Nottingham City Council Response
Local Government Association
EU exit impact on place: Call for information

Introduction

- As with other areas, Nottingham City Council's understanding of the impacts of Brexit is developing.
- Brexit is a historically complex area of emerging national policy that will have significant impacts on the economy and wider public life.
- The result of the referendum is not legally binding. Article 50 is yet to be used and the terms of any exit renegotiation will remain unclear for some time. Some of this note is therefore necessarily speculative.
- **As an ask of the LGA, Nottingham would be keen that the LGA utilises its sector-leading role with Government in this area and provides member authorities with a clear steer on how we might best engage to ensure that our views are heard. A Brexit "roadmap" which includes key local government milestones would be a useful product.**
- As discussed with the LGA, Nottingham City will look to submit a second response to the LGA's call for evidence in the New Year, subject to further developments.

Key Issues

- **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. 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 1.0% to 1.2% in November. 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 potentially 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.
- **Public Services** – To the extent that Brexit negotiations may result in lower net migration, particularly to Core Cities such as Nottingham, certain pressures on *some*

services *may* reduce. This possibility should be balanced with the likelihood that a reduction in net migration will lead to less money to pay for the same key services.

Response to Questions

LGA Question 1. Local growth

- *Have you identified opportunities associated with existing the EU and how to take advantage of these?*
- *Are there likely to be any significant changes to the labour market in your local area as a consequence of exiting the EU? What are the opportunities and/or risks associated with these changes?*
- *Are there likely to be any significant impacts on particular economic sectors in your local area as a consequence of exiting the EU? What are the opportunities and/or risks associated with these impacts?*
- *Are there likely to be any significant impacts on major companies in your local area as a consequence of exiting the EU? What are the opportunities and/or risks associated with these impacts?*
- *Are there any particular opportunities and/or risks in your local area from possible changes to the laws governing state aid?*

Nottingham Comment: BREXIT – SWOT Analysis

STRENGTHS

- As the value of sterling falls (against the € and the $) UK exports become more competitive (cost less) which HAS provided a stimulus to some export-orientated sectors, at least in the short/medium term.
- In real terms asset prices have fallen from the perspective of overseas investors which can stimulate investment/asset purchases. Longer term uncertainties and risks associated with Brexit will mitigate against this trend/opportunity however.
- Interest rates have fallen and so the cost of borrowing has fallen and this should provide a spur to investment. However, the problem facing investors and businesses (new and existing) is likely to be the (limited) availability of finance due to an increased in perceived risk by lenders.
- The numbers of UK students studying in EU countries is likely to fall which will boost domestic demand for university places and may improve UK graduate retention rates.
- Nottingham has strong international links with China (via the City of Ningbo) and with India that are likely to endure.

WEAKNESSES

- Brexit may shrink the UK market for goods and services - as an EU member, the UK is part of the single market in which no tariffs are applied to imports and exports between the member states. Since 50% of the UK's exports go to EU countries, this has given UK a say over the trading rules and regulations. Leaving the EU will contribute to shrinking the UK market (economy) and reduce its negotiating power as it will leave its powerful seat at the EU members table.
- Foreign inward investment into the region/ UK is likely to be reduced or at least decisions deferred, but we have no local intelligence to suggest this has been the case in a local context. In addition, we should expect to see some existing overseas companies

with a Nottingham/UK base scaling down or even relocating their UK operations to elsewhere within the EU – the financial and business services sector is a likely candidate. That will also draw out some professional services companies who serve these sectors (eg consultants, IT specialists etc). Again, we have not had any announcements by local companies to this effect, as yet.

