“Brexit” – Implications for Nottingham
Audit Committee
25 November 2016

Introduction

- The result of the UK’s Referendum on its membership of the EU was that 52%, a majority, were in favour of ‘Leave’.
- Turnout was relatively high at 72%.
- David Cameron resigned as Prime Minster following the result and Theresa May entered Number 10 and triggered a reshuffle in the Cabinet.
- This briefing covers some key implications for Nottingham and the City Council.
- It is worth highlighting that the result of the referendum is not legally binding and that the terms of any exit renegotiation will remain unclear for some time. Some of this note is therefore necessarily speculative.

Key Issues

- **Timing** - The Government has suggested that it will trigger Article 50 (beginning the formal process that will see the UK leave the EU) in early 2017. Barring an extension to negotiations (which would need to be agreed by the EU and the UK), the UK would cease to be a member of the EU in early 2019. Even this rough timing is now in some doubt following the High Court’s 3 November ruling (subject to appeal at the Supreme Court) that Government must consult Parliament before triggering Article 50.
- **Uncertainty** - With no clear model for what ‘Leave’ will mean, uncertainty will impact on many areas of the economy and wider public life from the present date until at least the point at which the UK formally leaves the EU.
- **The Pound** - A significant fall in the value of the Pound has occurred. The FTSE (as priced in pounds – Oct 2016) is at or close to record highs. Locally, NCC’s Treasury management strategy has protected the Council from short-term currency shocks by having all investments and borrowing in sterling. Nationally, some businesses are reporting increased exports as their prices are now more competitive and tourism levels have increased.
- **Inflation** - To the degree that the fall in the Pound is sustained, the rate of inflation will begin to rise. The latest figures saw CPI rise from 0.6% to 1.0%. The Council has already seen some supplier costs, e.g. in software, beginning to rise.
- **Economy** - Depending on the Government’s aims, and success in negotiations, reduced access to the single market will mean increased barriers to trade and investment; a fall in business confidence, and further currency shocks. This in turn will lead to slower trend economic growth for the UK and reduced public spending due to a smaller tax base than otherwise would have been the case. If immigration from the EU is reduced then certain sectors of the economy may struggle to employ the number of people they need with the appropriate skills.
- **EU Funds** - Reduced or no access to European Structural Investment Funds (ESIF) will close off a significant avenue for investments in infrastructure and skills.
- **Hate Crime** - Concerns have been expressed nationally about a rise in hate crime following the vote.

EU Structural Funds - Current Picture

- Nottingham City accesses European Structural and Investment Funds (ESIF) money for this round of EU funding round (2014-2020) via Derby, Derbyshire, Nottingham and Nottinghamshire (D2N2)’s Local Enterprise Partnership (LEP).

- D2N2's ESIF allocation for 2014-2020 is £214.3m. This consists of both the European Regional Development Fund (ERDF) and the European Social Fund (ESF).
- Most ESIF projects are D2N2 wide.
- The current ESIF programme did not start on time in the UK. This means that we are in a relatively early stage in terms of the number of projects that have reached the contracting stage.
- In his speech to the Conservative Party Conference, the Chancellor Philip Hammond pledged that local areas with existing EU funding agreements signed off by the time we exit the EU would receive replacement funding.

EU's Contribution to the City Economy
- Nottingham has benefitted from significant European Funds in the past including funding for BioCity, Old Market Square, Nottingham Contemporary and the New Art Exchange.
- The City has seen at least £190 million of EU funded projects since 2000 via the ERDF, ESF, Horizon 2020 and FP7 funding programmes.
- Over recent years, around £20 million of our two leading Universities' total annual income has been derived from research grants from EU sources.
- The CBI reports that the UK exports £227bn of goods and services to the EU each year, equivalent to 45% of all the UK's exports. We estimate that a similar proportion of Nottingham's exports goes to the EU. Seven of the UK's top 10 export markets are in the EU.
- According to available data there are 80 companies based within Nottingham City which have parent companies within the EU out of 205 local companies which have group ownership overseas. This is probably an under-estimate however.
- The Commission is in the process of taking policy and legislative decisions needed to open up the digital single market. The UK stood to be one of the Countries that could have gained the most from this given the size of the UK's e-commerce market.

Treasury Management
- As at June 2016 when the UK voted to leave the EU, Nottingham City Council had £95m of short term investments of which £55m was protected from changes to interest rates for periods ranging from 3 to 9 months.
- The current investment strategy is to reduce investments towards a minimum working balance of £30m and held for liquidity purposes. These balances will most likely be held in Money Market Funds on which the rates payable will reflect the lower banking rates offered post BREXIT. The Bank of England base rate has already been cut to 0.25%.
- The likely increase in counterparty credit risk associated with unsecured deposits with UK Banks will be minimised as long as the council's investment balance reduces as expected.
- The council had £73m of variable rate/short term loans and so the interest payable cost will see similar reductions and will neutralise any loss of investment income.
- The rates at which the council can fix new long term loans has seen a reduction across all durations of loan and our Treasury Management advisors Arlingclose forecast these low rates to remain for at least the next few years.

