Llywodraeth Cymru
Welsh Government

# Trade Policy: the issues for Wales

Securing Wales' Future

# Contents



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# Foreword

Wales is an outward-looking, globally trading nation. Our businesses trade across the world and in 2016 exports from Wales were worth £14.6 billion. In recent years we have posted our best inward investment figures for many years.

Leaving the European Union represents the greatest change in our international trade status for generations. Whatever the challenges, we are clear that leaving the EU does not mean turning our backs on our trading partners in Europe. Equally, we should embrace the new impetus for trading opportunities around the world.

As we face Phase two of EU exit negotiations, the Welsh Government will do all that we can to influence a negotiated outcome that is rational, evidence-based and serves the interests of businesses and citizens across Wales.

**Carwyn Jones AM**
**First Minister of Wales**

The decisions taken as the UK develops future trading relationships with the EU and the rest of the world will define Wales' economic interests for years to come. This paper sets out our priorities for our future trading relationship with Europe and the rest of the world after we leave the EU. I want to ensure that Wales continues to be seen as a great nation to trade with and invest in.

We recently published *Prosperity for All: Economic Action Plan* - a new national strategy for a more prosperous Wales. Trade is a vital component of Wales' economic prosperity and a key element of the new Economic Contract between business and government. Together we will ensure that Welsh businesses continue to exploit opportunities to trade around the world in new and existing markets.

**Ken Skates AM**
**Cabinet Secretary for Economy and Transport**

# Summary

At the start of 2017 the Welsh Government, together with Plaid Cymru, published a White Paper, *Securing Wales' Future*, setting out how we think the UK should approach withdrawal from the European Union. This new document addresses the key issues we believe need to be considered as the UK develops future trading relationships with the EU and rest of the world.

The Welsh economy is closely integrated into the Single Market and 61% of identifiable Welsh goods exports and just under half of our imports are to and from the EU. In addition, many Welsh components are incorporated into goods and services exported to the EU from other parts of the UK. Wales' success in attracting Foreign Direct Investment over many decades is largely based on access to the EU market of more than 500 million customers.

Wales is an outward-facing, globally-trading nation and remains very much open for business. Our economy is vibrant and diverse, and offers great opportunities for trade and investment. We host world-leading technology companies, excellent research and development facilities, a highly skilled workforce and a wealth of natural resources. Subject to a sensible Brexit, we are in good shape to meet future challenges and opportunities.

We believe that continued full and unfettered access to Europe's Single Market is vital to Wales' forward economic interests. We remain to be convinced that leaving a customs union with the EU is in our interests, at least for the foreseeable future. If the UK Government pursues its policy of leaving the Single Market and the Customs Union in favour of a wholly independent trade policy this will risk the imposition of non-tariff barriers and, potentially, tariffs, which could only be damaging to business in Wales and the UK. We have seen no sound argument to the contrary.

Trade will remain an area of EU exclusive competence until we leave the EU. After we have left, the UK's trade policy will be the principal responsibility of the UK Government but with a significant intersection with devolved powers in areas such as environmental standards, economic development, agriculture and skills and qualifications. Decisions on new trading relationships both with the EU and the wider world must be taken in close co-operation between the UK Government and Devolved Administrations in order to reflect fully the interests of the whole United Kingdom.

We strongly welcome the UK Government's recognition in their White Paper, *Preparing for our Future UK Trade* policy, that Devolved Governments (and, indeed, legislatures) have an important role in shaping future trade policy given the impact of trade on devolved areas of competence. We also welcome the emphasis on transparency and inclusivity as core principles of the way in which the UK Government intends to develop future trade policy.

We expect the UK Government to consult extensively with the Welsh Government and gain our consent whenever trade policy impacts on devolved competences. We are a willing and constructive partner and are ready to engage. We argue in *Brexit and Devolution* for new machinery to agree joint approaches on reserved issues which cut across devolved areas of competence. We call for the establishment of a UK Council of Ministers as a forum for consultation on trade issues between the four UK administrations. As an interim measure a new Joint Ministerial Committee on International Trade should be established to ensure that the UK Government's approach to trade policy takes into account the interests and concerns of the devolved institutions.

## How trade benefits Wales

**Trade is a vital part of ensuring the prosperity of Welsh people through fuelling the economy, generating jobs and providing choice for consumers at the most competitive prices. International exports provide an important market for Welsh firms, and imports provide inputs to businesses and goods for consumers, keeping prices down and increasing choice. In 2016 Welsh goods exports were £14.6 billion and in 2015 service exports were £1.7 billion. 61% of goods exports went to the EU and 35% of services exports went to the EU.**

The fundamental objective of trade policy is to improve people's incomes and living standards over the long term by ensuring the efficient allocation of economic resources nationally and internationally. The Welsh Government clearly has an interest in ensuring that trade policy delivers against these goals for Welsh citizens and businesses.

International trade is not 'zero sum' – all countries participating in free international trade can benefit from access to a wider range of goods and services, and to the gains that arise from greater specialisation. However, as is the case with innovation and technological progress, individual citizens can suffer if the demand for their skills and experience is eroded. Additionally parts of a domestic economy can be undermined, with significant short to medium term consequences, through opening up to more competition. Our economic action plan *Prosperity for All: Economic Action Plan* describes how the Welsh Government aims to help cushion the impact of economic change through promoting a commitment to a new Economic Contract between business and government to stimulate growth, increase productivity and make Wales fairer and more competitive.

Moreover, the theory that free trade results in an overall increase in well-being can fail to be translated into practice if competition is unfair. For example, if one country's policies do not build in the environmental costs of production into product prices, whereas others do, or where one country's labour standards are significantly below another's. The Welsh Government has generally supported the EU approach to international trade which insists on considering issues of regulatory equivalence when opening markets. We further believe in the merits of a strong framework of European regulation on environmental and employment standards, and a fair and effective system of social protection to help people when they need it. Wales is committed to 'fair work': decent life-enhancing work, without exploitation or poverty, where we build and share prosperity. Trade policy should support, not undermine, our social model.

Trading helps boost the competitiveness of our firms and promotes competition within the same sector. A Welsh manufacturer with access to global markets, striving to compete in them for instance, could increase efficiency with workers producing more for each hour worked and/or producing a product of a higher quality for the same inputs. This ultimately increases economic growth in Wales which in turn sees employees earning higher incomes and boosting living standards[1].

[1] There is a range of evidence to show that exporting helps to increase firm productivity. See for example (1) Learning-by-Exporting Firm-Level Evidence for UK Manufacturing and Services Sectors. Harris, and Qian Cher Li. **https://www.gla.ac.uk/media/media_36279_en.pdf**

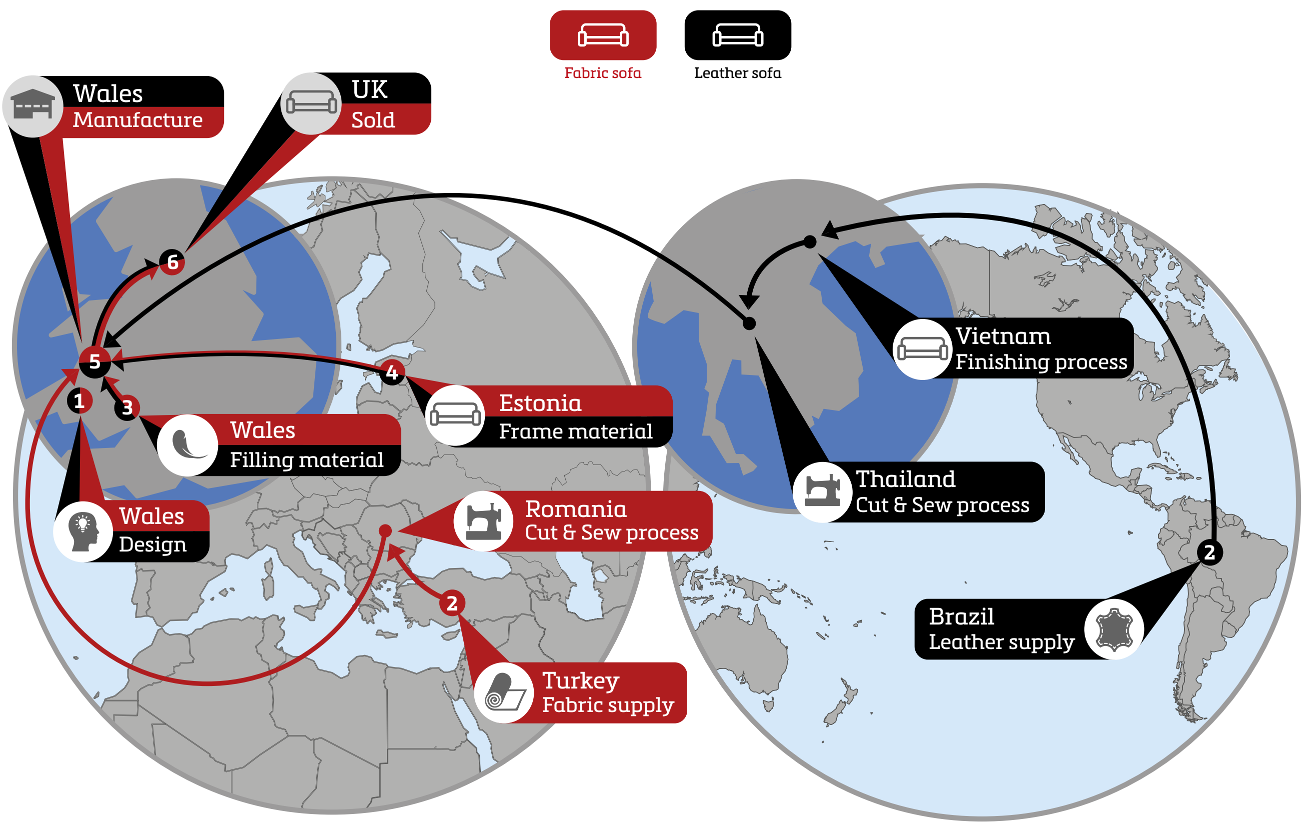
Trade encompasses imports as well as exports. Imports are crucial to the living standards of our citizens and they provide variety in consumer products and at lower prices. Access to the best quality inputs, which are often imported, is also critical to export success.

A 'Made in Wales' badge does not necessarily mean that each component part of the product is produced in Wales. Many companies in Wales have complex supply chains bringing in materials and components from the EU and other parts of the world. The importance of these global supply chains is highlighted below in the case study of the manufacture of a sofa in Wales.

Foreign Direct Investment – where a company from one country invests in operations based in another, either by setting up subsidiary operations or by acquiring existing businesses – has close links to trade flows, implying that trade and Foreign Direct Investment should be considered in parallel, especially as evidence suggests they can be complementary. Inward Foreign Direct Investment can provide firms with access to the most advanced inputs to production, including new technologies and working practices. Outward Foreign Direct Investment can unlock new markets where trade barriers make exporting from the home country challenging. It can also allow Welsh firms to benefit from the technology, innovative ideas and knowledge embedded in foreign companies.

Even where exporting is possible, Foreign Direct Investment can complement exports as companies participate in global supply chains: the OECD have found that exports can be increased by £2 for every £1 of outward Foreign Direct Investment[2].

## A Sofa Manufactured in Wales: An Example of the Global Supply Chain




[2] Productivity, Exporting and the Learning-by-Exporting Hypothesis: Direct Evidence from UK Firms Crespi Criscuol and Haskel; **personal.lse.ac.uk/criscuol/papers/prod_export_learn_28April07.pdf**

# UK Internal Market and EU Single Market

The economy of Wales is deeply embedded within that of the wider UK. **Trade gravity** helps explain why Wales trades more with Europe than the rest of the world. It is very unlikely that, in the short term, free trade deals with other countries — even the USA — could compensate for the loss of full and unfettered access to the Single Market. Any such suggestion would need to be supported by convincing evidence. Evidence we have yet to see.

Analysis shows that countries tend to trade most with their near neighbours, an effect known as 'trade gravity'.

In the case of the UK internal market the economy in Wales is deeply embedded within the wider UK economy. Close proximity means natural transport routes and lower transport costs, shared institutional and business contexts, and cultural and historical ties facilitate trade relationships. The degree of interconnectedness between Welsh businesses and businesses in other parts of the UK is currently not measured by official statistics (including how much Welsh firms export to the EU indirectly through the UK), but approximate calculations suggest they are likely to be at least as important as direct exports. More detail can be found in annex B.

It is for this reason that we are strongly committed to working with the UK Government and the other Devolved Administrations to ensure that Brexit does not destabilise the internal market within the UK. The Welsh Government is already providing support for businesses to grow and adapt their businesses both here and abroad. The Business Wales service offers a single point of contact for businesses and entrepreneurs to access advice and support and can be accessed online via **businesswales.gov.wales**

**61%**

**of indentifiable Welsh goods exports went to the EU in 2016**

**49%**

**of goods exports from UK went to EU in 2016**

However, next to intra-UK trade to the Welsh economy trade gravity helps explain why, access to the Single Market[3] formed by the other 27 members of the EU and the other countries of the European Economic Area (Norway, Iceland and Liechtenstein) is of critical importance to Wales' economic prospects. Analysis shows that any significant reduction in access to the Single Market — through the introduction of tariff or non-tariff barriers to trade — will be damaging, and the greater the reduction, the worse the consequences will be in terms of reduced or negative growth. The overwhelming majority of studies indicate that the costs of leaving the EU are closely related to the degree of access to the Single Market that is retained after leaving.

[3] Article 26(2) of the Treaty on the Functioning of the European Union ('TFEU') contains the following definition of the Single Market: '*The internal market shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of the Treaties*'.