- Uncertainty about employment and (especially) falling house prices will lead to reduced consumer spending, we know this from previous downturns. Which of course compounds problems associated with reduced investment.
- Reduced innovation due to less freedom of movement and loss of EU grants to universities in particular. Under the EU umbrella, both academic and industry talent were able to move freely between EU countries, which has had a positive impact on the R&D and therefore innovation in UK. This will lower productivity growth and competitiveness.
- Fall in (Council) tax revenues - since 50% of UK trade is exported to EU countries, Brexit will have a significant impact on the tax revenues as they will shrink unless other markets are opened or the UK keeps its position as a member in the open trade agreement, the European Economic Area.
- Finding talented (highly skilled and motivated) workers - the UK is one of the countries who benefit significantly from the free movement of labour in the EU. Leaving the EU will shrink the number of candidates which companies can choose from. The lower skill labour market will also be impacted. Some Nottingham companies employ a workforce that is e.g. 40% Polish.

OPPORTUNITIES

- Brexit may reduce (or at least ease) trade and other restrictions on SMEs - many did not (directly) receive many benefits from membership of the EU, yet they faced restrictions related to the trade regulations between EU member countries. By exiting the EU, SMEs will be able to release some of these regulations which can lead to positive impact on this important part of the economy.
- Cost-savings may be considerable - as a member in the EU, the UK contributed with GBP 13bn for the EU and received GBP 4.5bn worth spending. This means that the net contribution is GBP 8.5bn, which is 7% of the government spending on the NHS each year according to the Full Fact. These figures are of course very contentious and open to different interpretation.
- The UK economy doesn't tank/nose-dive because of our deep and long-standing economic and trade ties with countries within and outside the EU.
- UK exporters identify and access other (non-EU) overseas markets which enables them to offset lost/lower sales to the EU.
- The UK keeps its position as a member in the open trade agreement, the European Economic Area.
- A renewed emphasis on local government reorganisation eg unitary authorities. More radical and quicker transformation. Possibly even renewed impetus may be given to devolution (this will present threats as well as opportunities of course).
- Our negotiations with the EU over a new trade deal go well and (some sectors) at least see a net benefit given that they may face fewer regulations perhaps.

- Non-EU immigration continues to rise which offsets falls in EU migration and may therefore reduced skills gaps/shortages as one set of workers replace another.
- There are more job opportunities available to UK citizens, including those out of work, which may help to reduce unemployment (albeit may rise due to negative factors associated with Brexit – we suspect the net effect will be negative - unemployment will rise). A smaller potential workforce may lead to an increased demand for labour that may in turn lead to higher wages in e.g. the food industry.
- UK trade negotiations with the USA, Japan and others go well so we do get a compensating uplift in trade from non-EU markets.
- Core Cities Group work more closely and effectively together. Likewise, Nottingham forms stronger partnerships with neighbouring cities, especially Derby. Possibly Leicester, perhaps Sheffield.
- The Midlands Engine initiative gathers momentum.
- New regional development funds designed for UK objectives with possibly less bureaucracy.

THREATS

- This has never happened before. That is the reason there is so much uncertainty. There is no road map, no precedent, no lessons learnt from previous Brexit experience. We're in completely new territory.
- Uncertainty may (already is) lead to the postponement or deferment, or outright cancellation, of domestic and overseas investment plans/projects – the property sector is already taking a hit with obvious implications for construction. Banks and financial institutions likewise.
- The trade negotiations become acrimonious, protracted and eventually the UK becomes significantly worse off because we are unable to secure a 'good deal'.
- Given that aggregate demand in the economy will fall (due to falling consumption and investment) and that the scope to offset this through increased Government spending is limited (given significant budget deficit and limited scope to raise taxes), and that further cuts in public spending seem likely – all of this points in the direction of a (possibly rapid) slowdown in economic growth which may well turn into a recession (a prolonged downturn in output eg months) and possibly even a depression (negative growth over a year or more).
- Loss of jobs associated with trade between the UK/Nottingham and the EU. Knock-on (multiplier) effects through supply chains to exporters/importers resulting in further job losses elsewhere in the economy.
- Reduced inward investment – financial investment and foreign companies relocating here. Outward investment.
- The deferment, scaling down or outright cancellation of major and very expensive infrastructure projects such as HS2 (Eastern route).
- UK trade negotiations with the USA, Japan and others drag on so we don't get a compensating uplift in trade from non-EU markets.
- A renewed emphasis on local government reorganisation eg unitary authorities. More radical and quicker transformation. Possibly even renewed impetus may be given to devolution (this will present opportunities as well as threats of course).

