impact of leaving the Single Market and the Customs Union on customs procedures, and thus on supply chain costs. Companies are increasingly aware that the shift away from Single Market membership would represent a step-change in terms of the requirements for customs procedures and controls, even if a FTA were secured. Even if there were no tariffs between the UK and EU, an FTA would result in additional customs paperwork and checks to ensure compliance with EU regulations. Moreover, customs procedures around rules of origin might be required if the UK left the Customs Union.

> **Katherine Bennett OBE, Airbus – a multinational corporation that designs, manufactures, and sells aeronautical products worldwide, with over 25 UK sites**
> "Civil Aerospace is not subject to tariffs at all due to the WTO Agreement on Trade in Civil Aircraft. So we're not affected by tariffs like the car industry is. We're not complaining about that but we're more concerned about the non-tariff barriers like the paperwork etc."

Many companies think that the Government will not be adequately prepared for administering the border checks that will be needed if the UK leaves the Single Market, let alone if it leaves the Customs Union as well. The National Audit Office estimates that the number of administrative decisions by customs and immigration officers to permit people or goods to cross the border could increase by 230% and 360% respectively.[21] The pressures of completing additional checks will compound existing long-standing issues in border management such as manual customs checks and data gaps.

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[20] HM Treasury, HM Revenue & Customs, and Department for Exiting the European Union, *Future customs arrangements – a future partnership paper*, 15 August 2017

[21] National Audit Office, *The UK border*, 20 October 2017

Izaak Watson and Adam Hooper, Martin's Rubber – a rubber manufacturer who specialise in the production and supply of elastomeric products, based in Southampton
"Customs are not prepared to deal with niche materials such as polymers – no knowledge, definitely no expertise. The EU could make it very awkward for UK manufacturers if they wanted."

Ian Studd, British Association of Removers – the largest association in the UK moving industry, based in Watford
"The customs infrastructure will need to be rebuilt and the cost and time of deliveries will increase. Every single consignment will be underpinned by customs documentation. In the Eighties you could arrive at any border crossing and there would be a customs outpost and agents, but this infrastructure has largely gone. The cost of deliveries will increase: it is appropriate to say that they'll increase significantly."

Several sectors will be particularly vulnerable to delays, and businesses clearly want to avoid long queues at ports and food rotting in crates. Within freight, agriculture and food controls present particular risks given the potential for compromised food and plant health.[22]

Herwig Vennekens, Haribo – a German confectionery company, with its UK headquarters in Pontefract, Castleford
"Border controls make trading more complicated and more expensive. Often it means that goods are not so easily or readily available. For example, if a truck loaded with materials that we desperately need to make a product is held up, or not released at border control for a day or two, the worst case scenario in our industry would be production grinding to a halt because you don't have the ingredients you need. To work around this, or mitigate it, you would have to either stockpile raw materials which effectively means you have to have more of your capital sitting as stock, rather than being reinvested, which has a ripple effect on the whole supply chain and the business."

William Bain, British Retail Consortium – the trade association for all UK retailers, based in London
"Retailers have depended strongly upon EU supply chains in the past few decades. Everyday products like branded orange juices have just-in-time sourcing chains running through Zeebrugge and Dover. Products like supermarket pies and ready meals contain ingredients supplied on a cross-Great Britain and Ireland supply-chain basis, such as Irish cheddar."

[22] Public Accounts Committee, *Brexit and the UK Border – Seventh Report of Session 2017–19*, 4th December 2017

Ian Wright CBE, Food and Drink Federation – A trade organisation that represents the UK's food and drink sector, based in London
"As a perishable good, food requires very short delivery times. Throughout our industry you will find astonishingly short supply chains. A hold up at the border could potentially wipe out possible markets; just look at high value Scottish seafood products like langoustines, for example. You can see the effect of customs delays by looking at what happens to the market when it's affected by poor weather conditions. It took just three days for bad weather to lead to a shortage in iceberg lettuces."

James Walton, The Institute of Grocery Distribution – food and grocery supply chain organisation, based in Watford
"Stockholding is limited because its expensive – for a short shelf-life product it makes sense to stop it from rotting on the shelf or on the individual's house. A constant flow with as little delay and stockholding as possible means the supply chain is working as financially and environmentally efficient as possible."

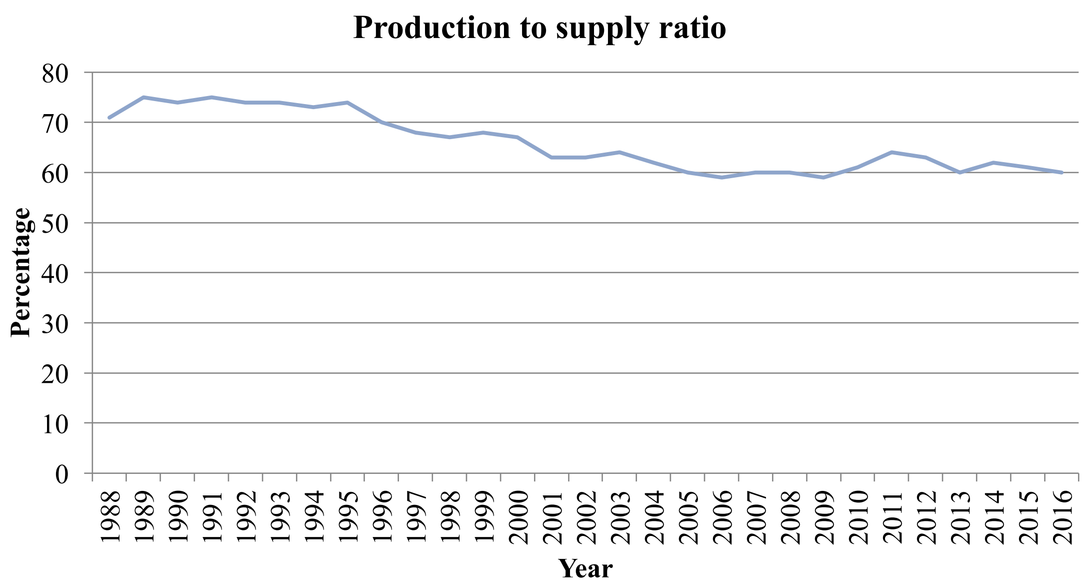
Other producers that work on time sensitive processes, such as those who ship goods on a 'just-in-time' basis, whose products are subject to additional border checks, or whose products need to be supplied in response to external events, emphasise how badly any delays could affect their work.

Katie Doherty, International Meat Trade Association – representatives of meat importers, exporters and wholesalers, based in London
"Food products of animal origin, such as meat, are subjected to veterinary checks under a European Council directive. Given the constraints of meats such as chilled poultry from Europe, which has a 2-14 day shelf-life, vets stopping consignments to take a micro samples of the meat to send to labs could take days or even more than a week with significant financial implications for business."

Will Atkinson, Atlantic Books – an independent British publishing house, based in London
"We print books in Poland, Netherlands, Italy and Slovenia. If our lovely books have to be stopped at the border then a reprint instead of taking a week might take 4 weeks. The timing around supply is quite important in publishing as we're a media business after all."

Businesses active in the UK's food supply chain highlighted their dependence on EU imports. As Figure 5 shows, the UK's food production to supply ratio has fallen to 60%, indicating that the UK is highly reliant on food imports, mainly from the EU.[23]

Figure 5 – The UK's Food Production to Supply Ratio



Source: Food Statistics Pocketbook: 2017 (DEFRA)

Analysis by the Institute of Fiscal Studies ("IFS") has suggested that increased tariffs and the introduction of customs controls could significantly increase food prices and also reduce the availability of certain products.[24]

> **Sue Davies, Which? – the largest consumer body in the UK, based in London**
> "74% of imported food currently comes from the EU so future trade arrangements are crucial in terms of limiting any impact on price and potentially on access to certain products. We need to make sure the impact on consumers is limited."

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[23] Department for Environment, Food and Rural Affairs, *Food Statistics Pocketbook*, 2017
[24] Levell, O'Connell and Smith, *How might Brexit affect food prices*, Institute for Fiscal Studies, 27 July 2017

Some of our interviewees pointed out that new impediments to trade with the EU could have an impact well beyond the exporting or importing companies.

> **Nicholas Northam, Interstate Hotels – UK division of an international hotel management company, based in Birmingham**
> "Some hotels rely on corporate customers visiting EU-reliant businesses so will feel the ripple effect. Hotels in the North East need Nissan and other business that rely on free trade with the EU for their business in the UK. If these business leave or are hurt, our hotel's business is hurt. For hotels, corporate customers are far more profitable than leisure customers, so no increase in leisure business from exchange rate changes will make up for a decline in corporate business."

Yet some companies are more phlegmatic about leaving the Single Market, either because they export services that they believe are not covered by the Single Market or because they experience non-tariff barriers despite the Single Market. There are also companies whose exports to the EU are not manufactured in the UK, but are produced elsewhere in the world, so do not benefit from the Single Market and Customs Union anyway.

> **John Thorpe, Millennia Computer Services – cloud-enabled hosting provider and platform, based in Yorkshire**
> "We know that there is no Single Market in Europe for services so we're in that existing situation now so as far as I'm concerned leaving doesn't actually change it. It puts us on the same footing as it does with America and I have absolutely no trouble transacting with America."

> **Simon Boyd, Reid Steel – A steel construction company, based in Christchurch**
> "It's horrendously difficult to trade because of the uneven playing field. There remain non-tariff barriers to trade in Europe. For example, in France you need to be able to buy the French insurance, then you have to make sure that all of your product has been passed by the French checking authorities. If you can't get over those two hurdles, you can't build."

> **John Mills, John Mills Limited – a telesales company, based in London**
> "Our manufacturers are in the Far East, so leaving the Customs Union and Single Market doesn't matter. We're not exporting from the UK – we'd love to do it, but because it's so much cheaper most of our manufacturers are in the Far East. Our core market is the UK, and our sales to the EU and the rest of the world won't be affected by Brexit at all as 80% of our exports to countries come directly from the Far East."

The Importance of the Customs Union

In our first round of interviews, few of the businesses we spoke to had really thought about the Customs Union as distinct from the Single Market. In this round, by contrast, we found companies much better informed about the implications of leaving the Common External Tariff and losing current trading arrangements established by the EU.

The fundamental point is that if the UK secures an FTA with the EU whilst remaining in the Customs Union, the number of customs checks for trade between the UK and EU would be significantly lower than if the UK only had an FTA with the EU outside the Customs Union. This is because within the Customs Union there would be no requirement for rules of origin checks. Furthermore, by remaining in the Customs Union, the UK would benefit from the EU's scale and bargaining power in negotiating deals and settling trade disputes with third countries. However, staying in the Customs Union would prevent the UK from being able to negotiate trade deals with other countries, which is why the Government has rejected this option.

When we asked about membership of the Customs Union, most companies – and the overwhelming majority who expressed an opinion – wanted Britain to remain members of the customs union.

> **Oliver Gadsby, Rowman and Littlefield – a publisher specialising in social sciences texts, based in London**
> "I think the ease of trade within the Customs Union would be something we should preserve and I'm quite happy participating with the EU's deals that come with the Customs Union."

> **Jon Moulton, Better Capital – a private equity investment firm, based in London**
> "Leaving the Customs Union is a bureaucratic nightmare – bit of a 'have your cake and eat it' stance. The Customs Union is helpful, it's good for both EU and us. If not membership of the Customs Union, we need something that looks very much like it. I think it's quite likely we will achieve this, since it's in the interest of both parties – no one wants a bureaucratic nightmare."

Businesses flagged potential disruptions to supply chains if the UK chose to leave the Customs Union.

> **Paul Trudigan, Fish for Thought – a seafood business, based in Cornwall**
> **"**I don't see the benefits of unpicking what we've got. This is an unimaginably large task and a complete waste of time. It involves an enormous opportunity cost when there are more important things we could be dealing with. If the UK had its own tariffs, I have no idea if the UK would increase tariffs on my imported products or decrease them."

Tony Walker, Managing Director, Toyota Motor Europe
"Potential logistics delays and customs administrative burden, because we have a fully integrated supply chain. The majority of the parts we use come from outside the UK. All of the materials come from outside the UK. And the vast majority of our products go outside the UK using cross-Channel ferries or tunnel."

Dr. Tony Doyle, Varilight – Manufacturer of switches, sockets and domestic electronics – Based in West Sussex
"We've wanted to expand our operations to depressed regions in the UK for a while, but if we leave the customs union we won't be able to expand our domestic production. Distributing to the rest of Europe from Britain won't be viable outside the customs union as the paperwork will just be too onerous to make it worth exporting part-built components from Britain. Instead we'll manufacture and distribute from our centre in Hungary."

Ali Athar, ITIM Limited – provides software, solutions, and services to retailers across Europe, based in London
"Real issue isn't so much tariffs – it's the paperwork and hold up outside the customs union that is the problem."

Compared to our first round of interviews there now appears to be much greater recognition of the degree to which trade with countries elsewhere in the world depends on deals negotiated by the EU, which the UK would need to renegotiate if it leaves the Customs Union. 63% of Britain's goods exports are directly or indirectly (by EU FTAs) linked to EU membership.[25] Estimates suggest that consumer prices fell by 0.5% for UK consumers as a result of FTAs with trade partners outside the EU.[26] This implies such FTAs save UK consumers approximately £5.3 billion every year.[27]

Laura Cohen, Ceramfed – the UK's Ceramics Association, based in Stoke-on-Trent
"The UK is benefitting from the EU's recent trade deals with countries such as South Korea and Canada – we're already seeing the effects. Exports to South Korea have risen enormously since the trade deal came in, and it is now the 3rd largest export market after the EU and USA. The Japanese FTA is also going to be completed in the next year or so – that's the fourth largest export market for Ceramics."

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[25] *The economic impact of Brexit*, Capital Economics for Woodford Investment, February 2016
[26] Breinlich, H, S. Dhingra and G. Ottaviano, *How have EU's Trade Agreements Impacted Consumers?*, CEP Discussion Paper, March 2016
[27] Breinlich, H, S. Dhingra and G. Ottaviano, *How have EU's Trade Agreements Impacted Consumers?*, CEP Discussion Paper, March 2016

> **Nick von Westenholz, The National Farmers Union – the union for British farmers, based in London**
> "The UK currently imports lamb from New Zealand. There is currently a tariff quota of 220,000 tonnes of lamb from New Zealand, but these will need to be split up if the UK cannot agree a deal with the EU."

> **Stephen Page, Faber and Faber – an independent publishing house, based in London**
> "We do business all over the world. English language penetrates pretty much everywhere and any disruption to that, or the need to renegotiate hundreds of treaties and end up with worse terms, for instance, or complicated terms or added administration, is painful. These markets matter to us. For example, Canada is very important, probably our fifth biggest market – English language, part of the old Commonwealth, so we have the rights to a lot of books exclusively in that market and new costs or administrative complexity could damage the market for UK published books."

Some companies stressed the importance of being able to rely on the EU to protect them in trade disputes. A number of firms and trade associations referred to the ongoing trade dispute with the US involving Bombardier, and the potential implications of Brexit on the Government's ability to support British companies in such situations.

> **Laura Cohen, Ceramfed – the UK's Ceramics Association, based in Stoke-on-Trent**
> "EU trade defence measures such as anti-dumping tariffs on Chinese tableware and tile producers have helped our sector to stabilise, invest and employ more people. We need a UK trade remedies system that can tackle the unfair distortions that disrupt real free trade. Without adequate UK measures, the British market could be flooded with cheap imported steel, ceramics and other materials from overseas."

A very small number of companies expressed enthusiasm for leaving the Customs Union. One argued that the Customs Union was protectionist and particularly damaging to the poorest countries in Africa (seemingly unaware that such countries benefit from tariff-free access to the EU through the "Everything But Arms" arrangement[28]). The others were optimistic about the UK being able to negotiate attractive FTAs on its own.

> **John Thorpe, Millennia Computer Services – cloud-enabled hosting provider and platform, based in Yorkshire**
> "They [the EU] are deliberately anti-development. I don't believe in throwing money at Africa – we want them to develop themselves. Customs Union is the problem in that being able to happen."

[28] *List of countries benefiting from the Everything But Arms (EBA) arrangements for least developed countries*, European Commission Trade Helpdesk

The risk of reverting to WTO MFN rules

With very few exceptions, the firms we spoke to regarded the prospect of a "Hard Brexit" resulting in a return to WTO MFN rules as potentially disastrous. The vast majority of the businesses we spoke to believed that such an outcome could result in significant disruption to their businesses, including significantly higher import prices for intermediate goods, much higher barriers to their exports and considerable friction in supply chains due to increased customs procedures.
While the precise impact of reversion to WTO MFN rules is impossible to predict, not least because it is unclear what tariffs the UK would impose, the fact that UK export would face the EU's external tariffs would have a dramatic impact on some companies. UK consumers would face higher prices for many goods and some products might no longer be available.