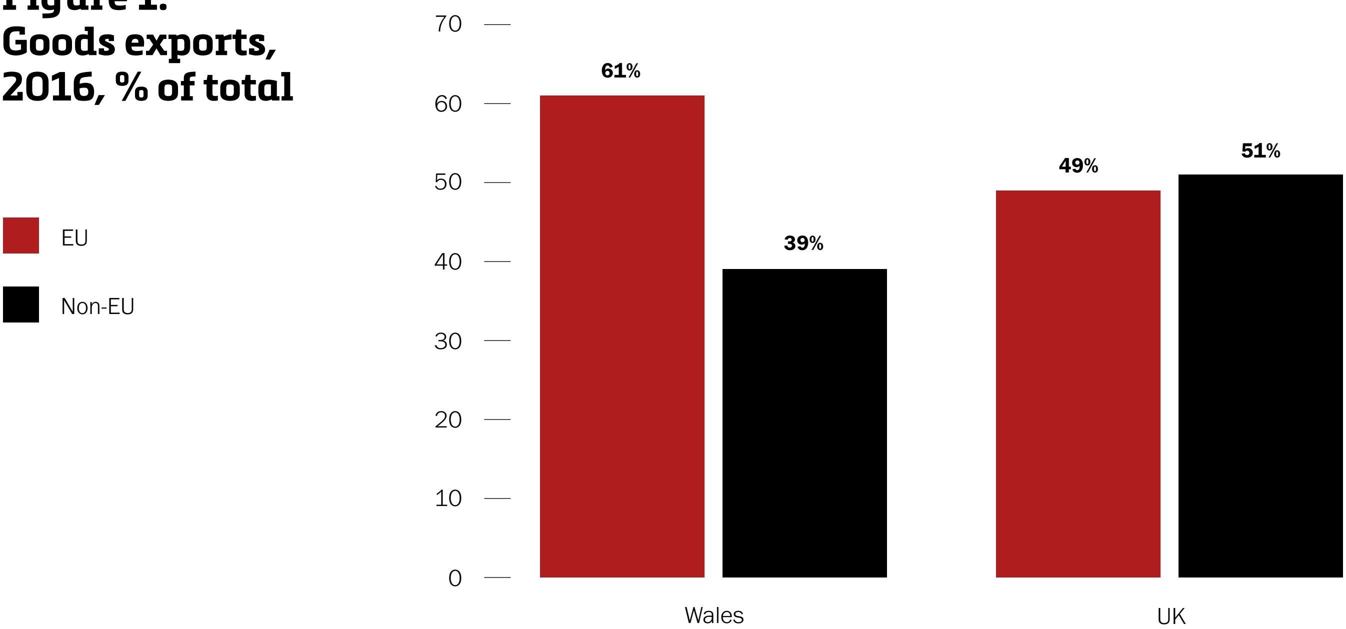
For example, analysis by the Centre for Economic Performance at the London School of Economics shows that the overall costs in the long run could vary between one and ten percent of income per head, with estimates towards the lower end of the range applying in the case of full participation in the Single Market, and estimates towards the higher end of the range applying were the UK to trade with the EU under World Trade Organisation rules[4].

**In 2016 Welsh goods exports were worth**

**£14.6b**

It is, therefore, rational for countries to look to their closest neighbours in the first instance when developing trading links. The Welsh Government has yet to be convinced that pursuing free trade deals with third countries — even the USA — could compensate for the loss of the sort of full and unfettered access to the Single Market which we believe is vital to the future prosperity of our nation. Any such suggestion would need to be supported by evidence and to date, no evidence has been published by the UK Government to support this view.

**Figure 1: Goods exports, 2016, % of total**




[4] See: Brexit: The Economics of International Disintegration Thomas Sampson CEP Discussion Paper No 1499 September 2017
**cep.lse.ac.uk/pubs/download/dp1499.pdf**

## Future trading arrangements

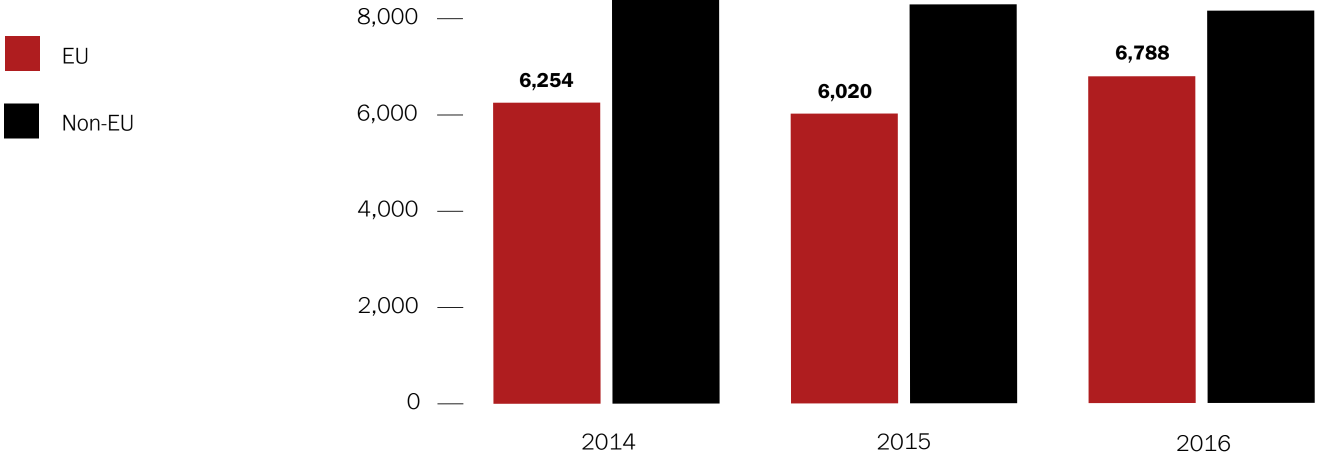
**The Welsh Government's position is that we must maintain full and unfettered access to the Single Market. We remain to be convinced that leaving the Customs Union with the EU is in our interests, at least for the foreseeable future.**

### EU

For more than four decades the UK has been part of the EU and with the development of the Single Market, championed by successive UK Governments, trade between the UK and the EU has become increasingly frictionless. In most cases, the costs and bureaucratic burdens which face a Welsh business selling a product in Germany or Malta are little different from selling it in Scotland. Businesses in Wales have come to rely on this ease of access to the Single Market both for sourcing items and for selling goods and services. HMRC data shows that 61% of identifiable goods exports from Wales to destinations outside the UK went to the EU in 2016[5] (see Annex B). The Welsh Government has been consistent in its conviction that ensuring full and unfettered access to the EU's Single Market must be the top priority for the UK Government.

In terms of the future trading relationship with the EU, this should be seen in two distinct phases; transition, and the long-term relationship.

**Figure 2: Welsh goods imports, £m**




[5] HMRC trade data for Wales is an approximation based on customs data and an apportionment of trade to Wales based on employee numbers. Trade data for Wales is therefore not precise and can vary over time depending on the methodology used to calculate the figures.

## The Transition Period

From the outset, the Welsh Government has argued for a period of transition to ensure stability for our businesses and our economy as we leave the EU. We have always been clear that the two years allowed under the provisions of the Article 50 process are insufficient to determine the basis of a forward relationship with the EU at the level of detail required. The UK Government has also acknowledged the need for a transition period or an 'implementation phase'.

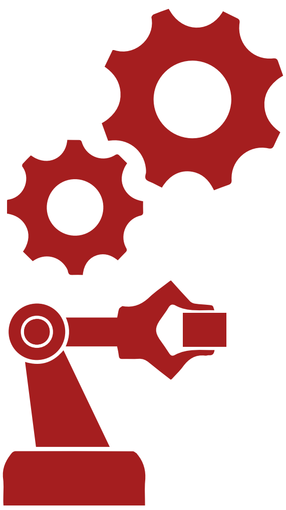
During this transition period, retaining full and unfettered access to the Single Market and remaining part of the Customs Union with the EU, on the basis of full alignment of our product and regulatory standards with the EU, is essential for Welsh business. This is driven by the fact that studies indicate that the impacts of non-tariff barriers are much, perhaps many times, larger than tariff barriers[6].

Avoiding a 'cliff edge' scenario has also been a key priority for many leading business organisations such as the Confederation of British Industry, Federation of Small Businesses and British Chambers of Commerce. While the exact form of any transitional deal might vary we believe it is vital it achieves the following outcomes:

- Continuity and clarity for businesses;
- No new tariff or non-tariff barriers including customs procedures;
- No divergence on regulatory standards or the certification required to access the EU's Single Market.

Agreement on a transitional arrangement should be agreed as early as possible. The lack of clarity on future trade arrangements with the EU is creating major challenges for businesses. In the absence of concrete information businesses are likely to plan on a 'worst case scenario' which could mean that companies choose to make investments overseas instead of within Wales, or delay investment decisions, damaging our economy now and in the future.

The Prime Minister said in her Florence speech on 22 September 2017 that an implementation period should continue on current terms and the framework for this time-limited period would be the existing structure of EU rules and regulations. We believe that the sort of transition now evidently envisaged by the UK Government – remaining in the Single Market and the Customs Union, effectively bound by all the disciplines of the EU while formally outside its political institutions – while in many ways unpalatable, is the only viable way to minimise barriers to trade, and hence minimise the impact on the Welsh economy. Given the financial consequences for the UK in achieving this 'status quo' we would urge the UK Government to consider these in relation to the economic damage that could follow from a 'cliff edge scenario' – a loss in economic output of up to 8-10%[7].



**In 2016**

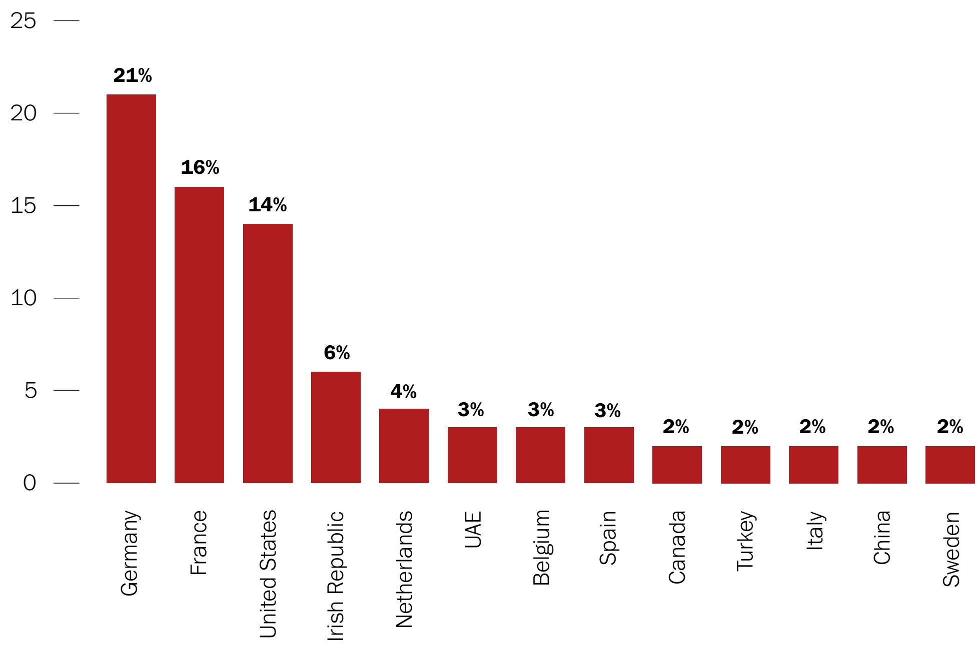
**54%**

**of total goods exports from Wales were machinery and transport exports**

**Manufacturing services – biggest services export from Wales in 2015**

[6] http://cep.lse.ac.uk/pubs/download/dp1478.pdf
[7] http://cep.lse.ac.uk/pubs/download/dp1499.pdf

**Figure 3: Major goods export destinations, Wales 2016, % of total**




Finally, as far as legally possible a transitional arrangement should stay in place until a long-term deal is agreed and not be time-limited in an arbitrary way, otherwise we risk simply delaying a 'cliff-edge'.

We now call on the UK Government to agree:

- more details on how the transitional period (implementation phase) would work;
- more flexibility around the transition period (not limited in an arbitrary way).

### At the end of the transition period

Retaining full and unfettered access to the Single Market also remains the key priority for the Welsh Government in the longer term, given the overwhelming importance of the EU market to Welsh businesses and the trade gravity theory outlined already.

The UK Government must be open and transparent about any potential trade-offs where its ambition to make trade deals with third countries around the world could jeopardise full and unfettered access to the EU. For Wales these negative trade-offs could be significant. To date we have yet to see convincing evidence from the UK Government as to why it believes the potential benefits of leaving the Customs Union outweigh the current benefits of being part of a customs union. As a result we argue for a long term customs relationship with the EU that mimics the status quo to the greatest extent possible.

### Outside the EU

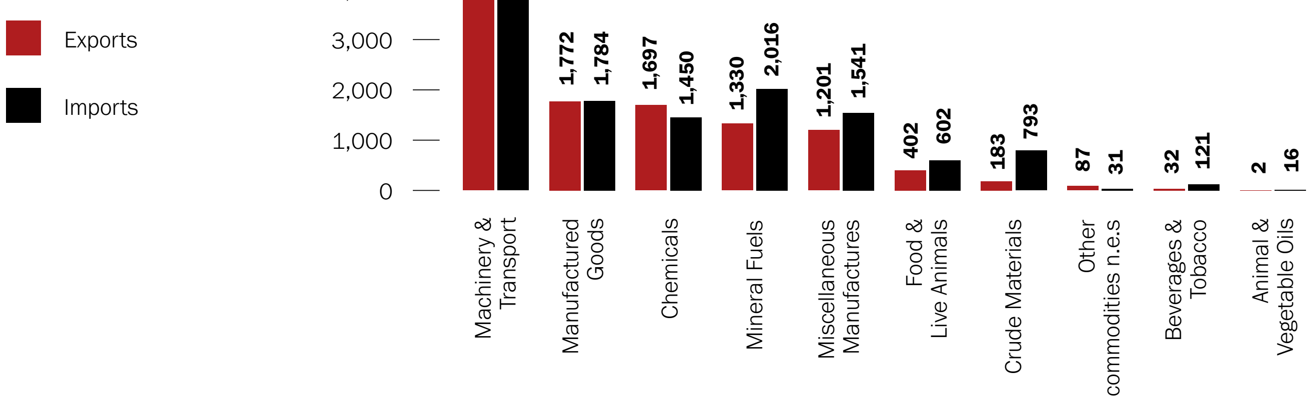
The UK Government has at times suggested that ‘no deal is better than a bad deal’ meaning that it might walk away from negotiations with the EU and trade on World Trade Organisation rules alone if it is not able to secure a favourable deal. A 'no deal' scenario is also possible if negotiations run out of time (or are not extended) before a deal or any transitional arrangements have been agreed. In this case, from March 2019 the UK would be trading with the EU with no preferential market access.