- Loss of EU funding used to support local economic and social regeneration. Knock on effects for the local authority and partner organisations.
- Reduced income and networking/collaboration at an EU level by universities will affect research, investment and spin-outs. Sectors such as life/bio-sciences might be affected (eg fewer start-ups and joint ventures).
- A significant loss of economic momentum (demand) across the EU, outside of the UK ie less demand for UK exports.
- See table at **Appendix 1** for more detail.

Comment: Possible sectoral impact (Nottingham key sectors)

Retail

- Another potential hit to consumer confidence couldn't come at a worst time for the retail industry, which is already under severe pressure from a change in shopping habits and a wretched summer that has seriously dampened demand on the high street. Even before the vote result, the uncertainty around the referendum caused shoppers to clamp their purses shut – resulting in the first decline in fashion sales for seven years.
- Fashion retailers are tipped to be the hardest hit from the falling pound, as the majority buy their goods in Asia and pay for them in dollars. Mike Ashley's Sports Direct last week admitted that it did not have hedges in place next year so profits are likely to have been hit by rising import costs.

Telecoms

- Vodafone's announcement that it could move its headquarters out of the UK more than 30 years after it founded the mobile industry has already been one of the most striking impacts of the referendum on corporate Britain.
- Given the EU's central role in regulating the telecoms sector, the decision to leave poses profound questions for a UK industry already in upheaval. Telefonica is reviewing what to do with O2 after its attempt to sell out to Hong Kong's CK Hutchison was blocked in May.

Industry/ Manufacturing

- Long cycles of capital investment in plants and tooling and multi-year contracts will provide breathing space for industry. However, inward investment in UK British manufacturing could take a blow. Germany's Siemens has said it will go ahead with a £310m manufacturing centre in Hull but further investments are on hold.
- The automotive sector – one of Britain's biggest industries, employing 817,000 people and turning over £71.6bn annually – is adopting a similar stance.

Construction and property

- Redrow and Taylor Wimpey both reported normal sales activity since the referendum, while Tony Pidgley, chairman of London house builder Berkeley, bought £800,000 worth of shares as house builders tanked on the FTSE. McCarthy and Stone, a house builder for people aged over 55, warned that Brexit uncertainty might slow its sales, as retirement home purchases tend to be discretionary.

- Demand for housing may remain robust given shortages, but construction costs could rise by as much as 12pc, said Ted Macdougal of Forrest, a developer. According to the Office for National Statistics (ONS), the UK imported £4.9bn worth of building materials and components from the EU in 2015, which will now be hit by the low level of sterling.

Insurance

- Insurers are just beginning to get used to the sprawling new capital rules known as Solvency II, which came into force in January after a decade of wrangling across Europe.
- After spending hundreds of millions of pounds each to prepare their firms for the new reporting and capital checks, and rethinking some parts of their business, such as old portfolios of annuities, insurers are now left wondering how much of the new system will be left.

Leisure and transport

- Airlines have already been hit by Brexit. BA owner International Airlines Group issued a profit warning just hours after the referendum result, saying it had suffered lower demand to fly in the run-up to the vote. EasyJet, too, has warned that "consumer uncertainty is likely this summer" and indicated it could move its base outside the UK.

Energy

- In the energy sector, it is utilities that stand to be most affected. National Grid and SSE have both urged the Government to ensure Britain remains in the EU's internal energy market (IEM), which enables smooth trading of electricity and gas between its members.
- Exclusion from the IEM could result in £500m a year of higher costs for UK consumers due to disruption to electricity trading and the potential cancellation of plans for new undersea power cables to the Continent.