> **Tony Walker, Toyota Motor Europe – manufactures and sells Toyota and Lexus vehicles, parts, and accessories. Toyota has two UK manufacturing operations in the UK based in Deeside and Burnaston**
> "Under a hard Brexit the car industry has one of the highest possible tariffs and we're also one of the industries that is most reliant on volumes. We need high volumes to cover our fixed costs ... In the UK, the consumer will be impacted because 85% of the cars sold here are imported and they will be tariffed ... If the costs of those goods go up by 10% it will not be possible for companies like ours to assume all the financial impact. We would expect that the market would need to adjust and one possible impact is prices rise."

> **Ian Wright CBE, Food and Drink Federation – a trade organisation that represents the UK's food and drink sector, based in London**
> "Assuming that it is possible, staying in the Single Market is extremely important. Food and drink products and ingredients often cross borders multiple times and our priority is maintaining tariff-free and frictionless access to our largest and most important market. For example, flour is sent from the UK to Ireland to be turned into processed foods that are often then imported back into the UK; 80% of the flour used in Ireland comes from the UK and could face a significant tariff, [if we went to WTO MFN rules] which could add 8-10% to the price of loaf of bread."

> **Sue Davies, Which? – the largest consumer body in the UK, based in London**
> "WTO MFN could mean dramatic increases in some product prices. It's difficult to assess what the precise impact would be on consumer prices but when you're talking about average tariffs of 22%, and as much as 60% on some products, then it could have a big impact."

> **Katie Doherty, International Meat Trade Association – representatives of meat importers, exporters and wholesalers, based in London**
> "Though the average MFN duty may be 3-4%, for meat it is 50% and even 60% in some cases."

For exporters to Europe, a “Hard Brexit” would mean facing the EU’s external tariff.

> **Rob Law, Trunki Luggage – a travel accessories business, based in Bristol**
> "Europe is our biggest market so of course we want open and easy access to it. Germany and France are our biggest export markets and if we have to impose the EU external tariff on luggage of 5.8% on exports to the EU that would go straight into our margin"
>
> **Herwig Vennekens, Haribo – a German confectionery company, with its UK headquarters in Pontefract, Castleford**
> “A lot of the current exports go into EU member states, Ireland being one of them. If there are tariffs, the products produced in the UK will be more expensive to those markets that import them. This places UK made products at a disadvantage versus those similar products produced in the EU. If you think that through, that could lead to a position where it is financially not attractive to produce in the UK for export and on that point.”

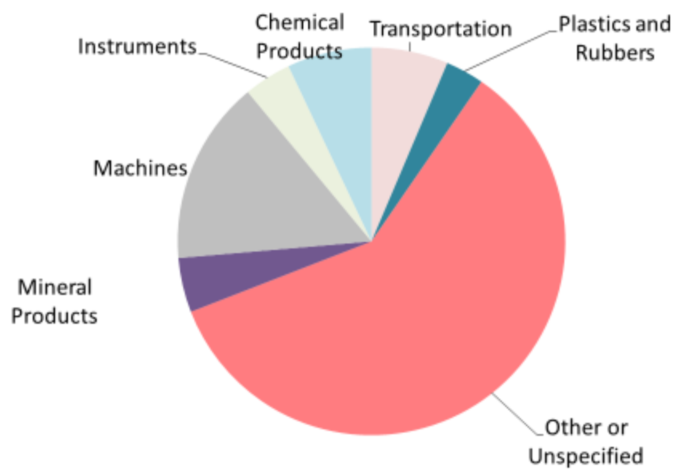
In some sectors, such as publishing, firms pointed out that leaving the Customs Union and reverting to MFN rules could mean British companies losing current advantages versus US competitors in selling to EU customers.

> **Stephen Page, Faber and Faber – an independent publishing house, based in London**
> “US competition will be a big problem as often UK publishers have exclusive rights in European markets is the English language. I’m concerned that US publishers will undercut UK publishers if given the same access to Europe, as it is not a main market for them. This is not good for writers or for the ecosystem of British publishing. By leaving the EU we will have a pushback from US saying you don’t need EU exclusives anymore, when in fact it is important for both British publishers and writers.”

New trade deals with non-EU markets: The United States

The United States is a very important market for many mid-sized British companies. Roughly 19% of UK exports of goods and services go to the US. Figure 7 shows the composition of goods exports, which spans a broad range of sectors.

Figure 7 – Composition of Goods Exports to the USA - total value of $61.6 Billion



Source: Observatory for Economic Complexity, MIT, 2016

We heard very different perspectives on the potential benefits of a US/UK trade deal, ranging from those who were excited at the prospect of greater access to a huge market to those who saw little upside since tariffs are already so low. However, both those who saw significant potential benefits and those who saw the upside as much more limited, were extremely sceptical about the prospect of achieving such a deal.

> **Ian Wright CBE, Food and Drink Federation – a trade organisation that represents the UK's food and drink sector, based in London**
> "Companies are excited for the UK to strike its own trade deal with the US, especially given the significant branded value add on scotch, gin and chocolate. But tackling non trade barriers is extremely difficult."
>
> **Tony Walker, Toyota Motor Europe – manufactures and sells Toyota and Lexus vehicles, parts, and accessories. Toyota has two UK manufacturing operations in the UK based in Deeside and Burnaston**
> "The EU already has a trade arrangement with the US for a tariff on cars. It's 2.5%. So it could be difficult for the UK to get a better deal than the EU has already got. It may not be so realistic to get anything radically much better in the UK."

Tom Shutes, Wakefield Ltd – Property Developers, based in London
"It's hard for construction companies to compete in US with US prices – their construction standards are much lower, so it would be difficult to compete. I'm not really sure what a trading relationship would give us that would improve on that."

Securing an FTA with the US that was advantageous to British companies appears very difficult for a number of reasons, including: first, where there is scope to reduce tariffs significantly (eg agriculture) US companies are likely to benefit more than British companies; second, there seems little prospect of reducing non-tariff barriers in the service sectors in which UK companies are strongest (eg financial services); third, Trump Administration's "America First" approach to trade negotiations suggests the US will take full advantage of the imbalance in scale and thus bargaining power between the UK and the US. On the last point, trade experts compared the UK's position outside the EU to that of an individual US state.

Lourdes Catrain; a trade partner at Hogan Lovells in Brussels:
"Imagine the U.S. negotiating an agreement as opposed to the State of California negotiating an agreement, there is a great difference in leverage and power."

Izaak Watson and Adam Hooper, Martin's Rubber – a rubber manufacturer who specialise in the production and supply of elastomeric products, based in Southampton
"The US is a particularly protectionist market and it's not so much about trade deals, as just an inherent unwillingness to buy anything that doesn't have an American flag on it. Certainly when we've been talking to oil and gas customers the fact that we didn't have an office or manufacturing facility in Houston basically meant they wouldn't even bother talking to us. Trade deal or no trade deal."

Nick von Westenholz, The National Farmers Union – the union for British farmers, based in London
"It's difficult to see short to medium term how we're going to get a trade deal with the US. The US was unable to reconcile with the EU when they were talking to each other on TTIP. It's a fact that international trade isn't about tariffs, it's about regulations – if you can adapt to US regulations, and you can absorb the costs of doing that, then you will. However, the UK would have to observe US standards. The UK can make a choice, but it can't really trade with the US without observing US standards, and this may mean abandoning harmonisation with the EU".

Enthusiasts for Brexit have repeatedly suggested that being able to secure an FTA with the US is one of the biggest upsides of leaving the Customs Union. The possibility that such a deal might only have limited benefits and may not be achievable, at least on terms attractive to the UK, thus seems critically important to assessing logic of exiting the Customs Union. Given the importance of this topic we intend to publish a separate report assessing in much greater detail the potential benefits and likelihood of a US/UK FTA.

New trade deals with non-EU markets: elsewhere in the world

While often optimistic about the scope for doing more business with markets elsewhere in the world, most of the businesses we spoke to were cautious about the potential upside or feasibility of securing FTAs with such countries. Some of the bigger markets, such as Japan, are much more focused on completing a trade deal with the EU than with the UK, which should not be surprising given the relative scale of the UK and EU markets. The likelihood of the UK to securing advantageous trade deals with some of the fastest growing economies in the world, such as China, India and Russia, seems a distant prospect given domestic political constraints in these countries, competing priorities, and relative bargaining power. Plus, the much greater success of other EU countries in exporting to such countries suggests that being part of the EU is not the critical impediment to the UK's export success. Figure 4 (on page 20) shows the destinations for UK exports in 2016, ranked by size. The UK's existing arrangements through the EU, the EFTA and FTAs secured by the EU account for £331 billion of UK exports, more than three times larger than the next largest trading partner, the United States. To give an idea of the relative importance, if exports to the EU, EFTA and EU enabled FTAs were to decrease by 10% as a result of Brexit, the UK would need to increase exports to the next 7 largest trading partners by over 20% to make up the shortfall.

Businesses and trade associations stressed the importance of building stronger trade links with fast-growing emerging markets. But most of the firms we spoke to did not think that leaving the Single Market and Customs Union was either necessary or helpful in achieving this objective. In fact, many companies and trade associations downplayed the importance of trade deals as being only one determinant of success in exporting beyond Europe.

> **Kim Conchie, CEO of Cornish Chamber of Commerce – chamber of commerce for Cornwall, based in Redruth**
> **"**No one has ever complained about existing trade deals acting as a barrier to doing business with these new markets. Cornish mining engineers went out to South Africa and Australia. There's a big market in those communities for Cornish food and drink and crafts."
>
> **Bridget Shine, Independent Publishers Guild – a body providing advice and information for publishers, based in London**
> "At the moment our members trade globally and, obviously some markets are stronger than others and again it depends on what they're publishing, but at the moment I don't know one of our members that are struggling because of trade agreements. It could be there isn't a market for their particular content, but it's nothing to do with trade agreements."
>
> **Dr. Tony Doyle, Varilight – Manufacturer of switches, sockets and domestic electronics – Based in West Sussex**
> "We've recently got a patent in America, it shows that being in the EU doesn't preclude us doing trade deals with the rest of the world. I'm not sure we should anyway, can you imagine the type of negotiations that would take place with a powerful country like America? We'll end up having chlorine washed chicken and beef steeped in antibiotics."

Many of the firms we spoke to emphasised that in exporting to such markets, the level of tariffs was often a secondary consideration. On the plus side, brand, reputation and expertise can overcome a tariff disadvantage. Conversely, non-tariff barriers can prove an impediment even where tariffs are low.

> **Colin Davis, FliteTec – A business supporting aircraft interiors, based in Amersham**
> "We'll sell to anybody. We've sold to Russia. For us the most important thing is to provide a quality service at a price, and we are able to send airlines their interiors back more quickly than sending it back to the manufacturer."

> **Simon Boyd, Reid Steel – a steel construction company, based in Christchurch**
> "British standards are seen as by many as the finest in the world. In Angola it's the engineering that gives us the edge – a lot of countries overseas look to buy a product that has a good reputation."

> **Mark Pursey, BTP Advisers – an international PR and communications agency, based in London**
> "One of our selling points, forgetting the politics, is that people like things that are British. That has a resonance for people."

> **Nick Petford, Northampton University – university, based in Northamptonshire**
> "The leather industry in Northampton went largely offshore, mostly to Asia – many of the old shoe factories have been turned into flats and apartments. But what stayed behind is quality, handmade leather manufacturing. The University of Northampton has the only working educational tannery in the UK. China is still interested in Northampton's expertise. Why? Because of the history of luxury shoemaking – the brand association, the soft power, the role of our Leather alumni."

Other companies, particularly those in the service sector, stressed the importance of culture including language, cultural competence and personal relationships as the primary barriers to international trade.

> **Oliver Gadsby, Rowman and Littlefield – a publisher specialising in social sciences texts, based in London**
> "We're trading quite a lot with China, Taiwan, Korea, those parts of the world. I think they will grow in importance, and Singapore, and other countries in Asia which have a growing affinity for English language content. But it works at present."

Christopher Nieper, David Nieper – a clothes manufacturer as well as online and mail order retailer, based in Derbyshire
"Culture is the biggest barrier when expanding trade, not language or geography. An entrepreneurial business finds ways around most hurdles – trade deal or no trade deal."

Ian Wright, Food and Drink Federation – a trade organisation that represents the UK's food and drink sector, based in London
"There's an opportunity to export quintessentially British products to China – products that have so far been neglected in trade deals. For example, it has been very difficult to get approval for the export of beef, pigs and poultry. This is also about soft-power deals. There's a significant opportunity to export the 'fifth quarter' of UK pigs and livestock that aren't consumed in the West. China has also been gripped by the 'Downton Abbey' effect which has seen an uplift in the demand for UK biscuits, tea and jam. English water is even exported to make the tea."

In some sectors, non-tariff barriers are the primary barrier to increasing exports, but firms generally expressed scepticism as to whether a post-Brexit Britain would make more progress than the EU in tackling these impediments to trade.

Katie Doherty, International Meat Trade Association – representatives of meat importers, exporters and wholesalers, based in London
China has huge potential as a market, but getting FTAs isn't the main priority. Rather UK meat wholesalers need veterinary approval, as this is the key to market access. At present the UK has approval to export its pork to China but none for poultry and lamb.

In this round of interviews, the businesses we interviewed once again emphasised their concern about whether the UK's negotiators would take sufficient account of the priorities and needs of SMEs. We also heard repeated concerns about the Government's capacity and capability to negotiate advantageous trade deals: many drew the contrast with the EU's depth of experience in such negotiations and superior economic and political clout.

Gregor Hofer, Speech Graphics – delivers pioneering facial animation technology to the entertainment industry, based in Edinburgh
"Europe has a lot more clout being able to get a trade deal with Asian countries than Britain alone at this stage. With the US, there is already such a close relationship there may be an opportunity to have a better trade deal there. But with Asia, it's probably better for Europe as a whole to negotiate anything."

Another striking finding from our interviews is the extent of business leaders misunderstandings about the UK's actual and potential trading relationships with the rest of the world. We encountered diverse and often factually inaccurate views about the extent to which existing trade depends on arrangements negotiated through the EU, the implications of reverting to WTO arrangements or the factors affecting the UK's ability to secure new trade deals.

Few of the companies we spoke to appeared to understand the full implications of WTO MFN clauses which would prevent the UK from offering or securing sector-specific deals with the EU without these being extended to other parties.

For example, some companies appear to believe that reverting to WTO rules will automatically lead to a reduction in the tariffs faced by British exporters in the rest of the world. Yet this is not the case. Where the EU has already negotiated an FTA, leaving the EU's Customs Union will lead to an increase in tariffs faced by UK exporters, unless the UK can negotiate an equivalent (or better) FTA. Where the EU currently does not have an FTA, WTO rules already apply, so UK exporters will face equivalent tariffs. So UK exporters will only see a reduction in tariffs where the Government is able to negotiate FTAs, and in the near term at least, reverting to WTO terms through a "Hard Brexit" would result in UK exporters to the rest of the world facing at best equivalent, and in some cases, higher tariffs.

4. Findings on the Brexit end-state for regulation

Our initial findings

In our first round of interviews we found that companies want Brexit to lead to streamlined regulation, not more regulation. Yet none of the firms we spoke to expect a regulatory "windfall". Indeed, many expressed concern that Brexit would paradoxically result in an increased regulatory burden. If British regulations diverge from EU standards, companies that export to the EU will now have to comply with an additional set of regulations. We also heard repeated concerns about the potential costs associated with employing EU citizens if companies are forced to navigate complex new immigration rules.

Contrary to much of the media and political commentary, the majority of businesses we interviewed were broadly satisfied with current regulatory approaches in their sectors. While there are always examples of specific aspects of regulation that seem overly burdensome or inappropriate, many spoke to the overall quality of EU regulations and rulemaking processes, claiming that the process of securing input and agreement from 28 member states usually helped weed out poor quality regulation.

Firms recognise that Brexit will provide the opportunity to adapt regulations to the British context, but most thought that this would result in only minor benefits to their businesses. In many areas, the Government has been one of the most influential voices in determining EU regulations, so these already typically reflect UK priorities. Some firms highlighted employment regulation and to a lesser extent, health and safety and environmental protection as areas where the UK might look to deregulate. However, most businesses expressed limited appetite for such changes, and the Government has thus far indicated that it intends to maintain EU labour protection standards.

Many firms expressed significant concerns about the loss of British engagement in EU rule-making processes. Firms that trade with the EU will still have to comply with EU regulations, but will no longer have the opportunity to influence these rules. This is particularly important in areas where British companies have particular strengths and distinct regulatory priorities, such as in financial services, the energy sector or the creative industries.

Many businesses specifically highlighted the important role specialised EU agencies, such as the European Medicines Agency ("EMA") or the European Aviation Safety Agency ("EASA"), play in regulating their sectors. When explaining the importance of these agencies in the creation of quality regulation, some businesses expressed anxiety about losing the ability to influence the policies of these agencies, or to benefit from their expertise.

