

2019 UK AUTOMOTIVE TRADE REPORT

INSIGHTS FROM AN INTERNATIONAL TRADE HUB AT THE HEART OF EUROPE



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2019 UK AUTOMOTIVE TRADE REPORT

FOREWORD



► If the course of our future trade policy started with the 2016 EU referendum, we are now at a crossroads. Our trading ecosystem has as its foundation borderless trade, integrated relationships with supply chains and regulatory alignment across Europe. Principles now under threat from a hard Brexit.

Automotive is ready to inform and assist government in promoting the country's competitiveness around the world; global trade is complex and it needs the knowledge and insight industry experts can offer. Looking globally, there are challenges enough without Brexit - even superpowers aren't immune from the effects of trade tensions, unsettling business and consumer confidence. Furthermore, the pathway to zero emission, connected and autonomous vehicles brings with it new business models, disruptors and trade challenges and the UK has to be in a position of authority and influence if it is to meet these challenges head on and prosper.

Our first UK Automotive Trade Report highlights just how important the automotive sector is to the UK economy, and how simple, frictionless trade is at its heart. This is the first time that SMMT's extensive registration and production data has been matched to external sources such as the ONS and HMRC to create an in-depth and comprehensive analysis of the sector. It paints a fascinating picture of the complexity of the global trading system and the UK's role within it. Its publication is timely, providing a clearly defined set of recommendations to help policymakers and industry keep this vital sector central to a changing UK trade strategy.

This sector is a global trade powerhouse that generates more than £100 billion in trade for the UK economy each year, and is the country's biggest single exporter of goods, accounting for 14.4% of total exports - the majority of which are shipped to our largest trading partner, the European Union. The US and Asia are other key markets but the sector operates globally, exporting to some 160 countries in total.

These are more than just numbers; they represent hundreds of thousands of jobs and livelihoods, which goes beyond large manufacturers to encompass a broad, delicately balanced ecosystem of parts, components and service suppliers.

Attracting volume manufacturing to the UK has helped establish a supply chain that supports not just domestic production but additional export opportunities as well. This adds to the strong premium and luxury brand presence in the UK traditionally. More recently, the UK has seen thousands of exciting start-ups and SMEs emerge, challenging current thinking in terms of mobility.

The UK needs to be at the centre of future regulatory discussions; promoting international collaboration, creating an environment that boosts trade, easing burdens and minimising or eradicating disruptions to trade flows. We must introduce an ambitious global trade policy, going beyond comprehensive trade agreements and exploring opportunities to reduce tariff and non-tariff barriers.

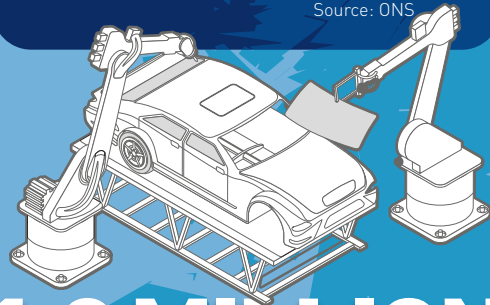
Over the 10 years since the global financial crisis, we have proven that the fundamentals of the country's automotive sector are strong. We have a dedicated workforce, engineering excellence, world famous brands, modern infrastructure and the technological knowhow to keep Britain innovating and competitive.

The outcome of the Brexit negotiations will ultimately decide our future trading relationship with the EU and we hope it remains a close and frictionless one. Regardless of this, however, the UK must have a strategy that is positive, modern and ambitious. The automotive sector should be at its heart as this report demonstrates that no meaningful trade policy can keep the UK at the forefront of global trade and innovation without taking us into account. ■

Mike Hawes Chief Executive
The Society of Motor Manufacturers and Traders (SMMT)

UK AUTOMOTIVE: £101 BILLION TRADE HUB

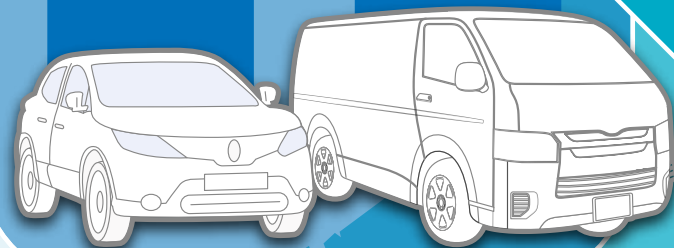
14.4%
AUTO SECTOR LARGEST EXPORTER OF GOODS
Source: ONS



1.3 MILLION
VEHICLES BUILT FOR EXPORT IN 2018

81.5%
Car production exported

59.3%
Van production exported



£44.4 BILLION
Exported in 2018

SECTOR GENERATES TRADE WORTH MORE THAN
£101 BILLION

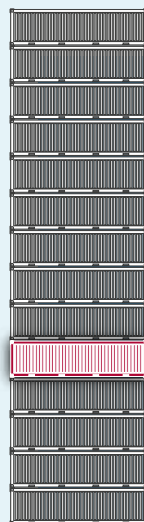
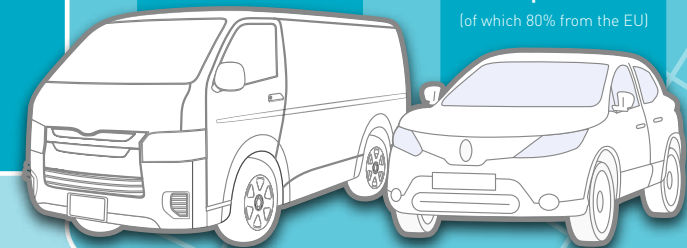
£57 BILLION
Imported in 2018

TOP 5 CAR EXPORT MARKETS

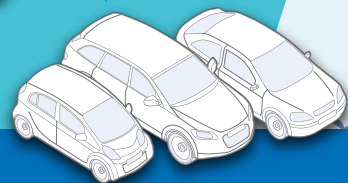


94.3%
New van market imported

87.9%
New car market imported
(of which 80% from the EU)



UK IS RANKED
10TH
IN THE WORLD FOR ALL EXPORTS IN 2018



IF AUTOMOTIVE WAS REMOVED FROM UK EXPORTS IT DROPS TO
14TH
BELOW BELGIUM, CANADA, MEXICO AND RUSSIA

SMMT ESTIMATES THE TOTAL VALUE OF TRADE COULD INCREASE BY

20%

FROM **£101** BILLION TO **£122** BILLION

8 RECOMMENDATIONS FOR GOVERNMENT AND INDUSTRY

- 1: Set forward-looking auto trade strategy
- 2: Preserve current market access
- 3: Strengthen industry engagement
- 4: Seek new trade opportunities
- 5: Lead regulatory discussions
- 6: Enhance domestic customs system
- 7: Foster trade promotion
- 8: Link trade and industrial strategies



SETTING THE SCENE: THE UK AUTOMOTIVE INDUSTRY

► The UK automotive manufacturing sector is a bustling European trade hub, moving vehicles, engines, parts and components worth more than £100 billion across the UK's borders each year. The sector is UK's largest exporter of goods, worth some £44.4 billion in 2018 – equivalent to 14.4% of all goods exported and 7.0% of all exports (source ONS). Some 1.3 million vehicles were produced for export in 2018.

The sector is also a key provider of jobs and wealth creation – with 168,000 people employed directly, a turnover of £82 billion and £18.6 billion added to the UK economy in 2018.

The UK automotive sector is truly global, with products exported to some 160 markets. Exports accounted for 81.5% of all car production in 2018, while imports accounted for 87.9% of new car registrations.

The sector has undergone huge transformation over the past two decades to position itself as a key trade hub. There has been significant investment to modernise plants and make them more efficient, supported by a flexible workforce making dynamic and reliable products that consumers want.

The composition of manufacturers has also changed significantly over this period. There are currently six

mainstream volume car manufacturers in the UK, eight major premium and sports car manufacturers, four commercial vehicle manufacturers and eight bus and coach manufacturers.

The UK is also home to the largest number of small volume car manufacturers and there are more than 2,500 suppliers to the sector.

The build-up of output at the Japanese-owned Honda, Nissan and Toyota plants during the 1990s, alongside ongoing production at Ford, MG Rover, Peugeot and Vauxhall, helped lift UK production to a new peak of 1.80 million in 1999 – the best since 1972's record 1.92 million units. Nissan began producing cars in the UK in the mid-1980s, with Honda and Toyota starting in the early 1990s. The culture and processes utilised at these Japanese-owned plants were adopted across the sector, helping to improve efficiency and international competitiveness.

However, by 2006 Ford, MG Rover and Peugeot had ceased car production in the UK and Vauxhall had stopped producing cars at its Luton plant. Then with the global recession limiting demand, UK car production fell to below one million units in 2009.

A sustained period of recovery followed, taking production back to 1.72 million units in 2016. This was supported by strong growth at Nissan and Jaguar Land Rover, each producing over half a million units. Output has since fallen following weaker domestic demand surrounding political and economic uncertainty, the slowdown in demand in key export markets such as the EU and China, combined with weaker demand for diesel cars and some disruption from the switch to WLTP type approved cars. Output in 2018 was down 9.1% on 2017 levels at 1.60 million units.

The UK has a strong focus on premium and luxury cars. In 2018, 45.8% of all cars produced were premium products (Jaguar Land Rover and MINI), while 1.7% were luxury and sports cars (including globally iconic brands such as Aston Martin, Bentley, McLaren and Rolls-Royce).

Commercial vehicle (CV) production recovered in 2018, helped

by growth at PSA's IBC plant at Luton making the Vauxhall Vivaro. This plant now accounts for almost three-quarters of UK output – the remainder being predominantly heavy commercial vehicles and buses. Output in 2018 rose 8.5% to 84,888 units on 2017.

CV production was around 200,000 units between 1999 and 2008 but fell with the scaling back and eventual closing of the Ford Transit plant in 2013, as well as LDV in 2009 and Vauxhall Astravan production by 2013. Today, 60% of CV output is exported, predominantly to the EU.

The importance of exports has increased in recent years, with 81.5% of cars built for overseas markets in 2018 – the third highest level on record. Exports in 2000 accounted for 64.8% of output, and surpassed 70% in 2004 and 80% in 2011. The EU accounts for more than half of all exports. The sector's success has been dependent on free and frictionless trade afforded by the UK's membership of the EU single market and customs union.

In the event of the UK leaving the EU without a deal, it would bring an immediate end to the seamless movement of goods, resulting in disruption and delays at the border, throwing just-in-time manufacturing into chaos and undermining the competitiveness of the sector – ultimately putting profitability and jobs at risk and threatening the viability of the sector.

Despite the current challenges, the automotive sector continues to undertake a technological revolution, with developments in ultra low emission technology and connected and autonomous vehicles, as well as data-driven manufacture and design. Looking ahead, the potential for the UK's automotive sector is significant, but economic and political uncertainty is already having an adverse impact on output, investments and job prospects.

SMMT data on investment announcements shows that manufacturers are putting investment and expansion decisions on hold until a decision is made on the UK's departure from the EU. Maintaining global competitiveness and an investment base here in the UK is essential to preserving a strong automotive sector. ■

THE SECTOR IS A KEY PROVIDER OF JOBS AND WEALTH CREATION

168,000 people employed directly
 Turnover of **£82 billion**
£18.6 billion added to the UK economy in 2018





2 UK AUTOMOTIVE TRADE SNAPSHOT

- The UK automotive sector is a vibrant trade hub. The industry is the driving force behind UK exports of industrial goods and a significant contributor to the UK's total exports.
- Automotive imports are essential for the sector, covering the vast majority of new car sales and supply chain production inputs.
- An incredibly diverse automotive manufacturing base, affluent domestic market and open trade and investment policy allowed UK automotive trade to quickly overcome the impacts of the financial recession in 2008.
- Declining trends in the last year show the impact of uncertainty linked to the UK's future relationship with the EU, international trade tensions, falling confidence among consumers around the world and global industrial challenges.

► The automotive industry's contribution as a driving force behind UK trade in goods today is a key success built up over a decade of investment.

TRADING WITH THE WORLD

In 2009, the global financial crisis seemed to have wiped out more than 10 years of slow and steady growth of UK automotive trade exchanges. With UK manufacturing, imports and exports of automotive products at record-breaking lows, no-one could predict that the sector was about to experience a phase of unprecedented expansion.

In 2018, almost 10 years after, UK automotive trade was worth more than £101 billion, an increase of 118% compared with 2009. Exports of motor vehicles, trailers and semi-trailers, including related parts and accessories, alone amounted to £44.4 billion in 2018 – almost as much as total automotive trade in 2009 (ONS data).

Today, without exports of motor vehicles, the UK would lose its position as the world's 10th biggest exporter of goods and slip to 14th place, behind Belgium, Canada and Mexico and Russia (WTO data).

In less than a decade, the UK automotive sector has transformed itself from a relatively sluggish market into a bustling trade hub, importing and exporting millions of cars, engines, parts and components across the world.

In the process, the sector – the 4th largest producer of motor vehicles in the EU – has maintained an equilibrium in its trade balance, with a deficit of just over £12.6 billion despite an import-dominated domestic car market and a regionally integrated supply chain largely dependent on imported componentry. This was possible thanks to the UK's diverse automotive manufacturing base, productivity levels among the most competitive in Europe and a modern, export-driven business model focused on high-value, high-quality finished vehicles.

However, after a peak in 2017, expansion has slowed. It is too early to say whether UK automotive trade has now entered into a downward period or whether cross-border exchanges will soon overcome the bearish trends.

