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FRANCE'S "RED TAPE" COST OF BREXIT

MARSH GUY CARPENTER MERCER OLIVER WYMAN

MARSH & McLENNAN COMPANIES

EXECUTIVE SUMMARY

As Brexit negotiations continue, we have been working with Clifford Chance to assess the impact that new tariff and non-tariff barriers between the UK and EU27 could have on European and British export businesses.

The direct annual costs of Brexit are expected to reach a total of about €70 billion, allowing for mitigating measures that affected companies will take. These costs will be shared between the EU27 and the UK for a total value of €37 billion and €32 billion respectively. A customs agreement similar to the Customs Union would reduce the impact to €17 billion in the EU27 and €21 billion for the UK.

We estimate the direct "red tape" cost of Brexit for French companies to be approximately €4 billion per year, making France the third most affected country after the UK and Germany. In France, the highest impact will be felt in the following sectors: agriculture, food, and drink (including cheese and wine); consumer goods (including perfume and beauty products); automotive; chemical; aerospace; and industrial goods.

Companies are not equally equipped to cope with these new challenges. In particular, small and mid-sized enterprises (SMEs) have more limited resources to manage the additional administrative load. Also, they generally have less experience with exports outside the EU27, so they are less used to dealing with customs and regulatory barriers. But, while European and British SMEs are especially vulnerable, a large proportion of French exporting SMEs have the advantage of having already exported outside the EU27.

French companies must prepare to act. Brexit will affect not only their customers and competitors, but also their suppliers and supply chain. Supporting SMEs will therefore be critical because the latter are particularly vulnerable and their failings would have a direct impact on the French economy as well as indirect effects on the supply chain of larger companies.

BACKGROUND

Our analysis aims to provide an initial assessment of the direct impact of Brexit on the business of exporting companies. The exact terms of Brexit are still uncertain and the conditions that will govern future commercial trade between the UK and the EU27 are not yet known. This analysis is limited to the most direct and foreseeable impacts for UK and EU27 companies and does not provide an estimate of the many indirect impacts of Brexit, such as pricing, migration, and exchange rates.

We collaborated with Clifford Chance to assess the direct costs of tariff and non-tariff barriers in the various economic sectors in the event of a return to World Trade Organization (WTO) Most Favoured Nation (MNF) conditions. Our model supposes a sufficiently long transitional period to allow the new obligations and operating practices to be implemented. We compare the direct costs of Brexit using gross value added (GVA) rather than gross domestic product (GDP), because GVA is a measure more easily comparable with economic impact across different countries and industries.

METHODOLOGY

Approach. This report estimates the most immediate and direct costs of post-Brexit trade barriers at a sectoral level for the EU27 and UK. It does this by applying WTO tariff rates and adding the estimated costs of the non-tariff barriers to trade in goods and services. The latter are estimated at a granular level by considering individual "behind-the-border" costs (for example, dual certification) and "at-the-border costs" (for example, time delays and administrative burdens). Our estimates are based on a combination of academic work, benchmarks, and industry interviews. For example, our behind-the-border estimates use a detailed list of regulatory barriers identified by Clifford Chance and public studies such as Berden et al.'s (2009) analysis on the Transatlantic Trade and Investment Partnership (TTIP); see also Eurostat and the Office for National Statistics (ONS) Pink Book.

From this we have built up a detailed picture of costs associated with regulations for each sector, which are then adjusted based on proprietary benchmarks and interviews with companies and trade associations. Our modeling is focused solely on the costs that can be mitigated. We have not modeled any additional revenue generated, for example increase in revenue for logistics firms or revenues from repatriated activities.

We have also drawn on the work by Oliver Wyman to produce the report "The Impact of Brexit on the Financial Services Sector" (2016); the figures used for the impact of Brexit on financial services are aligned between the two pieces of work.