The EU negotiates on behalf of all its members in the World Trade Organisation. As we leave the EU the UK will re-establish itself as an independent member of the World Trade Organisation. The UK Government is seeking a 'technical rectification' to enable this to happen, meaning that the UK Government will replicate 'as far as possible' the commitments made by the EU, except in some areas where a direct replication of existing commitments is not straightforward (eg splitting the EU's Tariff Rate Quotas and agreeing the limit of trade-distorting agricultural support, the Aggregate Measure of Support). The UK Government aims to have these schedules in place for the day we leave the EU, so they would be applicable straightaway in the event of 'no deal'.

It is important that the UK Government agrees a joint approach with the Devolved Governments ahead of any agreement at World Trade Organisation level. As trade impacts on devolved areas, like agriculture and fisheries and regional economic policy, we expect the UK Government to involve us fully in the development of trade policy.

Trading solely under World Trade Organisation rules with the EU would give rise to a high risk of significant commercial and economic disruption, with immediate increased costs and administrative burdens. It could result in the sudden appearance of barriers to entry to EU markets for those that trade in goods or services. According to the Federation of Small Businesses Welsh firms that do export are four times more likely to export to an EU destination than a destination outside the EU[8]. It could also lead to disruption of trade with third countries where the UK is no longer able to benefit from the cumulation of Rules of Origin with other EU member-states[9].

**Figure 4: Welsh goods exports and imports, 2016, £m**




[8] Making Brexit Work for Wales' smaller businesses: FSB September 2018
[9] So-called cumulative 'rules of origin' allows countries which are part of a preferential trade agreement to share production and jointly comply with the relevant rules of origin provisions.

# Types of trade barriers

## For Goods

**Tariffs**: a financial charge in the form of a tax imposed on goods transported from one customs area to another, and repeated each time that takes place.

**Non-Tariff Barriers**: Trade barriers that restrict imports or exports of goods or services through mechanisms other than the imposition of tariffs. They include, but are not limited to:

- **Customs procedures and classifications** including but not limited to:
  - Rules of Origin to determine whether a good is produced in a member country (with tariff reduction), or is coming from a non-member country (without tariff reduction). Rules of Origin usually require that the final product is 'substantially produced' in the exporting country (or in the case of EU free-trade agreements negotiated, with the EU).
  - Import licensing e.g. for military equipment or other sensitive items.
- **Quotas:** quantitative restrictions on imports.
- **Subsidies**: financial support used to protect domestic industries.
- **Tariff rate quotas:** allows a specified number of goods at one tariff rate (within quota rate) but additional imports are subject to higher tariff rate (out of quota rate).
- **Technical Barriers to Trade**: Regulations, standards, testing and certification procedures, which could obstruct trade. This could include rules covering technical, product and/or environmental standards, sanitary and phytosanitary measures dealing with food safety and animal and plant health.
- **VAT** related paperwork.

## For Services

- Different regulatory frameworks for businesses to operate within.
- Restrictions on foreign ownership/control.
- Complex accreditation/licensing rules for foreign businesses.
- Restrictions on foreign personnel (e.g. visas).
- Not recognising foreign qualifications.
- Subsidies for domestic industries/state-owned industries.

## Impact on Sectors in Wales

The EU's goods tariffs cover a broad range, from around 2% to 3% of the value of the good in some sectors (though the cumulative effect of goods re-crossing borders could be significantly higher) through to as high as 45% (see annex A) on some food products.

The impact on sectors of trading on World Trade Organisation rules will likely be dependent not only on the tariff rate but also the vulnerability of the sector to non-tariff barriers – in particular how dependent the business is on supply chains across Europe. Some Welsh companies specialise in the manufacture of products whose component parts cross national borders many times before being completed. Components used in the automotive industry for example often cross borders many times before being fitted into a final product.

Research suggests that non-tariff barriers (NTBs) are potentially more damaging than tariffs for many UK businesses notably the aerospace, food and automotive sectors[10]. The impact of customs procedures and technical barriers to trade, causing delays and costs, could be particularly damaging to the Welsh economy.

Customs procedures each time a component crosses a border generating tariffs, delays and checks, will add significantly to the cost of that product. This could render Welsh companies uncompetitive relative to competitors on the European mainland. In addition, companies in the EU will be aware of the need to ensure that their final product meets the criteria of being substantially produced in the EU to meet the Rules of Origin tests attached to the EU's third country Free Trade Agreements. Were the UK to become a 'third country' – in terms of its trade relationship with the EU – then our products will not be classified as 'made in the EU', so companies exporting from the EU may be less inclined to use components originating from the UK.

Similarly, technical barriers to trade such as regulatory barriers to doing business in the EU are likely to arise if the UK becomes detached from the Single Market and has no bi-lateral agreement in place. Such barriers will occur should domestic UK regulation begin to diverge from the EU. This could mean inspections at the border and tests to ensure that products meet EU standards. This could be particularly onerous for goods which are subject to additional controls such as animal products, nuclear material and chemicals. At present UK Government agencies are able to issue licences for such goods which are valid across the EU, but this could cease if we leave without a deal. UK companies might no longer be able to rely on accreditations from UK agencies to sell into the EU market.

Table 1 summarises the analysis undertaken by Cardiff Business School, in relation to the sectors potentially most vulnerable to the EU transition process in Wales[11]. The report focuses mainly on large and medium sized firms in the sectors that have been prioritised by the Welsh Government prior to publication of the *Prosperity for All: Economic Action Plan*. The findings suggest that:

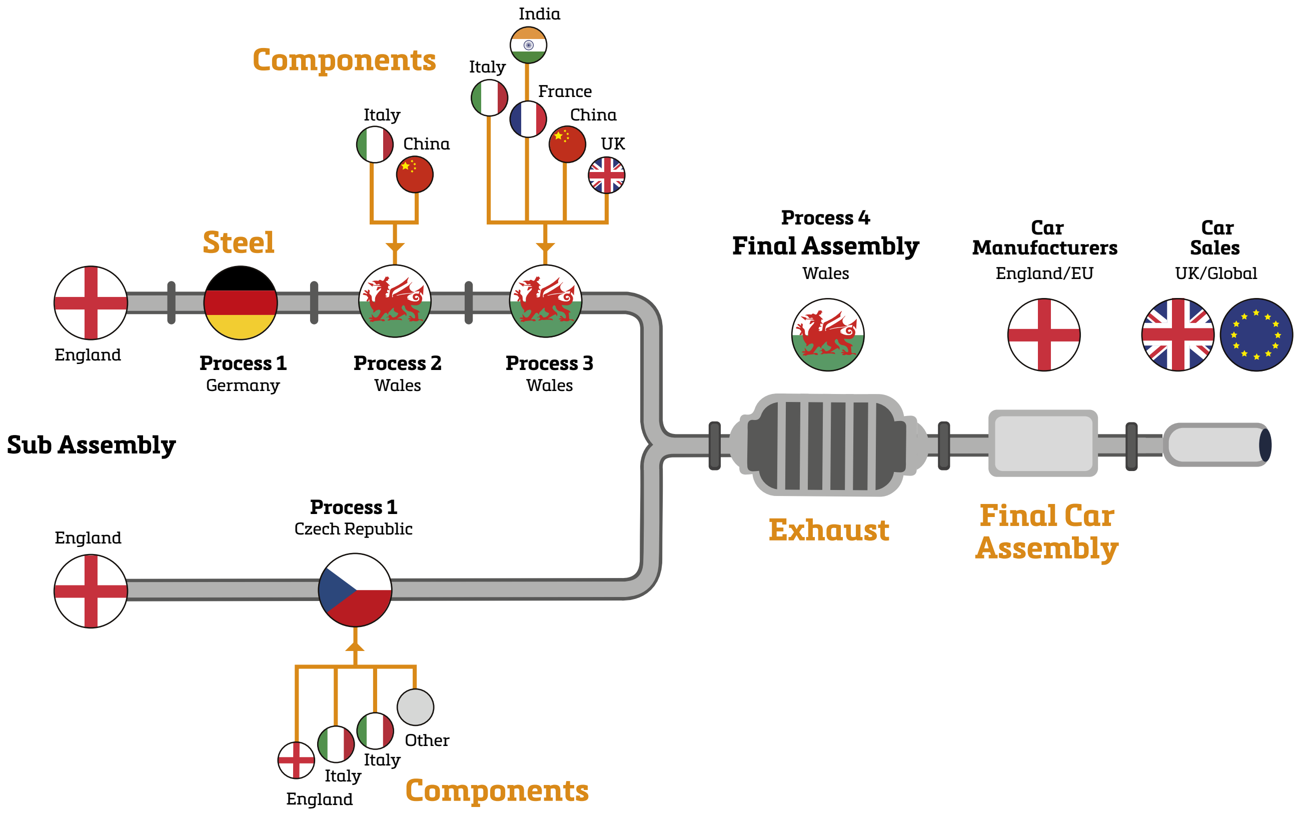
- Sectors most at risk from tariffs (imports and exports) include automotive, chemicals, steel and electrical engineering.
- The sector most at risk from non-tariff barriers is aerospace.
- Sectors that are non-EU orientated (in terms of inputs and markets) and with place-embedded production see Brexit as involving less risks. These sectors include construction and civil engineering, paper and wood, business services and TV production.

[10] The Product and Sector Level Impact of a Hard Brexit across the EU: Working Paper No. 550, November 2016, Martha Lauless and Edgar L. W. Morgenroth

[11] EU Transition and Economic Prospects for large and medium sized firms in Wales' Cardiff Business School

- For a number of medium and large businesses in Wales, Brexit is already being factored into business decisions with clear economic ramifications for Wales. Key business decisions are likely to be made long before Brexit negotiations are concluded.
- Intra-firm competition for investment is a key issue for Welsh businesses with branch plants in Wales but headquarters overseas. This is particularly an issue for sectors such as aerospace, automotive and transportation, and electrical engineering.
- Tariffs and non-tariff barriers between the UK and EU would cause difficulties for many firms.
- A number of the sectors likely to be most impacted by Brexit are also those ones which provide significant employment and value adding activity in the Welsh economy, therefore the wider economic impacts to Wales could be significant.

## An Automotive “Cross-Border” Supply Chain: An Exhaust System



## Table 1:
## Summary of how sectors in Wales were rated on different aspects of risk

| | Effects of tariffs on sector export trade directly and indirectly | Effects of tariffs on inputs | Effects of non-tariff barriers on trade and activity | Labour market risks | Effects in regional economy of changes in activity of firms | Effects linked to loss of access to EU knowledge and innovation networks and frameworks | Current age and structure of assets in Wales, susceptibility to corporate investmtment cycles | Positioning in corporate network, embeddedness and likely options to displace Welsh activity |
|---|---|---|---|---|---|---|---|---|
| Aerospace systems and services | Medium - High | Medium | High | Medium | High | High | Medium - High | Medium |
| Automotive, transportation and related | High | High | Medium | Low | High | Medium | High | Medium - High |
| Business services | Low | Low | Low | Low | Low - Medium | Low | Low | Low - Medium |
| Construction and civil engineering | Low | Low | Low | Low - Medium | Medium - High | Low | Low | Low |
| Elec. Eng. components, semiconductors | High | High | Medium | Low | Medium - High | Medium | Medium - High | Medium - High |
| Energy & utilities | Low | Low | Low | Low | High | Low | Low | Low |
| Financial services | Low | Low | Low | Low | High | Low | Low | Low - Medium |
| Food and drink* | Medium | Medium | Low | Medium | High | Low | Low | Low |
| Information and communications technology | Medium | Low | Low - Medium | Medium | Low - Medium | High | Low - Medium | Low - Medium |
| Insurance | Low | Low | Low | Low | Medium - High | Low | Low | Low - Medium |
| Medical/Health products and services | Low - Medium | Medium - High | Medium | Low | Medium | High | Low - Medium | Medium |
| Other adv. manufacturing and engineering | Medium - High | Medium | Medium | Low | Low - Medium | Low - Medium | High | Medium - High |
| Paper, wood, wood products | Low | Low | Low | Low | Medium | Low | Medium | Low - Medium |
| Process and chemicals | High | Low | Medium | Low | Medium - High | Low | Medium - High | Low - Medium |
| Steel | High | Low | Medium | Low | High | Low | Medium - High | Medium |
| TV production and creative | Low | Low | Low | Low - Medium | Medium | Low | Low | Low |

* Most of the food and drink companies interviewed were focused on the domestic market. Some parts of the primary production food and drink sector may be more impacted by non-tariff barriers

In addition to the sectors mentioned above we believe there are a number of other areas that need to be considered specifically.

### Natural Resources Economy

We have worked closely with stakeholders in Wales, through the Ministerial Brexit Roundtable and Trade and Supply Chain subgroup to consider the impacts of various scenarios including a 'no deal' and trade liberalisation on the Welsh natural resources economy.

We consider the risk of a 'no deal' scenario more likely for agricultural or fisheries products than for other goods because this is normally the most problematic area for Free Trade Agreements. Many existing EU agreements with third countries, notably the EEA Agreement, exclude agriculture and the customs arrangement with Turkey also excludes agricultural and fisheries products. A report by FAPRI-UK[12] considers both 'no deal' (World Trade Organisation default) and (extreme) unilateral trade liberalisation scenarios and found adverse effects on some of the considered agricultural commodities in the former and across all commodities in the case of the latter.

Views about a 'no deal' scenario include:

- Lamb exports would be impacted quickly, with the imposition of tariffs on the export of lower value lamb cuts and ‘light’ lamb to the EU, meaning this trade could cease.
- 90% of Welsh shellfish production is exported to the EU with many species transported live. As there is currently a limited domestic market for these types of fish, the scope for fishing businesses to continue to operate would quickly be severely impacted.
- Significant restructuring within the food processing sector as businesses seek to reduce numbers and amounts of ingredients and products crossing borders on multiple occasions.