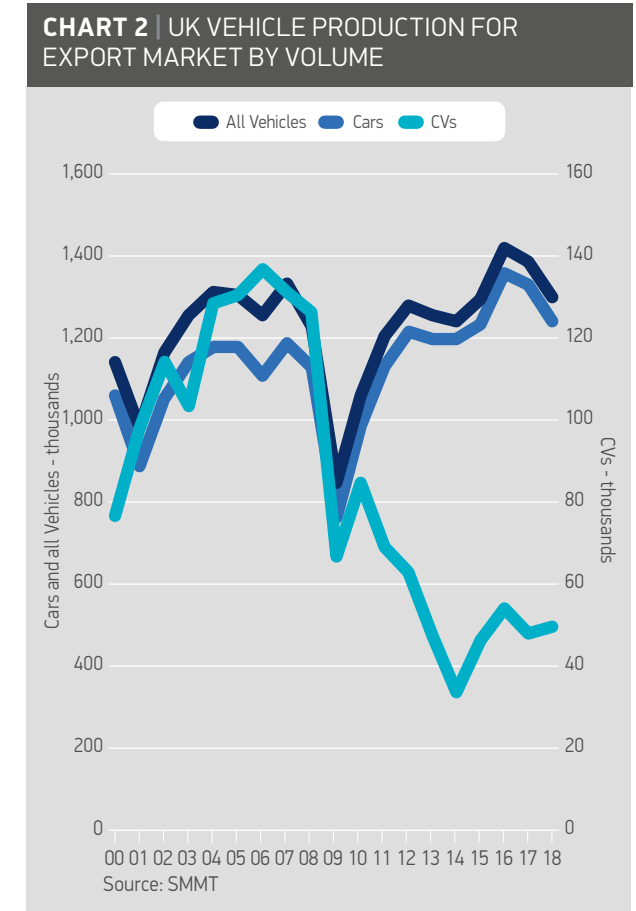
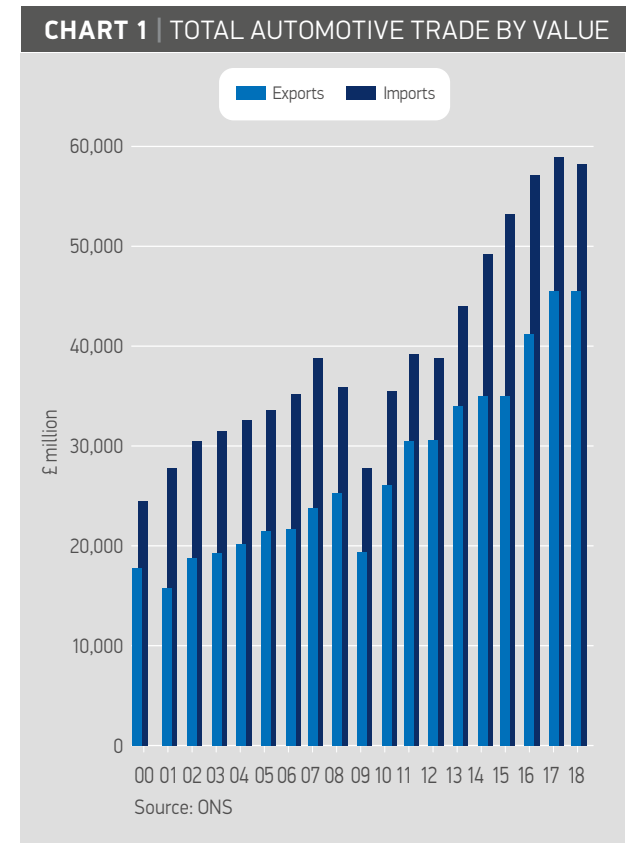
THE SECTOR'S TRADE OUTLOOK WILL LARGELY DEPEND ON FOUR FACTORS:

- 1 **The future trading relationship between the UK and the EU**
- 2 **The resolution of international trade tensions**
- 3 **The sector's ability to maintain a strong, diversified product portfolio**
- 4 **The sector's ability to adjust to global industrial challenges such as vehicle automation and electrification.**

FINISHED VEHICLE EXPORTS

The UK automotive industry is increasingly export-led. Since 2006, at least 75% of UK production of finished vehicles has been destined for overseas markets. In 2018, cars dominated exports of finished vehicles with a 96% share of the total, while CVs represented only 4% of exports.

In volume terms, 2016 saw a record-breaking 1.4 million vehicles leaving British production lines for overseas markets. However, despite maintaining a sustained export share, units shipped abroad declined to 1.28 million vehicles in 2018. On average, four in five cars and three in five CVs produced in the UK are destined for export.

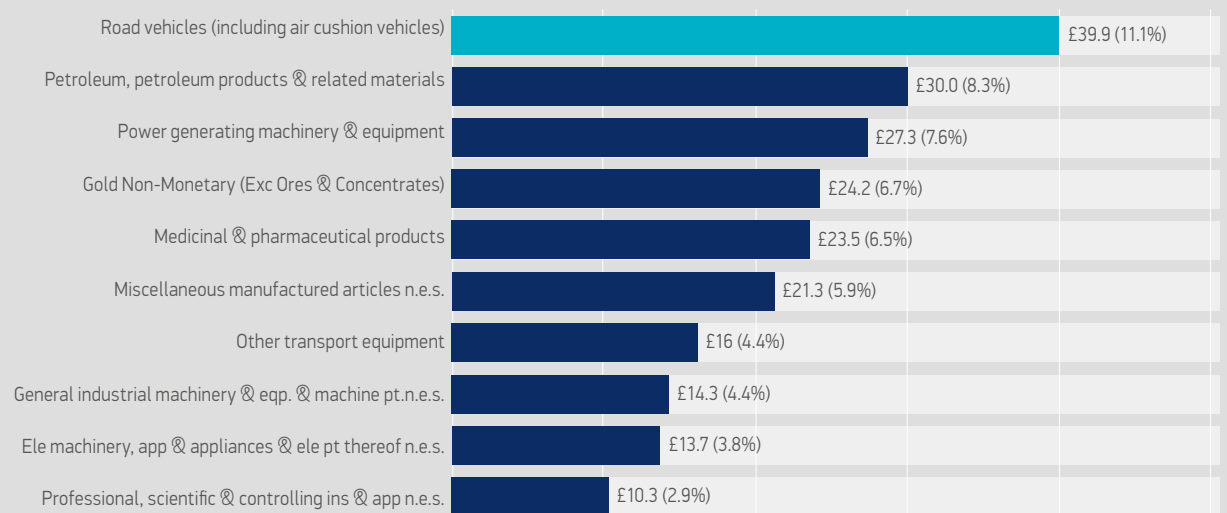


As a percentage of total production, exports of passenger cars peaked in 2011, covering 83.7% UK car production and driving the sector's comeback after the 2008 crisis. Despite a recent contraction of total manufacturing outputs, export levels have been sustained. 81.5% of UK-built cars were exported in 2018.

In value terms, car exports fuelled the sector's expansive phase. The structural overhaul of the sector in the 2000s has built resilience into the UK automotive industry, allowing UK carmakers to capture regional and global trade opportunities through high-value exports after the global financial crisis.

In 2018, the automotive sector was pivotal to UK exports of industrial goods. Exports of road vehicles were worth almost £40 billion, accounting for 11.7% of all UK goods exports, by far the UK's most valuable exported product (HMRC data).

CHART 3 | TOP 10 UK GOODS EXPORTED 2018 (VALUE)

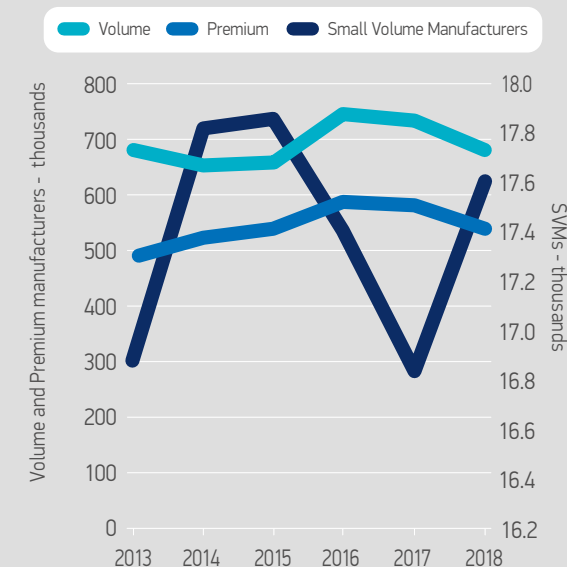


Source: HMRC

TOTAL GOODS EXPORT: £361.1 BILLION

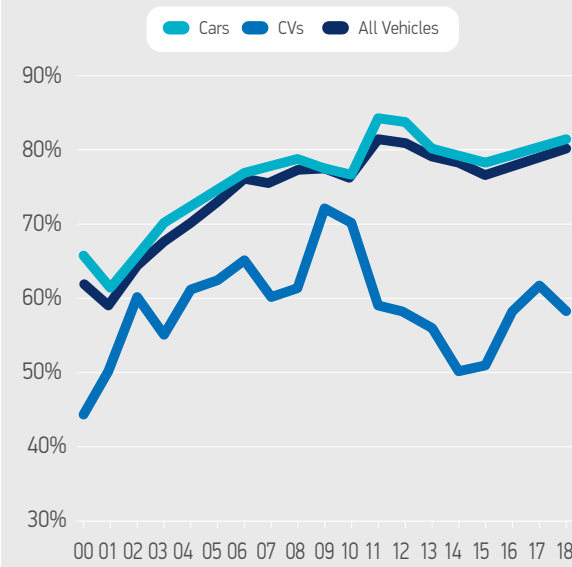
The diversification of the industry's export portfolio results from a large UK manufacturing base, with exports of premium and specialist vehicle manufacturers (SVM, luxury and sports cars) capturing high-value markets and volume exports supporting the creation of a strong domestic supply chain. Export trends for CVs are more volatile. In volume terms, this market never reached pre-crisis export levels. This industry is cyclical and has a dependence on one volume manufacturer so has experienced large percentage swings when compared year on year. In 2018, 59.3% of CVs were destined for export markets, down from 62.5% in 2017. The exports peak was 73.3% in 2009, but was below 50% in 2014/2015.

CHART 4 | UK CAR EXPORTS BY TYPE (VOLUME)



Source: SMMT

CHART 5 | UK VEHICLE EXPORTS BY SHARE OF TOTAL VOLUME



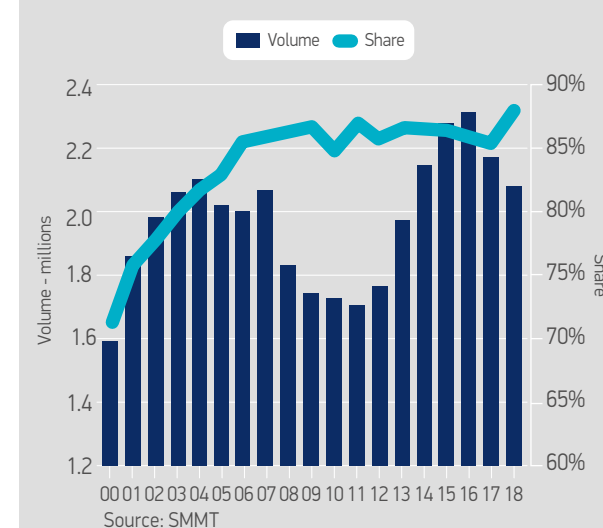
Source: SMMT

FINISHED VEHICLES IMPORTS

Traditionally, the UK is an affluent market for finished vehicles, with low brand loyalty. These factors create a highly competitive domestic car market – the second biggest in the EU after Germany. Competition is strengthened by attractive financial packages for car buyers, as well as a business-friendly environment.

Against this background, it is no surprise to see imports playing a major role in the UK car market. Following the closure in the early 2000s of some assembly plants of long-time investors such as Ford, MG and PSA, the share of imports rose from 71.7% in 2000 to more than 85% in 2006. A recent uplift in 2018 marked an all-time record share of 87.9% enabling unsurpassed UK consumer choice.

CHART 6 | UK REGISTRATIONS OF IMPORTED CARS



Source: SMMT

With regard to CVs, alongside the overall market for vans, import volumes have risen strongly since the recession. In 2018, imports stood at 337,078 units, 47.6% up on 2008, compared with 23.4% growth in the market overall. Imports share over this period has risen from 78.9% to 94.3%, having peaked at 94.9% in 2017. During the last decade, Ford Transit, LDV and Vauxhall Astravan production all ceased, supporting the significant shift to imports.

CHART 7 | UK LCV REGISTRATIONS (VOLUME)



Source: SMMT

There are currently some 4.6 million vans on UK roads, with almost all serving a role that will have a direct impact on the economy. The boom in online shopping has seen a surge in demand for delivery vans. The UK is now the EU's biggest online retail market, with 83% of consumers here buying goods and services online, compared with the EU average of 60%. Meanwhile, the rapid rise in the number of self-employed people, up from 3.3 million in 2001 to 4.8 million in 2017, has also been a key driver of van growth, with the trend to vehicle downsizing another factor.¹

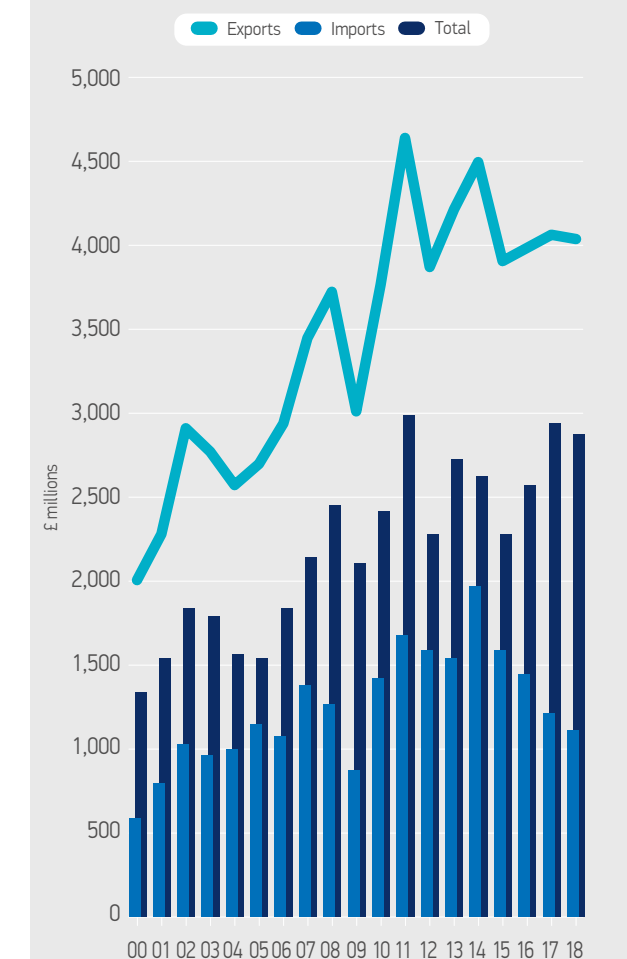
On the other hand, progressive opening to international competition has forced UK car manufacturers to increase their competitiveness, specialise in profitable market segments and seek new market opportunities.

ENGINES TRADE

The UK is home to nine engine manufacturers. Although the overall value of engine trade is not comparable with finished vehicles, the export of diesel and petrol engines remains an essential feature of the UK automotive industry.

In 2018, 2,715,400 engines were built in the UK, maintaining record levels of production, generating £8.5 billion turnover value in light vehicle engine production and supporting 8,000 jobs.

CHART 8 | ENGINE TRADE (VALUE)



Source: HMRC

¹ www.smmt.co.uk/wp-content/uploads/sites/2/SMMT-Light-Commercial-Vehicles-Delivering-for-the-UK-economy.pdf

2: UK AUTOMOTIVE TRADE SNAPSHOT

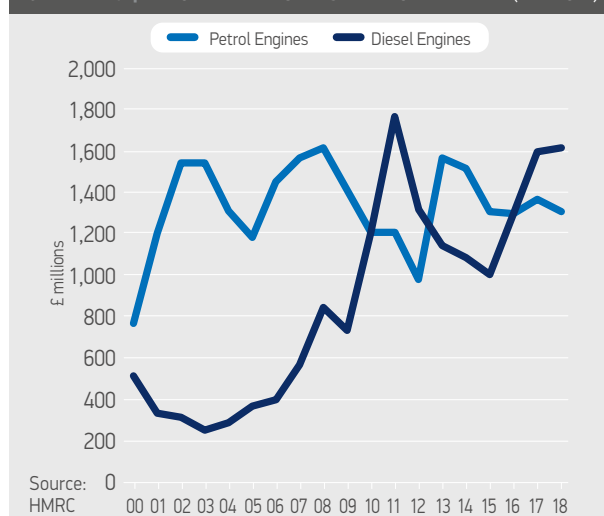
In 2018, total trade of petrol and diesel engines was worth more than £4 billion. The UK has consistently registered a trade surplus for this essential component in global supply chains. This surplus has widened in the last four years to reach a record-breaking £1.78 billion differential in favour of UK engine exports in 2018.