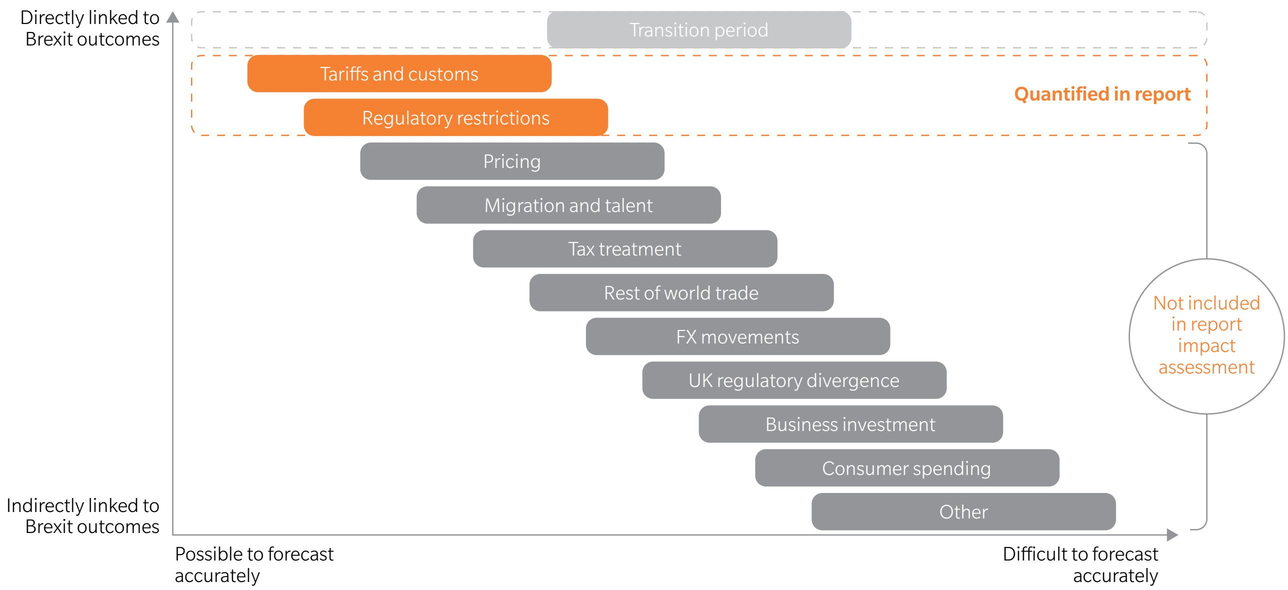
Scope and scenario. The analysis is limited to the first-order, direct EU27-UK trade costs only (see Exhibit 1). We have not considered a wider set of potential impacts that could arise from Brexit, such as workforce impacts, and have explicitly excluded in this report any impact from third-country free-trade agreements. We have modeled a scenario where the EU27 and UK revert to a WTO trading relationship with one another on a most-favored nation basis. We have assumed a scenario in which major regulatory "cliff edges" are avoided (such as an exit from EASA, REACH, and EURATOM without an adequate replacement, which would mean that planes are unable to fly, trade in chemicals would stop, and the UK's nuclear industry could shut down). This is informed by our discussions with industry bodies and affected companies for whom these scenarios are so severe that they are of less use for practical contingency planning (due to the extreme costs incurred). This report makes no comment on whether or not this is a realistic scenario.

We have assumed that there is a smooth transition to this WTO end state and effective alignment in regulatory standards as today. We have modeled the incidence of tariff and non-tariff costs to be borne by exporters and have not modeled pricing changes that will be passed on to importers. This simplifies multiple power and pricing dynamics that will play through supply chains and customer relationships.

The narrow focus of this report means that sectors such as hospitality and the public sector show limited impact. These and other sectors may face large impacts from potential restrictions in migration or higher import costs on goods and services, which we have not modeled.

Definitions. Throughout our analysis, we use a number of technical and defined terms, such as GVA, tariff and non-tariff barrier, and mitigation. We explain them in the Glossary at the end of this report.

Exhibit 1: Scope of the study



Notes: Assumes a smooth Brexit; Analysis does not include other Brexit-related impacts
Source: Clifford Chance and Oliver Wyman analyses

DIRECT COSTS BY COUNTRY

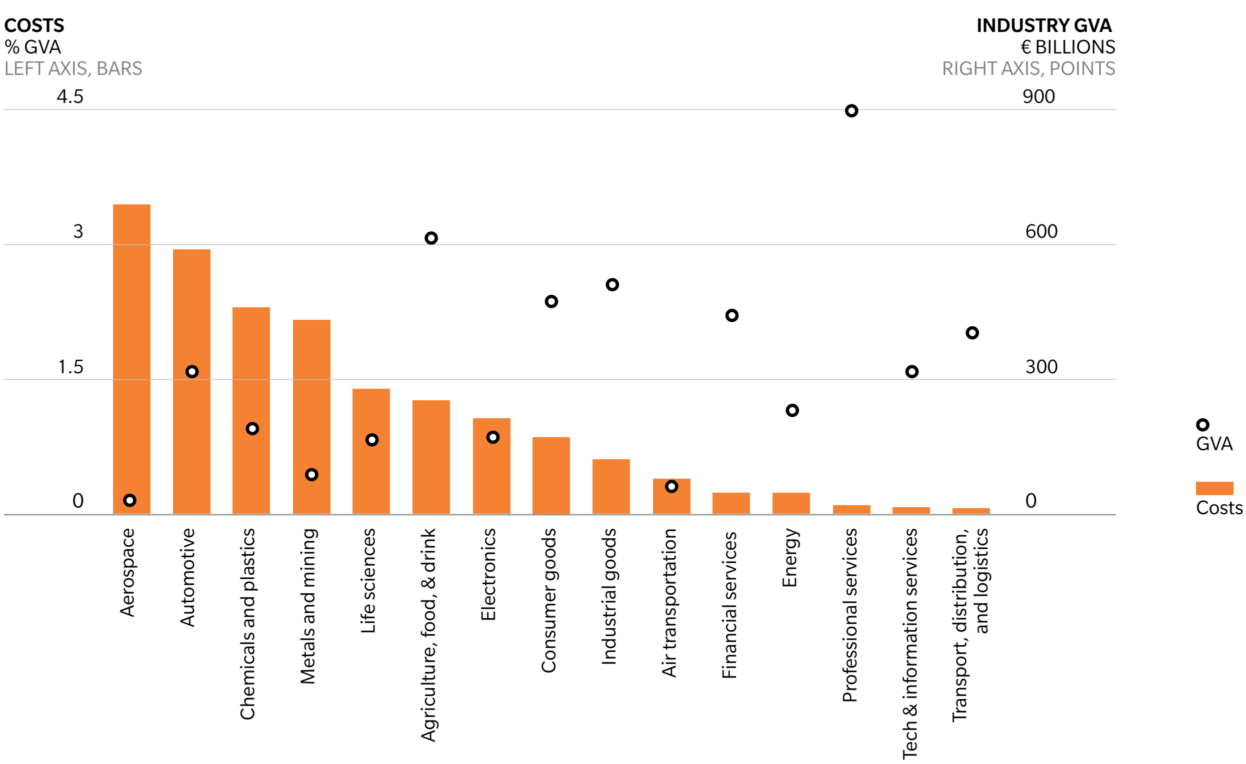
According to our estimates, the direct costs of Brexit will reach a total of €70 billion. EU27 and UK exporters are expected to support annual costs of about €37 billion and €32 billion, respectively.