### Services

Trade in services can be particularly difficult to liberalise given the regulatory complexities and political sensitivities associated with services. Even the EU’s Single Market has not fully liberalised trade in services. The services industry in Wales is closely linked with trade in goods. For example financial services, consultancy, advertising and legal services are all connected to trade in goods to some extent. The financial services sector is a major export sector generating a large trade surplus for the UK.


Whilst Wales is less specialised in trade in services there would be indirect impacts for the Welsh economy if it were not possible to maintain the same level of trade in services in the future. Also important is that there are important connections between regulatory alignment and free movement of people to facilitate trade in services. As we set out in our publication *Brexit and Fair Movement of People* we advocate a flexible — but managed — approach to migration more closely connected to employment. This must be coupled with rigorous prevention of exploitation of workers by unscrupulous employers to improve wages and conditions for all workers.

[12] www.afbini.gov.uk/sites/afbini.gov.uk/files/publications/FAPRI-UK%20Brexit%20Report%20-%20FINAL%20Clean.pdf

# Case Study: Welsh cheese producer

Current experience of exporting to the EU Customs Union countries is very simple – the same as taking orders and delivering in the UK. They have numerous weekly orders from customers across the EU. By comparison, it took 4 years to get its products registered in one non-EU country (for example, the wax used on the cheese had to be registered with the authorities).

They are required to include various paperwork in shipments to non-EU countries:

- **Health Certificate**
- **Certificate of Origin**
- **Certificate of Manufacture**
- **Commercial Invoice**
- **Packing List**
- **EAD (Customs Entry) – Export Accompanying Document – for movement of goods via an EU country to a 3rd country destination.**
- **Non-EU territories and certain EU regions request for a COA Report / Dioxins Certificate to accompany each shipment as they are audited by their local authorities.**

Shipments can also be subject to testing for various bacteria, toxins, pesticides, antibiotics and hormones. Also, for example, Canada is a more complicated market from a compliance point of view with the requirements for dual labelling on packaging (French and English), with minimum font sizes.

They have encountered frequent delays at border crossings, with products being held up for a week. Delays have not been due to anything amiss with paperwork, just that the customs Authorities have decided to do a random check. These delays have resulted in a cost impact and have affected the remaining shelf life. Examples of types of costs which could be incurred:

- Loading of a container - **3 FREE hours ONLY** for loading.
- Bill approval – All bills MUST be approved within **48 hrs** of vessel sailing date. **£50 charge per request** will apply for alterations after this time.
- Storage charges at port may vary – **£100 per day** average cost.
- Air freight storage charges may vary – **£10/piece per day** average cost.

One of their main concerns is the potential increase in red-tape which could result if/when the UK withdraws from the Customs Union. They currently employ a fulltime export administrator to deal with the export documentation for the company's exports to non-Customs Union countries. However, given the level and frequency of orders which are received from Customs Union countries, this person would not be sufficient to handle additional paper work if there was no harmonisation between customs systems with the EU and barrier free trade was removed.

A further consideration relates to exports to Asia Pacific/Australia. UK shipments are often consolidated in France for onward journey to Asia Pacific. A UK withdrawal from the Customs Union would mean that they would have to complete export documentation for both France and for the further onward journey to the destination country.

Reverting to World Trade Organisation tariffs is also a concern for them – understanding what the tariffs/quotas are what the implications are for UK cheese producers.

Canada is one of the company's most significant export markets and this is at risk with a UK withdrawal from the EU. Access to the Canada cheese market is through quota, with quota allocated to the EU and rest of World Trade Organisation members. Under the Canada-EU trade agreement more of the quota will be given over to the EU (2/3) with 1/3 remaining with other World Trade Organisation countries. So if the UK reverts to World Trade Organisation terms, there will be less cheese quota available for UK suppliers, including them.

## Primary priorities for them:

- **Retaining access to the Customs Union and free movement of goods** through tariff free trading and frictionless borders with EU
- **Understanding the impact on cheese quotas and retaining access to the EU allocation** in respect of the Canada-EU trade agreement
- **Minimising red-tape burden on SMEs** through maintaining access to the harmonised Customs Union, particularly those undertaking frequent transactions to Customs Union countries, but these frequent transactions may not be high value.

The consequences of leaving the EU (particularly in a 'no deal' scenario) for higher education in Wales could have a significant impact on the Welsh economy. This could materialise as the direct impacts of reduced spending on research and development make their way through the economy and have a negative impact on investment and productivity more generally. Wales' higher education institutions benefit from the research funds they have access to as a result of our membership of the EU, Horizon 2020 being the most significant. Exclusion from this collaborative research could impact directly on Wales' ability to maintain and attract new companies and to develop new industries. For example, the compound semi-conductor cluster in South East Wales has grown rapidly over recent years as a direct result of investments made in buildings, equipment and, crucially, top research talent drawn to Wales. These investments, like those more recently in the Advanced Manufacturing Research Institute in North East Wales, were supported with EU funds. Withdrawal from the European Union may also affect the ability of Welsh universities and colleges to attract staff and students from other member states (11% of academic staff and 5% of students in these institutions currently come from the EU). In combination these changes could limit the availability of highly skilled staff working in the UK and have a negative impact on growth and living standards.

## Health and Social Care

The Welsh NHS and care organisations rely on products, innovations, staff and industries whose position in Wales could be undermined as we leave the EU. We are particularly concerned where this could affect the availability of goods, medicines and medical devices.

Leaving without a deal, with the possibility of tariff and non-tariff barriers, would cause problems for the Welsh NHS. There would be a real risk of disruption to supplies of medical products and a potential rise in drug prices which would compound existing financial challenges. It could seriously undermine the ability of health and social care organisations in Wales to keep delivering the best care to patients.

There is a substantial benefit to the Welsh NHS of a thriving life sciences sector, which helps create an environment for staff to engage with novel technology, research and service innovation. The life science sector is one of Wales' fastest growing and most innovative industries, employing around 11,000 people in nearly 350 companies and contributing around £399m to the Welsh economy every year. Failure to reach adequate trade and co-operation arrangements could restrict growth in this sector, slow down access to cutting-edge treatments in the NHS and damage medical research in several ways.

As discussions move forward on new trade agreements, we want to ensure we maintain control of the provision of public services in Wales, like the NHS. We welcome the commitment made by the UK Government on this in their White Paper and are prepared to work with them to ensure the differing approaches to healthcare provision across the UK are reflected in any new agreements.

## Transport

Welsh ports play a hugely significant role in the commercial life of Wales, servicing a wide range of specialised and general markets. They make vital contributions to the wider UK economy, directly and indirectly, acting as a gateway to economic hubs in the Republic of Ireland, the UK, the rest of Europe and the wider world.

The Welsh port share of overall UK freight traffic for 2016 was 53.6 million tones (Mt) – around 11% of the UK total. 524,000 lorries and unaccompanied trailers travelling to and from the Republic of Ireland passed through Welsh ports, with the vast majority passing through the Port of Holyhead.

Ports in Wales (and the rest of the UK) are typically located in deprived areas due to the decline of major industry in Britain over the last century. As a result, many ports act as key employment hubs for local communities, particularly the larger ports at Holyhead, Fishguard, Pembroke Dock and Port Talbot. A report from the Welsh Ports Group estimated around 11,000 direct, indirect and induced jobs were connected to Welsh ports[13].

**In 2016 524,000 lorries passed through major Welsh ports to and from the Irish Republic****

The most pressing issue for Welsh ports is preserving the efficient movement of goods and people via seamless customs arrangements that are, as a minimum, no more burdensome than the current Customs Union regime. We have already noted the threats that any changes to customs rules which add to costs, time, inconvenience and regulation could have on the economy of Wales.

Welsh ports have a key role as the gateway between the Republic of Ireland and the rest of Europe, with 80% of goods carried in Irish registered HGVs between the Republic of Ireland and Europe passing through Welsh ports. The UK Government must be transparent about how an independent trade policy is compatible with maintaining a frictionless 'soft border' between the Republic of Ireland and Northern Ireland. The Welsh Government is fully supportive of a soft border, but we cannot support any outcome which has the potential to stimulate traffic away from the ports of Holyhead, Fishguard and Pembroke Dock in favour of another part of the UK.

## New trade deals

We have already stated that our approach to international trade is to prioritise participation in the EU's Single Market, and in a customs union with the EU at least for the time being, as this is where the majority of Welsh trade is transacted. We have yet to see convincing evidence as to why leaving the Customs Union arrangement with the EU in order to pursue trade deals with third countries is in the economic interests of Wales and the UK.

The Welsh Government fully supports the merits of international trade. Wales is a small outward-facing, globally trading nation and we are committed to internationalism. Economies and global trading patterns are never stagnant and people's spending patterns change over time. The Welsh Government fully accepts that there are significant trading opportunities outside of Europe and we are committed to working with businesses to promote Wales around the world. However, these trading opportunities should not be pursued at the expense of our trading relationship with our closest and most economically integrated neighbours. Building new trading relationships with other countries around the world should be seen as a complement to the relationship with the EU not as a substitute.

The Welsh Government will work with industry, at home and through its network of global offices, to support these links with the rest of the world.

If the UK Government is in a position to formally negotiate free trade deals with other countries, the Welsh Government expects our direct interest in

[13] www.britishports.org.uk/system/files/documents/welsh_ports_brochure.pdf
** this figure includes unaccompanied trailers

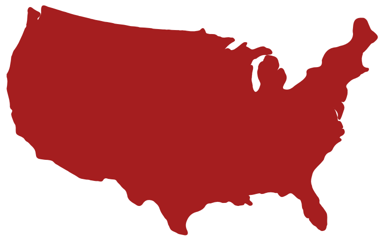
the trade negotiations to be respected, particularly given that these have important consequences for devolved areas such as economic development, agriculture and fisheries.

At present the Welsh Government has the opportunity to work with the UK Government to influence EU negotiating mandates on new EU Free Trade Agreements to ensure that Welsh interests are protected. It would be perverse if, post-Brexit, we had less opportunity to ensure that trade policy does not adversely impact on devolved areas.

**Germany**

**was the top export destination for goods from Wales in 2016**

We want to work constructively with the UK Government to ensure the UK has a coherent approach to trade. As part of this process the UK Government must respect devolution and not seek to impose policy that cuts across devolved areas. The Welsh Government will be interested in ensuring that Welsh industries and consumers are not unfairly disadvantaged by the agreement of third party Free Trade Agreements.



**USA**

**was a top export destination outside the EU for goods from Wales in 2016**

In its Trade White Paper and later Trade Bill the UK Government set out its commitment to seeking continuity in its current trading relationships covered by EU third country Free Trade Agreements and other EU preferential arrangements. We would urge the UK Government not to undertake this continuity exercise in isolation and to work with the Devolved Administrations.

Free Trade Agreements often take a long time to negotiate, are very complex and politically sensitive and they are not the only way to improve trade relationships. The importance of diplomacy and relationship building will be a priority focus in our future trade policy approach. The UK Government and the Devolved Governments should work together to improve trade relationships across the globe and provide export support to Welsh and UK businesses.

## Once we leave the EU, we will need deeper and more sustained co-operation between the Devolved Governments and the UK Government, including in relation to trade.

We have called for the establishment of a Council of Ministers, whose remit would include consultation on trade issues between the four administrations.

In the meantime, a new Joint Ministerial Committee on International Trade should be established to agree joint approaches on trade.

As we exit the EU we must develop new ways of working between the UK Government and the Devolved Governments to ensure both the integrity of the UK internal market and a coherent approach to international trade which respects devolved competence. As we set out previously in our *Brexit and Devolution: Securing Wales' Future* document we propose a UK Council of Ministers is established to strengthen decision making and collaboration, and to oversee issues which cut across both reserved and devolved areas. As an interim measure we propose a Joint Ministerial Committee on International Trade. This would provide a forum for discussing and reaching consensus on issues relating to trade.

The UK Government has introduced a Trade Bill which seeks to provide continuity for businesses and consumers in a number of important areas such as seeking membership of the Government Procurement Agreement (currently the UK benefits from this in its capacity as an EU member state) and transitioning Free Trade Agreements signed by the EU. The UK Government has also introduced a Taxation (Cross Border Trade) Bill to establish a standalone customs regime for the UK. We welcome the UK Government's recognition of the Welsh Government's role in developing and implementing future trade policy, however the Trade Bill creates powers for UK Ministers to make regulations on issues of devolved competence. As we have already set out in response to the EU Withdrawal Bill, powers given to UK Government Ministers to make secondary legislation in devolved areas must only be used with the prior consent of Welsh Ministers. The Trade White Paper suggested such consent from Devolved Governments would be sought and we believe this should be included on the face of the Bill. Further, as currently drafted, there are various restrictions placed on devolved Ministers' use of the powers provided for in the Bill which are not placed on UK Ministers. We believe, as a matter of principle, that devolved Ministers should have the same powers in respect of matters falling within devolved competence as UK Ministers are given in non-devolved areas.

We suggest there should be a Memorandum of Understanding for engagement between the UK Government and the Devolved Administrations on trade policy, including as a minimum:

1. Formal method for engaging with Devolved Governments on trade issues.

2. Principles of engagement:
   - UK Government to consult with and seek consent of the Devolved Governments in the development of a UK Trade Policy.
   - UK Government to work with Devolved Governments on a framework on trade.
   - UK Government to consult with the Devolved Governments on the negotiating mandate before negotiations with the EU or a third country start.
   - UK Government to engage with the Devolved Governments during the negotiations – where negotiations impact on devolved competence or issues of particular relevance to Wales or other devolved nations.
   - UK Government to consult with the Devolved Governments after negotiations are finalised.

3. Development of overarching principles for a trade policy:
   - Sustainable Development, maintaining important environmental, economic and social protections.
   - Supporting prosperity and well-being for all, including the well-being of future generations.
   - Transparency and fairness.
   - An evidence-based approach.
   - Promoting and protecting our place in the world, recognising our responsibilities on the world stage and promoting fair and ethical trade.