The sharp decline in engine imports in the last four years demonstrates the vitality of UK engine manufacturing and the competitiveness of the domestic industry for this crucial automotive market segment.

On the export side, while the value of UK petrol engine exports has consistently surpassed the £1 billion threshold since the early 2000s, the value of diesel engine exports has significantly increased since the 2008 recession. In the last two years, the value of diesel engine exports has exceeded the value of petrol engines' exports. In 2018, the value of diesel engines shipped overseas exceeded £1.6 billion, while petrol engine exports were valued at £1.3 billion.

The global slowdown in diesel demand, in part linked to fiscal penalties, is of particular concern, causing a decline in output of both diesel engines and diesel-engined cars made in the UK.

CHART 9 | ENGINE EXPORTS BY FUEL TYPE (VALUE)



TRADE OF PARTS AND COMPONENTS

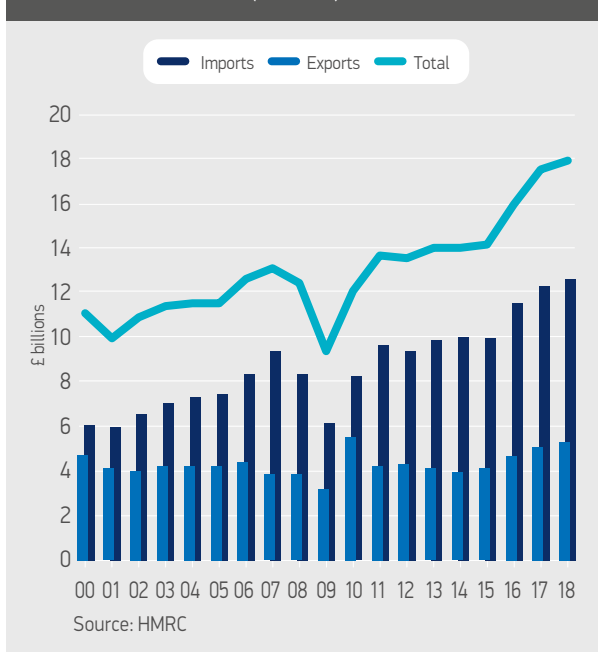
The post-crisis expansive phase for finished vehicles has been matched by a significant increase of total trade value for automotive parts and components. In the 2009-2018 period, this market segment has seen the value of cross-border trade exchanges increase by 92.5%, reaching an all-time record value of £16.8 billion.

However, while exports of finished vehicles played a pivotal role in the sector's trade growth, exports of parts and components had stabilised on pre-crisis level, until 2015.

Imports of automotive componentry, meanwhile, have been instrumental to the sector's expansion. In the aftermath of the financial crisis, access to high quality and cost-competitive parts and components allowed auto manufacturers to become high-value assemblers despite a relatively limited domestic supply chain.

Automakers' success has served as a catalyst for the entire UK supply chain. British suppliers and new investors have increasingly built next to OEMs, revitalising the domestic supply chain. UK parts manufacturers have also been looking for new buyers overseas, resulting in an uplift in exports, which exceeded £5 billion in the last two years.

CHART 10 | TRADE OF PARTS AND COMPONENTS (VALUE)



In addition, government programmes such as the SMMT-managed and Automotive Council-endorsed Long Term Automotive Supply Chain Competitiveness (LTASC) programme have been successful in driving competitiveness of UK suppliers. The £13 million supply chain programme leveraged an additional £41 million private investment from the sector, helping 27 companies create or safeguard 3,200 jobs.

Strengthening the UK suppliers' base and ensuring their participation not only in current regional and global supply chains, but also in innovative production systems and supply chains will be one of the key challenges for the future of our sector and UK trade policy.

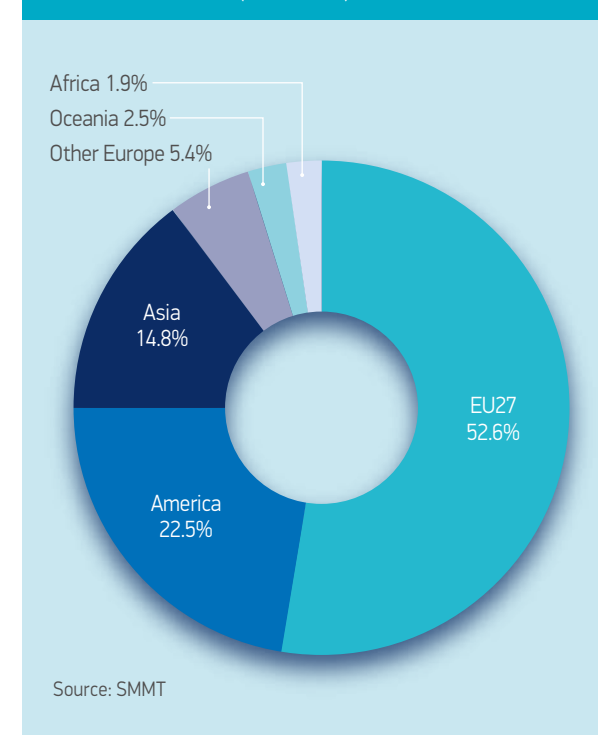


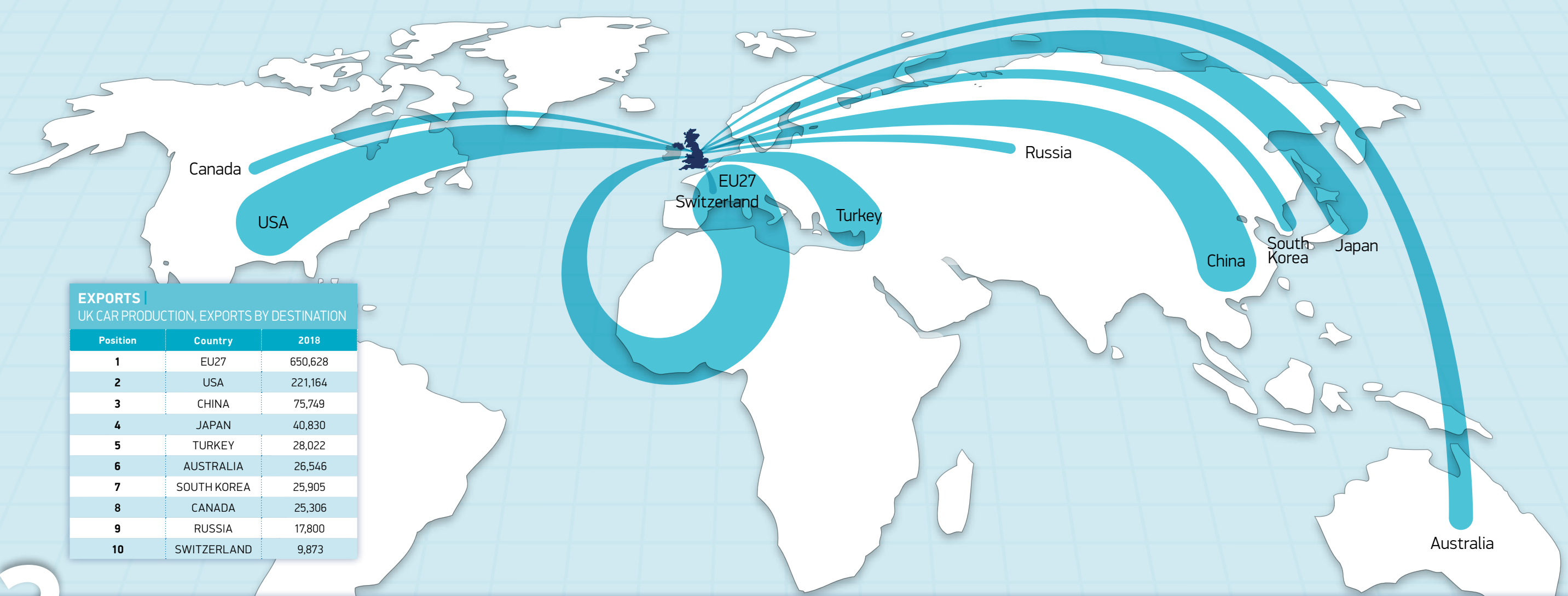
3 KEY TRADING PARTNERS

- UK cars are shipped to over 160 destinations, with European, American and Asian markets receiving the vast majority of UK passenger cars.
- The EU is and will remain the dominant trading partner of the UK automotive industry for the foreseeable future.
- Maintaining frictionless trade with the EU and high levels of economic integration with the wider European region, including Turkey, is an essential precondition for the industry's future global success.
- The vast majority of automotive trade flows are between the UK and preferential trading partners.
- The UK automotive sector has captured opportunities in fast-growing markets such as China.

► UK passenger cars are exported to some 160 markets worldwide. The wider European region is by far the dominant export destination, receiving 57% of UK-built cars. 90% of UK car exports go to Europe, America (22%) and Asia (15%) (SMMT data).

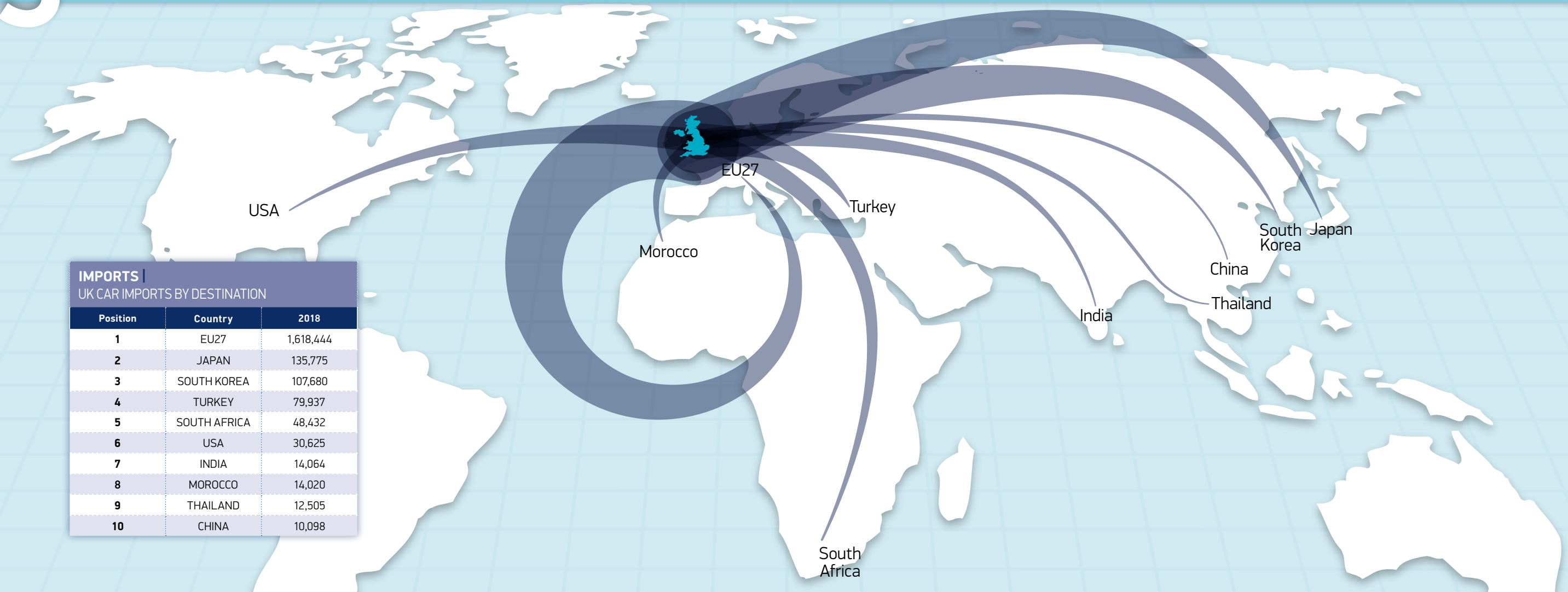
CHART 11 | UK 2018 CAR EXPORTS BY DESTINATION (VOLUME)





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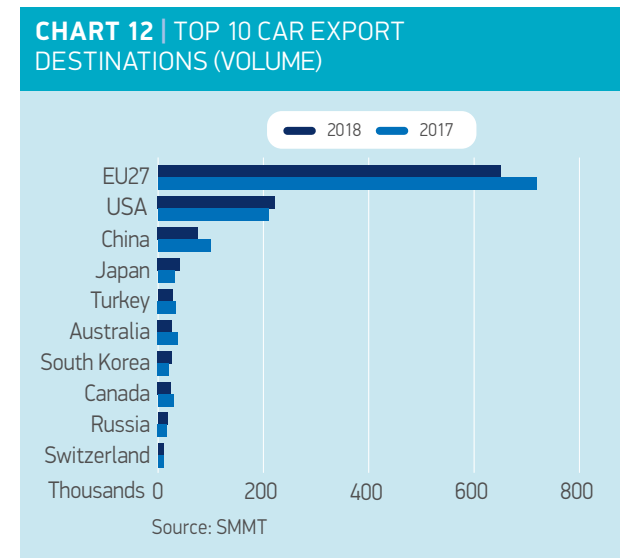
UK KEY TRADING PARTNERS FOR CARS BY IMPORTS AND EXPORTS



UK CARS: EXPORT DESTINATIONS

Despite a worldwide reach, 90% of British car exports are shipped to just 10 markets, with the world's four biggest economies dominating the ranking (80%).

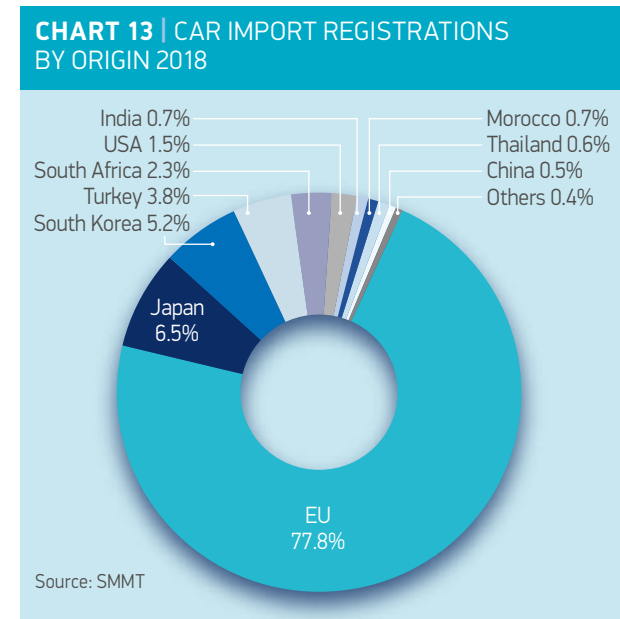
The EU is the top destination for UK cars, receiving 52.6% of exports. The USA is the second biggest market, receiving 17.9% of UK car exports. The biggest Asian markets are China and Japan, the third and fourth largest destinations, covering 6.1% and 3.3% of UK car exports. Turkey, Australia, South Korea, Canada, Russia and Switzerland make up the top 10.