In the UK, financial services will be the sector most affected, representing nearly a third of direct Brexit costs. Moreover, industries whose companies are highly integrated into European supply chains, such as aerospace, automotive, chemicals, and industrial goods, will be particularly affected.

The impact on EU27 exporting companies will vary by industry and region. For example, the sectors most affected at the EU27 level will be aerospace and automotive.

A customs agreement similar to the Customs Union would reduce the impact in the EU27 and the UK. This would result in a reduction of at-the-border tariff and non-tariff barriers for companies in different business sectors, compared to the scenario of returning to WTO terms. In a situation involving these conditions, the direct costs of Brexit would be €1 billion for the EU27 and €21 billion for the UK.

Exhibit 2: Estimated cost of tariff and non-tariff barriers on the EU27 economy, by sector



Source: Oliver Wyman and Clifford Chance analysis

Direct costs by industry reach up to 3.5 percent of GVA for some sectors, such as the aerospace, automotive, chemicals, and industrial goods industries (see Exhibit 2).

Although the distribution of costs between tariff and non-tariff barriers varies significantly across sectors, non-tariff barriers represent 55 percent to 100 percent of the costs of Brexit.

The impact on EU27 countries will vary, depending especially on the size of the affected sectors and their exposure to the UK.

In relative terms (compared to the size of the economy), the most affected countries would be Ireland, Belgium, and the Netherlands, reflecting their links with the UK and the importance of particularly affected industries. On the other hand, the absolute impact would be most important in Germany, the Netherlands, and France, in line with the size of these economies.

