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Ymadael â'r Undeb Ewropeaidd:
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Ymateb gan FSB Cymru

Welsh Parliament
External Affairs and Additional
Legislation Committee
Exiting the European Union:
Preparedness in Wales for the end of
the transition period
Evidence from FSB Wales

About FSB Wales

FSB Wales is the authoritative voice of businesses in Wales, with around 10,000 members. It campaigns for a better social, political and economic environment in which to work and do business. With a strong grassroots structure, a Wales Policy Unit and dedicated Welsh staff to deal with Welsh institutions, media and politicians, FSB Wales makes its members' voices heard at the heart of the decision-making process.

Introduction

FSB Wales welcomes the opportunity to respond to the inquiry on preparedness in Wales for the end of the transition period. Like many others across the public, private and third sectors in Wales, our primary role over the last few months since March has been helping the small business sector adapt and recover from the enormous shock of Covid-19.

Understandably, businesses have had to prioritise Covid response and that this and uncertainty around Brexit means that very few businesses have had the available bandwidth to have undertaken any preparations or engage with FSB on this issue in depth. This difficulty in engagement at present is exacerbated by the continued lack of progress in negotiations talks and the uncertain picture of what the world will look like on Brexit from 1 January 2021 from experts in the field. A glaring uncertainty remains the continued deferral of the details of the Shared Prosperity Funding, which is of particular importance in Wales in replacing EU funding, and points to wider issues around inter-governmental policymaking and consensus building in the current UK set up.

It is therefore unclear how employers can respond meaningfully at present on the issue when the details remain uncertain.

As such, much of our new data from this year is based around the impact on Covid-19, which in many ways overlaps with vulnerable sectors for Brexit, and what risks and opportunities arise in the Brexit context from the experience of adapting to Covid-19. FSB have also responded on the internal market consultation by UK Government, and draws on that analysis here.

Q1. Welsh Government action to prepare Wales for the end of the transition period;

We are sympathetic to the challenges to prepare Wales for the end of the transition period, which include:

- A lack of clarity from non-devolved matters such as the Brexit negotiations and to a lesser degree Free Trade Agreements;
- Historical lack of effective intergovernmental structures in the UK making this process of information sharing, cross national policy development difficult in some respects
- This in turn impacts on the engagement with Welsh SMEs as institutions such as Business Wales are limited in possible strategic preparedness beyond those of general risk assessments;
- Brexit fatigue is likely to have set in among SMEs, alongside issues such as the numerous changes in deadlines. For example, for those who prepared for Brexit

Covid-19 has also had a severe impact on the economy impact, exacerbating the following risks:

- SMEs – generally with little additional capacity and specialist department for such matters – have limited capacity available to deal with wider uncertainty caused by Brexit at present;
- Business Wales have been understandably overwhelmed by the need to respond to Covid-19 and to provide the necessary support for a crisis;
- Welsh Government has outlined its key priorities Covid-19 while continuing its Brexit work – nevertheless, it is likely that Covid-19 has shifted the focus away from Brexit to some degree;
- SMEs will be in a more vulnerable financial state with fewer reserves and greater debt (22% in our recent survey said they are in greater debt), with a likely impact on trade in the sectors most vulnerable to Brexit in the medium term (at least).

There are also possible opportunities arising from the adaptation and resilience of SMEs to Covid-19 crisis:

- Is likely to have increased the knowledge of and links between Business Wales and DBW and SMEs, as more SMEs have accessed support – this provides for useful networks of engagement for the future, and provides opportunity to be harnessed for business support in the development of Brexit.
- In the wider global economic effects of Brexit, it is likely that firms and governments will move to privileging diversification and security of supply chains rather than – or as well as – cost. This provides for clear opportunities

in making new relationships and Brexit provides an additional impetus for governmental support to do so;

- This builds institutional resilience for future shocks
- Many SMEs have shown themselves to be resilient, and many innovative in diversification their services and goods and changing their processes to adapt to Covid-19. These include matters such as providing PPE (filling a gap in complex needs in the supply chain), moving emphasis into digital trading and finding new local markets. This experience will help many SMEs with future adaptation.
- Conversations around the importance of business continuity planning are now a more common feature of business engagement.

Nevertheless, within this there are areas of work that Welsh Government does and can focus on to help, to provide effective support and preparedness within its own devolved competence and strategies:

Export, Trade and Investment

Within the UK, Wales is particularly reliant on export. The European Union is by far the largest customer for Welsh goods exports, accounting for 60% of the total Welsh goods exports market (EIS April 2020).¹ Therefore, it is important that UK Government secure the easiest and least costly access to the EU single market for UK firms.