Our new findings

In our second round of interviews, the firms we spoke to described the regulatory issues arising from Brexit with much more specificity, and unsurprisingly, most of the companies we spoke to expressed a far greater sense of urgency about getting the regulatory uncertainties resolved.

The risk of increasing the regulatory burden

The overwhelming majority of companies we spoke to were sceptical about the prospects of a regulatory windfall, and fear that Brexit will result in an increased regulatory burden. Many highlighted the significant costs attached to responding to regulatory changes or having to comply with multiple sets of regulation. Some referred us to a recent Federation of Small Businesses report suggesting that smaller firms have less resilience to such regulatory shocks, since they have much fewer resources to dedicate to such challenges.[29]

> **Rob Law, Trunki Luggage – a travel accessories business, based in Bristol**
> "We have a strong preference for staying in the EU standards agency to avoid regulatory duplication. We already spend about £50,000 per year on regulatory testing and assume a new UK agency would double those costs."

> **Tim Hames, BVCA – the industry body and public policy advocate for private equity and venture capital industry in the UK, based in London**
> "Many EU regulations stem from the UK in the first place, so reflect our priorities. Furthermore, firms have spent a lot of money, time and energy implementing them. Any attempts to roll them back would create additional costs."

> **Senior representative – a pharmaceutical business, based in Oxford**
> "Brexit may lead to the Medicines and Healthcare products Regulatory Agencys (MHRA) leaving the European Medicines Agency (EMA), forcing companies such as mine to get separate regulatory approval for our medical device in the UK market. This would raise costs and delay access to market for consumers."

> **Nick Petford, Northampton University – university, based in Northamptonshire**
> "Coordination costs for streamlining regulations – such as those governing the procurement process – are high and often bureaucratic."

Business leaders find it extremely difficult to work out how much UK regulations are likely to diverge from those of the EU following Brexit. Some pointed to the Government's commitments regarding "regulatory alignment" between Northern Ireland and Eire, coupled with the need to maintain uniformity of regulatory standards between Northern Ireland and Great Britain. These commitments would suggest there will be relatively limited scope for regulatory divergence between the UK and the EU (which effectively means the UK would have accept EU regulations without having a voice on them, like the countries in EFTA). Yet others pointed to the remarks by senior ministers, who repeatedly suggest a desire and ability to alter UK regulations following Brexit, with the aim of making them less cumbersome and damaging to growth.

[29] Hyde, Pool and Smith, *Regulation Returned: What Small Firms Want from Brexit, Federation of Small businesses,* July 2017

On the whole, the UK companies we spoke to would prefer to see the continuation of current arrangements.

> **Peter Till, Choice Hotels – UK division of an international hotels group, based in London**
> "The only EU regulations that have substantial effects on the hotel industry are the EU's labour protection laws, but there is no chance of the UK scrapping these after Brexit as these regulations are in line with the UK's preferences independent of the EU. EU labour protections have raised the cost of labour but done so in an appropriate way. The UK hotel industry has not suffered unduly because of that."

> **Peter Moody, St Austell Printing – a printing company, based in St Austell**
> "It would be a right pain [...] if the EU had different regulations to us. We wouldn't be able to sell our product in Europe because it has some trivial difference from the EU regulation, or have to pay to conform to those new rules."

Some companies suggested that the prospect of regulatory divergence between the UK and the EU would give them cause to set up a separate base in the EU.

> **Per Lundin, Evox Therapeutics – a biotech business, based in Oxford**
> "We are considering setting up a subsidiary in Sweden to enable us to have an EU base in the future for regulatory and other purposes"

Attitudes towards current regulation

Throughout our interviews, we frequently encountered a sharp distinction between firms' attitudes towards regulations in general and their views on the regulations that affect them directly. In talking about regulation in general, quite a few firms claimed there were too many rules and that regulatory burdens were too high. Many attributed such excessive regulation to the EU, at least in part. However, when asked to comment on the regulations directly affecting their own industry, most companies expressed a remarkable degree of satisfaction with current regulatory frameworks and standards.

> **Rob Law, Trunki Luggage – a travel accessories business, based in Bristol**
> "It's not cumbersome at all to follow EU regulations, especially the European-wide product safety standards EN71 – these help drive up standards."

> **Paul Trudigan, Fish for Thought – a seafood business, based in Cornwall**
> "I don't have any issue with EU regulation as it currently stands. I don't always know which regulations we follow come from Europe and which from the UK, but I don't look at regulations in my industry and think ' this is unreasonable."

> **Kim Conchie, CEO of Cornish Chamber of Commerce – chamber of commerce for Cornwall, based in Redruth**
> "People complain about red tape, but when you ask people what they would like removed, they're not able to be specific, as the EU regulatory framework is not actually as burdensome for business as critics would have you believe."

In discussing the regulations directly relevant to their own industry, many companies suggested that the burden of regulation could be reduced significantly through changing the way the rules were administered and applied, rather than necessarily requiring major change in the regulations themselves. Some companies suggested that the Government should just refine its approach towards implementing the EU rules.

> **Izaak Watson and Adam Hooper, Martin's Rubber – a rubber manufacturer who specialise in the production and supply of elastomeric products, based in Southampton**
> "It's more about the UK government being more pragmatic about the implementation of the rules rather than taking stuff out."

In a similar vein, some companies argued that any excessive burden from EU regulation was more due to UK "gold plating" than the EU rules themselves.

> **Mike McDonald, Serlby – a diversified holding company, based in Yorkshire**
> "Our managers believe the UK has been gold plating EU regulation to make it more burdensome than it needs to be, and as a result our businesses have suffered. Having said that, it's also likely that the UK government would have implemented similar standards outside the EU, so membership isn't to blame."

> **Kim Conchie, CEO of Cornish Chamber of Commerce – chamber of commerce for Cornwall, based in Redruth**
> "The UK gold plates EU regulation, as a result of a preference for higher regulatory standards. So an independent UK is unlikely to reduce 'red tape' and may increase it."

> **Lord Flight, Flight and Partners – a recovery fund which invests in businesses that have gone into administration, based in London**
> "Not much bad regulation has actually been forced on us by EU. A lot of it has been initiated by the UK with their gold plating. But there are some areas that are very EU driven"

> **Izaak Watson and Adam Hooper, Martin's Rubber – a rubber manufacturer who specialise in the production and supply of elastomeric products, based in Southampton**
> "We have more trouble with UK generated regulation than stuff from the EU."

Although the vast majority of the companies we interviewed expressed broad satisfaction with the regulatory frameworks under which they operate, including those aspects of regulation emanating from the EU, there were some exceptions. Companies that view Brexit positively typically suggested that exiting the EU would enable the UK to streamline or tailor regulations. However, this opinion was almost always articulated in generic terms, with the company leaders rarely identifying specific regulations affecting their own businesses that could be changed.

Jeremy Tozer, Tozer Consulting – leadership and strategy execution consultants, based in Henley
"Brexit is an opportunity to reduce the regulatory and bureaucratic burden, and create a framework to stimulate productivity, innovation and business growth."

Though some of the few complaints we did hear about regulatory burden were about UK domestic legislation rather than that imposed by the EU.

Alistair Fitt, Oxford Brookes – university, based in Oxfordshire
"All the barriers to international recruitment are imposed by the Government for immigration purposes – each year we have to spend £500,000 employing people to sift the certificates of acceptance for study for non-EU students, otherwise we end up losing the talent."

Opportunities to adapt regulations to the British context

On the whole the companies we interviewed were cautious about the scale and nature of the opportunities to take advantage of Brexit to tailor regulations to the British context. However, we did hear more proposals for specific regulatory changes in this round of interviews compared to the earlier round. It seems as if many firms, including those opposed to Brexit, have used the last several months to develop a deeper understanding of the potential impact of Brexit on the rules by which they do business, developing a "wishlist" of things they would like to see changed.

Whilst our purpose was not to evaluate each of these suggestions, many would appear to fall into the category of tweaks to current regulations that would favour a particular type of company, rather than being considered contributions to regulatory policy, weighing the trade-offs from society's perspective. For example, we heard the perspective that current-competition rules on retail pricing needed to be adapted to the world of e-commerce.

Rob Law, Trunki Luggage – a travel accessories business, based in Bristol
"We would like to see the anti-competition rule around retail pricing relaxed. It currently limits our ability to talk with retailers about their pricing which means some retailers cut our prices and damage our brand equity without us being able to act. The law was put in donkey's years ago and needs to be updated for the new e-commerce landscape."

Smaller financial services firms argued that EU regulation of the sector was overly burdensome and advantaged bigger firms.

Edi Truell, Disruptive Capital Finance – a private equity and venture capital firm, based in London
"We should reduce financial regulation. Little banks can't afford to comply with the endless stream of regulations coming out of Brussels – big banks are fine and happy with the rules because they have teams administering that. But as a challenger bank, it's very hard to break through – spent £10 million having to comply with these regulations. I'd like to see wholesale deregulation immediately – you would see a one off bounce in the sector."

> **Jon Moulton, Better Capital – a private equity firm, based in London**
> "Hardly anyone in financial services knows what's in the regulations anymore, it's just gone far too far – no cost benefit analysis – not much common sense. We need to reduce Financial Conduct Authority (FCA) regulations: the FCA handbook costs £4,500 and runs to 22 ring binders. It's also obsolete v quickly – some parts are even changed weekly – with some changes prompted by the EU, some the UK."

Smaller players in the fund management industry complain about the complexity and costs of MiFID II,[30] the EU's new set of regulations covering asset management.

> **Iain Baillie, Asset Match – provides an interactive auction platform for financial investors, based in London**
> "We are having to change because of MiFID II and the timetable for that change is 1st January, which is the timetable laid down by the European Union. Our understanding is that the FCA have absolutely no ability to use discretion in the date of implementation. Whereas if it was their own regime they would have discretion. However, most people think that the FCA has been a major contributor to the thought process even if it wasn't one of the drivers of MiFID. So I don't think there will be an enormous change."

> **Flight and Partners, Lord Flight – a recovery fund which invests in businesses which have gone into administration, based in London**
> "MiFID II doesn't really fit the UK market: MiFID II looks like it's the product of IOSCO, the EU regulatory group, reflecting EU culture. UK regulators had a hand in the original MiFID initiative and, at that point, the regulation was sensible and appropriate. MiFID II gives us pointless extra regulation and record keeping which I hope will go after Brexit."

Yet the idea that MiFID II is an unnecessary EU imposition on the British asset management industry that UK regulators will relax given the opportunity, seems implausible. The UK's Financial Conduct Authority ("FCA") was a primary driver of MiFID II, and more generally, the UK is often at the "hawkish" end of the spectrum on regulatory issues, and is unlikely to want to be perceived as less rigorous in this arena.[31]

Depending on their business, companies voiced different perspectives on the impact of Brexit on the UK's climate and broader environmental policies. Companies in the environmental sector worry that the UK may replace EU emissions targets with less ambitious policies[32] and that the lack of clarity in the sector may stall investment in clean energy technology. Companies in energy–intensive sectors hope Brexit offers an opportunity to reduce the burden of carbon and other emission targets.

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[30] Market in Financial Instruments Directive II sought to remove barriers to cross border financial services within Europe
[31] Caroline Binham, *Investment bank regulation flagged as next Brexit flashpoint*, Financial Times, January 16 2018
[32] Hepburn and Teytelboym, *Climate change policy after Brexit*, Oxford University Press, 2017

Laura Cohen, Ceramfed – the UK's Ceramics Association, based in Stoke-on-Trent
"Ceramic manufacturing is energy-intensive, with energy accounting for up to around 30-35% of production costs. However the current EU/UK energy & climate policies are complex and burdensome, and result in ever-growing, punitive compliance costs for our sector. Brexit gives the Government a unique, one-off opportunity to completely review and simplify its approach to climate regulations. We want Government to harness this opportunity, with less of a 'stick' (legislative drivers), and more 'carrot' (incentives) approach which could still meet UK climate decarbonisation goals, but would also maintain (or even improve) the UK's industrial competitiveness, productivity, investments and job creation."

Agriculture and the food industry as a whole face the prospect of radical reform, with a broad range of issues on which policy could shift significantly, including the level and targeting of farm subsidies, the level and shape of rural development funding, food security strategy, environmental policies, food safety regulations, seasonal labour availability, tariffs on agricultural imports and exports, incentives for innovation, and other rural development issues including agri-environment schemes and tourism.[33]

Sue Davies, Which? – the largest consumer body in the UK, based in London
"For a long time we've been saying we need to move away from the Common Agricultural Policy, we need to have a joined up approach to food policy. We've got a lot of challenges, whether that's obesity, environmental impact, food safety and food quality, which are often dealt with very separately to agricultural policy, so now we have a chance to really think about this and redesign a policy that works for consumers and join up the different competing priorities of agriculture. However, this is a massive task and there's a danger we just go on paying subsidies without addressing these wider issues."

Yet with the Government's future policy on agriculture still largely undecided, farms and food companies face massive uncertainties. The agreement on "regulatory alignment" between Northern Ireland and Republic of Ireland further fuels these uncertainties, since agricultural produce forms a substantial proportion of cross-border trade. How far can the UK diverge from EU policies if this commitment is to be honoured?

In the biopharmaceutical sector, all the companies we spoke to wanted a continuation of harmonised regulation under the European Medicines Agency. However, when pushed to identify opportunities for improvement arising from Brexit, some suggested areas where current regulatory approaches could be revised to facilitate innovation.

Per Lundin, Evox Therapeutics – a biotech business, based in Oxford
"There may be an opportunity for the UK to take a progressive view on advanced biological therapies, including cell therapy and gene therapy, similarly to what we have seen in, for Japan."

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[33] *The EU referendum: impact on UK agricultural policy*, House of Commons Library, 26 May 2017

Eliot Forster, MedCity - a public-private collaboration supporting the life-sciences cluster, based in the Golden Triangle
"There could be an opportunity to restore the UK's once leading position in conducting clinical trials. EU regulation has driven this activity to the US and elsewhere."

In our interviews we heard a lot about the EU's new regulations on data privacy, known as General Data Protection Regulations ("GDPR"), which attract strong opinions, both positive and negative. The commentary on GDPR extended well beyond the tech firms, and the legislation is clearly likely to impact companies across a range of different sectors.

Many firms felt that the purpose of the GDPR, to standardise data protection laws across member countries, and shift industry perceptions of data ownership is a positive, and that the UK should strive to keep stride with EU legislative standards in this area regardless of Brexit.

John Thorpe, Millennia Computer Services – cloud-enabled hosting provider and platform, based in Yorkshire
"I don't care about most regulation except one, which is very important – EU's GDPR / data protection. Even the US is paying attention to it: the EU is being a force for good here. The EU and UK are aligned on how they think about data protection, so GDPR in line with our preferences: companies just want to do anything with your data that they like; but people are sick to death of being treated as commodities and losing control of their digital footprint."

Lorenz Fischer, Sentient Machines – provides machine learning products to turn analysis of natural language interactions into data-driven business decisions, based in London
"It's important to implement GDPR to enable trade with Europe. If we moved to France or Germany, we would have a head start … Any new trade deal must involve data regulation – this is an issue of great importance to our business"

Some firms highlighted the challenges of implementing GDPR, whilst acknowledging the need for regulations in this arena.

Bridget Shine, Independent Publishers Guild – a body providing advice and information for publishers, based in London
"We suspect GDPR will not be as hard to implement as people fear – although people may be huffing and puffing about it, some of it is good. I've been told that most companies aren't compliant with current regulations, let alone GDPR."

Johnnie Ball – representing a fintech company providing automated cash flow analysis and forecast generation using machine learning, based in London
"GDPR will affect us but probably not as much as others. We're going to have to put a lot of time and resource into ensuring we're compliant. It has been written by policy makers with good intentions, but some requirements are impractical and will not have the desired effect. There has been a lot of push back from PSD2 so I'm hoping lessons will be learnt from that. The policy makers are reaching out and speaking to businesses and trying to do the right thing, but it's not an easy task."

However, we also encountered firms that see GDPR as overly burdensome and difficult to implement, particularly for smaller data-driven companies.

Alicia Navarro, Skimlinks – a data company specialising in marketing solutions for publishers, merchants and agencies, based in London
"GDPR is ill formed, ill-conceived and very concerning. The EU has clearly been really badly advised on the implementation of the GDPR. It's been driven by the countries that are really concerned about privacy in Europe like Germany, but without recognising the impact on small data-driven businesses. The costs of implementing GDPR are unreasonable, and it is big-tech that will benefit."

Whether in favour of GDPR or against, firms saw GDPR as an example of the kind of major regulatory change that would affect British firms whether or not the UK was in the EU; and where the UK could lose out by not being involved in the design and evolution of the new regulation.