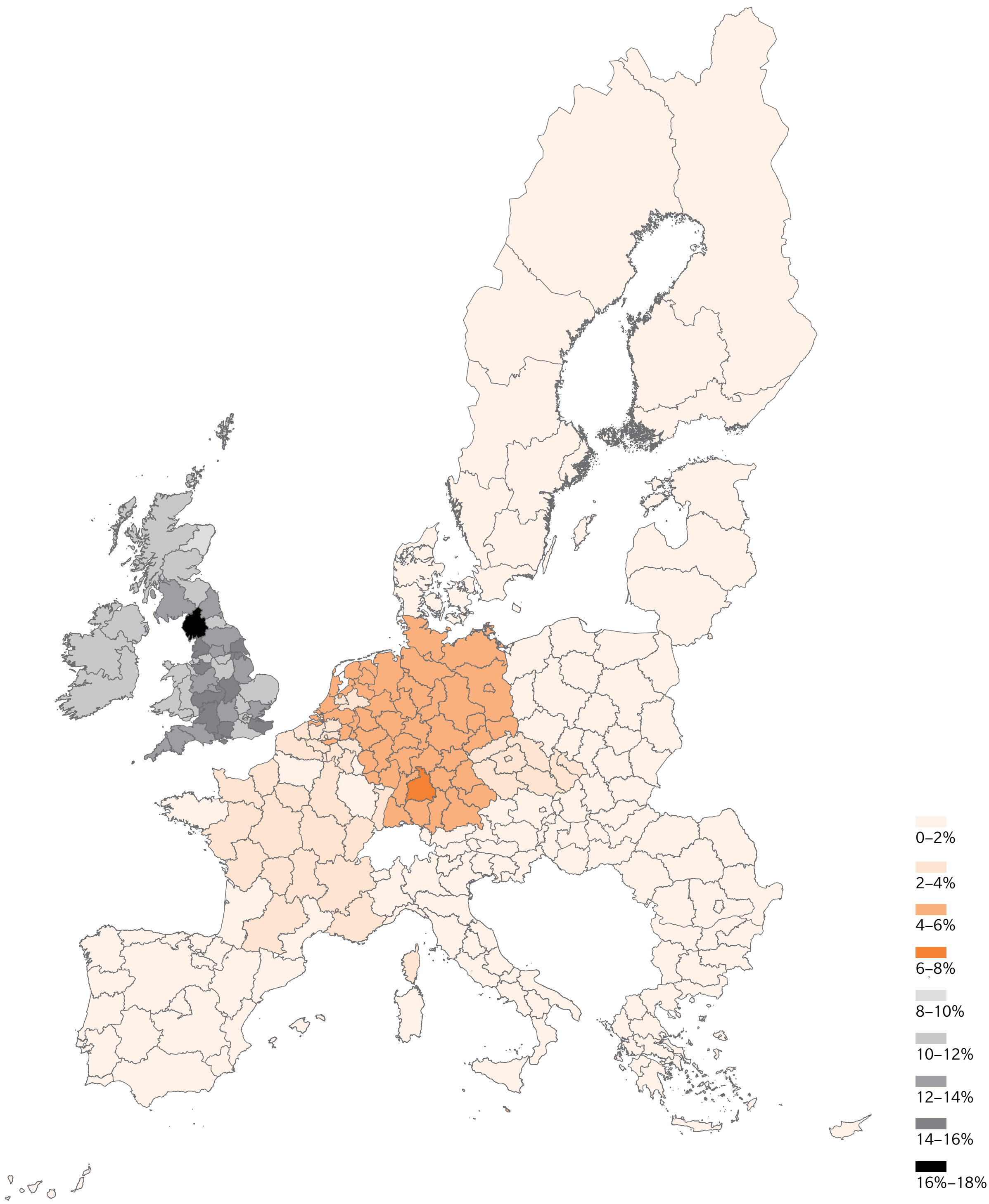
For example, the Irish food and beverage sector will suffer markedly from reduced access to British consumers. In Germany, 70 percent of the direct costs of Brexit will be borne by four regions – Bavaria, Baden-Württemberg, North Rhine-Westphalia, and Lower Saxony – due to their global leadership position in the automotive and manufacturing industries.

FRANCE: DIRECT COSTS BY REGION

In France, the direct annual costs for export businesses will rise to approximately €4 billion (after mitigation measures) or approximately 0.2 percent of GVA. So, France would be the third most affected country (in absolute terms) but relatively less affected than the European average (compared to total GVA). The most concerned French industries are agriculture, food, and drink (especially dairy products, wine, and spirits); consumer goods (especially jewelry, perfume, and clothing); as well as the automotive, chemicals, aerospace, and industrial goods industries.

The terms of Brexit will have diverse consequences depending on the region. In parallel with our report, economists agree with our conclusions and describe the sensitivity of the GDP to Brexit on a regional level, shown in Exhibit 3. In chemicals and plastics, Auvergne would be the region most affected by the UK's withdrawal from the EU; for transportation, this would be the Midi-Pyrénées region. To supplement an analysis by industry and by country, an analysis by region could enable national and local public authorities to assess, simulate, and anticipate the impacts related to Brexit. This analysis would also be useful to large companies whose suppliers may be local and undiversified.