Mining

- The mining industry has met the news of Brexit with more of a shrug than a scream. Miners carry out few UK-EU trades, and retain relatively small offices in London to facilitate access to the many institutional investors based here. This is unlikely to change soon, according to Tom Albanese, boss of FTSE 250 group Vedanta.

LGA Question 2. Local public services

Are there particular local public services in your area that are likely to be significantly affected as a consequence of exiting the EU? What are the opportunities and/or risks associated with these changes? Possible sources of opportunity or risk might include:

- *changes to the workforce*
- *changes in demand*
- *changes to the laws governing procurement*

Local Public Services

- Legislatively it seems that the proposed "Great Reform Bill" will look to largely enshrine existing EU law into UK law directly on the basis that any desirable changes can be made by Government at a later stage post Brexit. We would expect this to include **procurement law** for the immediate future pre and post Brexit.

- 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 potentially 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 a lot of employed EU nationals working here leave (voluntarily or otherwise) and return to their original Member States, that will create skills gaps in the existing workforce – this will affect some sectors far more than others with **social care** particularly badly affected.
    - (labour market theory suggest that increased skills gaps and shortages will lead to higher wages and therefore labour costs as employers compete to retain and attract new workers; but if aggregate demand for their products and services is falling due to a downturn in demand (possibly recession) then so we would expect to see a downturn in demand for labour which would relax pressures towards higher wage rates/bills).
- Potentially more flexible interpretation of state aid rules and procurement rules allowing the **UK Government and local authorities** to intervene to support the local economy in ways they currently cannot.
- As well as workers, our two **universities** may experience a (significant) fall in the numbers of foreign students and the income associated with them. This will also have knock-on effects on the local economy (through a fall in their spending) and in the housing market (especially private rented sector, but also a fall in the purchase of houses/flats by students/graduates).

LGA Question 3. Regional funding

- *What are the anticipated effects of shifting away from the existing EU regional aid regime (i.e. European Regional Development Fund (ERDF) and European Social Fund (ESF)) for your local area?*
- *What are the opportunities and/or risks for your local area associated with possible successor regional aid schemes?*

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 seen significant European Funding 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.

<u>Views on European Structural Funds and successor programmes</u>
Comment:

1. Funding to support economic development and economic growth at local level is very important. It is needed to address market failure in investment in skills/people and capital projects and fills in gaps that are not otherwise funded e.g. European Social Fund (ESF) is currently a vital source of funding for entry level skills and support for those further away from the Labour Market, particularly in the context of cuts to Adult Skills budgets. ESF is also one of the only routes whereby local economic needs have directly influenced employment and skills funding at a local level.
2. Any successor programme should be governed at the local level – local decision making is crucial to ensure programmes can be integrated with other local funds and activities. An example of this is the Nottingham Works programme which has brought together several local employment and skills delivery providers, and EU, national and local funding, to deliver support to young people at risk of unemployment and social exclusion.
3. A Single Pot would be the best model, with as few stipulations and 'category restrictions' as possible. Local places will have different priorities so need funds to be flexible.
4. EU Structural Funds are long term programmes (7+ years), with clear programme objectives and priorities. Any successor programme should also be long term to allow investment to make a difference over time, rather than pepper-potting. The ESIF model encourages a consistent strategy to be pursued over more than one Parliament, allowing evidence-based interventions to be pursued, with some flexibility built in through a general restriction on individual projects being three years maximum. A mid-term review then allows for adjustments to be made in the case of new circumstances or evidence emerging.
5. Eligibility for EU Structural Funds is objectively set and independent of political considerations. They benefit from certainty and clarity about the 'rules'. The criteria are based on need and opportunity and the programmes aim to achieve growth and

social inclusion. Any future programme should try to replicate the objectivity of the eligibility rules and be based on a balance of need and opportunity.