Regulatory harmonisation versus divergence

The vast majority of the businesses we spoke to want to minimise regulatory divergence from EU standards, seeing the potential benefits from being able to tailor regulations more closely to British needs more than offset by the incremental costs of having to comply with multiple sets of regulations. A number of firms also pointed out that in industries characterised by high levels of international trade, there was huge pressure for countries to align their regulations with the regulatory approaches and frameworks of one of the three main economic blocs : the US, EU and to a lesser extent, China. Given the increasing prevalence of tightly integrated cross-border supply chains in many sectors, there is limited scope for other countries to diverge from the regulatory approaches and standards of the three economic blocs that comprise most of global production and consumption.

William Bain, British Retail Consortium – the trade association for all UK retailers, based in London
"The main rule givers in determining the regulations that underpin international trade are the EU, the US, and to an emerging level, China. In trade deals, the EU and US have been successful in drawing countries within their own regulatory orbit. If you adapt regulatory standards to move towards greater access with the US market, you may move away from the regulatory alignment that allows preferential non-tariff barrier participation within the EU market."

Senior representative – a pharmaceutical business, based in Oxford
"Only the US and EU really matter for medical regulatory approval. We need to get regulatory approval for our medical device, and plan to do it in the EU and the US. If the UK had its own separate process it would be a major cost and time sink for us. We would certainly register in the UK because we have major clients in the NHS. However, it would be our third priority after the US and the EU so we might deprioritise the market. I am sure some companies might not bother getting UK approval at all."

Tony Walker, Toyota Motor Europe – manufactures and sells Toyota and Lexus vehicles, parts, and accessories. Toyota has two UK manufacturing operations in the UK based in Deeside and Burnaston
"The main issues are things like safety and the environment and emissions… There are only around five sets of technical regulations globally – including European ones, North American ones etc. … Individual countries do not have unique sets of regulations, so we need to avoid divergence. If we were different, would it be acceptable to have regulations in the UK that meant cars could be more polluting and less crash resistant? Or would we say that cars have to be less polluting and more crash resistant? And if different it would mean huge additional costs for testing to prove that we have met this regulation."

Indeed, in some industries, such as aviation, the regulations are already harmonised at the global level to a large extent. Any attempt to diverge from these global standards would be futile, and following Brexit, the UK would likely have less influence over their evolution than as part of the EU.

Colin Davis, FliteTec – Aircraft interiors, based in Amersham
"Regulations won't change in the aftermath of Brexit, the FAA, EASA, CAA – they've all got the same types of rules."

Some companies suggested that regulatory divergence from the EU could impact their competitiveness and prompt changes to their business model, potentially creating extra cost that would likely be passed on to consumers.

Izaak Watson and Adam Hooper, Martin's Rubber – a rubber manufacturer who specialise in the production and supply of elastomeric products, based in Southampton
"You just know that if regulation drifts apart over time that will become a total barrier to trade with the EU and they'll absolutely make it a barrier. Indeed, regulatory divergence will make some products unusable across borders – such as food safe products and seals."

Herwig Vennekens, Haribo – a German confectionery company with its UK headquarters in Pontefract, Castleford
"When entering a market, you always consider the costs and weigh them against the benefits before entering, you comply with each country'fs regulation and you readjust your market position if that environment changes. Most often this involves an unavoidable cost, which needs to be accounted for in some shape or form – the company will shoulder some as it invests in the market but most often it will ultimately be the consumer that is faced with the additional cost."

However, at least one of the businesses we spoke to argued that the UK should set its own rules and regulations and aim for mutual recognition of regulation rather than harmonisation.

Simon Boyd, Reid Steel – A steel construction company, based in Christchurch
"We need to reestablish British standards because we cannot be controlled by a foreign body determining the regulations and standards which are right for British business. British standards have been seen as among the finest in the world. We have decades of history in design and we know how to get things right. So why can't we say to the EU – when we're exiting the EU – we will recognise European standards for those who want to trade in the UK market – in turn you should recognise British standards as being acceptable in European markets."

Yet there is no indication that the EU would be prepared to accept mutual recognition of standards with the UK, since this would be contrary to the principles of the Single Market and undermine the ability of the EU to control its own regulatory standards. An FTA between the UK and the EU along the lines of CETA would involve recognition of conformity and other specific standards, but the scope of recognition will be tightly constrained. Goods and services sold in the EU will have to meet EU standards, while those sold in the UK will have to meet UK standards, so UK companies active in the domestic market and exporting to EU markets will have to comply with both sets of standards.

Perhaps somewhat ironically, much of the criticism we heard was about the degree of regulatory variation across the EU, either in the rules themselves, or in the way they are interpreted. This point was often put forward by business leaders in favour of Brexit, but could also be seen as an argument for greater regulatory harmonisation through the Single Market.

John Mills, John Mills Limited – a telesales company, based in London
"Television advertising harmonisation hasn't really taken place, there are all sorts of non-tariff barriers ... With 'fitness products' you can't make any claims to people getting about getting fatter and thinner in the UK, but the regulations vary from country to country. This means we have to edit our video – getting approval for the amendments can take weeks and all the editing can cost thousands. It's clear that the regulators don't understand anything about how much it costs to make relatively piffling changes."

Edi Truell, Disruptive Capital Finance – a private equity and venture capital firm, based in London
"The single market is not actually complete: This myth that it's actually a lovely single market is incorrect when it comes to private equity – I have had to register our business in every EU country with every regulator that we want to work – that's worse than it was 30 years ago."

Simon Boyd, Reid Steel – A steel construction company, based in Christchurch
"Each state interprets European standards differently**.** If you're trying to compete against a Portuguese company – the way the Portuguese may apply EU standards is different than the way the UK policies businesses to comply. Every country has its own domestic issues – it's trying to make one size fits all – it's just one of the fundamental flaws with the European project."

Ongoing involvement in EU regulatory processes and agencies

Many firms expressed concern about the potential impact of being excluded from the EU's regulatory agencies, and the prospect of the UK potentially becoming a "rule taker" on areas where the UK aligns with the EU after Brexit.

Izaak Watson and Adam Hooper, Martin's Rubber – a rubber manufacturer who specialise in the production and supply of elastomeric products, based in Southampton
"We could only be confident in the benefits of regaining sovereignty if we saw conclusive evidence of proactive work on regulation. We are due to leave the EU in March 2019, by now we would have liked to start seeing some details on regulatory changes. Without a regulatory 'safety-net' we are happy taking rules from the EU, if the UK alternative is inadequate. It is a concern if that in the rush to attract new trading partners the UK deregulates in an unsafe / unsuitable way, as that could have an adverse effect in terms of less safe practices, environmental protection etc. It is also clear that the EU would have no incentive to consider UK interests when writing or enforcing legislation."

Several cited specific organisations or agencies that play a critical role in their industry.

Ian Studd, British Association of Removers – the largest association in the UK moving industry, based in Watford
"Whilst it's been a slow painful burn, the various transport committees across Europe have been trying to consolidate the position for vehicles and drivers to stop drivers from Central and Eastern Europe undercutting the price of Western European Removals. If we leave The Federation of European Movers Associations ("FEDEMAC") we will not be able to push this legislation forward."

Katherine Bennett OBE, Airbus – a multinational corporation that designs, manufactures, and sells aeronautical products worldwide, with over 25 UK sites
"The UK plays an important role in shaping regulation in EU – especially in aerospace and aviation … We want access to and influence in EASA … Continuing a role in NATO is very important. There was the Franco-German defence partnership signed last summer. Where is the UK on that? ... That goes back to ministerial involvement with their European counterparts."

A biotech investor, based in Oxford
"The MHRA has to remain part of the EMA or else the pharmaceutical consumers and producers will be massively damaged. You would stop doing trials in the UK and shift activity to the US and EU as the UK would only be the fifth largest market by sales. For consumers there would be a delay in access to some drugs and some additional costs."

Saadi Hussain, SmartMed Global – Medtech company, based in London
"To keep the cost of engaging with the European market low – we need to retain our membership of European Agencies. In the medtech space legislation comes out daily."

William Bain, British Retail Consortium – The trade association for all UK retailers, based in London
"The UK has been successful in significantly influencing food regulation, and food safety. We've been at the heart of measures that look at the provenance of goods – for example, the protection of intellectual property around cheddar and scotch whisky."

Alongside participation in the many specialist regulatory agencies, many businesses expressed the importance of remaining involved in key EU policy initiatives, such as those to expand the scope of the Single Market to encompass digital services (the "Digital Single Market"), to address climate change, reduce energy prices and improve energy security (the "Energy Single Market") and to strengthen patents.

The goal of the Digital Single Market initiative is to remove barriers to the seamless provision of digital services across the EU. Ending roaming charges from June 2017 was an early achievement of this endeavour, and there has been progress towards harmonising data protection and facilitating cross-border portability of online content. In a number of interviews, companies flagged the potential benefits of the Digital Single Market, as well as the disadvantages of leaving it. The Digital Single Market is particularly important for organisations in the creative sector, and we heard considerable concern about the implications of the UK losing its voice in the negotiations.

Julia Amour, Festivals Edinburgh – an organisation focused on developing the Edinburgh Festivals, based in Edinburgh
"If we are not part of the digital single market negotiations we will not be able to influence policy, but will have to comply with it."

Since the UK has the most developed digital technology sector of all EU members the UK has more to gain from the introduction of the Digital Single Market than any other country.[34]

Another area in which the EU is perceived to be setting the pace on policy is climate change and environmental policy more generally. The EU has taken the lead in implementing the Paris Agreement as well as establishing the EU's Emissions Trading System ("EU ETS"), coordinating the efforts of member states and lifting their ambition. Organisations active in this arena expressed fear that without the initiative and resources of the EU, the UK would fall behind.

> **Ben Twist, Creative Carbon – a charity that works to embed environmental sustainability within the arts and cultural sector in Scotland, based in Edinburgh**
> "There's big risk that we lose urgency on climate change legislation: the EU keeps everyone's feet to the fire. The EU was a signatory to the Paris protocol so has targets to meet: the UK and Scotland do not have direct targets within Paris agreement, but only have targets as a share of the EU's agreements."

> **Penny Goodwin, Wastesavers – a charitable trust with a trading arm, Wastesavers Ltd. which delivers curbside recycling pick up, based in Newport**
> "At the moment Europe is incredibly strong on a number of environmental issues, setting long term strategies and goals. The EU set recycling targets which UK is following. But after Brexit a number of local authorities in the UK said, 'there is no point pushing ahead with x or y recycling scheme because the targets we need to meet may no longer be there, so why bother?' That's my worry."

Some organisations also highlighted the Single Energy Market as an initiative which would bring benefits to both UK companies and consumers; but they also pointed out that the UK was already withdrawing from this process.

> **Dr Andrew Kerr, Centre for Carbon Innovation – an accelerator for large-scale low carbon projects, based in Edinburgh**
> "The UK is already pulling out of EU single energy market negotiations – as a consequence we will lose the benefits of lower energy prices, and more secure reliance on the gas and electricity interconnectors across Europe."

Another example raised by the firms we interviewed is patent protection. Existing EU patent provisions are seen to be effective in protecting intellectual property and also, a source of cost savings. We heard concerns about whether the UK would continue to participate in projects to improve the European patent system, such as the Unitary Patent, not least because these are ultimately based on EU law.

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[34] House of Commons: Digital, Cultural, Media and Sport Committee, *The potential impact of Brexit on the creative industries, tourism and the digital single market*, 23 January 2018

Edward Oates and David Holland, Carpmaels and Ransford, A specialist patent law firm, based in London
"The European Patent Office (EPO) is not an EU agency, so access to the EPO for UK firms is not affected by Brexit. And the UK is continuing to be engaged with the creation of the new Unitary Patent (UP) and Unified Patent Court (UPC). But these are EU projects based on EU law, and ultimately, the ECJ."

Rob Law, Trunki Luggage – a travel accessories business, based in Bristol
"We wouldn't want to see any changes in the patent regulatory framework: first, we have EU wide trademarks and design registrations and are nervous about any changes that might be made to them; second, the EU patent lasts longer than the UK patent and is more attractive as a result."

EU support in competition and trade disputes

A number of firms expressed concern that the British companies would suffer without the EU's assertive approach and negotiating power in competition disputes.

Will Atkinson, Atlantic Books – an independent British publishing house, based in London
"The EU is very good at keeping massive corporations and monopolies in check. The European Commission got Amazon to change illegal practices. The British government wouldn't have done that in a million years. The Anglo-American 'love big business' type mindset, is much more relaxed about the likes of Uber and Amazon, whereas the European Commission are extremely unrelaxed. We need regulation, otherwise we're all going to be owned by American technology companies."

Stephen Page, Faber and Faber – an independent publishing house, based in London
"Brussels is taking a tough stand on US tech businesses, ensuring that competition thrives. I have less confidence in the Government being able to do that on their own. The UK has shown no stomach or appetite to tackle monopolistic behaviour where the European Union has."

John Dyer, Chrysalis Records – independent record label, based in London
"We will miss out on anti-competitive prosecution. The UK music industry is only the independents, if you like. … The feeling is that the understanding of what IP is, the understanding of what copyright is, is much better protected, in our eyes, in our industry, in our sector, by Europe than it is in the UK."

British companies also benefit from the EU's capacity to deploy an array of strategies to pre-empt and resolve trade disputes and distortions, such as anti-subsidy duties and anti-dumping duties. We heard anxiety about whether the UK could defend British firms' interests as effectively, given the lack of experience and capability in the Government, and the fact that as a much smaller market, the UK would have less negotiating clout.

> **Laura Cohen, Ceramfed – The UK's Ceramics Association, based in Stoke-on-Trent**
> "After years of contraction partly because of dumped imports from China, EU measures have helped our sector to stabilise, invest and employ more people. We need a UK system that can tackle the unfair distortions that disrupt real free trade."

5. Skills and Talent

Our initial findings

In our first round of interviews, companies across most sectors expressed concerns about continued access to EU labour, from highly skilled scarce talent in the creative, scientific and financial sectors, to seasonal low skilled labour in agriculture and hospitality. Business leaders recognise that they have a responsibility to help build the skills of UK nationals, but argue that the scale of the skill gaps, plus British cultural resistance to working in certain sectors, mean that maintaining access to EU labour will continue to be crucial to their competitiveness.

Our new findings

In this round of interviews, we found that firms' concerns about access to EU labour and skills had intensified. While accepting that some controls on unskilled immigration are now inevitable post-referendum, businesses across every sector expressed deep concerns about the impact of a much more restrictive immigration policy on their ability to access the kinds of labour they require. In particular, uncertainty around future migration policy has complicated investment decisions, as future access to EU workers remains unconfirmed. Uncertainty surrounding the post-Brexit status of EU citizens has also compounded the impact on staff recruitment and retention caused by Britain's perceived retreat from the world. Indeed, it was striking how many of those we interviewed stressed the psychological and mood shift that has taken place amongst EU employees and those working closely with them. For some businesses, the declining appeal of UK universities to EU students and researchers also presents a challenge, since in some scientific, technology and creative areas, universities provide the critical pipeline of talent.

Concerns about labour and talent shortages

One theme that cut across all our interviews: concern about continued flexible access to EU labour; for some companies this is about obtaining scarce skills: for others, it is about securing seasonal labour or workers in industries typically shunned by UK nationals.

Interviewees in many critical sectors for the UK, including digital services, design, engineering, finance and the creative arts were concerned with maintaining flexible access to high skilled talent. Many interviews suggested the UK lacks the domestic skills base to compete globally in several key industries. While there is work to be done to improve domestic education and training, attracting the best from abroad will continue to be part of the solution going forward. Many of the firms we interviewed stressed that attracting talent from Europe has been a key factor in determining their success; and that losing access to such talent might imperil their future competitiveness.

Alicia Navarro, Skimlinks – A data company specialising in marketing solutions for publishers, merchants and agencies, based in London
"The UK can compete with America because of the access to European talent. Skimlinks has 21 nationalities in an 80 person company – pooling talent from all over Europe."

Sarah Weir, Design Council – an independent national charity and the Government's advisor on design, based in London
"The Design sector needs EU labour not only because of the talent and diversity they bring to UK design but also to address a growing domestic skills gap. In the UK, our design workforce contributes over £70bn to our economy and design skills are becoming more and more important to future industries. However our education system has not kept pace: post 2014 design and technology is no longer part of the core curriculum and 50% of schools have dropped their courses. While 433,000 students studied design and technology in 2003, it's now down to 166,000. We are working to change this, but as we do, the need for EU designers in the UK and UK designers in Europe will not wain post Brexit, on the contrary it will grow."

In particular, firms emphasised the shortage of advanced technical skills. Indeed, our interviews confirmed the Parliament's Science and Technology Committee's recent findings that the UK is facing severe shortages in STEM[35] skills, often in key growth sectors.[36]

Izaak Watson and Adam Hooper, Martin's Rubber – a rubber manufacturer who specialise in the production and supply of elastomeric products, based in Southampton
"UK general manufacturing skills are not strong: we struggle to find UK trained and educated tool-making people, engineers, real world designers. Having 30% of our staff from the EU has been a game changer for the company over last 10-15 years. Access to motivated, keen, hardworking staff, when we were having real trouble finding UK nationals who actually wanted to turn up, has definitely allowed us to move the company forward."