Exhibit 3: Regional exposure to Brexit by proportional GDP

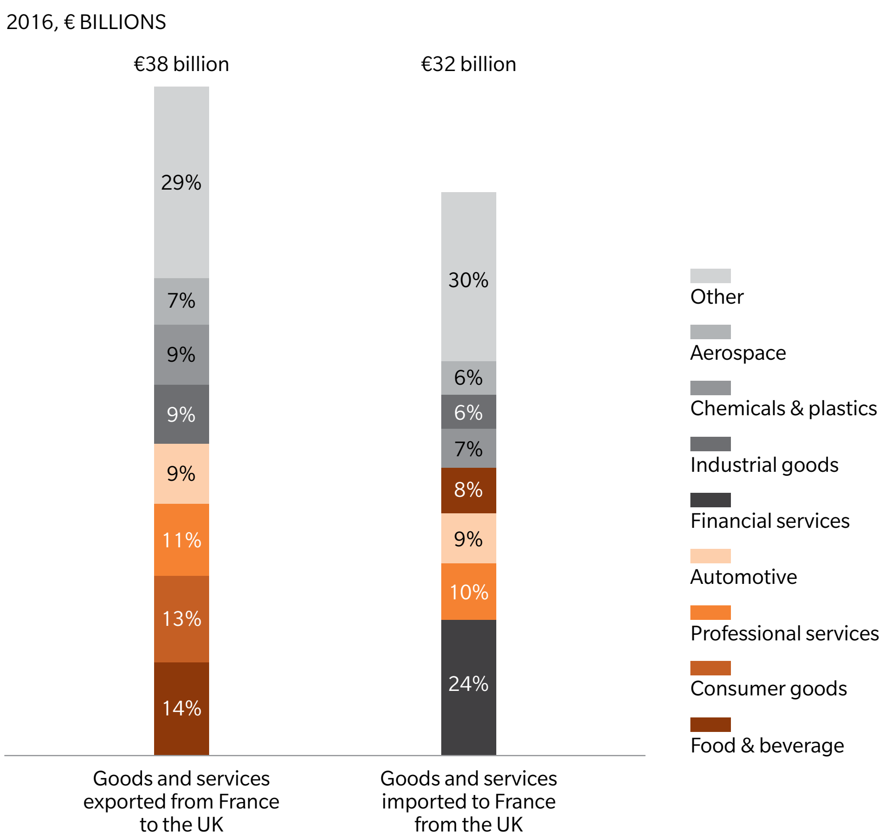


Source: "Assessing the exposure of EU27 regions and cities to the UK's withdrawal from the European Union," European Committee of the Regions, March 2018; and "The Continental Divide? Economic Exposure to Brexit in Regions and Countries on both Sides of the Channel," April 2018

FRANCE: DIRECT COSTS BY SECTOR

Trade between France and the UK is significant and reflects their geographical proximity and complementary economies. In 2016, the UK was France's fifth leading customer and eighth leading supplier. France exported €38 billion of goods and services to the UK, in particular food, beverages, and consumer goods, while France imported approximately €32 billion, largely composed of financial services and professional services (as Exhibit 4 shows)

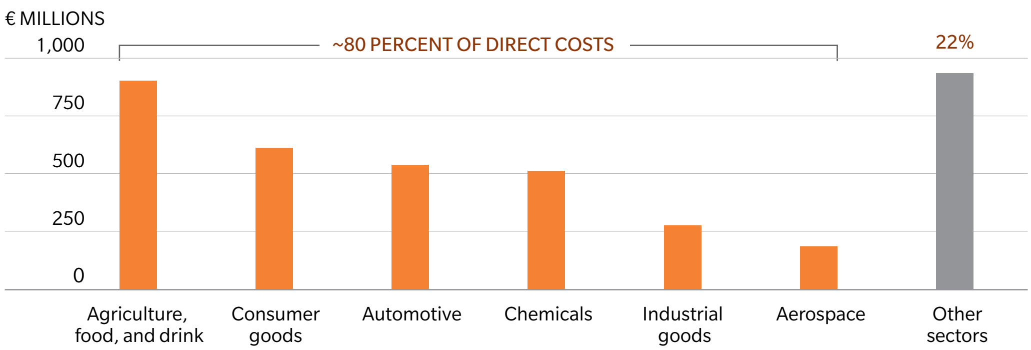
Exhibit 4: Imports and exports between France and the UK



Source: ONS, Oliver Wyman analyses

Exhibit 5 shows the six industries that will bear over three quarters of the direct costs of Brexit (after allowing for mitigation measures): agriculture, food, and drink; consumer goods; chemicals; automotive; industrial goods; and aerospace. The remainder includes a number of industries for which the relative impact will be lower, such as metals and mining, tourism, and professional services.

Exhibit 5: Estimate of direct costs (after mitigation measures) for French exports in different industries in France

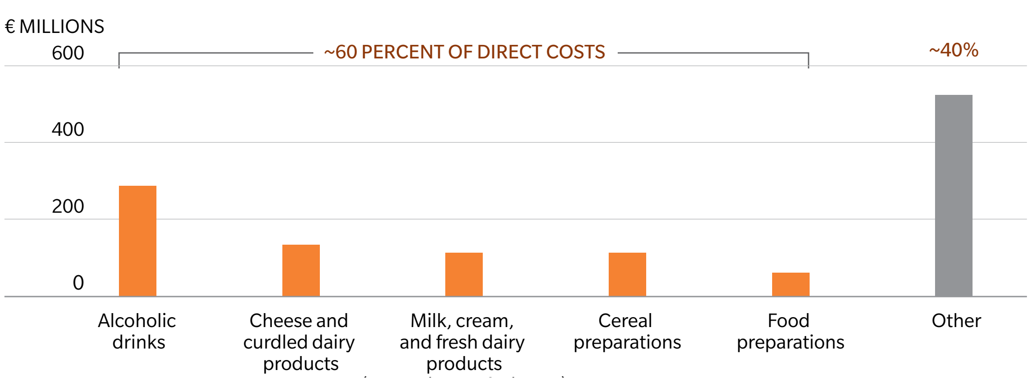


Source: WTO, Eurostat, ONS, CBI, Clifford Chance, Oliver Wyman analyses

Agriculture, food, and drink will be the most affected sector in the French economy, with total direct annual costs of close to €900 million, or nearly a quarter of direct costs for French companies. This reflects the fact that food and beverage is the leading export sector from France to the UK, and that Brexit would have a significant impact on tariff (namely a return to high WTO tariffs) and non-tariff barriers (significant effects in terms of delays, certifications, and so on).