In return the Welsh Government pledges to:

1. Be a constructive partner.

2. Share knowledge and analysis.

3. Work with UK Government to provide leadership for relevant stakeholders.

4. Work constructively using our overseas networks to promote and protect the interests of Wales and the wider UK.

A useful model for engagement on trade deals is the one used by the Federal Government in Canada. The federal government is responsible for negotiating trade deals on behalf of Canada but detailed consultation takes place with the Canadian provinces before trade negotiations get underway and then during the negotiations representatives from the provinces are present to contribute as the negotiations unfold. The Canadian provinces were included in negotiations on the Comprehensive Economic and Trade Agreement (CETA) between Canada and the European Union at the insistence of the European Union[14].

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**We've set a precedent in recent years, where the provinces are involved directly in the negotiations. They are part of the preparatory process, and when we go into a negotiation, representatives from interested provinces may be outside the room. Once the negotiation for that session is over, our lead negotiator on a subject would go and debrief them. It is enormously time-consuming, but in our case necessary for political reasons — as well as the fact that some of the issues under negotiation may fall under the authority of the provinces for implementation.**

Quote from a former Canadian deputy Minister for trade — Institute for Government report on Taking Back Control of Trade[15]

[14] Sub-national government involvement in international trade negotiations Wales Centre for Public Policy, Craig Johnson and Megan Mathias
[15] **www.instituteforgovernment.org.uk/sites/default/files/publications/IFGJ5448_Brexit_report_160517_web_v2.pdf**

# Wales in the World

## Promoting Wales' place in a globally competitive world is the core of our international strategy. We aim to protect our share of European trade in spite of the uncertainties created by Brexit.

Wales is an outward-facing nation that seeks to capitalise on opportunities to engage globally with other nations, especially in areas where we have common interests such as economic development, shared cultural relations and educational links. Promoting Wales' place in a globally competitive world is the core of our international strategy. Services are a growing part of Welsh exports and, where they have been under-emphasised in the past, now form a core part of our ambition. Foreign Direct Investment has been a major component of our economy for 50 years and we will continue to engage and attract investors to Wales in an increasingly competitive global environment. Wales has a first class environment in which to invest, work, visit and study.

The Welsh Government maintains a network of overseas offices to advance our international interests. Our offices contribute to the Welsh Government's activity in trade and investment, tourism, culture and education. These offices build and maintain relationships, facilitate business development engagement in conjunction with Wales-based colleagues, and work with Welsh expatriates and UK colleagues to further our economic interests.

In the light of Brexit and trade uncertainties it is more important than ever to promote Wales' interests around the world. There are currently fifteen offices across seven countries: Belgium; China; India; Ireland; Japan; the United Arab Emirates; and the United States of America. We are reviewing our overseas network and we will expand our international footprint during this administration in line with the Prosperity for All commitment to 'take a strategic approach to the expansion of our international offices, based on an assessment of economic opportunity for Welsh businesses'. Further offices will be opened in France, Germany, Canada and Qatar during 2018.

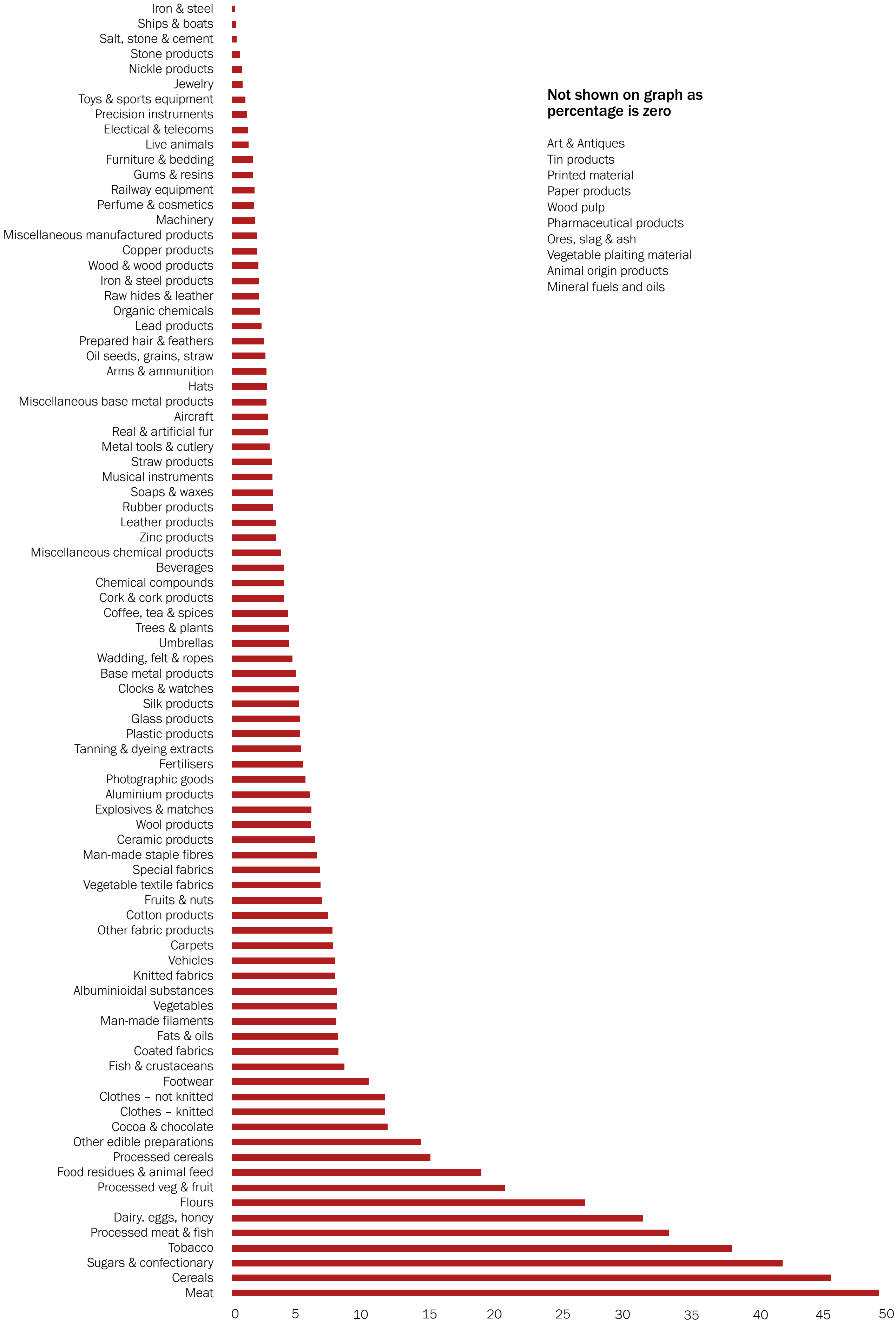
Core activity will be driven by our overseas events programme, which is published annually and enables companies to travel to markets to meet customers or to engage through exhibitions and trade shows. It includes a mixture of new and emerging markets which can be more challenging to access as well as more traditional markets where there are fewer barriers for Welsh companies to overcome.

The Welsh Government owns Cardiff Airport and works closely in support of the Airport's plans to expand the range of flights from Cardiff. This will make Wales more open for business and tourism. The flights between Cardiff and Doha, scheduled to commence in May 2018, will open the way for long haul travel to points east in a new and dynamic way.

We will stimulate and support a programme of inward visits – both diplomatic and commercial – to promote a clearer understanding of what Wales offers. We aim in this way to stimulate interest among decision makers or those who are in positions to promote interest in Wales.

Our inward investment results in recent years have reached record levels, however, a fall in referrals has coincided with the Brexit vote, resulting in a depleted pipeline of inward investment projects. We have commenced a new approach to targeted trade and inward investment activity focussing on strategic sectors in the current markets where we have an overseas presence, while also examining new market opportunities. Using historical inward investment and export data, we have identified sector trends in markets and will target significant investors in each of the markets. Our overseas events programme and decisions around our targeted support for exporters will also be informed by this new approach to business planning.

# Annex A: Potential World Trade Organisation implied tariffs between EU & UK by product, %




**Not shown on graph as percentage is zero**

Art & Antiques
Tin products
Printed material
Paper products
Wood pulp
Pharmaceutical products
Ores, slag & ash
Vegetable plaiting material
Animal origin products
Mineral fuels and oils

Working Paper no.550, The Product and Sector Level Impact of a Hard Brexit across the EU Martina Lawlessa,b and Edgar L. W. Morgenroth*, November 2016

## Annex B: Welsh International Trade

### Importance of international markets for Wales

International exports provide an important market for Welsh firms, and imports provide a source of inputs to businesses and goods for consumers.

However, if new trading arrangements with the EU limit the UK's access to the Single Market, the largest part of the impact on Wales is likely to be felt **indirectly** through Wales' trading links with the rest of the UK. This follows from:

- the very extensive trading links that exist between Wales and the rest of the UK.
- The fact that analysis shows that the largest effects from reduced access to the EU are the indirect economy-wide consequences of lower productivity growth.
- The fiscal consequences for Wales of slower UK growth.

In particular, there will be important impacts on sectors in Wales that export to the EU indirectly through the provision of inputs to products that are exported from the rest of the UK. There are no official statistics available on trade between Wales and the rest of the UK and hence on such 'indirect' exports, but approximate calculations suggest they are likely to be at least as important as direct exports.

Important indirect effects on import-using sectors and consumers would also be expected if imported goods become more expensive or difficult to obtain at the UK level.

This Annex aims to set out the key official statistics on Welsh international trade and highlight some of the major issues that arise in interpreting the associated data.

The official export statistics for both goods and services reflect a broad measure of 'output'[1] and not 'value added'. In consequence, a high value for exports does not necessarily mean that Wales benefits from a high level of value-added or employment. For context, value-added in production industries is typically around one-quarter the value of turnover.

The most extreme example of the disparity between export values and value-added is probably provided by the export of petroleum which shows a high value but where a large part of this value is accounted for by imports that are subsequently re-exported with little or no processing.

Although the value of services exports is much lower than that of goods, the share of value-added and employment will probably be higher in the production of most services, so the headline data will tend to downplay their importance. Services are also likely to play an increasingly important role over time, as there is a general tendency across developed countries for the demand for services to outpace that for manufactured goods, reflecting changes in the patterns of demand as affluence increases.

### Welsh export of goods

In respect of direct trade, data is available on exported and imported goods from HMRC[2].

The preparation of the data involves a degree of apportionment of UK totals for businesses operating across the UK. This means that the figures may not reflect accurately the dependency of Welsh business units on specific export markets. It also means that the data may have limited value in informing Welsh Government policy implementation, for example in respect of identifying market segments where export promotion may have most potential.

[1] The export values recorded in the regional trade statistics for goods have a broader definition than the value of sales – they cover the value of goods crossing the border, even where ownership has not changed (for example where refurbishment has been undertaken)

[2] **www.uktradeinfo.com/Statistics/RTS/Pages/default.aspx**

Furthermore, as already highlighted the figures for export values do not reflect value-added in Wales. This is a key point, which is explained further below, and means that great caution must be exercised before making inferences about the economic impact of changing export levels.

Data for exports can also be volatile, in part because a small number of businesses account for a high proportion of Welsh exports, and figures can be influenced by the timing of shipments. For this reason, data for a single year, and even more for an individual quarter, must be treated as indicative rather than definitive.

With these caveats in mind, recent trends in Welsh exports of goods are shown in Figure B1. (Methodological improvements undertaken by HMRC mean that data for the years prior to 2014 are less reliable than data for more recent years.)

It can be seen from Figure B1 that the total value of Welsh goods exports to EU countries is greater than that of goods to exports to non-EU countries with no strong trend over the most recent three years. In 2016, goods exports to the EU accounted for 61% of the total, compared to 59% in 2014.

The shares of the largest categories of goods exported from Wales, with the UK as a comparator, are shown in Figure B2.

Machinery and transport equipment are particularly important for Wales, although they also represent the largest category of UK exports.

Figure B3, provides an analysis at a more detailed level for the exports of those Welsh goods products which have the highest value.

Wales is more dependent on the EU as an export market for its goods than is the UK as whole, as shown in Figure 1 (page 6).