ORIGIN OF CAR IMPORTS

The EU also dominates car imports in the UK, representing 77.8% of the total in 2018. 80% of EU imports originate from just four EU members, namely Germany, Spain, France and the Czech Republic.

In the same year, imports from Asian trade partners represented 13.5% of the total. Japan and Korea covered 6.5% and 5.2% of imports, while imports from China have overcome the 10,000 unit threshold.



PREFERENTIAL EXPORTS

Almost 70% of UK car exports are shipped to markets where UK industrial products are not subject to tariff barriers or are eligible for preferential treatment.

In 2018, more than 650,000 UK cars were shipped to other EU member states tariff free and without unnecessary stops or checks at the border.

In addition, thanks to its EU membership, the UK currently benefits from 40 preferential trade agreements with more than 70 countries. Such agreements potentially reduce tariff and non-tariff barriers on more than 16% of UK car exports – the percentage of all UK-built cars exported in 2018 to countries offering some form of preferential treatment to British motor vehicles, amounted to approximately 200,000 units.

However, preferential trade with the EU's key trading partners is fundamentally different compared with intra-EU trade.



The combination of EU customs union and the single market creates a framework that allows goods to move freely between the UK and other EU member states.

Within the EU single customs territory, all goods, including automotive products, are traded tariff free regardless of their origin. This means that all UK cars destined for the EU market cannot be subject to any import tariff.

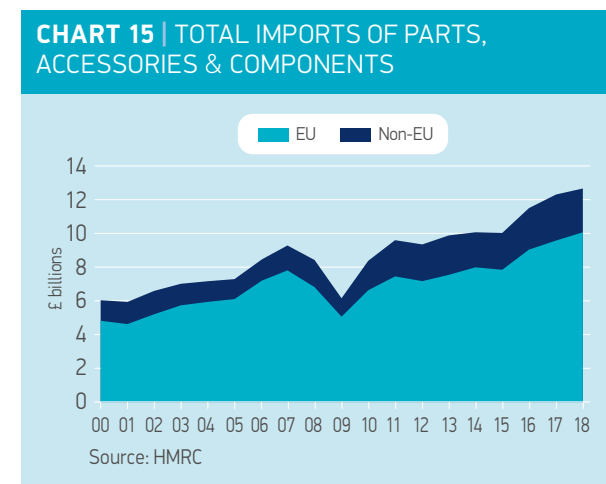
While tariffs never apply on intra-EU exchanges, free trade agreements (FTA) do not always eliminate tariffs. In some instances, FTAs offer lower preferential tariffs to key trading partners without fully eliminating import duties.

In addition, in cross-border exchanges with trading partners that have concluded an FTA with the EU, UK carmakers can make use of trade preferences only by complying with specific rules of origin. Full tariff and non-tariff barriers apply if:

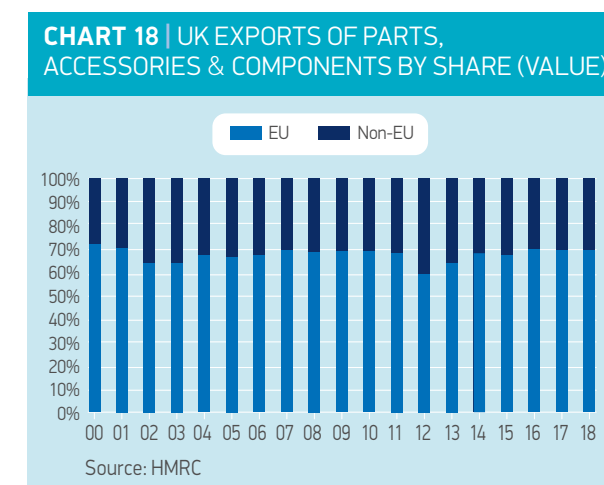
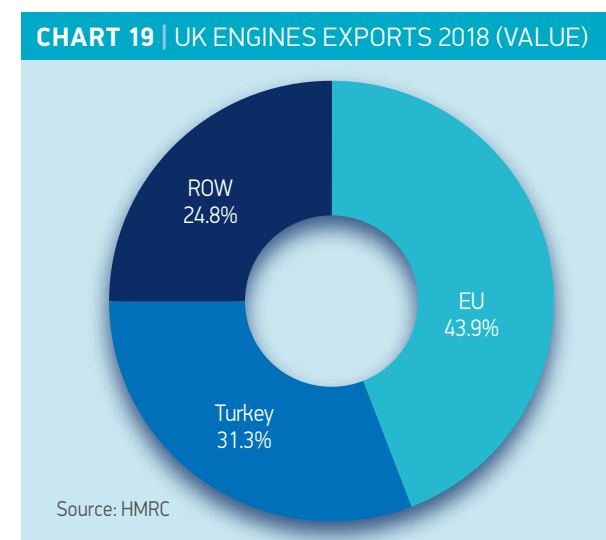
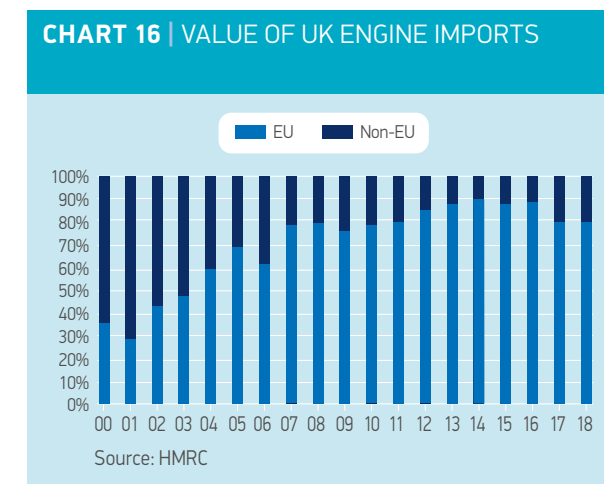
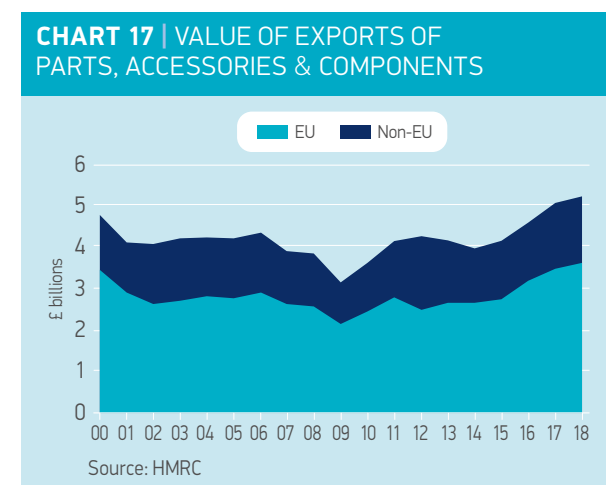
- 1: UK cars fall short of the necessary UK-EU content to qualify for preferential treatment; or
- 2: UK exporters decide not to make use of available preferences due to FTAs complexities, including rules of origin.

REGIONAL SUPPLY CHAIN

Highly integrated automotive supply chains exist across the EU and provide economies of scale that benefit both the EU27 and the UK. In 2018, more than £10 billion – 80% of automotive component imports to the UK – came from the EU. On average, 1,100 trucks from the EU27 deliver components worth £42 million to UK car and engine plants every day. Imported EU engines, the main component for any conventional vehicle, have consistently represented at least 80% of all engine imports since 2011.



In terms of exports, more than £3.6 billion worth of UK automotive parts were shipped to other EU members in 2018, 69% of the value of UK component exports.



Exports of UK engines are a perfect example of the integrated nature of the wider European region.

In this market segment, the EU remains the main export destination, with UK engine exports worth almost £1.3 billion.

The EU is followed by Turkey, with £913 million of exports, twice as much as the entire North America region. Together, the EU and Turkey account for 75% of all UK engine exports by value.

CASE STUDY: TURKEY

Since 1996, finished vehicles, engines, parts and components have been traded between the UK and Turkey tariff-free and without rules of origin requirements thanks to the existing EU-Turkey customs union. These favourable conditions allowed bilateral trade of automotive products between the UK and Turkey to prosper.

Turkish assembly plants largely rely on a steady supply of UK engines, which are then incorporated into passenger cars and commercial vehicles.

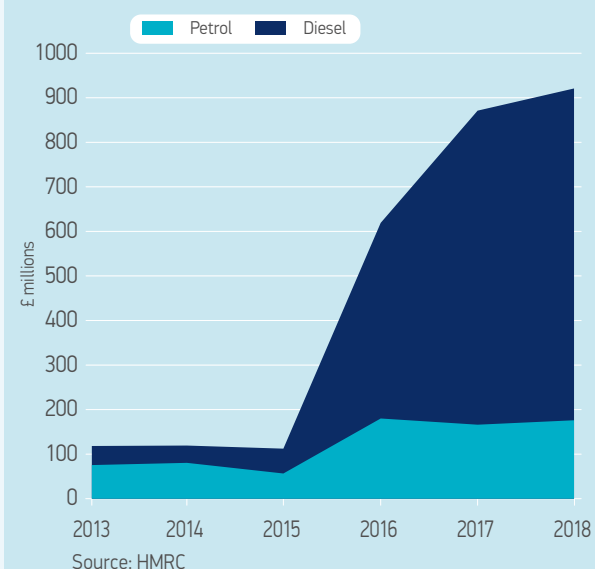
Meanwhile, in 2018 the UK imported more than 175,000 finished vehicles from Turkey, including cars and CVs, when the UK was importing just over 65,000 finished vehicles from Turkey in 2008.

NON-PREFERENTIAL EXPORTS

After the commencement of the new comprehensive FTA between the EU and Japan, only three out of the top 10 export destinations cannot offer preferential treatment to UK-made vehicles – the USA, China and Australia.

While car exports to the USA grew by 5.3% in 2017-2018, exports to China and Australia experienced a significant slowdown, decreasing by 24.5% and 31.3%.

CHART 20 | UK ENGINES EXPORTS TO TURKEY (VALUE)



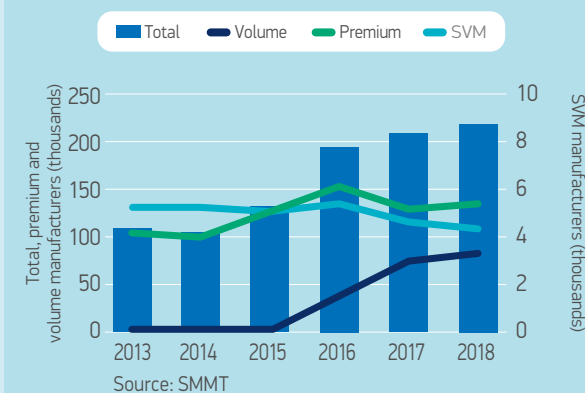
CASE STUDY: USA

In 2018, 17.9% of British car exports were directed to the USA, the second largest export market after the EU. With regard to trade in automotive parts and components, US imports to the UK are worth £467 million, while UK exports to the US are worth £358 million (HMRC data).

Since June 2009, the USA has enjoyed one of the longest periods of economic expansion in its history.

This might explain why the USA has consistently been one of the top export markets for UK SVMs and has performed well for exports of UK premium cars. Despite the positive performance, since peaking in 2016, both premium and luxury car exports have experienced a significant slowdown. Hence, the recent increase in UK car exports to the USA has been driven by UK volume manufacturers, who have sought to rebalance their production output over the last three years, resulting in an increased share of exports to the USA.

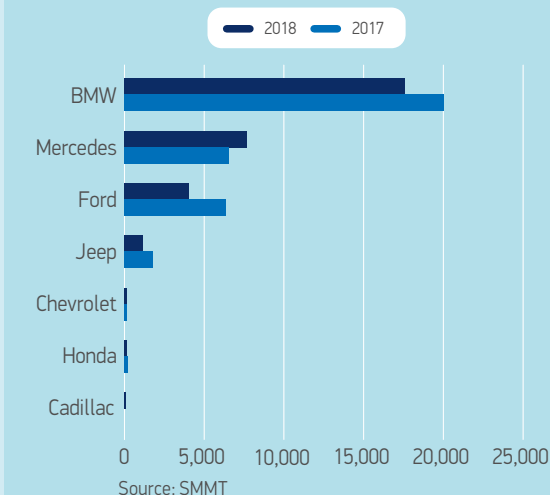
CHART 21 | UK CAR EXPORTS TO USA - BY VEHICLE TYPE (VOLUME)



Automotive trade with the USA is not a one-way relationship. In 2018, the UK imported more than 30,000 passenger cars from the USA. Of all UK registrations of cars built in the USA, 83% are German brands.

US brands have a long history of significant investment in production of vehicles and component in the UK and have been historically very successful in the UK market. Notably, the best-selling models since 1972 have been Fords. The Fiesta has been Britain's biggest selling car since 2009, although this is not made in the USA.

CHART 22 | UK REGISTRATIONS OF CARS IMPORTED FROM USA (VOLUME)



CASE STUDY: CHINA

UK exports to China of premium and luxury cars proved to be resilient during the global recession because of the relatively low volumes of exports at the time. Luxury and premium vehicles benefitted from Chinese market expansion as well as increased outputs, as those brands saw overall production levels improve. Both volume and small volume manufacturers grew their businesses in China over this period, with UK producers deciding to start exporting or broadening their model ranges.

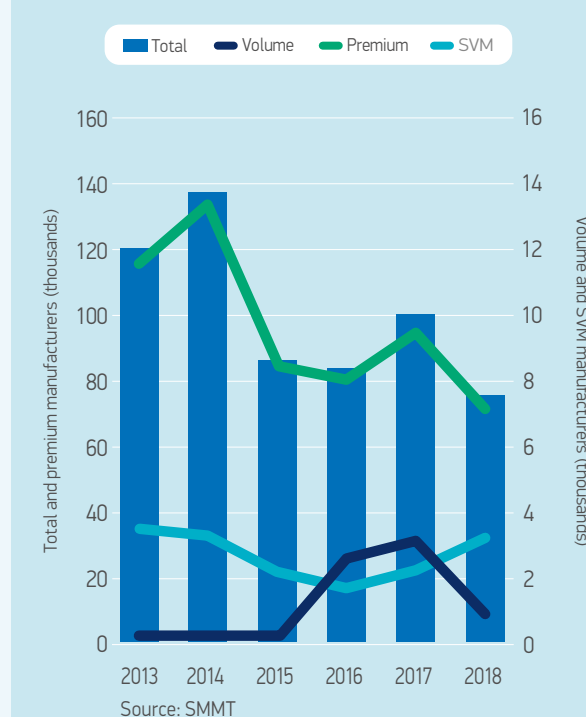
UK car exports to China peaked in 2014, at more than 135,000 vehicles. China briefly overtook the EU as the main export market for UK premium cars in 2014. Previously, China had already succeeded in overtaking the USA as the main export market for UK SVMs in 2011, before the USA regained its pre-crisis import levels.