As such, it is important that flexibility and ease of EU trade is protected for the success of these firms in Wales, in particularly vulnerable sectors (such as tourism, food exports and manufacturing). This is a UK responsibility, but it is important that all parties in Wales emphasise the importance of certainty for business confidence in ongoing trade in the EU particularly following the shocks of Covid-19. They should join our call that both the UK and EU side look to conclude a deal as soon as possible, keeping trade as free as possible to the benefit of both parties in this difficult time. It has been very discouraging to see the lack of progress during the transition year.

Within Welsh Government responsibility, we have been encouraged by the further development of an International Strategy to soon include and export strategy. It is important that such strategy be in place to deal with the uncertainties ahead and so Welsh Government should progress on this agenda as soon as possible.

This will look at the opportunities post-Covid-19 to look anew at diversified supply chains and trade routes as particular opportunities.. The focus should also be on internationalising SME firms within wales to build capacity for Wales to be globally competitive and able to take advantage of new opportunities post Brexit

¹ https://developmentbank.wales/sites/default/files/2020-02/EIW%20Quarterly%20report_Q2_English_FINAL.pdf

(see more in question 2), creating better alignment between domestic economic development and international trade and investment.

We will be publishing a paper on Trade and Investment policy soon, and will share this with the committee in due course.

We are concerned that the Export Strategy will not be able to be actioned, or that SMEs will be aware of it, in the time needed for January. Again, certainty for the future is a problem in particular for SMEs that often require longer lead in times to plan for changes.

There are key issues that International Strategy and Export Strategy needs to address, and after the Covid-19 crisis, Brexit can provide a catalyst and impetus to do so:

As the EIW of February 2020 notes, the net balance of UK exporters reporting growth in the value of exports fell by 1.3% to -7.1% in the quarter to 2019 Q3, which is a five year low. This indicates that there is a clear role to stimulate this area in the challenging times ahead, and to market the opportunities and support effectively to make a real impact.

Leading young export firms will be vital to the Welsh economy's development in the future, so identifying vulnerable areas to support and protect for the future is important. This would also build confidence for those looking to start-up businesses in the near future – a tranche of start-ups whose dynamism and innovation to build the Welsh economy in the longer term, that could be lost before they begin without confidence in recovery.

UKEF note that 60% of all potential exporters cite access to finance as a key factor in their export plans.

According to Economic Intelligence Wales, for SME exporters, barriers to increasing overseas trade included:

- transportation costs
- the levels of overseas competition
- poor knowledge of overseas markets
- foreign exchange risk
- Lack of finance to help with exporting.

The same source found that there was a significant knowledge gap about support available:

- Less than one quarter of exporting SMEs had sought export advice.
- Over 85% of SMEs that currently exported did not use any specific export finance products.
- Of those current exporters who had never used export finance products, almost three quarters did not know there was finance available to assist exporting activity.

- Of SMEs not currently using export finance, around 30% were interested in export finance products, including working capital loans, bond support for overseas contracts, insurances/guarantees to cover non-payment risks and foreign exchange support to guard against currency fluctuations.

This indicates the knowledge gaps, the current lack of awareness of export support and access to finance, and the needs of SMEs. These are areas that Welsh Government, Business Wales and Development Bank for Wales can have an influence. These areas of performance and resilience will be yet more important in the post-transition environment.

There is also room for WG to identify key emerging markets and areas in which to incentivise SMEs to take part. Our research indicate that most firms export on a reactive or opportunistic basis – seizing opportunities as they are approached with them on an ad-hoc basis. This indicates a role for Welsh Government to increase these opportunities and connections, by providing more of these contacts and opportunities, and in new key strategic markets. This should be aligned to the work of the International Strategy and Export Strategy. The role would be defensive – in terms of protecting access to EU markets, but also mitigating problems and actively seeing new global opportunities, by aggressively marketing and linking SME firms in key sectors to other markets.

Welsh and UK International trade policy, outreach, missions, and offices should place at the centre of their work:

- Secure the easiest and least costly access to the EU single market
- Prioritise easy non-EU markets for first-time and occasional traders
- Prioritise emerging markets for more ambitious and growth-orientated small firms
- Champion small business brands – in sectors and industries where Wales and/or the UK has a competitive advantage – to target markets abroad.
- Include a small business outlook in all work, and a small business impact assessment and SME proofing of all policy in order to capture the multiplier effects (or risk of perverse effects) of policy approaches.