**Figure B1: Welsh goods exports, £m**

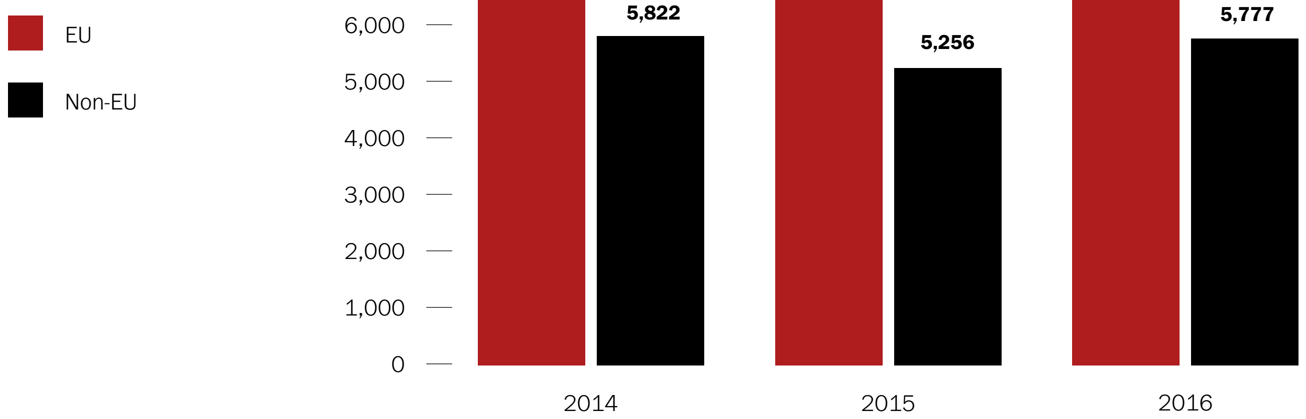


**Figure B2: Goods exports by industry, 2016, % of total**

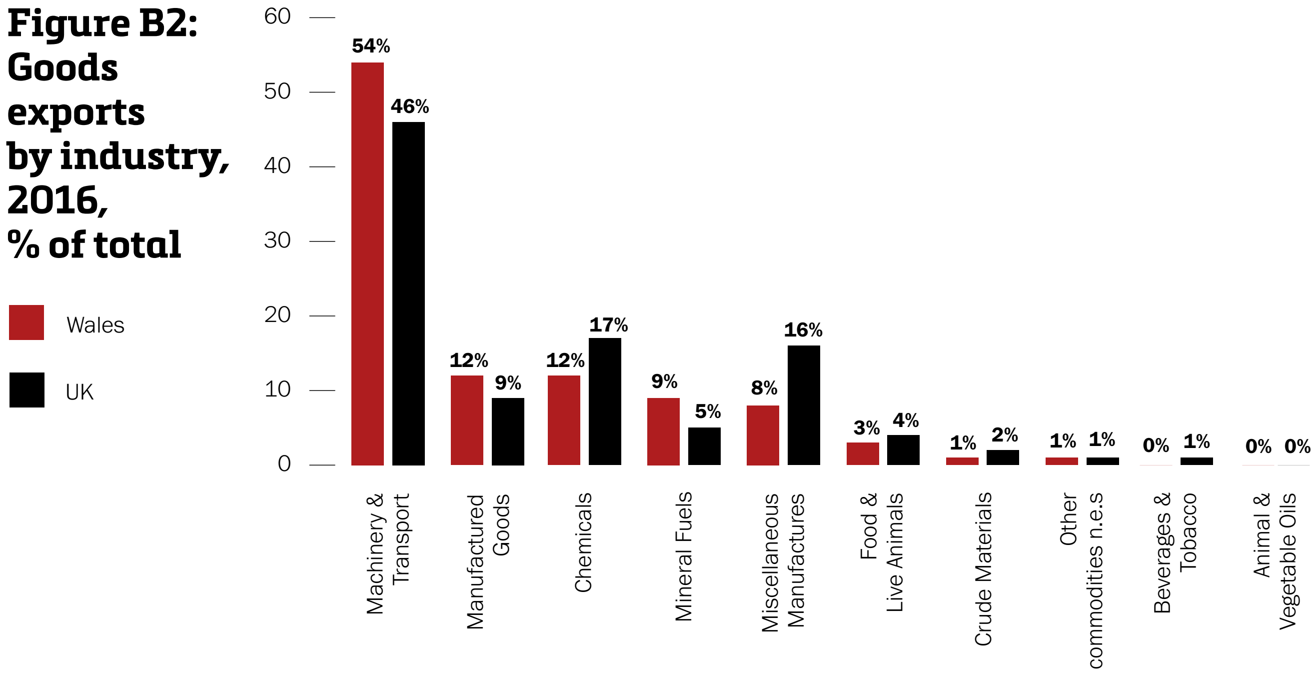



Figure 3 (page 9) provides more detail on export destinations for Welsh goods, ranked by their importance to Wales.

The top three countries to which Wales exports accounted for just over 50% of all exports in 2016 (the top 10 countries made up nearly 80% of all exports).

### Welsh export of services

Data on the export of services are produced by the Office of National Statistics on an experimental basis. As with trading goods, these statistics do not cover 'indirect' exports.

Figure B4 shows Welsh services exports for the most recent year, 2015, with data for goods exports shown for context.

The top three categories of service sector export from Wales in 2015 were:

- Manufacturing services (63%)
- Information and communications (16%)
- Real estate, professional, scientific and technical (13%).

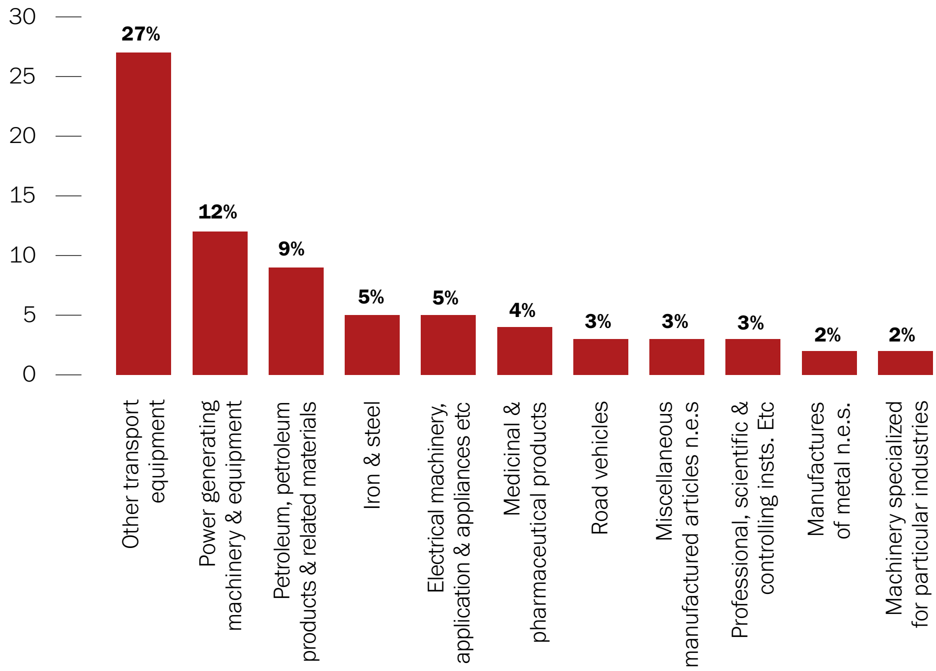
In contrast to the export of goods, around two-thirds of Welsh service exports go to non-EU countries.

### Welsh goods imports

HMRC also provides data on the import of goods (but no data is available on services imports).

Figure 4 (page 10) shows both exports and import levels for each category of goods in the most recent year, 2016.

## Figure B3: Major goods exports, Wales 2016, % of total




As with the export data, the figures are derived by apportioning import data for businesses operating on a pan-UK basis. This means that the data may not accurately reflect the dependency of Welsh business units on imported inputs. Along with the role of 'indirect' exports and imports which take place through Welsh trade flows with the rest of the UK, this means that it is not appropriate to compare Welsh exports and imports to compute a Welsh 'balance of trade'.

Figures 2 (page 7) and B5 analyse imports by source, and show that, in contrast to exports, Wales is more dependent on non-EU countries than EU countries for its imports.

### Inward investment

Foreign owned firms account for a large share of value-added (and investment) in Wales. In 2015, non-UK owned firms accounted for around 31% of Welsh private sector Gross Value Added — see Figure B6.

Wales has performed well in attracting new foreign inward investment projects over the last few years[3].

It is of course highly likely that inward investment across the UK will be negatively affected by the UK leaving the EU[4]. Again, the strength of the impact over the long term will be determined by the level of access to the Single Market that is eventually secured and the importance of EU markets to the investors in question. The latter will inevitably vary[5].

[3] Data for 2015/16: **www.gov.uk/government/uploads/system/uploads/attachment_data/file/550779/DIT_Investment_Results_2015-16_v1_05-09-2016.pdf**
[4] Recent evidence suggests that membership of the EU may have increased FDI into the UK by around 30%: **cep.lse.ac.uk/pubs/download/dp1453.pdf**
[5] For the importance of access to the EU single market and of other factors influencing inward investment, see: **www.gov.uk/government/uploads/system/uploads/attachment_data/file/277171/ep7-foreign-direct-investment-trends-manufacturing.pdf**

**Figure B4: Wales goods and services exports, 2015, £m**

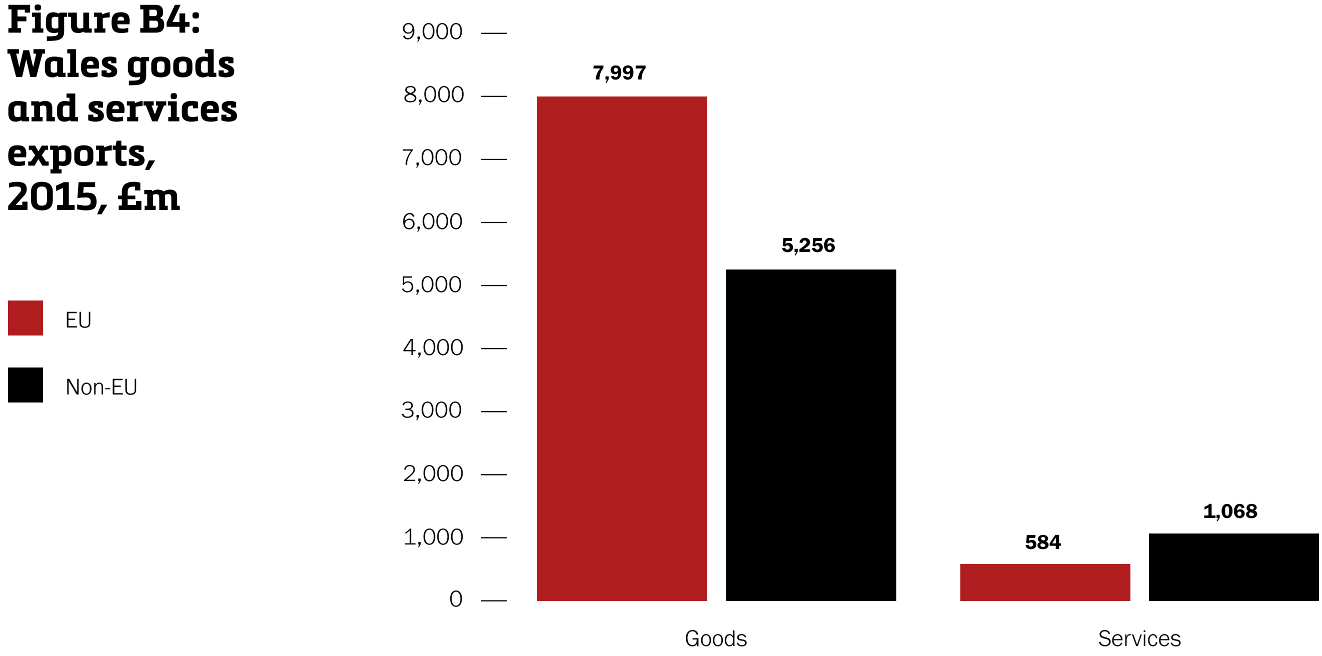
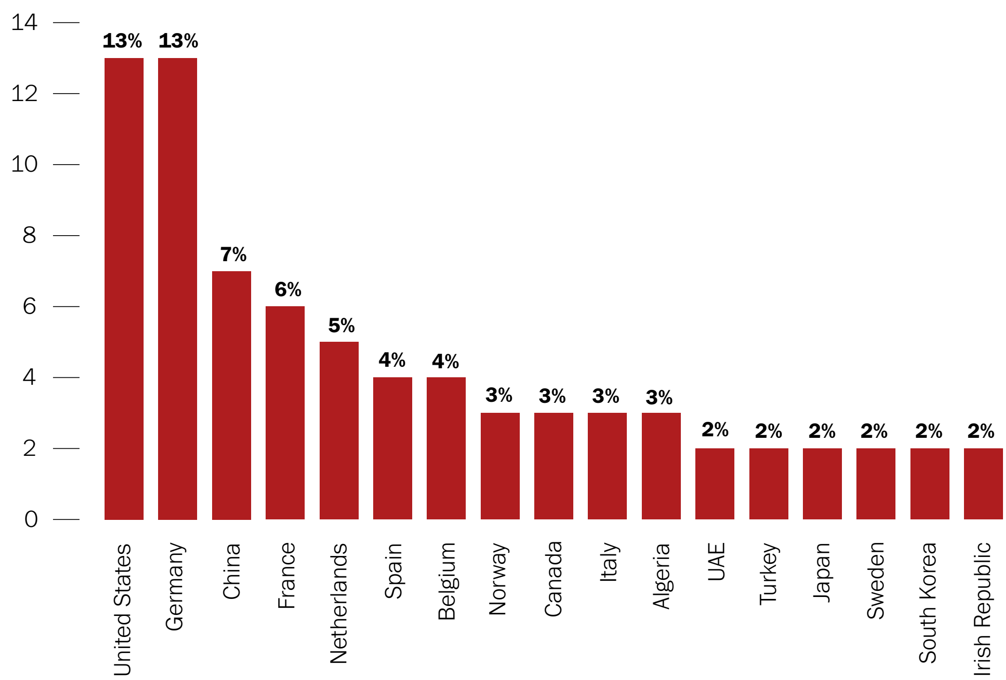
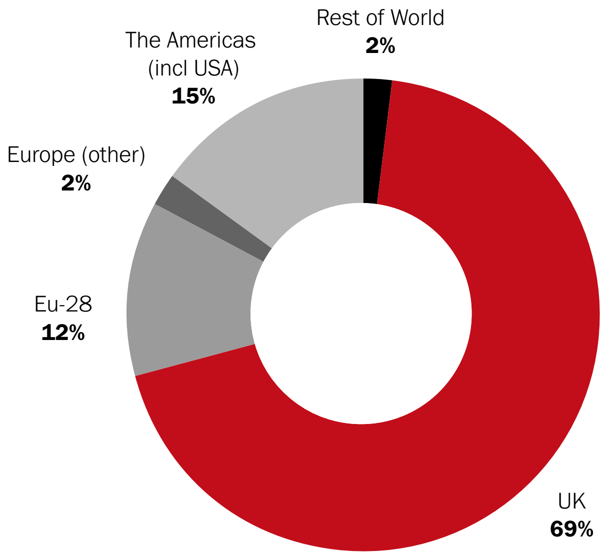



**Figure B5: Major import sources, Wales, 2016, % of total**



## Figure B6: Wales – value-added by country of ownership, 2015




A prolonged negotiating process is of immediate concern as this will create uncertainty, likely to deter both new inward investors and discourage existing overseas investors from making new, or replacement, investments. These adverse effects might still be mitigated by quick agreement on favourable transition arrangements.

The adverse effects of lower inward investment to Wales could be very significant, not least because the evidence shows that productivity, and pay, tends to be higher for people employed in multi-national businesses. In addition, there is evidence that such businesses generate 'spill-over' effects, prompting productivity improvements in indigenous firms.

### Spatial implications of trade

Reduced access to European markets that impacted on the viability of Welsh exporting businesses might be expected to result in effects that differ spatially. Data on exports is not available below the all-Wales level, but the extent of the dependency of an area on the manufacturing industry is likely to provide a broad indication of vulnerability.

Table B1 shows the share of the workforce in each local authority area in Wales that works in the production sector (which is comprised mainly of the manufacturing industry).