However, UK manufacturers' investment in production plants in China resulted in declining export levels, particularly in the premium car segment.

A general slowdown in the market, turbulences in the Chinese stock exchange and political measures also contributed to lower export volumes in 2015-2018, despite an uplift of luxury car exports and a 10% cut to import tariffs on passenger cars last year.

Measures that affected exports included a 10% super-luxury tax introduced in 2017, 15% customs duties on imported cars, additional taxes for imported components and variable emissions taxes.

CHART 23 | UK CAR EXPORTS TO CHINA - BY VEHICLE TYPE (VOLUME)



CASE STUDY: GOING GLOBAL

The global automotive sector is going through a period of unprecedented change, with new technologies and business models, demanding consumer expectations and increased competition. These challenges present huge new opportunities in areas where the UK is a world leader and UK-based companies are well placed to succeed. Businesses around the world are looking for engineering excellence, innovative new technologies and services and trusted brands – all areas where UK can deliver and there is huge interest in what the British motor industry has to offer.

In this context, relying exclusively on the domestic market represents a limit for UK automotive businesses, in particular, for suppliers offering innovative solutions and new automotive technologies.

To help UK automotive businesses go global, SMMT has a programme of international activity to support UK companies, whether they are taking their first steps overseas or are more experienced operators looking to explore new markets.

SMMT's annual programme includes 10 overseas events with visits to the largest, established markets as well as missions to explore new and emerging market opportunities. Most activity is supported by grants from the Department for International Trade (DIT). For more than 15 years, SMMT and the UK government, particularly through its Great campaign, have helped hundreds of companies grow internationally, connecting UK businesses with new international customers and potential partners in Europe, the USA, China, Japan, Korea, India and several other markets.

In addition to traditional supply chain events, the programme increasingly supports participation in trade shows focusing on new technology in order to help UK innovators seize future opportunities in developing next-generation vehicles, such as EVs and connected and autonomous vehicles (CAVs).

Expanding the UK automotive sector's international outreach can be instrumental in achieving the government Export Strategy's objective to grow UK exports from 30% to 35% of GDP.

INTERNATIONAL EVENTS 2015 -2019

SMMT is present at all major international automotive trade shows and exhibitions





4 CHALLENGES

BREXIT IMPACT

► The UK automotive industry's success following the 2008 crisis was built on two essential pillars: a favourable environment for automotive investments and seamless access to the European market.

- Maintaining current levels of regional integration and frictionless trade with the EU is an essential precondition for the auto industry's future global success.
- Losing preferential access to key markets would negatively affect UK auto manufacturers and consumers through the reintroduction of bilateral tariff and non-tariff barriers.
- An escalation of international trade tensions would severely disrupt the UK automotive sector.
- Technical and environmental regulations vary from region to region and often result in major additional costs.
- Vehicle electrification and automation challenge traditional business models and policy frameworks.

Both pillars are threatened by a disorderly EU withdrawal and by the potential introduction of trade barriers between the UK and its closest trading partners.

Brexit uncertainty exacerbates investment risks and undermines the UK's attractiveness as an investment hub for domestic and international automotive manufacturers. The impossibility of precisely estimating trade costs in the medium to long term hampers sourcing and export strategies alike, and risks damaging the industry's reputation and overall competitiveness.

The introduction of new trade barriers would also disrupt the fully integrated regional supply chain and reduce market access for more than half of UK automotive exports.

BREXIT TARIFFS

In a 'no deal' scenario, UK exports would inevitably face tariffs on automotive products destined for the EU27 market. Tariffs on UK exports of light vehicles would amount to £1.9 billion.

If passed directly on to consumers, import tariffs would push up the cost of UK-built cars sold in the EU by an average of £2,800, and that of light commercial vehicles by £2,000 – affecting demand, profitability and jobs. UK manufacturers would have to absorb these costs – in a market with wafer thin margins – in order to maintain market competitiveness.

In terms of imports, the UK's tariff schedule in a 'no deal' scenario would – temporarily – maintain tariffs on finished vehicles, while liberalising all parts and components. This solution aims to limit manufacturing costs and maintain negotiating capital at the same time. However, unilateral tariff liberalisation and the imposition of tariffs on trade with the EU would result in a major impact on UK manufacturers and importers.

Tariffs on imports of EU light vehicles would amount to £3.1 billion. UK buyers of cars or vans from the EU would be faced with an average increase of £1,700 if manufacturers and their dealer networks were unable to absorb these additional costs.



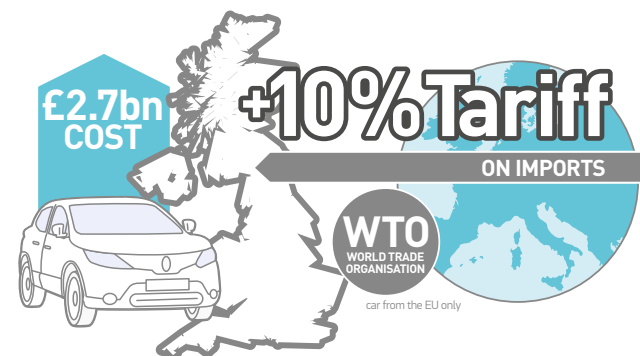
Impacts for other market segments might be even more disruptive. Heavy duty vehicles and buses would face 22% and 16% tariffs respectively. For UK manufacturers of parts and components, tariff liberalisation will mean sudden exposure to increased competition from third countries and the loss of free and frictionless trade to their main export market.

BREXIT AND CUSTOMS

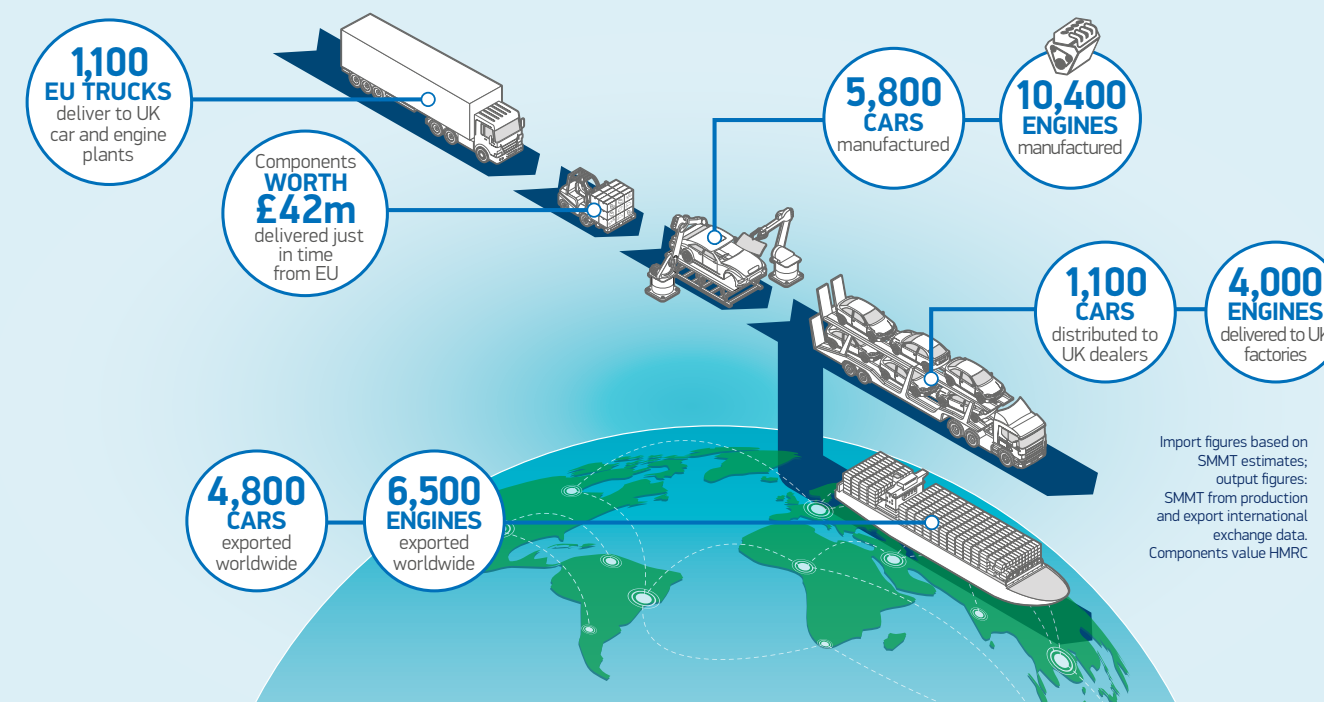
Every day, more than 1,100 trucks cross into the UK from the continent bound for UK car plants (based on an SMMT member survey) – the vast majority without being checked at customs – to deliver some £42 million of components. Every day, these components help build 5,800 cars and 10,400 engines – the majority is then shipped back to EU customers and assembly plants.

Seamless movement of automotive goods across the Channel has been enabled by the UK's participation in the EU customs union and single market, which provide EU businesses with the ability to move goods within the community without stopping at borders.

The introduction of any friction at the border – be it in the form of additional and costly administrative requirements or delays to the movement of goods – would undermine the competitiveness of UK Automotive and would be particularly challenging for the small- and medium-sized businesses that make up more than 90% of the automotive sector.



IN A SINGLE DAY IN UK AUTOMOTIVE...



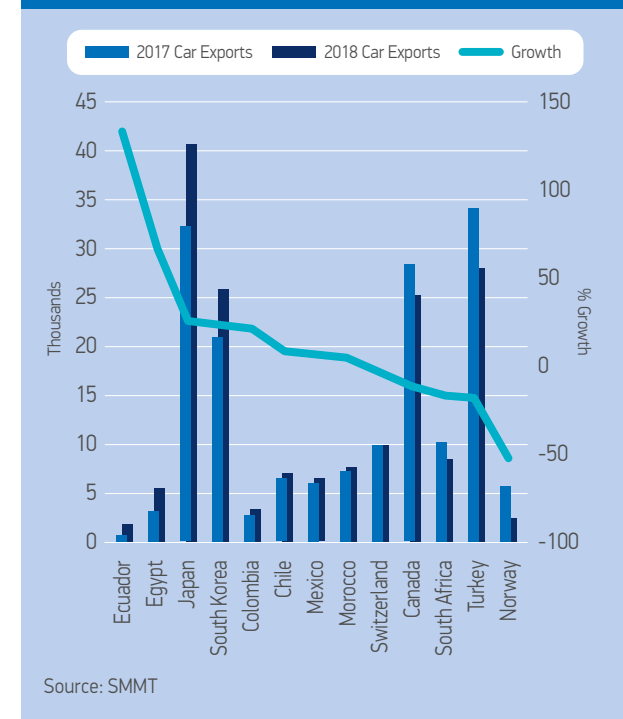
Import figures based on SMMT estimates; output figures: SMMT from production and export international exchange data. Components value HMRC

REPLICATION OF TRADE AGREEMENTS

After its withdrawal from the EU, the UK might cease to be a party to all EU preferential trade agreements, unless the UK government successfully replicates the effects of these treaties on exit day. The replication of complex trade agreements requires time, and the UK is unlikely to preserve preferential treatment with several key trading partners unless a transitional period maintaining the status quo is secured in negotiations with the EU.

More than 16% of UK cars are destined to preferential trading partners. Some of them are among the world's fastest growing markets for UK car exports.

CHART 24 | PREFERENTIAL TRADE WITH SELECTED COUNTRIES (VOLUME)



Thanks to their competitive European supply chain and the extensive network of preferential trade agreements, UK automakers are penetrating markets traditionally protected by significant trade barriers – Asian, South American and northern African markets among them.

In 2018, Japan and Korea stood out as growing export destinations for UK cars, with growth rates of 26% and 23.5% respectively. In South America, UK car exports to Ecuador more than doubled in one year, while exports to Colombia and Chile increased by 21% and 6%. In the Middle East, Egypt recorded a 69% increase of UK car exports.

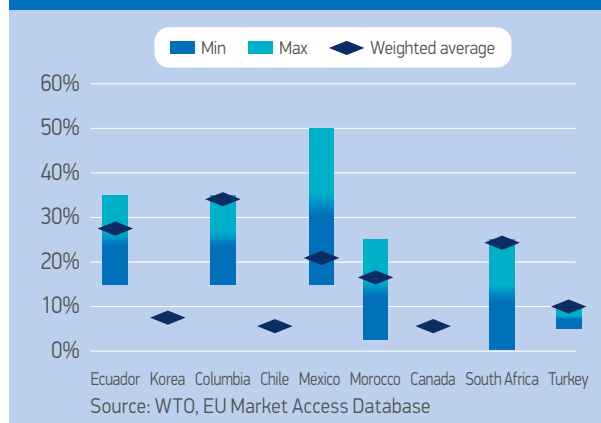
UK passenger cars are currently eligible for tariff-free treatment in countries such as South Korea, Chile, Mexico, Morocco, Egypt and Turkey. Reduced tariffs are applicable to UK cars exported to South Africa, Ecuador, Colombia and Canada.

Shifting to trade on WTO terms with these countries would mean the end of some of these markets as a significant export destination for UK cars, with the application of average tariffs

above 15% in Egypt (43%), Ecuador (26.5%), Colombia (35%), Mexico (21.3%), Morocco (25%) and South Africa (25%).

The reapplication of WTO tariffs in South Korea (8%), Chile (6%), Canada (6.1%) and Turkey (10%) is likely to reduce exports of luxury vehicles to these markets, while exports of premium and other types of UK-built cars could be severely hit.

CHART 25 | SELECTED TRADE PARTNERS: TARIFFS ON CARS (MIN, MAX, AVG)



For countries where 0% tariffs apply on imported cars from any WTO member without the need to have a preferential deal in place – such as Japan – the lapse of existing trade agreements would mean that car exports originating from EU27 countries would face significantly reduced non-tariff barriers, while regulatory barriers will apply in full to UK-built cars.

The replication of the text of existing agreements alone would not be sufficient to maintain current levels of market access. Similar trade terms can only be preserved if UK automotive exporters are able to continue to count EU27 content to comply with rules of origin set by the different agreements in order to qualify for preferential treatment.

Preferential rules of origin vary considerably from agreement to agreement. For example, older trade deals impose high regional content thresholds for passenger cars to qualify for preferential treatment, while modern comprehensive FTAs usually set lower content thresholds. For components, different types of rules of origin apply depending on the single FTA.

TABLE 1 | TYPICAL RULES OF ORIGIN FOR PASSENGER CARS (HS 8703) SELECTED EU TRADE AGREEMENTS

Country	Switzerland (1972)	Korea (2010)	Canada (2016)
Minimum Regional Value Added	60%	55%	50%

Should the UK automotive sector lose the ability to cumulate content originating from the EU27, UK content alone is unlikely to suffice to qualify for preferential treatment.