Protecting vulnerable sectors

The Covid-19 crisis has provided an opportunity to test new approaches to stimulate sectors of the economy and to protect key sectors from a short-term shape economic hit.

While the eventual cost to public finances will be substantial, and the toleration for further public finance may be limited, it is still important to look at interventions that have been successful during this period as economic levers to mitigate what could be a short-term shock to facilitate a better Brexit in the longer term. Keeping young innovative businesses running – and providing confidence for new start-ups in a new environment for opportunities - will prove to be vital to Wales and the UK's success in the new global relationships.

There should also be new levers available and used to experiment with to provide for new stimulus

Economic levers that could be of use include:

- Tourism Hibernation Scheme – including access to low interest loans that could also be a stimulus for post Brexit tourism, taking advantage also of possible ‘staycation’ incentives.
- Eat Out to Help Out
- Export Vouchers and tax breaks for business
- Explore how Freeport will be used to provide innovation centres, looking too at the role of agglomeration and regulation, rather than tax breaks alone, and ensuring SME proofing so that supply chains can be developed that help local economy, and not displace them.
- The possibility of looking to use variations of Furlough in some limited form, targeted at specific key sectors (such as hospitality and tourism), and aligned with a wider skills and employment agenda should be considered.

Q2. Preparedness of key economic sectors in Wales;

As has been widely noted, in economic terms, Wales is dependent on sectors that are dependent on the EU market, and employ larger numbers of EU-27 staff – for instance, in tourism and hospitality, agriculture and construction.²

In terms of business recovery, there is concern around Covid-19 and a No Trade Deal Brexit creating a perfect storm scenario for areas with a strong reliance on EU markets and access to migrant labour. These include the rural economy, food and agriculture, tourism and manufacturing.

There is a danger that all the areas affected by Covid-19 are also most vulnerable to a double whammy as they are also potentially the sectors that will be most affected by exiting the EU.

It is also likely to be the areas most affected by Covid-19 – including taking on greater debt, a loss of earnings and uncertainty on revenue in future, as it is – who are likely to have the least capacity available to address Brexit risks, especially given the uncertainty on the detail of what it entails.

Anecdotally, our experience of previous deadlines (March 31st 2019) is that they create an incentive to NOT use precious time and resource on Brexit preparedness. Those who had prepared at the time had the opportunity costs of doing so that others did not do. It is likely that this has itself bred fatalism and Brexit fatigue. Similarly, the political ‘smoke’ around Brexit and the on/off nature of the likelihood of a trade deal with the EU have meant that dedicating

² A *Skilful Exit* (FSB:2017), p 18; J Portes & G Forte, *Migration in Wales: The impact of post-Brexit policy changes* (Wales Centre for Public Policy: 2019), p 17

significant resource to preparation for the unknown at a time of national crisis has proven a luxury few businesses have been able to afford.

As noted above, when it comes to export trade and supply chains, Covid may act as precursor and point to resilience building; or may exacerbate difficulties with added uncertainty on top of uncertainty. It is in fact the uncertainty that makes preparation difficult (and potentially futile) – as noted it is in everyone’s interest to conclude a deal to provide certainty – and this certainty is more important during Covid.

Q3. The implications for preparedness arising from the negotiation of UK international agreements, including the UK-EU future relationship agreement (or agreements), other significant free trade agreements (e.g. UK-USA, UK-Japan, UK-Australia, UK-New Zealand etc.), and the Continuity Negotiations and Coordination programme (formerly referred to as the Trade Agreement Continuity Programme);

As noted above, there are concerns on the progress in the exit negotiations, particularly in the light of Covid-19 and its impact on small businesses. Wales is particularly dependent on the EU market for exports and in sectors particularly hit by Covid-19. As such, it is vital that Welsh Government continue to prioritise influencing UK Government to come to a deal for open trade with the EU promptly, and allow SMEs some certainty and time to adapt as needed.

On the progress of Free Trade Agreements, the inclusion of specific devolved national needs in the FTAs is encouraging, and that Welsh Government has been vocal in for example stating its strategic preference for Japan trade deal to build on its recent work in that market. The Minister for International Relations and Welsh Language has stated that after the UK’s negotiations with the EU, a trade agreement with Japan is the Welsh Government’s main priority.

That the UK negotiating objective documents for the FTAs also provide some examples of where the UK Government believes there are specific benefits for sectors in Wales (such as lamb, and the automotive industry) is welcome.