Ali Athar, ITIM Limited – provides software, solutions, and services to retailers across Europe, based in London
"If we can't get EU labour – there might be wage inflation because of scarcity of skills – and obviously we're already seeing wage inflation due to higher import costs. This will be the biggest issue. There's a general technical skills shortage in the UK – graduates aren't doing technical degrees, we've got that problem anyway."

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[35] Science, Technology, Engineering and Mathematics

[36] House of Commons, *Closing the STEM skills gap*, Science and Technology Committee, 16 March 2017

Many of those interviewed highlighted the intrinsic value of diversity in their businesses and unique contributions of international talent.

> **Julia Amour, Festivals Edinburgh – an organisation focused on developing the Edinburgh Festivals, based in Edinburgh**
> "We have performers from 70 countries, if our product becomes less international, then our reputation and attractiveness to audiences suffers."

> **Lorenz Fischer, Sentient Machines – provides machine learning products to turn analysis of natural language interactions into data-driven business decisions, based in London**
> "Being able to attract international talent is very important, and that includes having Erasmus students who would then consider the UK for PhD study."

Businesses in sectors reliant on low skilled labour, including hospitality, removals, and food and drink, expressed concern about ongoing access to lower skilled labour from within the EU. In these sectors recruiting domestically is challenging, not just because of a lack of relevant skills, but also due to a perceived lack of interest by British workers.

> **Peter Till, Choice Hotels – UK division of an international hotels group, based in London**
> "British people, especially in London have always relied on immigrants to do hospitality jobs. Some are low skilled jobs that aren't valued in UK culture (such as waiters, housekeepers etc.). Even before the UK entered the EU, waiters at leading London restaurants were always French, Italian, Spanish or Asian. There has always been culturally a lack of interest by the part of British people to work in the service industry. The industry has been portrayed as a low skilled one, with low pay, bad working conditions with little opportunities for advancement – this is no longer the case."

> **John Guthrie, British Hospitality Association – the leading trade association for the hospitality industry, based in London**
> "The hospitality industry is dependent on freedom of movement – 96% of the EU nationals working in hospitality would not be able to gain entry into the UK under the existing non-EU nationals system as they wouldn't meet current immigration salary threshold of £30,000. The industry would need to recruit an additional 60,000 workers per year if it could no longer hire from the EU. In addition, the sector would face difficulties as there is a mismatch between the geographical location of vacancies (London) and the domestic labour pool (North East England)."

> **Ian Studd, British Association of Removers – the largest association in the UK moving industry, based in Watford**
> "At the minute we estimate that the industry is short of 45,000 drivers. This situation will only worsen if the UK leaves the EU. The average driver age is 50, which means that as the current drivers age out of the industry the UK will rely

more and more on migrant drivers. Once you remove the rights of residence of EU drivers, UK transportation firms will face a real problem finding workers."

Ian Wright CBE, Food and Drink Federation – A trade organisation that represents the UK's food and drink sector, based in London
"One third of the food and drink workforce is European – the industry is churning people out at 25-30,000 per year – lots are leaving and so we need workers. Also, almost every vet in a supervisory role with the Food Standards Agency is Spanish or Romanian: we don't produce enough vets to fill all the jobs in the UK; and anyway all British vets want to do small animal work, rather than supervision in the food sector."

Some companies recruit locally and are therefore less reliant on staff from the EU. However, they are concerned that when other businesses that do rely on staff from the EU begin looking for employees closer to home that this might have a knock-on effect.

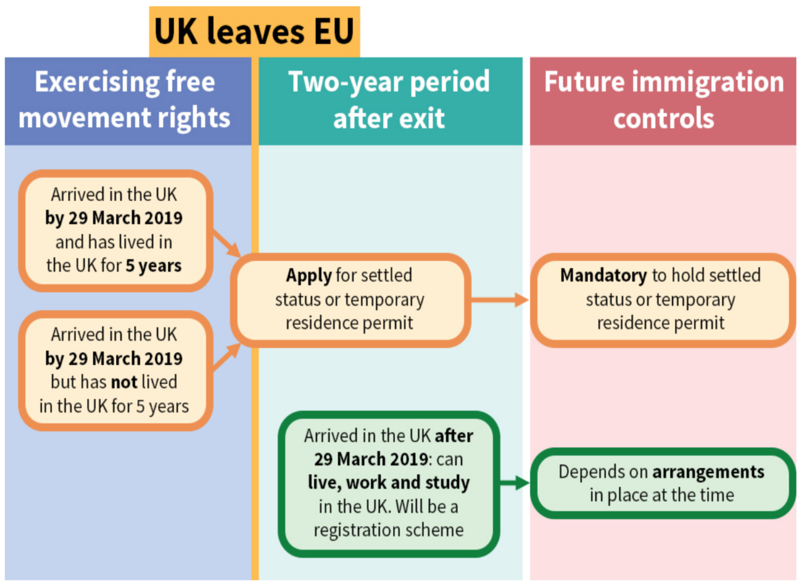
Herwig Vennekens, Haribo – a German confectionery company with its UK headquarters in Pontefract, Castleford
"In the first instance we won't be affected because we won't have people leaving. We employ predominantly from the area local to our factories in the UK. But there will be a knock on effect we feel from other industries who have relied or are relying on agency staff from EU member states. They will have a need for UK labour, and there is a shortage of it. At this point, it will become an even more competitive recruitment market and we are going to be faced with a number of people being headhunted and offered new jobs, perhaps nearer to where they live or what have you. And then we will find ourselves in a similar position to those immediately affected."

Concerns about the post Brexit immigration system

In contrast to the first round of interviews, we found firms much more focused on the practicalities of what a new post-Brexit immigration system would look like. While accepting that, post-referendum, new restrictions on migration are inevitable, many were frustrated and concerned by the perceived slow pace of progress of the Government, both in clarifying the status of EU citizens in the UK, and in articulating how a new immigration system might work.

Since interviews for this paper began, the Government and EU appear to have reached a high level agreement on EU citizens' rights in the UK after Brexit, as outlined in Figure 7.[37]

Figure 7: Free Movement Rights after the UK leaves the EU



Source: Gov.uk

Despite this development, there remain numerous questions about the details and practicalities of the future immigration system and the Government's promised White Paper has been repeatedly postponed. As a result, there is still considerable uncertainty for the many UK businesses which employ, and plan to recruit, EU citizens. The firms we interviewed expressed frustration at the lack of detailed planning for, and information about, the post-Brexit immigration system, highlighting unanswered questions about pay thresholds, application processing timetables, skill requirements, etc.

> **John Guthrie, British Hospitality Association – the leading trade association for the hospitality industry, based in London**
> "The BHA has dim view of the planning for post-Brexit migration to date as the Migration Advisory Committee ("MAC") was only given commission by Home Secretary 13 months after Brexit … At the heart of what we are looking for is some form of work permit scheme where we have continued access to an EU workforce post transition. Year on year the number of work permits should decline, but we need time to promote the industry and hire more British workers."

[37] *The status of EU nationals in the UK: what you need to know,* UK Government, 11 January 2018

Jane Spiers, Aberdeen Performing Arts – a charity managing three performing venues, based in Aberdeen
"We are very concerned about government plans to set pay thresholds for working in the UK that may impact adversely our ability to recruit labour from the EU, as many creative employees in the creative and cultural industries are in lower paid jobs."

Neil Dickens, IC resources – a specialised technology recruitment provider, based in Richmond
"Our visa system for non-EU staff is already incredibly punitive when compared with the EU's bluecard scheme which supports high skilled workers coming into other parts of the EU. To get a new employee can cost a firm £15k, whereas to do the same in Berlin it costs nothing. The visa scheme creates a message that 'you have to pay for the honour of having an employee in the company."

Companies that are used to moving people quickly around European offices, or for foreign site or customer visits, shared concerns about how much more difficult this could become in a post-Brexit system. There remains a lack of clarity of whether these workers will need visas or whether travel will continue unimpeded. Interviewees suggested that any bureaucracy should be as light touch as possible. Some pointed to the ESTA system used by the US as a possible model to follow (although others regarded US visa rules as highly protectionist and burdensome).

For those multinational companies with a strong presence in the UK, an efficient and timely post-Brexit visa system would be of great importance.

Herwig Vennekens, Haribo – a German confectionery company with its UK headquarters in Pontefract, Castleford
"One point I think which is quite relevant is free travel within the EU or into the EU … I'm talking more about situations where you're not going to recruit somebody but you effectively have people that come over – when they currently work and live in the EU – to work on a project without them becoming an employee of us in the UK, for a single meeting, or up to a couple of weeks or months, in order to get certain projects up and running."

Katherine Bennett OBE, Airbus – a multinational corporation that designs, manufactures, and sells aeronautical products worldwide, with over 25 UK sites
"Sometimes people [Airbus staff] need to travel somewhere overnight, to a manufacturing line or whatever, to ensure the product is ready for the customer the following day. It would be difficult to then have to deal with visas in an already time-pressed situation. It is better for people to be able to move quickly."

A new visa system would also need to ensure that industries with traditionally lower pay, such as the creative sector, would not be negatively impacted by salary threshold requirements.

> **Julia Amour, Festivals Edinburgh – an organisation focused on developing the Edinburgh Festivals, based in Edinburgh**
> “We are worried by visas that equate salary with professional worth – average salaries are not high in the creative industries and government quotas would probably be too slow to react to changes in demand for artists.”

Across many different types of business, we heard worries about added bureaucracy and costs to employ EU citizens.

> **Eliot Forster, MedCity - a public-private collaboration supporting the life-sciences cluster, based in the Golden Triangle**
> “Bringing in talent at this level should be fine, shouldn’t it? No-one is looking to keep out exceptionally skilled PhD level people. But the question is how much bureaucracy and uncertainty is added. We need to move people in and out, transferring and sharing skills. How easy will that be?”

Some companies are already taking steps to build greater resilience in their workforce planning by identifying new sources of talent in the UK and outside the EU. However, they have found such planning has proved difficult given the lack of available detail regarding future immigration policy.

> **Peter Till, Choice Hotels – UK division of an international hotels group, based in London**
> To prepare for a potential reduction in EU labour, we are taking several steps: First, we are exploring how to bring labour in from new markets. This might be the US, Mexico or the Philippines. But it will not be as easy to bring these people in as it is to bring in people from Poland now. Second, we are setting up training hotels to get British people more interested in the industry. There are roadshows to get careers officers to think about the hotels industry. We have to become better at pushing the positive aspects of the hospitality industry – when you become good at this job you can do it anywhere in the world.”

Anxiety regarding the uncertainty surrounding future immigration policy

Many businesses expressed frustration with the level of uncertainty about future immigration policy, with some claiming this had a direct impact on investment decisions. The Government has provided limited guidance to date, apart from the report leaked to the Guardian in September 2017[38] which was subsequently retracted. Indeed, it has been reported that the Government will delay its immigration white paper, originally scheduled to be published last summer, until the transition deal is done.[39]The Home Affairs Select Committee has highlighted that this delay means the Government is unlikely to have an immigration system ready for when the UK leaves the EU in March 2019[40]. Firms pointed out that uncertainties about their post-Brexit immigration status were already creating anxieties for their EU employees.

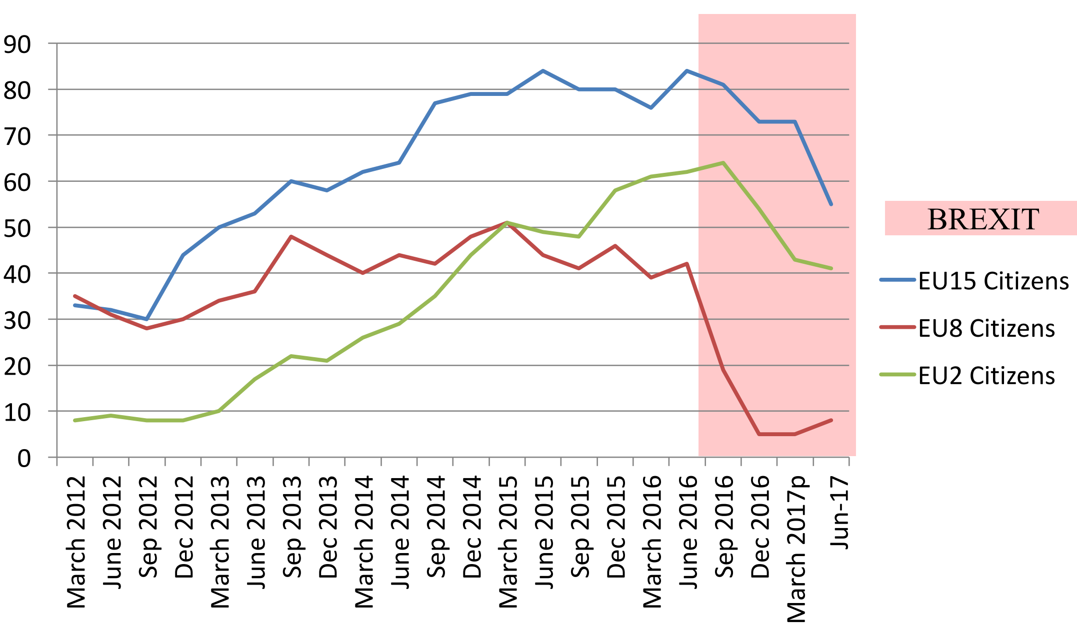
> **Eliot Forster, MedCity - a public-private collaboration supporting the life-sciences cluster, based in the Golden Triangle**
> "29% of our employees are from other EU countries, the majority with PhDs. When they make decisions about where to work, it's not just about the money, but the schools, how easy it is take a holiday back home, about the quality of life, about building a home for the long term – Brexit raises questions about all of these factors."

[38] Nick Hopkins, *Leaked document reveals UK plan to deter EU immigrants,* The Guardian, 5 September 2017
[39] Alan Travis, *Brexit immigration paper delay criticized by UK businesses*, The Guardian, 5 February 2018
[40] House of Commons, *Home office delivery of Brexit:* Immigration, Home Affairs Select Committee, 7 February 2018

Recruitment and retention already becoming more challenging

Many of the firms we spoke to cited instances where the prospect of Brexit was already having an impact of their ability to recruit and retain talent from the EU. Figure 8 demonstrates that this is more than an anecdotal perception: net migration rates from the EU have fallen sharply since the referendum. In our interviews we heard many anecdotes of European workers leaving since the referendum, and of new European hires being more difficult to attract.

Figure 8 - EU Net Migration by EU Citizenship



Source: Migration Statistics Quarterly Report: November 2017

Neil Dickens, IC resources – a specialised technology recruitment provider, based in Richmond
"After Brexit we witnessed five analogue integrated circuit designers, with an average salary of £50-60k, choose to take jobs outside the UK. This was a huge surprise given that the UK has always been in a leading position for integrated circuit design, and previously 80% of the employees would have moved to London."

Stan Boland, Five AI – an autonomous vehicle company, based in Cambridge
"Every interview with a potential hire from the EU is about Brexit."

John Dyer, Chrysalis Records – independent record label, based in London

"If you've got a block over the water where there is freedom of movement, and people recognise that freedom of movement is available, then everyone has 'open for business' posters above the buildings. There is a feeling that we're not open for business."

Cosima Gretton, Mindstong – Previously a doctor, based in London
"A number of my surgical team, including senior emergency general surgeons and colorectal surgeons, left the UK to return to Europe. Mostly they went home to Greece."

Stephen McCall, InterContinental Hotels Group – UK division of an international hotels group, based in London
"Brexit has made some staff feel unwelcome who are now considering leaving."

Many of the business leaders we interviewed stressed the impact of Brexit on worker morale, both EU citizens themselves and those working closely with them, or linked by family.

Alicia Navarro, Skimlinks – A data company specialising in marketing solutions for publishers, merchants and agencies, based in London
"We've seen resignations at a faster rate than before due to the negative impact on morale**.** People say "I've come here and added to society – I've helped to enhance the UK's reputation."

Senior representative- a pharmaceutical business, based in Oxford
"We rely on the best people to execute our business plan and our ability to attract these people has definitely been affected by Brexit. People can see what is going to happen in the UK and don't want to come – they perceive a change in cultural attitudes. They see Brexit as a personal attack on them and so feel unwelcome and want to leave. Most of the best talent is not British and so if people don't want to come, we are in trouble."

In the seasonal and lower skilled labour markets, the devaluation of sterling is leading to fewer temporary workers and workers being recruited from different parts of Central and Eastern Europe. However, equally challenging is the uncertainty over the rights of incoming workers.

Ian Wright, Food and Drink Federation – a trade organisation that represents the UK's food and drink sector, based in London
"There are around 80,000 temporary or seasonal workers in the UK food and drink manufacturing industry. About half or one third stay to service demand over the festive period but this number has been hugely difficult to reach this year. The currency devaluation requires employers to recruit from different parts of Europe – previously many came from cities in Romania and Bulgaria – now we see more from rural areas."