**Table B1:**
**Workforce in the production sector, 2016 (%)**

| | |
|---|---|
| Flintshire | 24 |
| Caerphilly | 22 |
| Blaenau Gwent | 21 |
| Wrexham | 21 |
| Neath Port Talbot | 20 |
| Torfaen | 17 |
| Merthyr Tydfil | 16 |
| Rhondda Cynon Taf | 15 |
| Bridgend | 14 |
| Newport | 14 |
| Carmarthanshire | 12 |
| Isle of Anglesey | 12 |
| Vale of Glamorgan | 11 |
| Powys | 10 |
| Monmouthshire | 9 |
| Denbighshire | 8 |
| Pembrokeshire | 7 |
| Cardiff | 7 |
| Gwynedd | 7 |
| Swansea | 6 |
| Ceredigion | 5 |
| Conwy | 4 |

Source: Welsh Government

**Table B2:**
**Workforce in the agriculture, forestry and fishing, 2016 (%)**

| | |
|---|---|
| Powys | 14 |
| Ceredigion | 13 |
| Pembrokeshire | 8 |
| Isle of Anglesey | 8 |
| Gwynedd | 8 |
| Carmarthenshire | 6 |
| Monmouthshire | 4 |
| Denbighshire | 4 |
| Conwy | 3 |
| Flintshire | 3 |
| Vale of Glamorgan | 1 |
| Wrexham | 1 |
| Merthyr Tydfil | 1 |
| Neath Port Talbot | 1 |
| Swansea | 1 |
| Blaenau Gwent | 1 |
| Bridgend | 1 |
| Caerphilly | 0 |
| Newport | 0 |
| Rhondda Cynon Taff | 0 |
| Torfaen | n/a |
| Cardiff | n/a |

Source: Welsh Government

Agriculture may also be affected by reduced market access, and, depending on the replacement arrangements put in place, by changes to the system of agricultural support. The relative dependency of Welsh local authority areas on agriculture is indicated by the data on employment in Table B2.

Although there are no official statistics, approximate calculations suggest that indirect exports are at least as important as direct exports. An indication of sectors in which Wales is likely to be a net exporter (importer) to (from) the rest of the UK can be gained by examining the degree to which Wales is relatively specialised across sectors. This helps provide some context for considering which sectors could be vulnerable to decreases in demand from the wider UK economy.

**Table B3:**
**Specialisation by sector in Wales (2015)**

**Location Quotients by SIC2 Industries, Wales, 2015**

Most specialised

| | | |
|---|---|---|
| 24 | Manufacture of basic metals | 3.7 |
| 32 | Other manufacturing | 3.0 |
| 39 | Remediation activities and other waste managment services | 2.4 |
| 01 | Crop and animal production, hunting and related service activitieis | 2.1 |
| 75 | Veterinary activities | 2.0 |
| 30 | Manufacture of other transport equipment | 1.9 |
| 27 | Manufacture of electrical equipment | 1.9 |
| 38 | Waste collection, treatment and dispostal; materials recovery | 1.7 |
| 65 | Insurance and pension funding | 1.7 |
| 33 | Repair and installation of machinery and equipment | 1.7 |
| 84 | Public administration and defence compulsory social security | 1.6 |
| 29 | Manufacturing of motor vehicles, trailers and semi-trailers | 1.5 |
| 36 | Water collection, treatment and supply | 1.5 |
| 21 | Manufacture of basic pharmceutical poducts and preparation | 1.5 |
| 02 | Forestry and logging | 1.5 |
| 10 | Manufacture of food productions | 1.5 |
| 55 | Accommodation | 1.5 |
| 20 | Manufacture of chemicals and chemical products | 1.4 |
| 50 | Water transport | 1.4 |
| 42 | Civil engineering | 1.4 |
| 87 | Residential care activities | 1.4 |
| 17 | Manufacture of paper and paper products | 1.4 |
| 25 | Manufacture of fabricated metal products | 1.3 |
| 18 | Printing and reproduction of recorded media | 1.3 |

Note: figure for Mining and coal and Lignite has been excluded from Table 4 as an outlier due to its small scale

Source: ONS

**Specialisation by sector in Wales (2015)**

**Location Quotients by SIC2 Industries, Wales, 2015**

Least specialised

| | | |
|---|---|---|
| 81 | Services to buildings and landscape activities | 0.7 |
| 78 | Employment activities | 0.7 |
| 59 | Motion picture, video and television programmes etc | 0.7 |
| 64 | Financial service activities, except insurance and pension funding | 0.7 |
| 82 | Office administrative, office support and related activities | 0.7 |
| 94 | Activities of membership organisations | 0.7 |
| 80 | Security and investigation activities | 0.7 |
| 28 | Manufacture of machinery and equipment n.e.c | 0.6 |
| 74 | Other professional, scientific and technical activities | 0.6 |
| 69 | Legal and accounting activities | 0.6 |
| 61 | Telecommunications | 0.6 |
| 03 | Fishing and aquaculture | 0.5 |
| 52 | Warehousing and support activities for transportion | 0.5 |
| 13 | Manufacture of textiles | 0.5 |
| 14 | Manufacture of wearing apparel | 0.5 |
| 60 | Programming and broadcasting activities | 0.5 |
| 66 | Activities auxiliary to financial services and insurance activities | 0.4 |
| 72 | Scientific research and development | 0.4 |
| 58 | Publishing activities | 0.4 |
| 62 | Computer programming, consultancy and related activities | 0.3 |
| 95 | Repair of computers and personal and household goods | 0.2 |
| 51 | Air transport | 0.1 |
| 63 | Information service activities | 0.1 |
| 15 | Manufacture of leather and related produces | 0.1 |

Table B3 shows areas where Wales is most and least specialised compared to the rest of the UK. These figures are created by comparing levels of employment by industry in Wales with levels across the UK as a whole.[6]

## Structural change in the economy

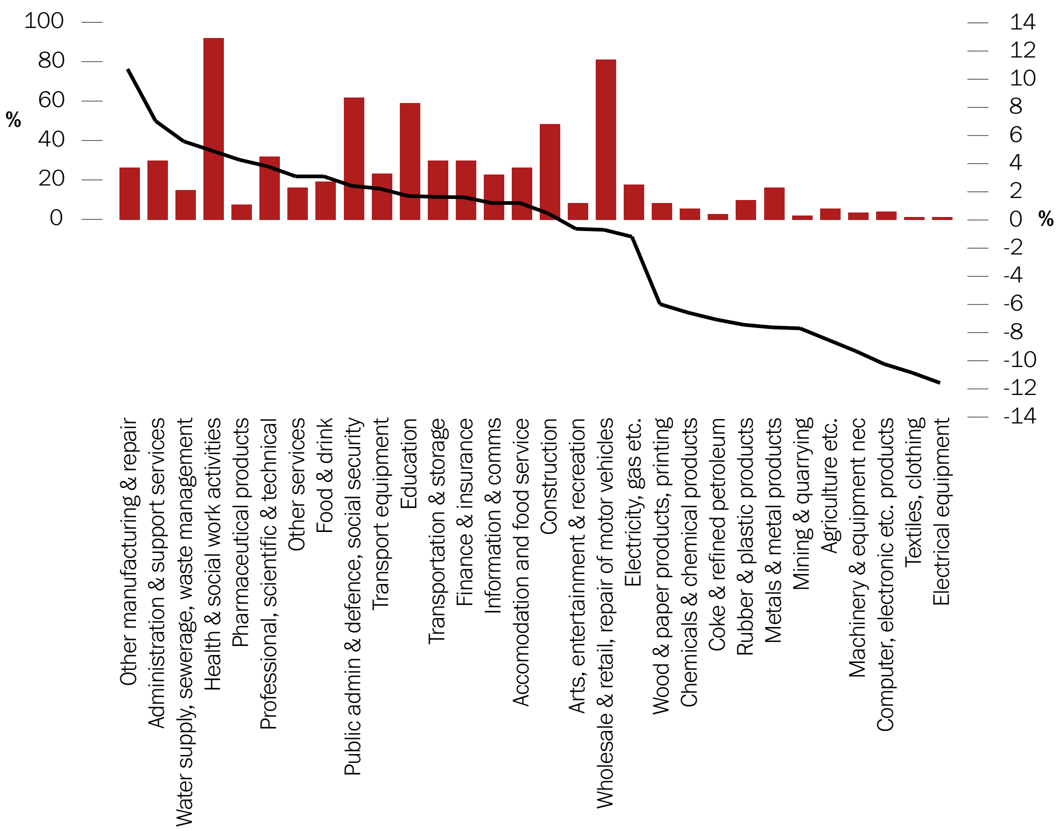
The impact of leaving the EU on Welsh exports needs to be assessed in the context of relative sector scale and of the continuing large scale structural change which would affect the composition of the economy even in the absence of Brexit.

This structural change reflects a range of factors including technological change, competition from other areas and changes in the structure of demand as income levels rise. The nature of these factors makes it very difficult to forecast future economic structure and the relative size of sectors.

Figure B7 provides an indication of the relative size of sectors in Wales for the year 2015 and of each sector's change in share of total output over the period since 1997. The sectors are ranked from the one with the largest increase in contribution to Gross Value Added (GVA) through to the one with the largest decrease in contribution. The contribution of each sector to GVA in 2015 is shown by a bar.

The average absolute change in sector share over the period 1997 is quite large over 20%.

**Figure B7: Wales GVA by sector: change 1997-2015 and share of total 2015**




Change in 1997–2015

Share of total 2015

[6] The location quotient shows the relative intensity of employment in Wales compared to the UK as a whole. A ratio of one indicates that Wales has the same share of employment in the sector as the UK as a whole. A figure of, for example, two, indicates that Wales has twice as high a share of employment in the sector as the UK, while a figure of 0.5 indicates a Welsh share of employment that is half that for the UK as a whole. Figures for Mining etc have been excluded as an outlier and due to the small scale of the industry

# Annex C: Impacts of Alternative Post-Brexit Trade Agreements on UK Agriculture: Sector Analyses using the FAPRI-UK Model

In August 2017 the Agri-Food and Biosciences Institute (AFBI) published the outputs of detailed economic modelling examining the potential economic impacts on the domestic agricultural industry of three alternative post-Brexit trade scenarios. This note provides an overview of the main findings of this research and some additional commentary. The full published report can be found at: **www.afbini.gov.uk/publications/afbi-report-post-brexit-trade-agreements-uk-agriculture**

## Modelling Approach

The FAPRI-UK modelling system uses specified equations to capture the inter-relationships between variables affecting supply and demand in the main agricultural sectors of England, Wales, Scotland and Northern Ireland.

The trade scenarios analysis made use of an adapted version of the FAPRI-UK model (in conjunction with the FAPRI-EU Grain, Oilseed, Livestock and Dairy model). The modified modelling system enabling a more appropriate representation of potentially non-fully integrated UK-EU agricultural markets post-Brexit reflecting a position where the UK could be outside the EU Single Market and Customs Union[1].

The three specified trade scenarios used in this research were intended to enable a broad, illustrative assessment of the likely bounds of potential impacts under contrasting and stylised, theoretical trade arrangements, and were not intended to necessarily reflect the most likely negotiation outcomes. Specifically, the scenarios reflect:

i. Bespoke Free Trade Agreement (FTA) with the EU;

ii. World Trade Organisation default Most Favoured Nation (MFN) tariffs;

iii. Unilateral trade liberalisation.

The main assumptions used within each of these scenarios are set out in Table C1.

[1] A separate price determination process for the UK was specified, so that UK agricultural commodity prices could diverge from those of the remaining EU-27 countries.

**Table C1: Summary of Trade Scenarios**

| Bespoke Free Trade Agreement with the EU | World Trade Organisation Default | Unilateral Trade Liberalisation |
|---|---|---|
| 5% trade facilitation costs* on UK-EU27 trade | 8% trade facilitation costs* on UK-EU 27 trade | 8% trade facilitation costs* on UK-EU 27 trade<br><br>Zero tariffs applied on imports to the UK from both the EU and the rest of the World |
| UK retains tariff and quota free access to the EU and EU retains tariff and quota free access to the UK | MFN tariffs applied to imports from the EU<br><br>Tariff Rate Quotas (TRQs) from 3rd countries retained<br><br>MFN tariffs applied to UK exports destined for the EU | MFN tariffs applied to UK exports destined for the EU |
| UK maintains EU tariff structure to rest of the world | No change in tariff structure for exports to the rest of the world | No change in tariff structure for exports to the rest of the world |

* Note: Trade facilitation costs reflect the costs of additional cross border administration checks (such rules of origin, sanitary and phytosanitary inspections and delays at ports).

These scenarios were compared against a baseline which assumes continuation of current trade and domestic agricultural support arrangements (i.e. the UK remaining fully integrated within the EU single market and with direct payments to farmers equivalent to existing payments under the Common Agricultural Policy). The projection period covers 2016-2025, with the alternative trade arrangements under each scenario incorporated within the modelling from 2019. No changes are made to the underlying macroeconomic assumptions, e.g. exchange rates, for the separate scenarios for the purpose of this analysis.

The scope of the analysis considers aggregate agricultural sector[2] measures such as production, producer prices (wholesale prices for cheese and butter) and output, rather than potential farm-level impacts and their distribution. To focus on the effects of alternative trade scenarios, the scope of the analysis does not attempt to model any changes to domestic agricultural policies within the scenarios.

Given the uncertainties and modelling assumptions, the interpretation of the results should focus on the broad direction and magnitude of potential impacts rather than specific point estimates[3]. The focus of

[2] Some agricultural sectors such as sugar and horticulture, and the impacts on food products more generally, are not covered by this analysis.
[3] It should also be noted that the magnitudes of these estimates would also be affected by developments in respect of exchange rates and world markets.

results within the report is at the UK level, where greater confidence may be justified given the uncertainties regarding how the projected impacts under the alternative scenarios would work through spatially within the UK. However, whilst there are some price differences projected within the UK for some agricultural commodities, the estimated impacts at a Wales-level generally tend to move broadly along the same price path as the rest of the UK, reflecting the integrated UK market. The report also notes the potential differential effects under alternative scenarios between agricultural producers and consumers given changes to commodity prices (and by implication food prices).