Alcoholic drinks (such as wines and spirits) constitute the leading category of concerned goods, followed by dairy products and cereal preparations (see Exhibit 6). The top five categories of goods represent nearly 60 percent of estimated costs.

Exhibit 6 : Estimated cost of tariff and non-tariff barriers for the main categories of French exports of food and beverage products in France



Source: WTO, Eurostat, ONS, CBI, Clifford Chance, Oliver Wyman analyses

Exhibit 7: Estimated cost of tariff and non-tariff barriers for the main categories of French exports of consumer goods in France

Source: WTO, Eurostat, ONS, CBI, Clifford Chance, Oliver Wyman analyses

Although some of these costs may be passed on to the end consumer, this will depend on the type of goods. High-end products (like Champagne) will be in a better position to take advantage of lower price elasticity. It is likely, however, that some French products will be less competitive relative to foreign products, which may be relatively unaffected or not at all affected by Brexit (such as the wines of South Africa and Australia, English cheeses, and cereals from the US or Argentina).

French exports of consumer goods will be forced to bear direct costs of over €500 million (as Exhibit 7 shows). Jewelry, watchmaking, clothing, cosmetics, and travel goods will be particularly affected and account for approximately 50 percent of estimated costs.

As in the food and beverage industry, some companies will manage to pass these additional costs on to consumers. Luxury items occupy a large portion of French exports of consumer goods and, given the nature of these products, demand elasticity should make it possible to pass on most of the cost of tariff and non-tariff barriers to end consumers.

The automotive, chemicals, aerospace, and industrial goods industries will also bear major direct costs of about €1.2 billion. But this figure is likely to rise as a result of indirect costs. The supply chains for these industries are long and complex, and some involve many border crossings between the UK and the EU27.

FRANCE: DIRECT COSTS BY COMPANY SIZE

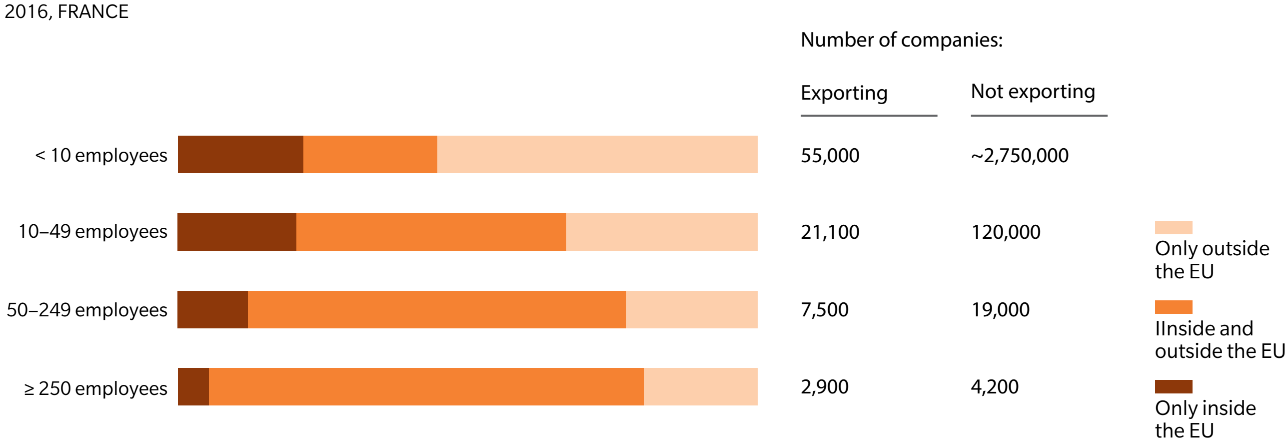
Size will be a critical factor in the ability of companies to adapt to the administrative complexities and the additional costs generated by Brexit (see Exhibit 8). While large corporations have more experience of exporting products outside the EU and managing administrative procedures, SMEs are more vulnerable and the additional costs could be significant for some of these companies. This impact will be especially notable for SMEs that do not export large amounts outside the EU27 and could be enough to drive some companies into financial difficulties.

The proportion of SMEs exporting only within the European Union is lower in France than elsewhere: 20–25 percent for French SMEs compared to 40–70 percent for British or German SMEs. But there are still 15,000 to 20,000 SMEs that have never had to cope with exporting outside the European market and may have trouble managing the new tariff or non-tariff barriers.

It will be critical to support SMEs during this transition. Their failings would not only have direct consequences on their own financial situation, but could also lead to significant indirect effects on the supply chain of large corporations (through additional delays, costs, disruptions, and so on).