CASE STUDY: JAPAN

The UK and Japanese automotive industries are linked by a long-standing trade and investment relationship. Since the mid-1980s, several Japanese investors have chosen the UK as their European hub.

The results of the Anglo-Japanese partnership are remarkable. In 2018, three out of the top four British car best-sellers worldwide were from Japanese brands, namely Nissan, Honda and Toyota.

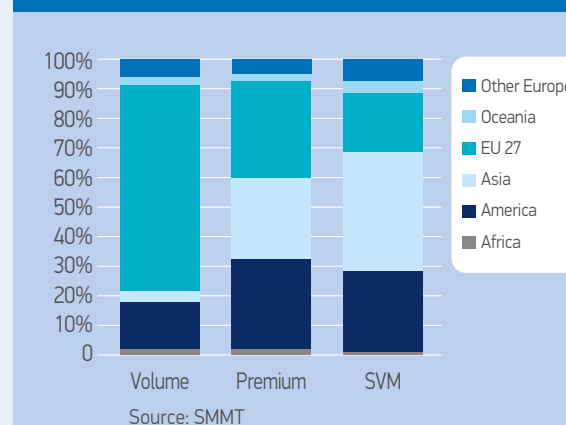
TOP 10 BRITISH BEST-SELLERS WORLDWIDE

- 1 Nissan Qashqai
- 2 MINI
- 3 Honda Civic
- 4 Toyota Auris
- 5 Vauxhall Astra
- 6 Range Rover Sport
- 7 Nissan Juke
- 8 Range Rover
- 9 Range Rover Velar
- 10 Jaguar F Pace

The UK's attraction as an inward investment destination for Japanese manufacturers was not just the possibility to reach the UK domestic market but, moreover, the opportunity to use the country as a gateway to the EU and, ultimately, the single market.

Today, almost 70% of cars exported by UK-based volume manufacturers (VMs) are destined to other EU members. Japanese brands play a key role in this market segment.

CHART 26 | UK EXPORT DESTINATION BY VEHICLE TYPE IN 2018 (VOLUME)



In addition to fruitful Japanese investment in the UK, bilateral automotive trade is on the rise. Exports of UK passenger cars to Japan have increased by more than 160% in the last five years, from a little more than 15,000 units in 2013 to more than 40,000 units in 2018.

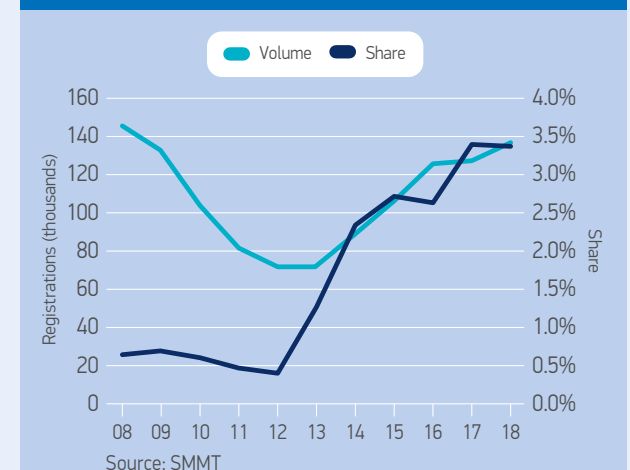
Over this period, exports were driven by premium and volume vehicles, with a recent uplift in exports of luxury cars.

CHART 27 | UK CAR EXPORTS TO JAPAN - BY VEHICLE TYPE (VOLUME)



In parallel, registrations of new cars originating in Japan amounted to more than 135,000 units in 2018, covering 3.4% of the UK market.

CHART 28 | UK NEW CAR REGISTRATION - ORIGINATING FROM JAPAN (VOLUME)



Japanese exporters of motor vehicles to the UK can gain up to £4.8 billion thanks to the newly ratified EU-Japan trade agreement. At the same time, a replicated agreement would reduce testing costs and formalities for UK automotive products exported to Japan.

The evolution of the UK-Japan automotive trade and investment relationship will largely depend on the ability to maintain the same levels of market access to the EU market after the UK's withdrawal and on the replication of the EU-Japan comprehensive trade agreement.

CASE STUDY: SOUTH KOREA

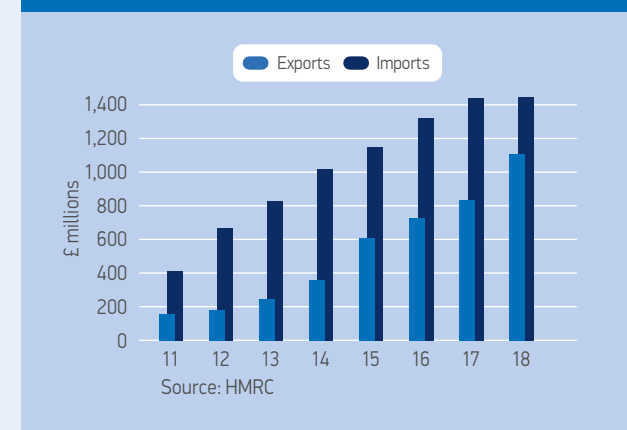
The EU-South Korea trade agreement is the cornerstone of the booming exchange of automotive products between the UK and South Korea. Since 2011, when the agreement entered into force, bilateral trade in vehicles, parts and accessories increased by more than 333%, from £535 million to more than £2.3 billion (HMRC data).

Benefits of the agreement were mutual. For Korean car manufacturers, the reduction of tariff and non-tariff barriers meant a major increase in export volumes and values towards the UK. The UK is now the second biggest export market in the EU for Korean-made cars after Germany. The value of exports of Korean cars to the UK rose from £350 million in 2011 to £1.2 billion in 2018, a 250% increase (HMRC data), while exported units in the same period increased from fewer than 50,000 cars in 2011 to more than 107,000 in 2018 (SMMT data).

Korean brands could also benefit from the high levels of regional European integration and export cars tariff free to the UK from other production facilities in the EU and Turkey. Hyundai, Kia and Ssangyong's combined new car registrations in the UK represented 8.0% of the market in 2018, almost 190,000 new vehicles.

The agreement offered similar opportunities for UK car manufacturers to expand their business in the Korean market. Since 2010, UK car production for Korean buyers has risen more than five-fold. South Korea is the UK's seventh biggest car export market, covering 2.1% of UK car exports in 2018, up from 1.6% in 2017. The value of exports of UK cars to South Korea rose from £133 million in 2011 to £943 million last year (HMRC data). UK car exports increased from 5,500 units in 2011 to almost 26,000 units in 2018 (SMMT data).

CHART 29 | UK-SOUTH KOREA TRADE IN CARS BY VALUE



Despite an increase in bilateral trade of automotive parts and components, the agreement had a limited impact on the integration of UK and Korean supply chains. In this market segment, South Korea enjoys a trade surplus, with more than £113 million of imports to the UK, while exports of UK parts and components in 2018 were worth around £33 million.

Without a bilateral UK-South Korea replicated agreement, trade of automotive products would happen under WTO terms. This would mean the reintroduction of a 10% tariff on imports of Korean cars, 2%-5% tariffs on Korean parts and an 8% tariff on UK cars and components to South Korea.

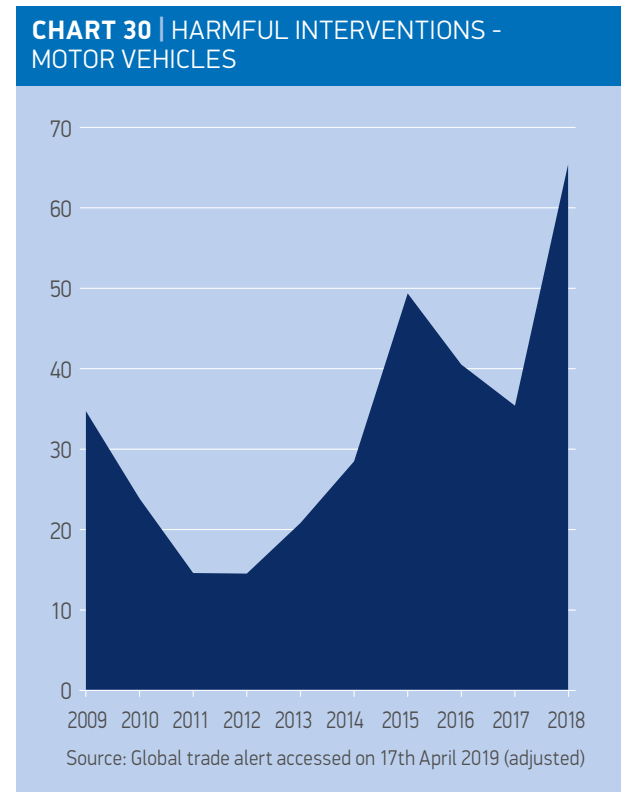
²Data adjusted to December 31, 2018, including trailers and semi-trailers, website accessed in April 2019.

INTERNATIONAL TRADE TENSIONS

In a meeting in Washington DC at the beginning of the 2008 recession, G20 countries reaffirmed their commitment to avoid protectionism as a response to the global crisis. Although some protectionist measures were adopted by all G20 economies, ultimately the global trade environment has not yet witnessed widespread beggar-thy-neighbour policies, which would have further exacerbated the crisis.

Trade of automotive products was not subject to significant trade restrictions in the aftermath of the crisis. However, the situation has radically changed in the last few years. According to Global Trade Alert, the number of new harmful interventions affecting trade of motor vehicles increased from just 15 per year in 2011-2012 to 66 last year.²

The vast majority of harmful interventions took the form of import tariffs, applied either directly to automotive products or on raw materials used in their production. Globally, the UK is the third most affected jurisdiction by such measures after Germany and China (Global Trade Alert).



Traditionally, steel has been the primary metal used in the production of many automotive parts and components. The World Steel Association estimates that, on average, 900kg of steel is used per vehicle.

More recently, aluminium has been increasingly considered as a valid alternative for the production of certain parts and components. Thanks to its physical properties, the use of aluminium in the production of automotive products has helped car manufacturers to make cars lighter and more fuel efficient, playing a key role in reaching lower emission targets.

Existing trade-restrictive measures targeting essential

production inputs, as well as related compensatory and retaliatory measures, risk inflating manufacturing costs worldwide, to the detriment of end users and downstream industries.

Disruption of international supply chains would be considerable if producers are forced to seek domestic alternatives to imported materials targeted by import restrictions. Such alternatives often do not exist or are not cost competitive.

A further escalation of international trade tensions in key global markets such as the EU, USA, China and other Asian markets would represent a significant threat to the UK automotive industry.

In this regard, the significant slowdown in Chinese demand for automotive products rings an alarm bell. UK car exports to China declined from over 100,000 units in 2017 to a little more than 75,000 in 2018, a 24.5% decrease. This contraction was recorded despite China's decision to lower tariffs applied on imported UK cars from 25% to 15%. The impact of reciprocal tariffs on billions of dollars' worth of USA-China trade might have affected China's domestic market far more than a single tariff reduction.

For the future success of the UK motor industry, current trade tensions impacting automotive trade should be resolved through collaborative efforts to eliminate existing and future trade barriers.

AUTOMOTIVE REGULATIONS

Automotive safety and environmental regulations differ from country to country. However, three regional blocks shape the sector's regulatory framework:

- 1: The EU and the block of countries following the type-approval approach embodied in the 1958 UNECE agreement;
- 2: The US and the group of counties following the self-certification approach embodied in the Federal Motor Vehicle Safety Standards (FMVSS);
- 3: China, which opted for a unique mix of national standards (Guobiao or GB).

Despite efforts to create global regulations in the context of the UNECE World Forum for Harmonization of Vehicle Regulations (WP.29), existing differences create significant costs in designing, producing, testing and marketing automotive products in different markets.

The UK's withdrawal from the EU represents a double challenge for the UK automotive sector. First, the UK is likely to lose its ability to shape EU rules and influence the setting of requirements from within one of the main regulatory superpowers. Second, any attempt by the UK to set its own automotive regulations in the future risks creating additional trade barriers.

In this context, it is essential the UK maintains its role in UNECE discussions and support initiatives for future global technical regulations. In parallel, UK policy-makers should refrain from any regulatory initiative that might result in new frictions on trade between the UK and the EU or create UK-only requirements.



TABLE 2 | AUTOMOTIVE REGULATIONS

Position	USA	EU	China
Authority	NHTSA, part of the department of Transport	UNECE EU Commission EU Council EU parliament National Authorities	Ministry of Industry and Information Technology (MIIT) Administration of Quality, Supervision, Inspection and Quarantine (AQSIQ)
Regulations	FMVSS	UNECE Agreement 1958 UNECE Agreement 1997	EU regulations GUO BIAO (GB)
Compliance Procedures	Self-certification + Sample verification	UNECE 1998 Agreement and Global Technical Regulations Type approval	Chinese type approval

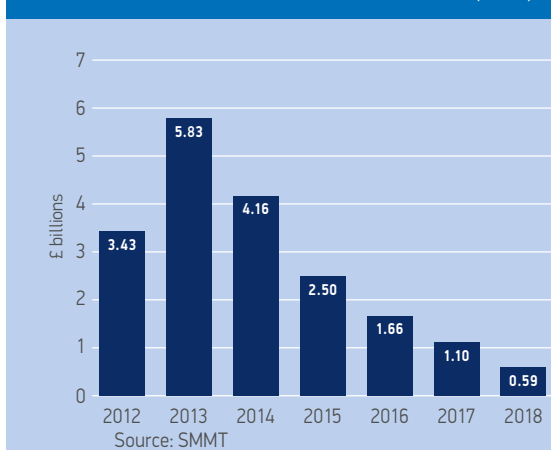
Source: SMMT, adjusted from CAR (2016)

INVESTMENT RISKS

For decades, the UK has represented an ideal hub for new automotive investment. The UK's favourable business environment and the ever deeper integration of the EU single market were two essential pillars to revitalise domestic motor manufacturers and attract new investment from abroad. Many overseas investors, Japanese automotive manufacturers in particular, have chosen the UK as their European base since the 1980s.

Although the industry fundamentals remain strong, with increasing expenditure on automotive R&D investment, mounting political and business uncertainty has led UK investors to take a cautious approach when considering future investment plans. Dwindling levels of publicly announced investment decisions are a warning signal of investors' reluctance to make new commitments without the necessary clarity on the UK's future trade and industrial framework.