## Findings

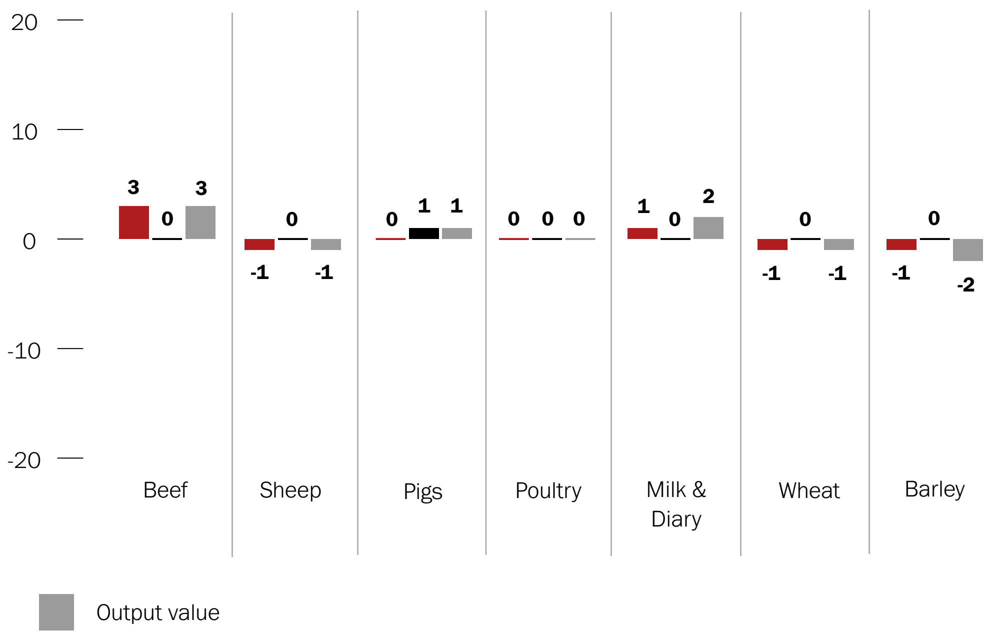
### i. Bespoke FTA with the EU

In the case of a bespoke FTA with the EU, given the limited changes to trade arrangements (and hence the extent of disruption to trade flows) compared to the baseline, overall this scenario tends to suggest relatively modest effects on agricultural producer prices across agricultural sectors, and consequently only marginal effects on production and the value of output. UK prices tend to increase slightly for those products where the UK is a net importer (e.g. beef and cheese), but decrease slightly for commodities where the UK is a net exporter (e.g. sheep and barley). The projected percentage difference in the value of output (producer price X production) for each commodity (beef, sheep, pigs, poultry, milk and dairy, wheat and barley) between the baseline and this scenario in 2025 ranges between -2% and +3%.

Limited effects are also projected in general for Wales in this scenario. Production of cattle in Wales is projected be +0.2% higher than the baseline in 2025, with sheep production unchanged. Milk production and prices are also slightly higher (+0.4% and +1.2%, respectively) compared to the baseline in 2025 – though within this context such estimates may be suitably interpreted as not significantly different from the baseline.

**Figure C1: Projected percentage change in UK commodity prices**

**Production and value of output compared to baseline in 2025 – bespoke FTA with the EU, %**



### ii. World Trade Organisation default

The World Trade Organisation default scenario represents more 'protectionist' trade arrangements, through the introduction of MFN tariffs on UK-EU27 trade. For many agricultural commodities, the relevant default MFN tariffs are significant, and the modelling suggests that this would lead to significant adjustments to trade flows between the UK and EU27 for some commodities, with consequent impacts on the UK domestic market. The results indicate considerable variation in outcomes under this scenario across agricultural commodities, with the direction of impacts generally associated with whether the UK tends to be a net exporter or net importer of the specific agricultural commodity.

UK producer prices and output values are projected to be notably higher for dairy, beef, pigs and poultry sectors compared to the baseline in 2025, with the imposition of tariffs reducing the competiveness and volume of imports from the EU. In the case of beef, the projections suggest producer prices around 17% higher than the baseline in 2025. Pig meat and poultry producer prices are projected to be around 18% and 15% higher[4] compared to the baseline by 2025. Commodity prices for cheese and butter are projected to be 29% and 43% higher, respectively, with UK milk and dairy prices around 30% higher in this scenario than under the baseline in 2025[5].

Higher producer prices tend to exert a positive effect on production, but would also be expected to feed through into consumer prices and hence impacts on consumers' budgets and consumption patterns; higher food prices would be expected to disproportionately impact lower income households for whom food expenditure makes up a greater share of income. However, the modelling also suggests negative impacts for some other commodities, particularly for sheep meat, as MFN tariffs applied on UK exports to the EU adversely impact on the competitiveness and hence volumes of such UK exports, boosting the availability of supplies within the UK market and pushing down on prices (the UK price of sheep meat is projected to be around 30% lower in this scenario than the baseline in 2025). The UK sheep sector results, however, exhibit some degree of sensitivity to the assumptions around how the existing EU TRQ (tariff rate quotas) would be divided.

The changes to trade flows are also projected to have a downward effect on UK wheat and barley prices - projected to be around 4% and 5% lower, respectively, compared to the baseline in 2025. However, the direction of price impacts is reversed for wheat prices in a sensitivity analysis which instead assumes no wheat tariff is applied to UK exports to the EU.

As a consequence of the effects on prices and production, the value of output for beef is projected to be +29% above the baseline in 2025, +44% for pigs, +28% for poultry and +37% for milk and dairy. The value of output for sheep meat is projected to be -38% lower compared to the baseline in 2025, and the report notes the potential consequences that could arise in terms of medium to longer-term structural adjustments, though any such adjustments will also be influenced by a range of factors, such as other sources of household income and farming motivations.

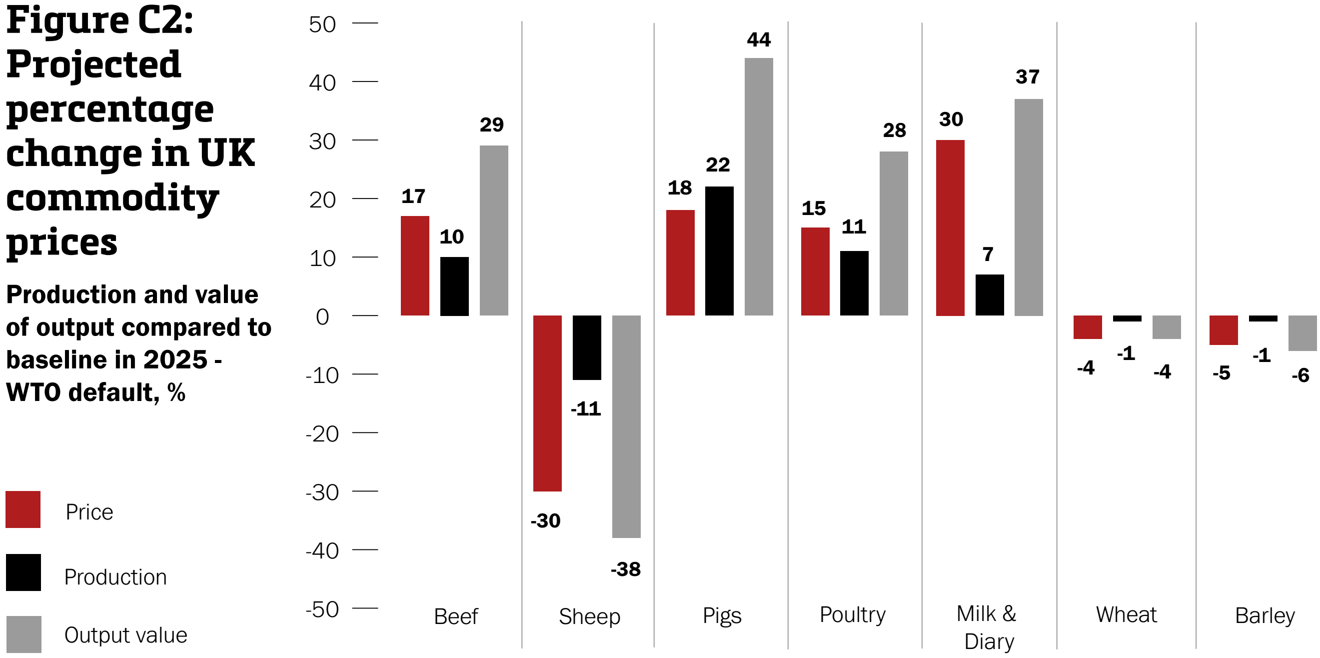
At a Wales level, cattle production is projected to be around 12% higher than the baseline in 2025, and sheep production 15% lower. Milk prices are also projected to be around 28% higher than in the baseline, with production around 9% higher.

[4] The modelling does not specifically analyse processed meat - processed trade is of importance for these products, and application of tariffs to such goods may be likely to imply a larger UK price increase than indicated by these projections.

[5] For a sub-scenario where the UK sheep meat TRQ for third country imports is reduced by 50%, the sheep meat price is around 13% lower compared to the baseline in 2025, drawing out the importance of decisions regarding relevant TRQs.

**Figure C2: Projected percentage change in UK commodity prices**

**Production and value of output compared to baseline in 2025 - WTO default, %**




### iii. Unilateral trade liberalisation

This scenario is intended to represent a 'radical' position removing the domestic protection offered by tariffs on imports. The unilateral trade liberalisation scenario shares some common assumptions to those of the World Trade Organisation default, though importantly in this case zero tariffs are applied on imports to the UK from both the EU and the rest of the world[6]. Exports from the UK are subject to trading partners MFN tariffs, including for UK exports to the EU.

For the unilateral trade liberalisation scenario, the results indicates that the removal of UK import tariffs would lead to a negative impact on UK producer prices, production and the value of output across all considered agricultural commodities, the variation in the extent of impact reflecting the difference between UK and world prices. Beef and sheep sectors are particularly affected given the highly competitive production of these commodities in some other countries, which leads to increased inflows of such imports.

The UK beef price is projected to be around 45% lower than in the 2025 baseline, with EU imports displaced by supply from the rest of the world[7]. As a consequence of the effects on prices, beef production by the end of the projection period is around 10% below the baseline. The UK sheep meat price is projected to be around 29% lower than the baseline in 2025, which leads to domestic production around 11% below the baseline in 2025. Lower prices provide some positive effects on domestic sheep meat consumption. Producer prices for pig meat and poultry meat are also projected to be lower (-12% and -9% lower than the 2025 baseline, respectively).

[7] Though there is uncertainty around the extent of displacement of EU imports by rest of the world imports due to factors such as consumer preferences, which could moderate the extent to which UK beef prices would be lower.

For the dairy sector, cheese and butter prices are projected to be around 11% lower than the 2025 baseline, with producer milk prices in GB around 10% lower - which as a consequence pushes down on domestic milk production. UK prices for wheat and barley are projected to be around 5% and 7% lower than the baseline in 2025, the more moderate impacts being a result of these commodity prices being close to world prices.

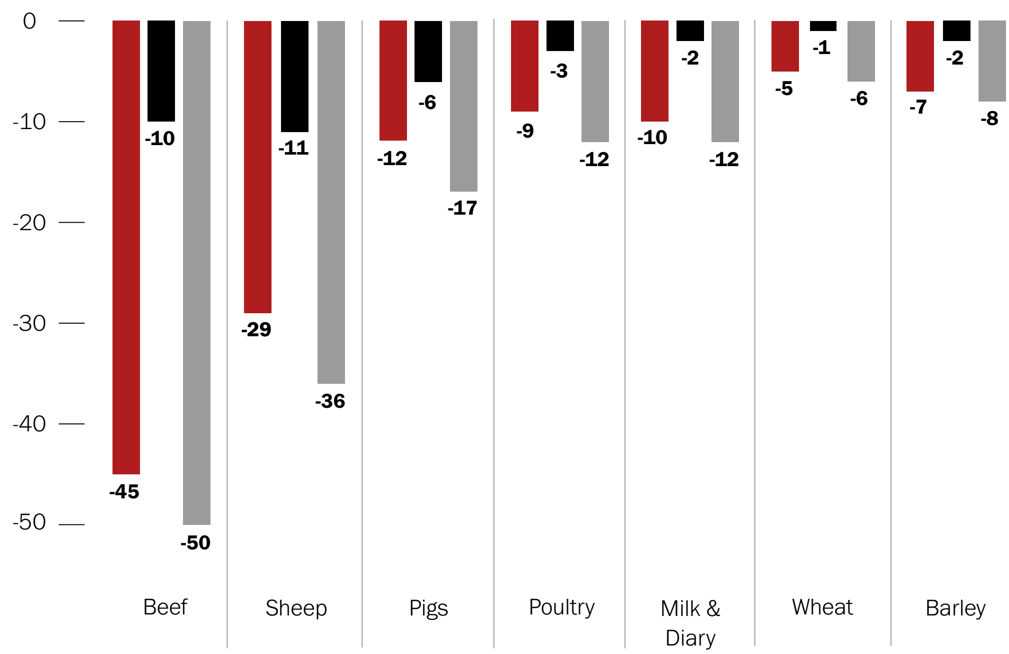
As a consequence of these effects on prices and production, the value of output of beef is projected to be around 50% lower compared to the baseline in 2025, with sheep output value -36% lower, and milk and dairy around -12% lower.

Whilst the depressing effect on domestic producer prices is projected to lead to lower domestic production, lower producer prices would be expected to be reflected in lower food prices and expenditure on such goods for domestic consumers.

Production of cattle and sheep in Wales in this scenario are both projected to be over 10% lower compared to the baseline in 2025. The alternative scenarios also suggest notable impacts on livestock numbers in Wales. In both the World Trade Organisation default and trade liberalisation scenarios sheep numbers are lower (around 18-19% lower than the baseline). However, for beef cows the effect varies substantially with increases projected under the World Trade Organisation default but a notable reduction under the unilateral trade liberalisation scenario compared to the baseline in 2025.

**Figure C3: Projected percentage change in UK commodity prices**

**Production and value of output compared to baseline in 2025 - unilateral trade liberalisation, %**



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