Importance of students and researchers

Businesses in the technology, scientific and creative sectors pointed to the importance of the inflow of EU students and researchers into UK universities. In areas like artificial intelligence or gene therapy, companies are often closely linked to the academic community and dependent on the universities for their pipeline of scarce talent drawn from all over the world. Several businesses in these sectors claimed they were already witnessing changes since the Brexit vote, while others fear that things could change quickly in the future.

> **Stan Boland, Five AI – an autonomous vehicle company, based in Cambridge**
> "Universities are feeling the chill already in attracting post-doc talent – and that's where we get our talent from. Just seems bonkers to discourage a top machine learning guy from coming to study at Oxford. The UK has three of the five best institutions for visual AI in Europe, but they'll only stay in the premier league if they can get the best talent."

> **Gregor Hofer, Speech Graphics – delivers pioneering facial animation technology to the entertainment industry, based in Edinburgh**
> "We get a lot of new recruits from university and they've seen a drop in applicants from the EU because of Brexit. Over the longer term there are going to be fewer EU nationals studying in the UK. There is going to be a shortage of skills because the UK does not have the skills in abundance that we need."

> **John Dyer, Chrysalis Records – independent record label, based in London**
> "Courses will shut as people stop coming from EU, just as these courses are becoming really good. We've had marvellous traction attracting Europeans who don't have equivalent music courses."

> **Saadi Hussain, SmartMed Global – Medtech company, based in London**
> "It's vital that in any post-Brexit immigration set up there is a large allocation for students. Medical students who come to the UK to study take back the knowledge to countries like Bangladesh, where we work, and facilitate international trade."

6. Funding and subsidies

Our initial findings

In our first round of interviews, businesses from a number of sectors highlighted potential concerns about the future of EU subsidies or funding. Businesses that currently depend on EU protection and subsidies, such as agriculture and fishing, expressed concerns about how the Government would replace the Common Agricultural Policy and the Common Fisheries Policy. Firms in deprived areas were worried about whether and how the Government will replace funds from the European Regional Development Fund ("ERDF") given its support for small and medium sized enterprises. Companies reliant on EU funding sources, such as Horizon 2020, Creative Europe and the European Investment Fund articulated concerns about potential funding shortages and the uncertainty about what would replace such schemes. However, during this initial round of interviews, these topics were usually raised as potential issues, rather than as specific concerns.

Our new findings

In our second round of interviews, we heard much more specific concerns about funding issues and a far greater sense of urgency about finding solutions. In some areas, the Government has made commitments about continuing current funding levels for a defined period, so firms' questions revolve about what happens afterwards. For example, the Government has committed to continuing agricultural subsidies on the current basis until at least 2022,[41] but what happens thereafter is unclear. Likewise, on the scientific front, the Government's commitment set out in the joint report on phase 1 negotiations to continuing to participate in Horizon 2020 until, at least 2020,[42] has been widely welcomed, but again there are uncertainties about what will happen in the longer term. In other areas, the Government has moved to launch new funds, for example £51 million for the Centre for Connected and Autonomous Vehicles,[43] or redirected existing mechanisms to fill the gap left by EU initiatives (eg using the British Business Bank to replace the European Investment Fund). Many of these steps have been welcomed by industry participants, but there is still an underlying uncertainty and some scepticism about their sustainability.

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[41]Rt Hon. Michael Gove, *Farming for the next generation,* Speech to the Oxford farming conference, 5 January 2018
[42] Negotiators of the UK and the EU*, Joint report on progress during phase 1 of the negotiations under article 50 TEU on the United Kingdom's orderly withdrawal from the European Union,* 8 December 2017
[43] UK Government press release*, Winners of £51 million government competition to develop world-leading self-driving car testing infrastructure unveiled,* 19 October 2017

Agriculture and Fishing Subsidies

The future of agricultural and fishing subsidies is potentially one of the most politically contentious topics arising from Brexit.

The EU's Common Agricultural Policy ("CAP"), which has always been controversial in Britain, constitutes around 40% of the EU budget and payments made to farmers under CAP comprise around 50-60% of farm income in the UK.[44] A sharp reduction in subsidy support would have a huge impact on the sector, with profound implications for the farming industry, as well as rural communities across the country. In addition, an FTA with the US (or even Australia or New Zealand) would likely entail a substantial opening up of British food markets to foreign competition through reduced tariffs, which would render many British farms economically unsustainable.

The eventual shape of the UK agricultural policy will have to reconcile four difficult and conflicting considerations. First, the Government commitment to maintain regulatory alignment in Ireland on matters affecting the Good Friday Agreement. It is difficult to see how this commitment would be compatible with any significant divergence in subsidy arrangements or hygiene and safety standards between the Republic of Ireland (and thus the EU) and Northern Ireland (and thus the UK), unless farms in Northern Ireland were allowed to operate on a significantly different basis than farms elsewhere in the UK. Second, any FTA negotiation with the US (and also Australia and New Zealand) will require the UK to make significant concessions on agricultural tariffs and (particularly with the US) food standards (eg on "chlorine washed chicken") a prospect that is likely to encounter significant public criticism. Moreover, it is hard to see how such concessions could be reconciled with the commitments made on Northern Ireland.

Third, the combination of the UK's own agricultural tariffs on food imports and subsidies to domestic producers must be designed to enable British farming to evolve to meet a number of policy objectives around food security, environmental protection and the preservation of rural communities. Finally, the future of the UK's agricultural exporters depend critically on whether the UK retains access to the Single Market or secures an FTA with the EU. Leaving the EU on a "Hard Brexit" basis would see British farmers facing extremely high tariffs on their exports to the EU.

> **James Walton, The Institute of Grocery Distribution – food and grocery supply chain organisation, based in Watford**
> "Government has said that their current intent is to fund farmers at the current rate – although what will happen afterwards is unclear. The food and farming policy which is in the works that might give us a bit more of a steer around government intentions – we'll expect a subsidy scheme. Clearly the design is going to be very important as whatever happens the shape of British farming will come to reflect the shape of the subsidy scheme and the generosity of the payments."

[44] Department for Environment, Food and Rural Affairs, *Total Income from Farming 2014 – 2nd estimate United Kingdom*, 26 November 2015

Nick von Westenholz, The National Farmers Union ("NFU") – the union for British farmers, based in London
"The proximity of the EU is key to the UK's agricultural export success, it's easy to send produce back and forth. If the UK were to increase the level of the trade with the US then British farmers would have to prepare to open up to US agricultural products – e.g. beef and cereals. This clearly poses a challenge for UK farmers, especially because they have different standards and lower production costs. Would the British public really be ok with the UK lowering its standards of production to compete with US producers?"

Mike McDonald, Serlby – a diversified holding company, based in Yorkshire
"We own an agribusiness company which is heavily reliant on EU subsidies. If farm subsidies are removed, land valuations will likely decline. That will directly impact balance sheet of the business, meaning less assets on which to borrow and obtain capital for growth"

On a much smaller scale, fishing raises almost equally contentious and challenging issues. Although most British fishermen voted for Brexit, the fishing industry is highly dependent on the EU in terms of subsidies, tariff protection and export markets: 66% of UK fish exports are sold to EU markets.[45] Although many in the fishing industry believe that leaving the Common Fishing Policy would give British fishermen larger quotas, it is difficult to see why the EU would agree to this whilst maintaining tariff free access to EU markets.

Paul Trudigan, Fish for Thought – a seafood business, based in Cornwall
"The industry believes we will get control of our waters back and gain all the benefits without the downsides. Some things not considered by the fishing industry are already having a negative impact, such as the depreciation of the pound leading to increased fuel costs."

Regional Development

Businesses of all kinds operating in the poorer parts of the UK, including Wales and Cornwall, benefit from a range of regional development subsidies focused on four key areas: innovation and research, the digital agenda, support for small and medium-sized enterprises, and the low-carbon economy. Firms we interviewed from such regions expressed considerable concern about the future of such funding.

Penny Goodwin, Wastesavers – a charitable trust with a trading arm, Wastesavers Ltd. Which delivers curbside recycling pick up, based in Newport
"We receive a lot of EU funding and don't believe UK government will replace it. I am worried about the amount of funding that will just disappear overnight and that will affect jobs and the ability for us to run our services. Without EU funding, I would lose my training department completely, so that would be four people out of work there."

[45] *Written evidence FBR001,* DEFRA, 5 September 2016

Paul Trudigan, Fish for Thought – a seafood business, based in Cornwall
"EU funding is really important for Cornwall. People forget where that money comes from. During the referendum people believed that the government would spend the money they fund on the EU directly on Cornwall. They assumed EU funds could be replaced by UK government funds."

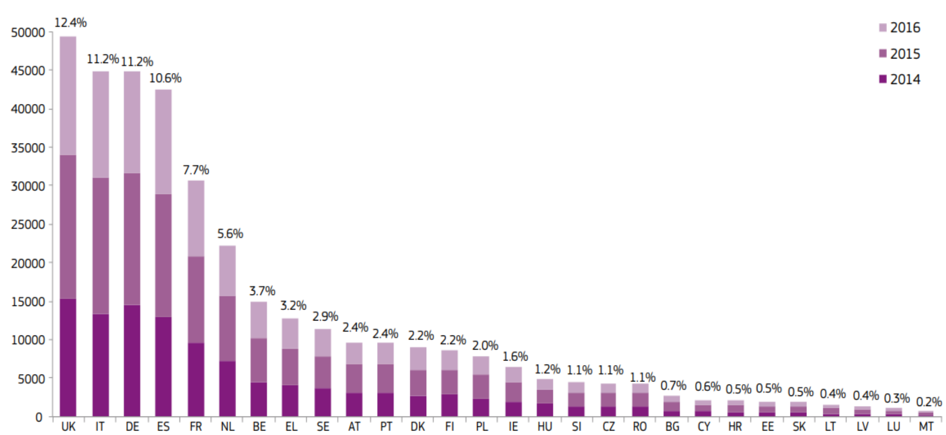
Peter Moody, St Austell Printing – a printing company, based in St Austell
"We directly benefited from EU subsidies by hiring consultants with EU money, and obtaining EU funding to build our factory (20% towards full cost)"

David Spinks, Ladbrook Manufacturing – a metal engineering business, based in North Walsham
"EU funding helped us upgrade our transport when we bought two lorries. We also got £10,000 for a new machine. We know we are paying a membership fee for Europe, but we are getting our money's worth."

Science & Technology Funding

The UK has a proven track record of being able to attract a disproportionate share of EU funding for scientific and technological research. Much of this funding originates from the EU Framework Programmes for Research and Innovation (Horizon 2020), the European Structural and Investment Funds ("ESIF"), and from the European Investment Bank ("EIB"). Figure 9 demonstrates that the UK submits more applications for Horizon 2020 funding than any other country.

Figure 9 - Number of Horizon 2020 applications per EU Member State and share of overall Horizon 2020 applications.



Source: EC Europa – Horizon 2020 Statistics

Total funding from EU research programmes amounted to €8.8 billion during FP7, the last round of research financing.[46] This funding plays an important role across a range of academic settings, industrial sectors, and organisation types, supporting research and development at every stage of the innovation pipeline. EU funding also has a significant leverage effect, crowding in other sources of private funds, such as contributions from programme participants.[47] Firms suggested that if Brexit meant that if the UK would no longer participate in pan-European funding programmes, benefit from EU funding arrangements and influence EU programming priorities, there would be a significant impact on their ability to innovate.

> **Colin Riordan, University of Cardiff – university, based in Cardiff**
> "The main issue is that there needs to be some form of transition deal otherwise we're going to fall straight out of Horizon 2020 and Erasmus. We've got students now who are planning their Erasmus term abroad in 2019/2020 – they're picking that destination. We don't know what to tell them about whether they can still participate in the programme. Furthermore, the UK will lose the opportunity to influence negotiations around the direction of the FP9 (the next Horizon 2020) where there are areas of considerable divergence in the interests of Western European and Accession countries."

> **Gregor Hofer, Speech Graphics – delivers pioneering facial animation technology to the entertainment industry, based in Edinburgh**
> "We have university collaborations with University of Edinburgh and also with Heriot-Watt and a lot of their funding comes from the EU so that's something that in general is going to hurt on a lot of different levels."

Many of those we spoke to in the creative sector expressed concern about the future of funding for collaborative initiatives.

> **Jane Spiers, Chief Executive Aberdeen Performing Arts – A charity managing 3 performing venues, based in Aberdeen**
> "Creative Europe funds cross border work with European venues and festivals giving access to talent and artists for cultural exchange. We need reassurance that we can continue to work quickly when we put teams together and we need to have quick and easy access to EU labour and minimal administrative bureaucracy."

[46] *The role of the EU in UK research funding,* The Royal Society, December 2015
[47] *The role of the EU in UK research funding,* The Royal Society, December 2015

Many businesses in the technology and venture capital arenas expressed concern about the loss of funding from the EIB. However, they acknowledged the steps the Government had taken to mitigate these concerns, notably by repositioning the British Business Bank to fill at least part of the gap.

Alicia Navarro, Skimlinks – A data company specialising in marketing solutions for publishers, merchants and agencies, based in London
"It will ruin the start-up community if we cannot access foreign funding – I'm happy to go to Lisbon or Berlin where they're doing a lot to try and entice start-ups."

7. Transition Issues and Implementation Priorities

Our initial findings

Throughout the first round of interviews, the businesses we spoke to emphasised that effective implementation will be as important as the policy outcomes. They focused on two aspects of implementation: first, execution of the transition to minimise disruption and potential "cliff-edge" effects; and second, the effectiveness and efficiency of new policies and processes, such as customs procedures, immigration rules and sector specific regulation. Many businesses were also sceptical that these matters would be resolved by 29 March 2019, particularly as companies will need time to adapt once the policy outcomes are known.

Our new findings

In our second round of interviews, the companies we spoke to put much greater emphasis on transition issues and implementation priorities, raising more specific issues, and asking much more pointed questions. While the vast majority of the firms we interviewed welcomed the Government's recognition that a transition period will be necessary, many are now urgently looking for detail on how such transitional arrangements will work. Will it be a continuation of the status quo, or some intermediate step between full EU membership and the ultimate end-state? Several companies highlighted that in the first half of 2018, they will have to begin making business decisions and plans for 2019 and 2020, so an understanding of what will happen after March 2019 is of critical and immediate importance. Many stressed that Brexit-related uncertainties are already having a damaging impact on their businesses.

In this light, businesses generally welcomed the fact that the Brexit negotiations could now move beyond the first phase of the negotiations and hoped to receive more detailed information about the transition arrangements as negotiations enter the second phase in early 2018. In preparation for this next level of discussion, the European Commission released its recommended draft negotiating directives in December 2017. These are quite clear:

> "There should be no "cherry picking": The United Kingdom will continue to participate in the Customs Union and the Single Market (with all four freedoms). … All existing Union regulatory, budgetary, supervisory, judiciary and enforcement instruments and structures will apply, including the competence of the Court of Justice of the European Union. The United Kingdom will be a third country as of 30 March 2019. As a result, it will no longer be represented in Union institutions, agencies, bodies and offices. The transition period needs to be clearly defined and precisely limited in time. The Commission recommends that it should not last beyond 31 December 2020."

The Government has suggested a not dissimilar approach, although Theresa May, in her Florence speech, suggested a somewhat longer timeframe, saying that "considerations point to an implementation period of around two years".[48]

However, the debate since the beginning of 2018 has raised numerous questions about the practical and political feasibility of this approach to the transition period. There are two fundamental problems.

First, leaving the EU on 29 March 2019 would mean the UK immediately fell out of over 700 separate agreements with third-party countries, including the FTAs with Korea, Canada and Mexico.[49] So even though the UK and EU could agree continuation of the status quo arrangements for the subsequent two years, including membership of the Single Market and Customs Union, this would not be automatically recognised by third parties. Negotiating bilateral arrangements to get around this problem is not feasible in the time frame, since there are far too many agreements and third-party countries are unlikely to want or be able to commit scarce negotiating capacity and legislative time to arrangements which will in any case be temporary. Having the UK remain a member of the Single Market and Customs Union, but with other countries unable to treat UK companies on that basis, could create considerable complexity, even for trade within the EU. For example, German exporters to Canada may have to strip UK components out of their rules of origin calculations, since this will be assessed on the basis of production with EU member states.

Second, the EU has made it clear that during the transition period, the UK will be bound by freedom of movement of people and will be subject to ECJ jurisdiction. This has led both Brexit proponents such as Jacob Rees-Mogg and opponents such as Nick Clegg to describe the arrangement as turning the UK into a "vassal state". The Government appears to be arguing for a veto on EU decisions of particular importance to the UK, and it may be that some clause along these lines can be negotiated, but it is hard to escape the conclusion that Britain will be in an unambiguously weaker position during the transition period than as a full member of the EU: still paying into the budget; still subject to ECJ jurisdiction; and still adhering to all EU regulations and law; but unable to be involved in administering regulations, shaping their evolution, or protecting specifically British interests in trade negotiations, unless as conceded by other EU members.