Exhibit 8: Breakdown of exporting companies by export destination and company size

TYPE OF EXPORTS BY COMPANY SIZE
2016, FRANCE



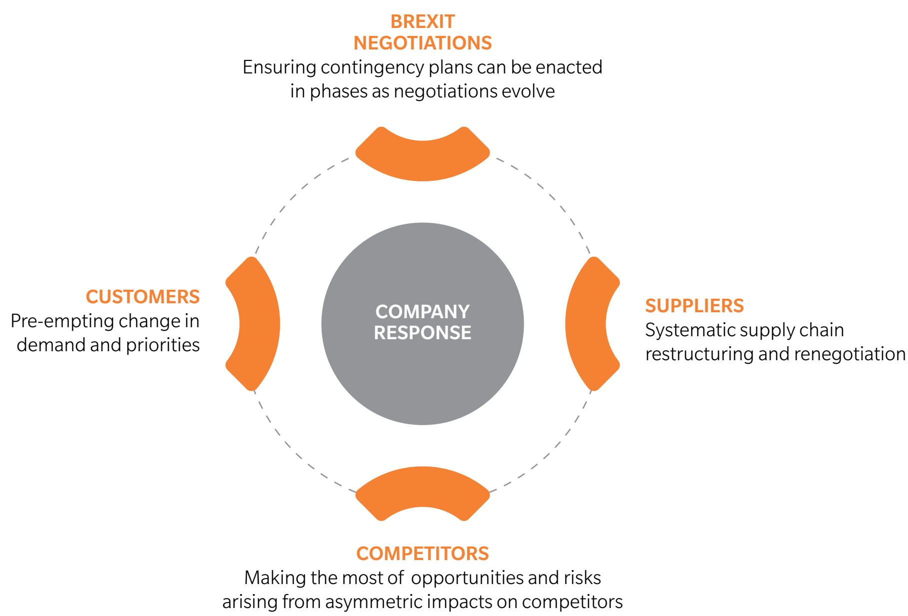
Source: Eurostat, Oliver Wyman analyses

RECOMMENDATIONS

COMPANIES

French companies must assess the impact that Brexit could have for them and start to prepare – operationally and strategically – within the framework of different scenarios. In addition to the terms of Brexit and its direct implications for their businesses (in terms of tariff and non-tariff barriers), companies will also have to consider the impact for their suppliers, customers, and competitors (see Exhibit 9).

Exhibit 9: Exogenous factors affecting company response to Brexit



SMEs and larger companies will be affected differently by Brexit. Large companies are generally better equipped to deal with Brexit because of their organization and experience with international trade. But SMEs export less outside the European market, so they are not used to coping with tariff and non-tariff barriers; they also have more limited resources and operational capacities.

Many SMEs are integrated into the value chains of the French and European economy, and large companies may find it beneficial to ensure the stability of their supply chain. Large companies would do well to analyze their value chains to understand the precise impact of Brexit on their internal organization (for example, with goods and services moving several times across the border with the UK) as well as on their suppliers (and the suppliers of their suppliers, and so on).

In-house procurement and production processes at large companies whose activities are distributed between the UK and the EU27 will be more complex and expensive to maintain and production may have to be restructured and relocated in some cases. Production of the Airbus A380 in Exhibit 10 illustrates the complexity of some of these supply chains and the implications of Brexit.

Exhibit 10: Airbus A380 European production itinerary

Shipped by roll-on/roll-off
Shipped by barge
Shipped by road convoy
Construction
Logistics

In addition, some companies may face difficulties if some of their suppliers (or suppliers of suppliers) are located in the UK or are affected by Brexit. For example, a supplier's supplier located in the UK will have to bear high costs both when importing and when exporting its products, and could face difficulties and delays; this would jeopardize the value chain as a whole. Large companies would enjoy a more transparent procurement chain, several levels above their direct suppliers, which would help them to identify the critical and vulnerable suppliers. They could then support these suppliers and their adaptation.

PUBLIC AUTHORITIES

Given the costs and risks that Brexit brings to bear on French companies, French public authorities must identify and measure these risks precisely and support companies in the transition to post-Brexit.

First, public authorities would need to identify the most affected segments, industries, and regions. They could do this by modeling the impact of Brexit at a very detailed level based on several plausible scenarios (such as customs union or WTO) to prioritize government initiatives. These analyses could also be used to test various assumptions beyond direct costs, for example the implications of Brexit on household consumption, corporate investments, and the ability of companies to pass on costs through their prices.

Strategies aimed at reducing these costs and risks could then be developed. For example, the Irish Farmers' Association (IFA), used analyses of the impact of Brexit on Irish farmers as the basis for its requests to renegotiate the Common Agricultural Policy. In France, an analysis of the agricultural sector, particularly on the northwest coast of Europe, would make it possible to define a suitable strategy depending on the scenario selected.