CHART 31 | PUBLICALLY ANNOUNCED UK AUTOMOTIVE INVESTMENT DECISIONS (£BN)



GLOBAL TECHNOLOGY SHIFT

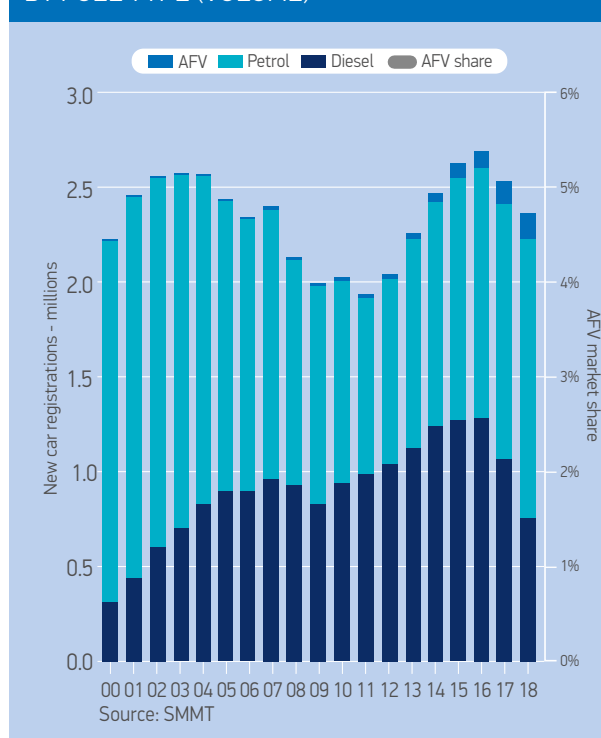
The automotive industry is going through a dramatic shift in the way vehicles are powered and driven, as well as in the way they are manufactured.

To date, there are 195,410 plug-in vehicles on UK roads, out of about 35 million cars. The new car market share of plug-in vehicles in 2018 was 2.5% (battery electric vehicles 0.7%; plug-in hybrids 1.9%), up from 1.94% in 2017. Alternatively fuelled vehicles represented about 6.0% of new car registrations in 2018.

According to Deloitte's global projections, EVs – including battery electric vehicles and plug-in hybrids – will represent 20% of global light duty vehicles sales by 2030. Bloomberg's projections foresee a 28% market share.

The progressive substitution of traditional internal combustion engine vehicles with intelligent vehicles powered by electricity or alternative fuels will be accompanied by a complete overhaul of existing business models.

CHART 32 | UK NEW CAR REGISTRATIONS BY FUEL TYPE (VOLUME)



The forthcoming changes present significant opportunities for the sector. However, change also means new challenges to the existing automotive legislative framework, including commercial policy.

To remain relevant, the UK motor industry will need to be fully integrated into future international supply chains stretching from suppliers of new raw materials to the most advanced software developers. The UK business ecosystem and the UK automotive sector in particular must strive for continuous improvement, favourable legislation and innovation.

In this context, a strong collaborative approach must be built between UK automotive manufacturers, innovators and policy makers to ensure that the UK remains an investment hub where the next generation of vehicles will be designed, developed, manufactured and deployed.

The government's £1.5 billion planned investment in EV development, infrastructure and market development through to 2021 is a step in the right direction. More critical is ensuring an orderly structural transition in the UK automotive industry from designing and manufacturing internal combustion engines and vehicles to designing and manufacturing batteries, power electronics, motors and electric vehicles.

Domestic, regional and international trade rules should develop accordingly, in order to support the UK automotive industry's participation in new global value chains. Future trade rules should allow unhindered and safe exchange of data, free flow of data as part of the wider data economy, a correct use of new technology to lower trade costs and increase productivity.



5 OPPORTUNITIES

- The reduction of non-tariff barriers is a key priority for the UK and European automotive sector.
- Removing tariffs through bilateral trade negotiations is important to improve market access and open new commercial opportunities.
- Shaping mutually supportive trade rules and industrial strategies is pivotal in ensuring the UK will play a key role in the development of electrified vehicles and connected and autonomous vehicles.
- Automation, electrification and the servitisation of the automotive industry present vast untapped potential.

REDUCTION OF NON-TARIFF BARRIERS

► While most discussions on trade in industrial goods tend to focus on tariffs, non-tariff barriers (NTBs) are often more costly than import duties. Although most NTBs serve legitimate policy objectives, NTBs affecting UK automotive exports can result in overly restrictive measures, redundant operations and burdensome compliance procedures.

According to a 2016 business survey by the International Trade Centre (ITC), EU exporters are affected by a large variety of NTBs.

Conformity assessments and technical requirements, entry formalities, rules of origin and taxes were identified as some of the most burdensome measures. The automotive sector is no exception and reducing these NTBs can achieve considerable benefits for UK automotive exporters.

TABLE 3 | ISSUES WITH BURDENSOME REGULATIONS RAISED BY EU EXPORTER, BY TYPE

	Number of issues (product/destination/ partner)	Share of total (%)
A. Technical requirements	1,229	16.9
B. Conformity assessment	22,314	31.9
C. Pre-shipment inspections and other entry formalities	582	8.0
D. Trade remedies	41	0.6
E. Quantity control measures	215	3.0
F. Charge, taxes and price control measures	193	2.7
G. Finance measures	103	1.4
H. Anti-competitive measures	33	0.5
I. Trade related investment measures	10	0.1
J. Distribution restrictions	24	0.3
K. Restrictions on post-sales services	12	0.2
L. Subsidies	1	0.0
M. Government procurement restrictions	29	0.4
N. Intellectual property	13	0.2
O1. Preferential rules of origin and related certificates of origin	580	8.0
O2. Non-preferential rules of origin and related certificates of origin	594	8.2
P. Export related measures	1,291	17.8
TOTAL	7,264	100

SOURCE: ITC business survey in the EU, 2015 - 2016

A: TECHNICAL BARRIERS

Modern comprehensive trade agreements such as those between the EU, Korea, Canada and Japan contain automotive-specific chapters aimed at addressing regulatory barriers and facilitating the recognition of equivalent automotive standards. The agreement with Japan also includes an innovative safeguard mechanism allowing the re-imposition of tariffs should the parties fail to implement their commitments on automotive regulatory barriers.

According to a recent government-commissioned impact assessment on the EU-Japan trade deal, the British automotive industry could gain £1 billion in exports. However, potential export gains for UK motor manufacturers are dependent on the removal of regulatory barriers and related costs,³ given that Japan does not charge any tariffs on automotive imports from the UK. A similar 2013 study assessing the impact of a potential trade agreement between

the EU and USA estimated the UK's motor vehicle output could increase by as much as 7.3% should the parties agree to reduce NTBs by 75% in the sector.⁴

Automotive chapters should become part of all future trade agreements. However, regulatory barriers related to technical standards, type approval certificates or testing requirements could also be reduced through discussions with relevant counterparts without the need to launch formal trade negotiations.

In this context, the UK automotive sector would greatly benefit from the achievement of a robust International Whole Vehicle Type Approval scheme under the future UNECE regulations section.

A harmonised global approach to regulations applicable to SVMs would be beneficial for UK manufacturers of luxury and sports cars. In particular, British SVMs need appropriate regulations that are commensurate with their lower volumes,

³DIT, Impact assessment of the EU-Japan Economic Partnership Agreement (EPA) on the UK, 2018

⁴CEPR, Estimating the Economic Impact on the UK of a Transatlantic Trade and Investment Partnership (TTIP) Agreement between the European Union and the United States, 2013

overall market impact and administrative burden.

A broader use of functional equivalence and mutual recognition of similar safety standards could also represent a quicker way to considerably lower costs of automotive product development, manufacturing and marketing. However, mutual recognition of respective standards must not undermine the current high levels of vehicle safety and environmental performance or result in new barriers on trade with existing trading partners.

B: RULES OF ORIGIN

A simplification of rules of origin would help automotive exporters make use of existing trade preferences, particularly for automotive SMEs interested in internationalising their business.

Future rules of origin for automotive products should reflect the existence of global value chains by providing greater flexibility on the use of non-originating materials (NOM). Reasonable value added thresholds, increased tolerance thresholds for NOM, a greater use of diagonal and full cumulation would provide additional flexibility.

In particular, rules of origin on electric batteries and key materials and components for new-generation vehicles should be attainable and reflect the existence of international global value chains. Allowing fleet averaging as an option to calculate originating content and permitting duty drawbacks would also be beneficial to qualify for preferential treatment and reduce costs.

C: CUSTOMS FORMALITIES

Customs procedures and border enforcement rules can cause high additional costs for UK automotive traders. Such costs could be reduced through customs administrative arrangements or FTAs aimed at eliminating unnecessary controls (for example, controls at origin, but not again upon arrival).

Arrangements should allow for efficient customs clearance taking into account participation in international supply chains and strengthen the actual benefits to which trusted partners have access. Enhanced cooperation on security could also help reduce pre-notification requirements.

An overhaul of existing formalities for origin declarations would be beneficial. At present, suppliers send a declaration for a fixed period of maximum two years and the onus is on suppliers to inform their clients if anything changes during that period. A longer or unlimited validity of the declaration until informed otherwise would reduce the administrative burden for OEMs who must contact suppliers each time a declaration expires and on suppliers who in many cases are re-submitting the same information for the same part year on year.

D: TAXATION

Cars are frequently subject to luxury taxes with particularly negative impacts on British premium and luxury brands. For example, in Indonesia motor vehicles are classified as luxury goods and are subject to a sales tax ranging from 10% to 120%, depending on the vehicle type. In Australia, a 33% luxury tax is applied above the value of AUD 64,132 (approximately £35,000) for regular cars and AUD 75,526 (approximately £40,000) for fuel-efficient vehicles.

In some jurisdictions, fiscal measures benefitting domestic producers of electric vehicles are not available for equivalent imported vehicles, a discriminatory treatment resulting in market distortions to the detriment of British motor manufacturers. In other cases, such as the so-called kei cars in Japan, domestic vehicles enjoy tax and insurance incentives which are not available for directly competitive imported automotive products.

Domestic taxation is usually excluded from formal trade negotiations. However, separate government-to-government discussions could also tackle taxes when they are particularly impactful on international automotive trade, including potentially over-restrictive fiscal measures on diesel.

REDUCTION OF TARIFF BARRIERS

Even if the vast majority of UK trading partners offers at least some form of preferential treatment to automotive products, tariff reduction is still necessary to open new overseas markets.

Some of the existing preferential trading partners maintain tariffs on UK automotive exports, although at a reduced rate compared to tariffs applied on imports from non-preferential trading partners.

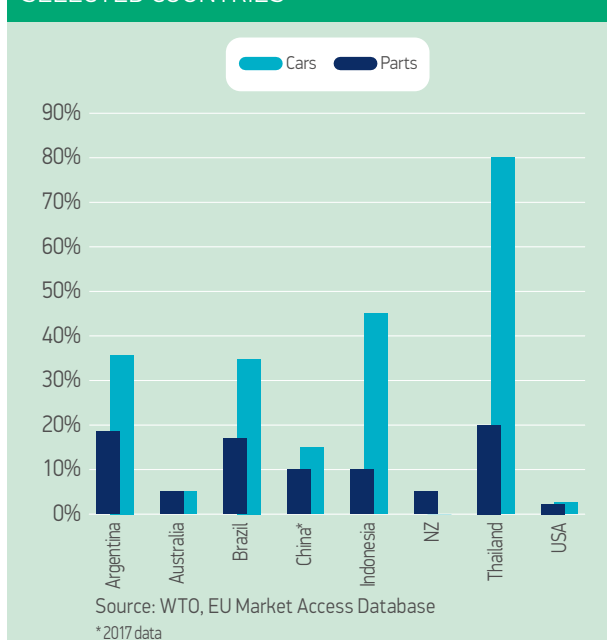
TABLE 4 | MIN MAX PREFERENTIAL AND MFN TARIFFS (SELECTED COUNTRIES AND PRODUCTS)

Country	Product	EU	MFN
Colombia	Passenger Cars	0% - 4.4%	15% - 35%
	Parts	0% - 5.4%	0% - 10%
Ecuador	Passenger Cars	6.3% - 25%	15% - 40%
	Parts	0% - 10.9%	0% - 15%
South Africa	Passenger Cars	0% - 18%	0% - 25%
	Parts	0% - 15%	0% - 20%

Source: EU Market Access Database

For countries with which the EU does not currently have a preferential trade agreement in place, tariff peaks on automotive products can be very significant. In particular, large markets in South America and south-east Asia remain heavily protected by prohibitive tariffs. An average 35% tariff on passenger cars applies in Argentina and Brazil, the largest potential markets in South America. Prohibitive tariffs on cars are applied in rapidly developing economies such as India (125%), Thailand (80%), Vietnam (70% tariff peak) and Indonesia (50% tariff peak). Tariffs on parts and components in these countries are equally high, often ranging between 10% and 30%.

CHART 33 | AVERAGE TARIFFS FOR SELECTED COUNTRIES



High tariffs effectively ringfence regions that are increasingly attractive destinations for both finished vehicles and components, either for the sheer size of their markets or their increasing importance as regional manufacturing hubs.

Tariffs for top export destinations such as the USA, China and the Pacific region are generally lower compared with rapidly developing markets, but automotive exports to these countries often remain costly. Given the importance of these markets for British automotive exports, tariff reductions would be beneficial.

In 2018, China reduced tariffs on cars from 25% to 15% and lowered duties on components from 6-25% to 3-6%. However, given the role of China as the world's biggest automotive market and producer, tariffs remain a significant barrier.

In the USA, tariffs on passenger cars (2.5%) and components (0-2.5%) are significantly lower compared with other major automotive production hubs. However, a 25% import duty on light commercial vehicles, pick-up trucks and heavy duty vehicles represents a significant tariff peak.

In the Pacific region, Australia applies tariffs up to 5% on passenger cars and components. New Zealand has almost entirely liberalised imports of finished vehicles, while an average 4.3% tariff still applies on parts and components.

Contrary to regulatory barriers, tariff reduction is achievable only through the negotiation of fully fledged trade agreements at the multilateral, plurilateral or bilateral level.

An agreement among all WTO members would represent the optimal solution to lower tariffs globally. However, given the longstanding deadlock in WTO multilateral negotiations requiring consensus from the entire membership, only two options are effectively available.

A sectoral plurilateral agreement under the aegis of the WTO represents a second-best solution. Such agreement would eliminate tariffs among all major automotive producers and traders. However, the possibility of free-riding for those WTO members who would not join the negotiations as well as major divisions in similar negotiations on services and environmental goods are a stark warning for the prospect of plurilateral negotiations on automotive trade.

Hence, regional and bilateral trade negotiations remain the most viable option to reduce tariff costs. In this context, the UK's withdrawal from the EU adds a significant layer of complexity. The UK should continue to advocate for further trade liberalisation in EU trade negotiations, if the EU and the UK maintain an exceptionally close trading relationship after the UK's exit. In this scenario, three priorities should top the agenda of UK's trade policy:

- 1: Advocate a speedy finalisation of longstanding trade agreements and negotiations between the EU and emerging markets such as Argentina, Brazil, Vietnam, Thailand and Indonesia.
- 2: Advocate discussions with existing preferential trading partners to upgrade and modernise older trade agreements.
- 3: Advocate speedy negotiations with major industrialised economies such as the USA, Australia and New Zealand.

Should the EU and the UK agree on a looser trade relationship, in setting its own trade policy the UK should ensure that any agreement with third countries would not result in additional barriers on EU-UK trade. In this scenario, the UK should closely follow the EU trade agenda and avoid embarking into negotiations that risk hurting the interests of the UK and the wider European automotive industry.