For British businesses trading with countries outside the EU, the third-country problem could end up proving extremely difficult. But so far, many businesses have yet to grapple with the issue, and the Government appears to have focused on it only recently. For example, in early February the Government issued a "technical note" suggesting that during the transition phase, third countries should "interpret relevant terms in the international agreements, such as "European Union" or EU

[48] Theresa May, *PM's Florence Speech: A New Era of Cooperation and Partnership between the EU and UK*, 22 September 2017
[49] Financial Times, *After Brexit: The UK Will Need to Renegotiate at Least 759 Treaties*, 30 May 2017

member state" to include the UK".[50] However, third-countries may themselves face legal barriers to agreeing to this proposal, even if they want to (which some may not).

By contrast, the problem of the UK becoming a "rule-taker" during the transition period has already roused the anger of many politicians.[51] Yet both seem inescapable consequences of taking this approach to the transition.

One possible alternative to this approach would be to extend the Article 50 process. Under this approach, the UK would not leave the EU until the end of the transition period. Third party arrangements would automatically stay in place, and the UK would maintain its position in EU regulatory agencies and decision-making forums. However, this alternative approach also has issues.

First, other EU members may object to the EU's continued involvement in decision-making when it is clear that the UK is leaving. There would need to be agreement on what kinds of decision it was appropriate for the UK to engage on. Second, any delay in departing the EU will be fiercely resisted by Brexiteers, who will worry that this might be the first step towards reversing the referendum decision. Many pro-Brexit leaders would appear to prefer no transition period, rather than a transition that involved deferring the UK's formal departure from the EU, regardless of the consequent economic impact.

However, from a business perspective, such an approach would seem more appealing than the Government's current proposition, not least because it would involve making one set of changes (at the end of the transition), rather than two (at the beginning and the end of the transition).

In discussing the path to the Brexit end-state in our interviews, business leaders emphasised the case for a transition period, and the need for clarity on how the transition would work.They also stressed the damaging effects of uncertainty and the growing psychological and cultural impact of Brexit. Many firms told us that Brexit was already causing damage to their business.

The case for a transition period

Virtually all the firms we spoke to emphasised the need for a carefully managed transition, avoiding potential "cliff-edges", to give firms sufficient time to adjust to the complex legal and trading issues that must be resolved. Many companies were quite specific about what they wanted to see from a transition deal.

> **Toby Poston, British Vehicle Rental and Leasing Association – the leading trade association for the vehicle rental and leasing sector, based in Amersham**
> "We need: no cliff edges, rubber-stamp most existing EU regulation, smooth customs regulations, little or no tariffs, freedom to hire foreign workers."

[50] Jim Brunsden, *UK to pretend Brexit does not mean Brexit to avoid legal chaos*, Financial Times, 10 February 2018
[51] Jacob Rees-Mogg, Brexit Select Committee, 24 January 2018; Nick Clegg, *On Brexit, Jacob Rees-Mogg is right: Britain risks vassal status*, Financial Times, January 27 2018

Sue Davies, Which? – the largest consumer body in the UK, based in London
"Important that it's as smooth as possible in terms of people being guaranteed the same level of protection and no shocks in terms of price increases."

Stephen Page , Faber and Faber – an independent publishing house, based in London
"The most important thing is maintaining consumer confidence. Britain cannot afford to go through a period of being cut adrift, so a clear, serious, sensible, patient transition would be important to us. If there is a drop in high street spending, that'll cause major problems for us, so the idea of walking away without a deal is alarming."

Some companies outlined the range of severe consequences that could result from uncertainty resulting from a poorly-managed transition deal.

Ian Wright CBE, Food and Drink Federation – a trade organisation that represents the UK's food and drink sector, based in London
"Transition is more important than the destination. Hope is not a policy! We are concerned that a poorly managed transition or no deal might cause a run on food. We can imagine a situation where families begin stockpiling, in anticipation of rising food prices and constraints on availability."

Saadi Hussain, SmartMed Global – Medtech company, based in London
"SMEs are in no position to make plans in 2 years, they'll be swept up by the whirlwind. For example, I'd need at least two years to choose an office in London or Frankfurt, otherwise I'll fail. If you can't adapt you'll be gone."

Colin Davis, FliteTec – Aircraft interiors, based in Amersham
"The majority of businesses having to adapt to changes are SMEs – a lot of lip service is paid to us, but little is done for us, we'll have to adapt whatever happens."

Other companies were not as specific about which measures they wanted to see implemented, or maintained, in the transition period, but they were explicit that businesses needed more clarity and less ambiguity. Many felt that, as they were given enough notice about the framework they would be operating within after March 2019, they could find ways to adapt.

Izaak Watson and Adam Hooper, Martin's Rubber – a rubber manufacturer who specialise in the production and supply of elastomeric products, based in Southampton
"We would like to know what we're doing and that there is no ambiguity. If there's a cliff edge and automotive industry packs up and leaves UK that would massively affect us. What that will look like is anyone's guess."

James Walton, The Institute of Grocery Distribution – food and grocery supply chain organisation, based in Watford

“The transition arrangements need to have clarity – we don’t want to extend uncertainty.”

Tim Hames, BVCA – the industry body and public policy advocate for private equity and venture capital industry in the UK, based in London
"The industry would prefer a transition rather than a hard swap. Particularly for those venture capital funds for whom the European Investment Fund is a fairly natural partner. This would smooth the path, leading to a much easier transition."

The mechanics of the transition period

The vast majority of the businesses we interviewed welcomed the idea of a transition period to ensure readiness in several areas including maintaining supply chain continuity, adjusting to new legislation, mitigating the impact of shock events and protecting business viability. However, the ability to achieve this depends for businesses on understanding exactly what a 'transition period' actually means. Would it be an extension of the Article 50 period, so everything remains as it is now? Or would it be some intermediate status en route to the ultimate end-state – in which case businesses need to know what will remain the same and what will be different?

The majority of businesses we spoke to were in favour of a longer transition period to give the UK authorities time to adjust the immigrations, customs and other infrastructure to prepare for a post-Brexit relationship with the EU. Businesses also emphasised the need for clarity around the transition period, especially as many start planning for the next business cycle.

Stephen McCall, InterContinental Hotels Group – UK division of an international hotels group, based in London
"We would favour a long transition and adjustment period. It's impossible for a one off Brexit deal to deal with everything."

Herwig Vennekens, Haribo – a German confectionery company with its UK headquarters in Pontefract, Castleford
"Like many businesses, we support an implementation period at the point of Brexit, for at least 2 years, and would welcome clarity on what this will look like so that we can reflect this in our planning."

John Thorpe, Millennia Computer Services – cloud-enabled hosting provider and platform, based in Yorkshire
"Having a transition period/arrangement is important. I'm keen on the EEA/EFTA model. Could we stay like that for a while? EFTA is out of EU – people should be happy with that."

Some businesses highlighted the risk of creating a transition which may be effective at stalling Britain from reaching the 'cliff edge' but risks creating torturously complex legal and policy positions in the interim.

Alistair Fitt, Oxford Brookes – university, based in Oxford
"It depends on how they do the transition – there's a whole load of decisions to be made, and there's a possibility that says these arrangements will be different before and after the transition and the bureaucracy will never catch up."

A few of the firms we interviewed, those that were more in favour of Brexit, emphasised the importance of putting a time limit on any transition period.

> **Simon Boyd, Reid Steel – a steel construction company, based in Christchurch**
> "Transitional arrangements must be time limited because business needs certainty – but if we didn't have any transitional period we'd manage just fine on the WTO rules."

> **Mark Pursey, BTP Advisers – an international PR and communications agency, based in London**
> **"**It's important we don't have a long transition. The longer we hang around and say we're out but are actually half in, and can't crack on and do bilateral trade deals, the longer the purpose of this whole thing takes to come to fruition."

However, too short a time limit may be insufficient in the event that Brexit requires significant changes for the UK's business sector.

> **Saadi Hussain, SmartMed Global – Medtech company, based in London**
> "The length of time of the transition is important, SMEs are in no position to make plans in two years. They'll be swept up by the whirlwind. If I find out that I need office space, I will need a minimum of two years to get myself an office in London or Frankfurt – otherwise I'll fail."

> **Tony Walker, Toyota Motor Europe – manufactures and sells Toyota and Lexus vehicles, parts, and accessories. Toyota has two UK manufacturing operations in the UK based in Deeside and Burnaston**
> "Like many sectors, we believe a transition period is essential and this needs to be based on the same conditions as current – and with no time limit [meaning until a final deal can be agreed and implemented]. Without that we can't get the security and clarity to make future investment decisions … We were very pleased, as was all of industry, that phase 1 was finished and very pleased that we're on to phase 2 … We're now talking about what practical arrangements need to be put in place. But we still require this to be on the same terms as current because if not we will have two changes, and it's very costly and difficult for us to change."

The damaging effects of uncertainty

In discussing the path to the Brexit end-state, firms of all types emphasised the damaging effect of uncertainty on their businesses. Some businesses indicate that they have seen reduced demand resulting from falling consumer confidence relating to uncertainty around future economic prospects.

Herwig Vennekens, Haribo – a German confectionery company with its UK headquarters in Pontefract, Castleford
"A transition arrangement buys time and preserves the status quo, which is perhaps what is necessary in the short term to minimise disruption as much as possible on supply chains, employees and consumer confidence. However, as helpful as this for a short period, it has limited value – ultimately there will be change and we need to know what that looks like."

Kim Soep, Broth Art – an art consultancy, based in West Scotland
"People who have the disposable income to buy art are the types of people who monitor the property market leading to falls in demand during periods of economic turbulence. I sold at the same art fair three years running: first year broke even, second year made a 10% profit, third year on the day before the Brexit vote made an 80% loss as the event was so poorly attended. And it's been harder to pick up new clients since the vote."

Kim Conchie, CEO of Cornish Chamber of Commerce – chamber of commerce for Cornwall, based in Redruth
"Uncertainty is what will ruin the UK economy more than anything. We are getting no clarity from politicians. We are going to talk ourselves into a recession if we aren't careful. The Brexit process will take years. It is rumbling on and is a pain for business."

Uncertainty undermines business confidence leading to delays in decision-making, and significant opportunity costs for companies that are unwilling to make significant capital investments. Several companies highlighted that uncertainty was already stopping them from planning for the future.

Ian Studd, British Association of Removers – the largest association in the UK moving industry, based in Watford
"It is hard to plan for the future without certainty. Once we have a degree of clarity around what Brexit looks like in terms of freedom of movement and customs union then at least our businesses can plan for the future. At the minute we're kind of sitting there- you're reflecting on what's happening all the time without being able to move."

Tim Jarvis, CEO, See That – a video content production company, based in Hove
"Quite clearly, the biggest concern for us, and something we're already feeling, is the uncertainty in the market. I'm worried about the wider shocks. Lots of SMEs serve bigger companies. They are worried about investing. So they are trying to sit tight and wait to see what happens."

> **Johnnie Ball – representing a fintech company providing automated cash flow analysis and forecast generation using machine learning, based in London**
> "The uncertainty around investing in the UK might put off US investment. Venture capital funding isn't drying up but startups are nervous. Right now funding is stable as the pound has plummeted – making investing in UK companies a bargain for US venture capital funds – but who knows if this will last."

> **Tom Shutes, Wakefield Ltd – Property Developers, based in London**
> "The most damaging thing for business is instability. The election result was the worst outcome as it leads to more uncertainty. The interim arrangement means more uncertainty for even longer."

Brexit is causing difficulty for some businesses that need to take longer-term decisions, particularly for those multinational organisations that are headquartered outside of the UK. The effect on decisions are likely to begin to show in 2018 when the business planning for 2019 and beyond begins.

> **Herwig Vennekens, Haribo – a German confectionery company with its UK headquarters in Pontefract, Castleford**
> "With the new business planning cycle coming into play, we have to start coming up with some idea of what we believe the reality in 2019 will look like and we might not get it right, but we will certainly have to put something into our plan in terms of an assumption…We hope that there will be as little disruption as possible, but we are a flexible business and we will develop 'plan b' if we need to."

> **Eliot Forster, MedCity - a public-private collaboration supporting the life-sciences cluster, based in the Golden Triangle**
> "I expect a big psychological shift in January 2018. Firms have already done their budgets for 2018. As soon as the year begins they'll be looking out to 2019 – and that's when Brexit happens. So they'll start making decisions. And the less they know about what's going to happen, the more they'll be preparing for the worst."

The psychological and cultural impact of Brexit

Several of the companies we spoke to were already noticing the impact of Brexit on their staff and office morale. In some sectors, such as technology and academia, where cross-cultural and cross-border collaboration is very common and often an important aspect of the sector, the uncertainty around future immigration rules and the UK's wider participation in the EU – logistically, legally and culturally – are having a negative effect.

> **Katherine Bennett OBE, Airbus – a multinational corporation that designs, manufactures, and sells aeronautical products worldwide, with over 25 UK sites**
> "[the main issue is the impact on] the mindset of the head office in Tolouse, France."

Colin Riordan, University of Cardiff – university, based in Cardiff
"People are agitated, worried and nervous. It has calmed down over the last few months, since we put lots of support in place, since the government has become much clearer about arrangements. What matters in what happens in the future – what we'll be asking of students. If we want to recruit someone from Germany and it's more complicated and is off-putting that could really affect people more generally as reduce the global appeal of the university."

Particularly concerning to some business leaders was the perception that Britain is turning its back on the world and sliding towards isolationism. For businesses and sectors relying on international cooperation and an outward perspective, this was especially troubling.

Tim Jarvis, See That – a video content production company, based in Hove
"We have already seen reduced numbers of applicants for high-skilled jobs in the UK resulting from the perception by international talent that Britain is now 'in retreat' from the world."

Dr Andrew Kerr, Centre for Carbon Innovation – an accelerator for large-scale low carbon projects, based in Edinburgh
"There is a cultural perception that UK is cutting itself off from the world which is damaging to business. We are basically saying this is not such a fun place to be any more. That cultural element of Brexit has been downplayed during Brexit discussions to date."

Dr. Tony Doyle, Varilight – Manufacturer of switches, sockets and domestic electronics – Based in West Sussex
"Clients in other countries already seem to be treating us more distantly as a result of Brexit. We have had a German client for three years, last year we began to introduce them to new products, and they seemed really keen, but now they've gone terribly quiet. Many continental clients think that Britain has turned its back on the European project. It's not just the possible question of tariffs across borders, and the customs union, it's the attitude, people don't 'like us' any more."

Bridget Shine, Independent Publishers Guild – a body providing advice and information for publishers, based in London
"At the moment Britain all seems very inward looking. It is about cultural identity and the message we send out to the rest of the world and I think that's a really important message"

Alicia Navarro, Skimlinks – A data company specialising in marketing solutions for publishers, merchants and agencies, based in London
"A more immediate impact which is one of morale – founders feel they've come here and added to society and enhanced the UK's reputation, but equally they're happy to go to Lisbon or Berlin – where they're doing a lot to try and entice starups."

Others mentioned negativity among staff and cynicism about the Government's ability to properly manage the future relationship with the EU. This was leading to pessimism about the future institutional framework businesses will operate under and a decline in businesses confidence.

Saadi Hussain, SmartMed Global – a Medtech company based in London
"Fear is that Brexit is such a looming shadow, on a culture that is already slightly cynical – one of the psychological effects is to increase negativity and pessimism. Business requires trust in a better future that many have lost."

Richard Osborne, Angel Eye Media – a TV, film and video production company, based in London
"I'm being asked to give up a good relationship with an organisation which supports our industry, and has supported it for many years and is consistent and doesn't change every five years, and I'm being asked to now trust whatever government gets in in the UK, and that's a disaster."

Some interviews mentioned how critical cultural diversity was to their business success, and expressed concerned that increased isolation from the EU would reduce this.

Will Atkinson, Atlantic Books – an independent British publishing house, based in London
"The cultural melting pot makes the reservoir of ideas just a bit richer. It's just a diversity thing. If everybody was white, 45, male and had been to Oxford, I'm sure you'd get good stuff, but you won't get everything. We're an English publishing house, publishing in English, based in London, but our publishing is probably better because we have a bit of European sensibility in the building. Any of the creative industries thrives on diversity so having different cultures and personalities in the building literally makes the place more creative, and for a creative industry to be creative is only a good thing."

Katherine Bennett OBE, Airbus – a multinational corporation that designs, manufactures, and sells aeronautical products worldwide, with over 25 UK sites
"We obviously want to make sure that all EU27 based workers can still come to the UK. We will continue to hire apprentices and graduates from the UK. But we will lose richness and diversity – such as the different languages being spoken in the canteen. We will lose opportunities for people from EU 27 to work here. They like coming here, either for a specific project or perhaps to improve their English. And vice versa. We send our people to work in EU and China … To get on in Airbus now, you need to have worked in another country, which will be made much harder if there isn't ease of movement."