These analyses would help to define concrete initiatives, such as raising awareness, offering financial support to the most affected companies, or establishing non-financial support to prepare for the transition. The impact analysis would allow public authorities to create an awareness campaign for the most concerned players and support them in the transition phase. This awareness-raising campaign could be supported by supplying financial, strategic, and administrative tools. Financial support such as bridge loans or targeted programs could provide sufficient liquidity for the most exposed companies to manage the transition. For example, the Irish promotional bank Strategic Banking Corporation of Ireland (SBCI) recently launched a Brexit Loan aiming to finance up to €300 million in cash flow under preferential terms for the most exposed SMEs (namely those that export the most to, or import the most from, the UK). Administrative and operational support, such as help with transition management (certifications, declarations, and so on) could provide technical support to help out the smallest and most vulnerable companies. Finally, strategic and financial support could be provided to those companies that are most dependent on the UK, to help them diversify their geographical exposure, for instance with products such as the Assurance Prospection Premiers Pas (A3P) offered by Bpifrance.

GLOSSARY

At-the-border costs: These are the costs of non-tariff barriers incurred when crossing the border, for example declarations and delays in shipments crossing the border. At-the-border cost estimates use a variety of public data, including HM Revenue & Customs figures, to size additional administrative costs and figures adapted from C. Hornok (2011) "Need for Speed: Is Faster Trade in the EU Trade-Creating?" to estimate the impact of delays. The resulting estimates have been tested and iterated with industry participants, trade associations, and our own proprietary benchmarks.

Behind-the-border costs: Costs of non-tariff barrier not directly linked to crossing the border, for example double certifications between the UK and EU27.

EU27: European Union (EU) countries excluding the UK.

Gross value added (GVA): Value of production at market prices minus the value of intermediary consumption at purchase cost. This is a national accounting production balance that is similar to GDP and breaks down the added value of various sectors of the economy. GVA can be obtained by subtracting any tax levied on production and adding any subsidies that the production may receive from base-price GVA. GVA does not take account of the depreciation of production resources.

Mitigating measures, or mitigation: Company or government initiatives to reduce the impact of Brexit, specifically to reduce the size of the calculated impact on trade resulting from tariff or non-tariff barriers. The mitigation assumptions at a sector level assume all companies act to mitigate the impact of Brexit, but this is not a given and will require planning and execution. We use 2016 data throughout our analysis.

Non-tariff barrier: A restriction to trade not involving an import tax or duty.

Tariff: A tax or duty to be paid on a particular class of imports or exports.

Tariff barrier: Corresponds to the customs duties that foreign products will have to support (pay) on entering a national territory.

AUTHORS

OLIVER WYMAN

Hanna Moukanas
Partner & Market Leader, Paris
hanna.moukanas@oliverwyman.com

Kumar Iyer
Partner, London
kumar.Iyer@oliverwyman.com

Lisa Quest
Partner, London
lisa.quest@oliverwyman.com

Anthony Charrie
Principal, London
anthony.charrie@oliverwyman.com

CLIFFORD CHANCE

Jessica Gladstone
Partner, London
jessica.gladstone@cliffordchance.com

Mark Poulton
Partner, London
mark.poulton@cliffordchance.com

Phillip Souta
Head of UK Public Policy, London
phillip.souta@cliffordchance.com

CONTRIBUTORS

OLIVER WYMAN

Eric Bach, Paris

Marc Boilard, Paris

Jerome Bouchard, Paris

Michel Jacob, Paris

Gilles Roucolle, Paris

Xavier Ruaux, Paris

Rafael Asensio, Madrid

Francois Austin, London

Fabian Brandt, Munich

Duncan Brewer, London

Pablo Campos, Madrid

Paddy Doran, London

Crispin Ellison, London

Rebecca Emerson, London

Andrea Federico, Milan

Nick Harrison, London

Finja Kütz, Munich

Lindsey Naylor, London

Neil Reid, Frankfurt

Ted Rudholm-Alfvin, Amsterdam

David Stewart, London

Nick Studer, London

Davide Taliente, London

Giovanni Viani, Milan

CLIFFORD CHANCE

Michel Petite, Paris

Laurent Schoenstein, Paris

Chris Bates, London

Hans Beerlage, Amsterdam

Marc Benzler, Frankfurt

Alex Cook, Prague

Robert Crothers, London

Niek De Pauw, Bruxelles

Javier Garcia de Enterria, Madrid

Isabelle Hessell-Tiltman, London

Jenine Hulsmann, London

Daud Khan, London

Thomas Krecek, Frankfurt

Christian Kremer, Luxembourg

Stephen Lewis, London

Dan Neidle, London

David Pudge, London

Anselm Raddatz, Düsseldorf

Jörg Rhiel, Frankfurt

Jaime Sánchez, Madrid

Paolo Sersale, Milan

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