Leaving the EU – Process
- Although the referendum result is not binding, the current Government has accepted that it has a "*democratic duty to give effect to the electorate's decision.*"
- The Government has indicated that Article 50 will not be triggered until early 2017. Article 50 is the formal notification which the UK would have to make to the European Council and the Commission. Unless otherwise agreed (with the European Council), the UK will cease to be a member of the EU

two years after this notification. The EU has pushed for early use of Article 50 by the UK but has no powers to enforce this.
- The European Council (Donald Tusk is the current president) will agree guidelines for negotiations – without the UK present.
- The Commission (Jean-Claude Juncker is the current president) will then negotiate an agreement on behalf of the EU. This may take up to a decade and would require new treaties. Perhaps one to cover withdrawal and one to cover the future UK/EU relationship.
- A transition period is therefore possible.
- Any final agreement will need to be approved by both the UK and a majority of the remaining member states under the qualified majority voting process.
- The European Parliament must also approve the deal by a simple majority. British MEPs will have a vote.
- A state that has left may request a return. However, this would be on the same basis as a country joining for the first time (and would probably mean that the UK would have to join the Euro and lose existing opt-outs).
- The UK already benefits from opt-outs in relation to monetary union, banking union, the Schengen agreement (EU internal border control), justice and home affairs.

Possible Models for a Future UK/EU Relationship
- A significant cause of uncertainty is that it is not yet clear what the 'leave' vote means in practice.
- There has been discussion of following the pattern of Countries such as Norway (European Economic Area) or Switzerland (a Free Trade Agreement) which have preferential access to the single market but are not members of the EU. **See annex 1**.

Summary of Possible Implications for Nottingham and the City Council
- **Economy** – Slower growth in 2017 than otherwise expected and reduced trend economic growth for the UK in the medium and longer term (dependent upon the access to the single market which the government negotiates). Some businesses which export may benefit via the lower pound.
- **Public Spending** – A reduced tax take from a smaller economy will lead to lower public spending and prolonged austerity. This may include less funding for Nottingham City Council via Business Rates and Government grants.
- **Skills** – Reduced immigration may increase skills gaps and make recruitment to key sectors more difficult.
- **Costs** – Are likely to rise via a faster rate of inflation.
- **EU Funds** – It is not clear whether Government will provide replacement funds post-Brexit following this round of ESIF.

Annex 1

The possible models on which the UK could develop a new relationship with the EU:

EEA membership

The EEA, which encompasses the EU, Norway, Iceland and Liechtenstein, enables Norway, Iceland and Liechtenstein to enjoy the benefits of the EU's single market and free movement of goods, services, people and capital without the full privileges and responsibilities of EU membership. The non-EU EEA member states are required to adopt much of EU law and contribute to the EU budget but do not have voting power or formal access to the decision-making process.

The Swiss model

Switzerland has concluded a large number of bilateral agreements with the EU to give it access to the single market. The agreements provide for the free movement of goods and people but not services. Swiss goods must meet EU regulatory requirements and Swiss law must be considered equivalent to corresponding relevant EU legislation. The Swiss financial contribution to the EU is much lower than that of the non-EU EEA member states. The EU has concluded that the Swiss model is not viable in the longer term and has stated that a framework agreement along the lines of the EEA agreement will need to be agreed in the future with Switzerland.

Customs union

Turkey is part of a customs union with the EU that allows for tariff-free access without quotas to the internal market for goods but not services. It has, to a large extent, control of its own trade policy and does not have to allow for the free movement of EU persons. It is required, however, to adopt a common tariff with the rest of the EU for third-country goods and is restricted in its ability to conclude agreements with other countries without EU consent. Turkey is required to harmonise its laws with those of the EU in relation to, among other things, competition, intellectual property and consumer protection.

Free trade agreement

Several countries, for example, Singapore and Canada, have standalone free trade agreements with the EU. The ability to export services, in particular financial services, may not be easily achieved through a free trade arrangement, as these tend to be designed for trade in goods not services. This would be a disadvantage for the UK, which is a significant exporter of services, particularly financial services.

World Trade Organisation

The UK is already a member of the World Trade Organisation (WTO), although as with all the member states, the EU currently acts on its behalf at WTO level.

If the UK were to trade with the EU as a WTO member but not as an EU member state, it would control its own trade policy, it would not have to allow for free movement of persons and would not need to contribute to the EU budget. EU law would not apply in the UK. UK exports to the EU would, however, face tariffs and exporters would continue to need to meet EU product standards. The WTO offers little protection to exporters on an individual basis as there is limited ability to enforce its rules.

The WTO arrangements are of less benefit in the area of services, so this would likely be a disadvantage for the UK.