At the same time, the UK should ensure its automotive businesses are not at a competitive disadvantage compared with EU competitors. This could be achieved through parallel negotiations avoiding significant time gaps between the conclusion of EU agreements with third countries and the finalisation of similar agreements between the UK and new EU preferential trading partners. In this scenario, parallel negotiations seeking ambitious agreements with Australia and New Zealand would be a reasonable first step.

CAVS DEPLOYMENT AND STANDARDS

Future trade rules applicable to the UK automotive sector could help create business opportunities only if fine-tuned with the development of next-generation vehicles and related technologies.

Today's driver assistance technology and the next generation of autonomous systems are set to deliver an overall annual £62 billion economic benefit to the UK by 2030 (SMMT Connect and Autonomous Vehicles: Winning the Global Race to Market). The development and deployment of connected vehicles could create 420,000 new jobs across automotive and adjacent sector.

The UK is on track to become a world leader in autonomous vehicle testing and deployment thanks to forward-looking enabling legislation, the availability of enabling infrastructure and market attractiveness.

The forthcoming transport revolution also represents a unique opportunity to favour international harmonisation and avoid the development of a patchwork of national regulations or standards for new transport technologies, which would ultimately represent additional costs and barriers to trade.

The creation of a global level playing field largely depends on the capability of all major players to agree on common standards applicable to future vehicles. Common international standards would maximise the opportunity for the UK to become a global hub for CAV development and deployment.

In this context, the UK's role in developing UNECE Global Technical Regulations is pivotal. In addition, the UK should advocate for a stronger partnership between automotive regulatory superpowers such as the EU, the USA and China to bridge existing differences and find acceptable compromises.

TRADE, R&D INVESTMENT AND INDUSTRIAL STRATEGIES

The sector's response to mounting external challenges is a renewed effort to bring forward the industry's technological innovation frontier.

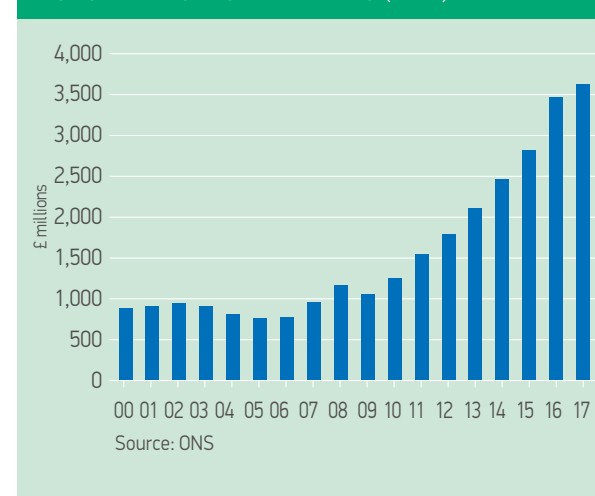
Although Brexit uncertainty is threatening new major capital investment, the UK automotive sector continues to invest in research and development. In 2017 alone, R&D expenditure in the sector amounted to a record-breaking £3.6 billion (ONS data).

The automotive business is the second biggest employer in the UK of R&D researchers, technicians and support staff after the pharmaceutical sector. In 2017, the automotive industry employed more R&D staff than computer programming, software development or R&D services (ONS data).

The sector's ambitions have been matched by the launch of the UK government's Automotive Industrial Strategy.

The overall strategy sets out how the government plans to support businesses to create better, higher-paying jobs with investment in the skills, industries and infrastructure of the future. The Industrial Strategy sets out what it calls grand challenges:

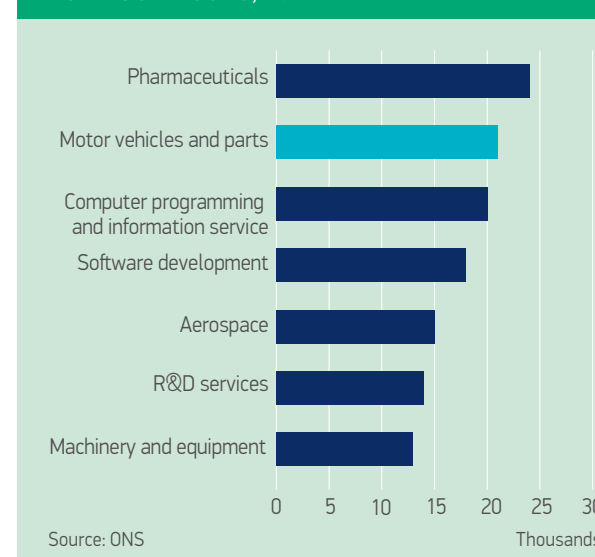
CHART 34 | R&D EXPENDITURE IN UK MOTOR VEHICLES AND PARTS (£MN)



artificial intelligence and data, ageing society, clean growth and future of mobility. These recognise the areas the country (and globe) are going to evolve in, and the five foundations of productivity: people, places, business environment, infrastructure and ideas, which set a path to improve productivity in the UK.

The specific Automotive Industrial Strategy Sector Deal is a signal from UK government of the strategic importance to the economy of having a strong automotive industry. The sector deal builds on the longstanding partnership between government and industry. The automotive deal, the second sectoral agreement signed under the government's new Industrial Strategy, recognises the substantial changes that are taking place in the industry, from how vehicles are powered to the way in which they are built. It commits government and industry money to ensure the UK remains a globally leading country in which to research, test and build components and vehicles while meeting the grand challenges set out in the overall Industrial Strategy.

CHART 35 | EMPLOYMENT IN R&D PERFORMED IN UK BUSINESSES, 2017



Regardless of the outcome of Brexit negotiations, the UK automotive industry must take centre stage of future trade, investment and industrial strategies, and these strategies must be mutually reinforcing. A credible forward-looking trade agenda must focus on the UK's largest exporter of industrial goods, while a serious investment and industrial strategy should aim to increase the sector's technological development and production potential.

Taking into consideration the peak in UK car production and domestic market in the last 10 years, SMMT estimates the total value of trade could increase by 20%, from £101 billion to £122 billion. This could be achieved through the revitalization of the UK sales market and by preserving existing supply chains and market access levels. Sound trade, industrial and investment policies must ensure that the shift to automated, connected, electric and shared vehicles will result in even greater trade opportunities for UK manufacturers.

In this context, trade rules applicable to next-generation vehicles and components should allow UK automotive manufacturers to supply new raw materials and innovative parts tariff-free from key trading partners, while future investment should land modern facilities in the UK – including gigafactories to produce electric batteries – in order to add local value to final products through substantive manufacturing activities.

THE RISE OF AUTOMOTIVE SERVICES

Traditionally, the international trade framework has clearly distinguished rules applicable to goods and rules applicable to services. However, services already permeate and add value to the UK automotive industry.

Automobile engineering services are essential to design, develop, produce and test new automotive models, R&D is critical to spur automotive innovation, manufacturing services are pivotal in producing automotive products.

The UK's aftermarket industry generates more than £21 billion in revenues and contributes £12.2 billion to the UK economy, but that is still a fraction of what British maintenance services could gain globally and in markets such as China, India and the Middle East.

Marketing services are often at the centre of automotive branding strategies and play a key role in enhancing visibility of UK automotive products when they are introduced to new or under-served markets.

The UK domestic market would not be the second biggest car market in the EU if passenger cars were not offered in combination with innovative financial solutions and insurance services. Leasing exemplifies how the boundaries between goods and services are already blurred in our sector.

Clearly, greater penetration of UK services in preferential and third markets could benefit the UK automotive industry.

A stronger synergy between UK auto exporters and British financial and insurance services could foster international operations, including the prospect of smaller suppliers taking their first steps to exporting overseas.

Gathering additional evidence in this area could help create modern, business-friendly trade rules. For example, the full inclusion of services in the calculation of regional value added thresholds could help UK automotive exporters to qualify for preferential treatment in future FTAs.

Easing labour mobility for professionals offering automotive-related services could also help address longstanding skill gaps and ensure that talents across the world can contribute to the sector's success.

It is foreseeable that services will play an even greater role in the automotive industry. The future of mobility is inherently linked to the idea of mobility as a service. Today, some of the world's biggest mobility providers do not own a single vehicle. We can expect traditional manufacturers to take a more proactive role in shaping new mobility services.

According to a 2018 report by PWC, today, less than 3% of industry revenues and less than 1% of profits come from connected services and mobility services. By 2030, these may both be around 30%.

A future in which intelligent environmentally friendly vehicles transport goods and people on demand can be fully deployed only if domestic legislation and international trade rules will enable cross-border exchanges of automotive goods and services bundles.



6

EIGHT RECOMMENDATIONS FOR GOVERNMENT AND INDUSTRY

1 SET FORWARD-LOOKING AUTO TRADE STRATEGY

- Any UK trade policy needs to have the automotive industry at its heart, regardless of the outcome of Brexit negotiations. Failing to do so would immensely reduce the chances to increase the contribution of UK exports to the national GDP and endanger the UK's role as a leading exporter of industrial goods.
- Government and industry should exercise thought leadership in shaping national, regional and global trade rules applicable to new-generation vehicles and automotive technologies. The sector needs a positive, modern, automotive-friendly trade agenda.

2 PRESERVE CURRENT MARKET ACCESS

- Ensuring no new barriers are introduced on trade between the UK, EU and wider Euro-Mediterranean region is essential to protect regional supply chains, maintain a competitive domestic market and preserve the majority of key UK automotive exports.
- Maintaining existing trade terms for preferential access to major markets beyond the European region is pivotal to support the sector's international expansion strategy and to preserve British consumers' choice.
- Government and industry should spare no efforts to defuse international trade tensions in major automotive markets. Such tensions threaten the multilateral trading system and risk disrupting trade flows of raw materials and automotive products.

3 STRENGTHEN INDUSTRY ENGAGEMENT

- Close collaboration between government and UK Automotive as the UK's largest exporter of industrial goods is essential. Collaboration should be ensured through the establishment of flexible engagement mechanisms, including automotive interests at the highest level of UK trade strategy and policy formation.
- UK exporters and importers need to ensure trade policy experts are part of their senior management teams, in order to give a meaningful contribution to the development of government trade policies on priority markets, rules of origin and key defensive and offensive trade interests.
- Given the complexities of trade policy, government should reassess its model of generalist civil servants and ensure that a team of specialists leads industry engagement in this area.

4 SEEK NEW TRADE OPPORTUNITIES

- Government and industry should explore opportunities to improve market access for UK automotive products by reducing tariff and non-tariff barriers.
- Comprehensive trade agreements should not be considered the only instrument available to reach ambitious trade policy objectives. Non-tariff barriers can be addressed without resorting to formal trade negotiations.
- Any potential gain from the reduction of trade barriers with third countries cannot be analysed in isolation from potential negative impacts on existing trading partners.

5 LEAD REGULATORY DISCUSSIONS

- The UK needs to remain at the forefront of international norm-setting of automotive regulation.
- The UK's role in UNECE discussions must be preserved and strengthened, especially in key technology areas.
- The UK should increase its efforts to bridge gaps between regulatory superpowers, reduce existing regulatory barriers and avoid the development of a patchwork of national regulations or standards for future transport technologies.

6 ENHANCE DOMESTIC CUSTOMS SYSTEM

- Government and industry should collaborate to enhance trade facilitation and ensure legitimate trade does not face costly border delays.
- Investment in physical and digital infrastructure is crucial to provide a world class customs service to UK automotive importers and exporters.
- Create a non-burdensome systems environment which supports and promotes trade to and from the UK for businesses of all sizes.
- Incentives should be provided for upgrading, investment and upskilling of suppliers dealing with customs formalities today and in the future – especially smaller businesses.

7 FOSTER TRADE PROMOTION

- Many of the markets with the greatest opportunities for UK firms often present significant language and cultural challenges, complex regulatory environments and market access barriers.
- Financial support must be available to support UK companies, in particular to help them explore distant, risky markets.
- Government support is crucial to enabling an impactful presence at key international events, to raise UK profile and open up opportunities for UK firms.

8 LINK TRADE AND INDUSTRIAL STRATEGIES

- Mutually supportive trade rules, industrial strategies and investment plans can ensure that the UK will remain a hub where automotive businesses can develop, manufacture, deploy and trade their products.
- The UK automotive sector should give inputs going beyond traditional topics and step-up to the challenge of building a solid industry position on future key policy areas - from mobility services to data exchanges, privacy and cybersecurity.
- Government and industry should work ever closer in a cross-departmental effort to ensure that the UK's strategic interests in a strong, modern and innovative automotive sector are prioritised and sustained by future trade and industrial policies.

**ANNEX: DATA SOURCES**

SMMT has used three key sources for the trade data – ONS, HMRC and our own SMMT data sets. The two government sources are used for value of exports and imports. They use slightly different classifications and approaches, but the overall difference is relatively small in this context (see table). We have used ONS data for the headline figures and HMRC data for country specific information (which is not available from the ONS data). SMMT data is used for volumes of vehicle production destined for export and new registrations by origin.

For more information on SMMT data and for additional data please contact aisdata@smtt.co.uk

Export £billion	2017	2018	% change
HMRC	43.0	42.2	-1.9%
ONS	44.9	44.4	-1.2%
Difference (£)	-1.9	-2.2	
Import £billion			
HMRC	55.3	54.6	-1.3%
ONS	57.6	57.0	-1.0%
Difference (£)	-2.3	-2.5	

The ONS data uses the change in ownership balance of payments methodology, whilst HMRC uses physical movement of goods.

The ONS data uses SIC29 and covers all motor vehicles, including engines and parts and accessories. The ONS data gives both home and export details and a split between EU and non-EU. See <https://www.ons.gov.uk/economy/nationalaccounts/balanceofpayments/bulletins/uktrade/previousReleases> and for data and <http://www.siccodesupport.co.uk/sic-division.php> for SIC29 definition.

The HMRC 4-digit data codes and for the purposes of this report certain codes in 87 (motor vehicles and parts and accessories) and 84 (engines). The detailed codes are given below. The HMRC data can be analysed at country level, so offers greater granularity.

Chart 3 uses HMRC SITC Division (two digit Standard International Trade Classification) data, whereas table opposite and other HMRC data in this report uses four digit codes.

<https://www.uktradeinfo.com/Statistics/BuildYourOwnTables/Pages/Home.aspx>

HMRC CODES USED

- **8701** Tractors
- **8702** Motor vehicles for the transport of >= 10 persons
- **8703** Motor cars and other motor vehicles principally designed for the transport of <10 persons, incl. station wagons and racing cars
- **8704** Motor vehicles for the transport of goods, incl. chassis with engine and cab
- **8705** Special purpose motor vehicles
- **8706** Chassis fitted with engines, for tractors, motor vehicles
- **8707** Bodies, incl. cabs, for tractors, motor vehicles
- **8708** Parts and accessories for tractors, motor vehicles
- **8709** Works trucks
- **8716** Trailers and semi-trailers
- **840731, 840732, 840733, 840734** Petrol Engines
- **840820** Diesel Engines

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