6. Any successor programme should have clear and robust governance and stable delivery mechanisms. It is hoped that this could be less bureaucratic that the arrangements the EU Commission has insisted upon. The Intermediate Body concept as a way of localising management of EU funding is a potential route to devolved decision-making, albeit currently complex as it is part of a multi-layered EU structure that includes EU, national and local decision-making levels.   We also look forward to more streamlined and proportionate audit arrangements.
7. Devolved Sustainable Urban Development (SUD) funds could provide a useful basis for future programme(s). The powers to define strategic objectives and choosing the appropriate mechanisms for delivering these is a step that has been made through SUD that we would strongly support maintaining.
8. Geography – local authorities should be building blocks of any larger geography.
9. Match funding – leverage of other funds is an important factor but can disadvantage certain sectors e.g. voluntary sector. Match funding requirements of previous EU Programmes have often proved complex and restrictive. Some thought needs to be given to how this leverage could work in the context of 100% localisation of business rates.
10. Successor programme should make provision for smaller projects as well as large ones i.e. a range. There has been a move towards larger projects in recent years but this can disadvantage certain sectors.
11. We hope Brexit will provide an opportunity for a lighter touch and more flexible interpretation of State Aid and procurement rules.

Appendix 1

ECONOMY – MEDIUM/ LONGER TERM (2018-22)

KNOWN/HIGHLY PROBABLE	LIKELY/POSSIBLE	POTENTIAL RISKS	ELABORATION
	Complex & protracted EU negotiations would prolong uncertainty	EU 'digs in' & a deal is delayed & below UK expectations	Heavy decline in fixed investment.
	Eventually, uncertainty eases, domestic demand begins to slowly recover	Less open to trade (non-EU)	Assuming a Trade Deals is taking shape (2018) & comes into effect (2019-20)
	Some sectors recover eg retail, logistics, consumer services	Uncertainties affect long term future of UK telecoms sector, pharma. & financial services sectors	Less access to grants & investment affects R&D, infrastructure investment
Decline in number of EU students > skill shortages & reduced spending in Nottingham economy (also housing mkt/PRS implications)	Decline in the number of UK residents studying in other EU countries.		
		Levels of non-EU immigration increase	Skill shortages may then be offset (to an extent)

	"Modestly weaker economic growth" say Moody's. Others are less sanguine.		Moody's think the UK economy won't 'tank' because of our deep economic & financial ties with & outside the EU (member states)
	Trade with EU states will recover but remain below pre-Brexit trend/expectations (if not levels). But non-EU economies could grow faster & some are bigger eg USA, China.	Reduced trade will lead to slower productivity growth due to limited access to finance, technology & skills/talent. The UK will still have to abide by EU regulations of some sort.	UK is currently involved in trade negotiations with USA & Japan. It may (or may not) need deals with others eg China, India, Australia. Trade is only one driver of growth & prosperity, but Brexit would have knock-on effects on others eg investment, employment & innovation.
		Some other EU members states promises/ conduct their own in/out referendums > uncertainty	
	Sterling volatility (from time to time) seems likely		
Exclusion from EU panels on trade, products & services.			
	Reduced investment in R&D and universities (core & R&D budgets cut back)		
	Lower FDI > some investment/facilities are redirected elsewhere; some UK operations close	Substantial supply-chain (negative multiplier) effects affecting SMEs & labour demand	

This paper is intended as an emerging analysis of some of the issues around a potential "Brexit" and nothing contained here should be read as representing the policy of Nottingham City Council

		Vulnerable local key sectors: retail; life sciences; high value manufacturing; FIBS; possibly visitor economy	
Loss of EU regeneration funding.		Reduction in scale/number of investment projects with knock on effects for HE, construction, public sector (NCC in particular)	Core Cities group ltr: EU membership 63k jobs & £1.8bn investment.
		UK Government's policy response to Brexit is misguided or counter-productive eg austerity > recession.	UK Government's (& NCC's) policy response to Brexit will be vital in determining the scale & impact of Brexit on the (local economy). The trade settlement (eventually agreed with the EU, USA etc) will have big implications for the future of key sectors eg manufacturing, construction, FIBS.