More generally, Brexit was seen as damaging the UK's reputation as an open, tolerant country which is fundamental to the UK's role as a cultural, business and intellectual hub. Performing arts centres and publishing houses spoke about the importance of cultural exchanges to high quality output.

> **Richard Osborne, Angel Eye Media – a TV, film and video production company, based in London**
> "Many of my staff are married to EU people. It's just bad for morale having staff that might have to go away. I don't think people are actually going to get sent back, but it's a psychological impact, and is palpable. And I'm in a creative industry. If I made ball bearings you could probably be unhappy and make ball bearings, but if you're supposed to write comedy scripts… My industry relies on people's psychology, so don't underestimate people being depressed."

> **Jane Spiers, Aberdeen Performing Arts – a charity managing three performing venues, based in Aberdeen**
> "We fear Brexit will put barriers in the way of cross cultural exchange – there is lots of cross border collaboration and movement in the arts that is currently up in the air. Perhaps I am most worried about attitudinal shifts – Brexit may be perceived by other countries as the UK turning its back on the EU and the world. Artists may not feel they are entering a welcoming environment."

> **Stephen Page, Faber and Faber – an independent publishing house, based in London**
> "A lot of creative people are aghast. This feels like a step away from connectedness. Writers don't see themselves as British, writers write for readers wherever they are."

Brexit is already causing damage to British businesses

In the first round of interviews, most of the businesses we spoke to had yet to feel much direct impact from Brexit. However, in this round, many firms spoke of the impact Brexit was already happening. Some highlighted the opportunity cost of so much effort being devoted to Brexit in their own companies or by the Government. Some talked about the impact of regulatory uncertainties. Many referred to the impact on their ability to recruit and retain staff and some find an adverse impact on decision making.

Companies are now beginning to price in regulatory risk or are paying for advisory services to help navigate uncertainty, both which increase costs.

> **Per Lundin, Evox Therapeutics – a biotech business, based in Oxford**
> "Brexit is already having an impact on product development by adding in a regulatory risk in our product development plan."

Other firms are reporting a slowdown in demand and a decline in applications from jobseekers. This reflects drops in consumer confidence in certain markets such as property, where house price declines are reducing construction demand. In the labour market the decline in applicants appears driven by the impact of Brexit on the desirability of the UK as a place to work and create businesses, plus the decline in sterling.

Neil Cooper, MLM Group – one of the largest privately owned engineering, environmental and building control consultancies in the UK, based across Britain
"MLM lost one big contract weeks after Brexit as a result of lower confidence in the property market, and we witnessed the impact of Brexit across a number of our markets through a slowdown of projects."

Neil Dickens, IC resources – a specialised technology recruitment provider, based in Richmond
"We've seen a 75% drop in EEA applicants coming into the deep tech sector. EEA entrepreneurs have moved away from the UK because of Brexit – a combination of the emotional impact and the drying up of skills. They now see Europe, rather than Britain, as their playground."

Some businesses also reported the impact of the depreciation of the pound. While the decline in sterling has made some UK exporters more competitive, depreciation was also increasing the costs of imported components. Companies are seeking to get their suppliers to absorb the incremental costs, or alternatively, are trying to pass them on to their customers through increased prices. Moreover, some businesses claimed that sterling's depreciation had made it even harder to attract top foreign talent in globally competitive sectors such as biotech, as they are unable to compete with the compensation packages on offer in the US.

Roger Soep, Q5 solutions – a office equipment supplier, based in Argyll
"Businesses that I deal with are holding back from investing in new machinery because they don't know what's going to happen. One company that we supply in Glasgow – a hi-tech outfitters that build satellites – have seen their turnover increase due to the fall in the pound but net profit has stayed the same as they need to import components from Europe."

Christopher Nieper, David Nieper – a clothes manufacturer and online/mail order retailer, based in Derbyshire
"The big opportunity of having a weak pound is that it makes British products more competitive overseas. David Nieper buy fabrics from EU, in euros, which we bring to UK – we sew them then export them back to customer in Germany. As pound gets weaker, sales are Europe are worth more but fabrics cost more."

Katherine Bennett OBE, Airbus – a multinational corporation that designs, manufactures, and sells aeronautical products worldwide, with over 25 UK sites
"We are saying to our suppliers that we do not expect prices to go up. We expect them to absorb any additional cost of Brexit as aerospace is a very competitive market."

A biotech investor, based in Oxford
"People from Northern Europe don't want to move to the UK because the sterling is getting weaker. People don't want to move from the US to the UK because salaries in the UK are much smaller. Our options are to hire lower quality people from the UK, or move parts of the company away from the UK to the US."

Neil Cooper, MLM Group – privately owned engineering, environmental and building control consultancies in the UK, based across Britain
"If the UK leaves, the cost of doing business will rise, with falls in Sterling relative to other currencies, raising the cost of materials, good and services."

Many of the companies we interviewed are struggling to understand the potential implications of Brexit for their businesses. Smaller companies cannot afford to devote much resource to planning for different scenarios, so many take a pragmatic approach – focusing on running their business well, while being prepared to adapt to whatever outcome eventuates.

Julia Amour, Festivals Edinburgh – an organisation focused on developing the Edinburgh Festivals, based in Edinburgh
"I don't think there has been enough focus on the difficulty for SME businesses of understanding what these issues are and what they look like. We don't know what we don't know. Because we had those raft of measures in place for our working lives, we are still finding out what the barriers are that will start being erected."

Tim Jarvis, See That – a video content production company, based in Hove
"We don't have the capacity to have a team of people working out the effects of Brexit – we're just riding the wave I guess, and seeing what happens, and having to react as it happens."

However, it would be wrong to conclude that British businesses are invariably gloomy about the future, whatever their concerns about Brexit. Many were adamant that they would be able to adapt and flourish, whatever happens.

Bruno Prior, Forever Fuels – a wood pellet supplier, subsidiary of Summerleaze, based in Maidenhead
"If the outcome of Brexit is that the UK economy completely refocuses and significantly reduces financial services, I don't really care. The economy is like the weather to a sailor; he just has to sail whatever it is. There's no point complaining about it."

Tim Jarvis, See That – a video content production company, based in Hove
"We'll have to adapt, and that's the beauty of SMEs that, one way or another, we will find a way to carry on. We have to, that's how SMEs survive, that's how SMEs grow."

8. Conclusions

Our key conclusion from these interviews is unambiguous: most British business leaders believe the current path of Brexit could cause significant damage to business, both because the end-point will inevitably mean more barriers to trade, most likely more regulation, and almost certainly less influence; and because the process of leaving the EU is creating huge uncertainties and diverting management efforts. While it is possible to debate the magnitude of the economic impact, the fact that Brexit will have a negative impact, and that this impact may be significant, seems unarguable. While our interviews revealed multiple concrete reasons why British businesses fear Brexit will hurt their businesses, we heard almost no specific reasons, or even good arguments, to back up the rhetoric about how and why Brexit might help British business.

It is difficult to reconcile the notion that Brexit will liberate British business from the grip of a "protectionist EU" with the facts. The EU's Single Market is by far the largest and most successful initiative to create a truly frictionless cross-border market for goods and services in the world. The EU continues to be successful in securing FTAs with major trading counterparties around the world, most recently with Canada and Japan. This means that some 48% of UK goods and services exports go to the Single Market, plus another 12% to markets with which the EU has established or agreed FTAs[52]. Given the composition of the UK's goods and services exports, leaving the EU's Single Market and Customs Union will inevitably mean that UK businesses will face more tariff and non-tariff barriers. Despite claims to the contrary, there seems no remotely realistic scenario in which a Brexit which requires exit from the Single Market and Customs Union will result in British businesses finding it easier to sell their goods and services abroad.

The idea that Brexit will free British business from "overly burdensome EU regulation" is also difficult to support. Whilst we did hear some general complaints about the level of regulation, this was as often directed at UK-originated rules as at those emanating from the EU. Mostly what we heard was that companies are broadly satisfied with the EU regulations directly affecting their own sector; that they fear Brexit will lead to more, not less regulation by imposing a dual burden; and that they want the UK to continue to be engaged in the specialised EU regulatory agencies.

Confusion and uncertainty about the Government's current approach to Brexit is exacerbating the negative impact on British business. The businesses we spoke to repeatedly emphasised their need for clarity about "the rules of the game" to enable them to make investment decisions, hire employees and strike deals. Yet British businesses are now faced with the double uncertainty of not knowing what the end-point is likely to be, nor how it will be reached. Some companies pointed out that some Government ministers have repeatedly asserted "have cake and eat it" positions, then retreated when EU negotiators point out these are unacceptable or infeasible (eg on payments to the EU, or on Ireland). Other firms highlighted that Government positions on one aspect of Brexit (eg Ireland) appear incompatible with their positions on others (eg status of EU citizens, Customs Union). Perhaps the greatest source of frustration to the companies and trade associations we interviewed is when important issues currently seem to be glossed over or dismissed as insignificant (eg third-party arrangements during the transition, rules-of-origin checks, the impact of reduced access to specialist skills).

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[52] Office for National Statistics, *Geographical breakdown of the current account*, The Pink Book, 2016

Having witnessed the Government assert unsustainable positions about the terms of the UK's departure from the EU, before conceding on all three main issues (Northern Ireland, payment of existing obligations and the status of EU citizens), businesses are anxious that the Government should not now do the same on both the end-state relationship with the EU and the transition arrangements. They see a real prospect that the UK "crashes out of the EU" without a deal – a "Hard Brexit". It is true that some enthusiasts for Brexit welcome the prospect of such an outcome as a "clean Brexit", but most British businesses we spoke to believe that such an outcome would be anything but clean. An abrupt switch to WTO terms, and a loss of the multitude of other regulatory arrangements that underpin trade in goods and services with both the EU and elsewhere, would result in disruption to supply chains and significant loss of competitiveness.

Having asserted unrealistic positions about the terms of the UK's departure from the EU, before conceding on all three main issues (Northern Ireland, payment of existing obligations and the status of EU citizens), businesses are anxious that the Government should not now do the same on both the end-state relationship with the EU and the transition arrangements. For the end-state, the Government, or at least individual ministers, have been suggesting tailored solutions (eg "CETA plus, plus, plus" or "a partial Customs Union"), which EU negotiators currently make clear they cannot (due to MFN or other WTO rules) or will not (due to their broader impact on the integrity of the Single Market) accept. It is of, course, possible – and highly desirable from the perspective of British business – that the EU will budge on some of these issues eventually, perhaps allowing a hybrid version of Single Market membership alongside restrictions on Free Movement. Yet so far there has been little indication of their willingness to do so.

For the transition period, the Government has proposed an approach that has attracted fierce criticism from all sides, since it creates enormous complexity for businesses, whilst putting the UK into the position – as both a prominent Brexiteer and the pro-Remain former Deputy Prime Minister have described it – of a "vassal state", forced to implement rules it has no hand in determining.

Even if the Government soon sets out a clear strategy and is then united in making it happen, it is getting very late to resolve all the outstanding issues. Given this situation, the prospect of a smooth transition to a sensible end-state is far from assured. Many businesses are fearful that they will end up experiencing an increasingly shambolic progression towards a highly undesirable end-state, with the political discourse becoming ever more heated as the real world consequences become ever more evident.

This paper does not attempt to reopen or reassess the 2016 Referendum decision. We have not looked at the wider sovereignty, political or social arguments that were raised at that time and are thus not presuming to make an assessment of Brexit as a whole. Our focus is solely on the challenges and opportunities Brexit creates for the small and medium sized British business that underpin livelihoods and job creation across the UK. However, based on our interviews and other research, we are confident in asserting that Brexit could end up having a significant negative impact on British business, and that the way Brexit is currently being implemented is exacerbating this impact. Indeed, some of the businesses we have spoken to already report a palpable shift in mindset among both UK companies and their international counterparts away from international trade and partnerships. Far from being a step towards a more "Global Britain", many of the businesses we have spoken to fear that Brexit currently risks creating a more insular and less prosperous Britain.

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Appendices

Appendix 1

List of Interviewees

Businesses (Consenting to be Named)

Airbus – Katherine Bennett
Asset Match – Iain Baillie
Aberdeen Performing Arts – Jane Spiers
Angel Eye Media – Richard Osborne
Atlantic Books – Will Atkinson
Better Capital – Jon Moulton
Broth Art – Kim Soep
BTP Advisers – Mark Pursey
Carpmaels & Ransford – David Holland
Choice Hotels – Peter Till
Chrysalis Records – Jon Dyer
Creative Carbon – Ben Twist
David Nieper – Christopher Nieper
Disruptive Capital – Edmund Truell
Edinburgh Festivals – Julia Amour
Evox Therapeutics – Per Lundin
Faber and Faber – Stephen Page
Fish for Thought – Paul Trudigan
Five AI – Stan Boland
Flight and Partners – Lord Flight
Fintech company – Johnnie Ball
Forever Fuels – Bruno Prior
Haribo – Herwig Vennekens
InterContinental Hotels Group Europe – Stephen McCall
Interstate Hotels and Resorts - Nicholas Northam
IC Resources – Neil Dickens
ITIM – Ali Athar
JML – John Mills
MedCity – Eliot Forster
MedTech Global – Saadi Hussain
Millennia Computer Services – John Thorpe
MLM group- Neil Cooper
Pertemps Investment – Tim Watts
Principle Hotel Company – Tony Troy
Reid Steel – Simon Boyd
Rowman and Littlefield – Oliver Gadsby
Sentient Machines – Lorenz Fischer
See That – Tim Jarvis
Serlby Mike McDonald
Sheffield City Region – David Campbell Molloy

Skimlinks – Alicia Navarro
Speech Graphics – Gregor Hofer
St Austell Printing – Peter Moody
Toyota Europe – Tony Walker
Tozer Consulting – Jeremy Tozer
Trunki luggage – Rob Law
Varlight – Dr. Tony Doyle
Veritas International – Simon Rowland
Wastesavers – Penny Goodwin
Wakefield Ltd – Tom Shutes
Which? Magazine – Sue Davies

Trade Associations
Independent Publishers Guild – Bridget Shine
British Association of Removers – Ian Studd
British Ceramic Federation – Laura Cohen
British Retail Consortium – William Bain
BVCA – Tim Hames
BVRLA – Toby Poston
British Society for Motor Manufacturers – John Guthrie
Cornish Chamber of Commerce – Kim Conchie
Design Business Association – Deborah Dawton
Design Council – Sarah Weir
Food and Drink Federation – Ian Wright
Independent Publishers Guild – Bridget Shine
The National Farmers Union – Nick von Westenholz

Universities
Cardiff University – Colin Riordan
Edinburgh University – Andrew Kerr
Northampton University – Nick Petford
London School of Economics – Swati Dhingra
Northampton University – Nick Petford
Oxford Brookes – Alistair Fitt

Appendix 2 – Members of Parliament

Members of Parliament who supported this research project by providing introductions to companies in their constituencies

Rachel Reeves, Leeds West, Labour
Norman Lamb, North Norfolk, Liberal Democrat
Simon Hart, Carmarthen West and South Pembrokeshire, Conservative
Iain Wright, Hartlepool, Labour
Yvette Cooper, Normanton, Pontefract and Castleford, Labour
Crispin Blunt, Reigate, Conservative
Vernon Coaker, Gedling, Labour
Ian Duncan Smith, Chingford and Wood Green, Conservative
Ben Bradshaw, Exeter, Labour
George Freeman, Mid Norfolk, Conservative
Michael Gove, Surrey Heath, Conservative
David Davies, Monmouth, Conservative
Stuart McDonald, Cumbernauld, Kilsyth and Kirkintilloch East, SNP
Keir Starmer, Holborn and St Pancras, Labour
Mark Tami, Alyn and Deeside, Labour
Jessica Morden, Newport East, Labour

Appendix 3 – List of Interview Questions

In order to establish which aspects of Brexit are most important to your company or sector, we described a number of different aspects of Brexit to companies and asked them to rank their importance on 1-5 scale where 1 is unimportant and 5 is important.

1. Continued membership of the Single Market (so no tariffs or regulatory barriers to trade)
2. Continued membership of the Customs Union (so no Rules of Origin checks, and no change to UK participation in the EU's existing FTAs with Canada, Korea, Mexico, etc, and prospective EU deals with Japan, etc, but UK cannot do its own trade deals)
3. Maintaining existing trading arrangements with markets with which the EU already has preferential trade deals (EEA – Norway, Iceland, Switzerland; FTAs – Mexico, Canada, Korea, etc – also Japan in prospect)
4. The opportunity for the UK to strike its own trade deal with the US
5. The opportunity for the UK to strike its own trade deal with other non-EU markets.
6. Regulatory harmonization with the rest of Europe
7. Opportunities to change regulations once Brexit happens, either to reduce the regulatory burden or to make the regulations more suitable for the UK
8. Continued participation in EU regulatory agencies relevant to your sector
9. Access to EU funding and subsidies
10. Access to EU labour and skills
11. Transition arrangements to enable your company to adapt to the changes resulting from Brexit.
12. Something else?