Nevertheless, these add another layer of uncertainty on the current export and trade until the negotiations are concluded which allows little time for businesses to prepare or to ‘orientate’ themselves effectively to a new trading state. While there are obviously clear large markets identified that are vital to prioritise, this will likely impede access to emerging markets that may have a strategic benefit to Welsh companies and in diversifying trade routes and chains in the future. It is in all our interest that these deals are concluded quickly and with an eye to free access, and in protecting vital supply chains to small businesses.

Welsh Government Business Wales, DBW and academia should work together to spotlight Brexit’s hidden impact on importers and small firms in global supply chains, and a view to mitigating their effects, and target finance at SMEs moving toward export innovative sectors.

Q4. Intra-UK intergovernmental agreements relating to the end of the transition period, including the common frameworks programme.

The intragovernmental arrangements that will be required for the UK following leaving the EU's regulatory regime will require strong intergovernmental protocols, and mechanisms, that will seek to replicate the functions of the EU Commission in the context of a four national unitary state, and to provide mechanisms similar to those seen in federations such as Australia and Canada.³

There are challenges in bringing this into and keeping 'with the grain of the UK's constitution', and over the course of devolution intergovernmental mechanisms have often been found wanting. The numerous Supreme Court cases in Wales are a testament to this.

It is therefore incumbent on all four national governments to work together and foster the necessary mechanisms (including dispute mechanisms) for effective working and to keep standards. Our general understanding is that the common frameworks co-working has been positive and augers well. Some of the discussions around the overarching complement to the frameworks of an internal market discussion has been more concerning, with point scoring and positioning, which undermines the credibility of all that they are protecting all the UK nations' future prosperity. Not unreasonably, businesses expect a more collegiate approach and should not have to account for 'political wiring'

Mutual Recognition

FSB welcomes the introduction of mutual recognition as a general standard but would emphasise the need for some flexibility across all jurisdictions. Smaller businesses across the UK recognise the benefits of mutual recognition; it allows smaller business to access markets that would otherwise be impenetrable. However, it is important that its expansion does not lead to the distortion of market standards, lower market standards or anti-competitive behaviours that may result in smaller businesses being undercut. For instance, the principle of mutual recognition should not allow products that have been produced to different standards to be sold as if they were of identical quality. FSB also takes the view that the long-term stability of minimum standards helps to foster a conducive business environment and to establish a level playing field.

Smaller businesses recognise that the expansion of mutual recognition will result in reduced administrative burden and welcome the principle for that reason. However, businesses have suggested that the legislation should include exceptions to the rule of mutual recognition where its application might result in the application of lower market standards. As with the Swiss model, all countries within the UK Internal Market should be able to derogate from the mutual recognition principle under agreed exceptions such as public health should such

³ <https://www.gov.uk/government/publications/uk-internal-market>

a response meet the proportionality test. This is separate to and more nuanced than the existing exclusions discussed in the white paper.

Non-discrimination

Small businesses across all UK jurisdictions are supportive of the need for legislative protection against direct discrimination, as they often feel disadvantaged by rules that favour larger, more established businesses. It is equally important that the new framework prohibit indirect discrimination, be that by legislation or by other standards, to allow for a level playing field between smaller and larger businesses. If non-discrimination is enshrined in legislation, businesses will be able to pursue legal action through the courts where a violation occurs. To minimise the burden upon the courts, the independent oversight body should have jurisdiction to arbitrate matters regarding both direct and indirect discrimination.

Smaller businesses seek some degree of flexibility in the application of both principles. As documented in the white paper, there may be instances where non-discrimination should be applied and mutual recognition not applied. Mutual recognition encourages administrations to accept regulatory standards, which may be inconsistent with their own, such as food safety or planning regulations, in such cases the doctrine should not apply, but authorities must act in accordance with the principle of non-discrimination.

Non-discrimination is intended to supplement mutual recognition and thus should be subject to greater flexibility. The principle should be applied on a case-by-case basis with enough latitude to allow for country specific diversions.

Competition

Government must consider the implications of the internal market principles on competition across the UK. The Internal Market model has been successful in removing market barriers across several jurisdictions but it has also been found to unveil and exacerbate economic disparities between countries and market participants. Central and devolved governments should jointly appoint a regulator to oversee this. In other internal market jurisdictions, the existence of this disproportionality has helped shape the infrastructure around State Aid.

Although smaller businesses accept the benefit of State Aid policies for the entire business community, it is important that smaller businesses not be forgotten by a focus on larger businesses. Small businesses grant that the UK Internal Market should be subject to a single State Aid regime, therefore all four administrations should actively support its smaller businesses as these changes come into place to minimise any disparities.

Given the focus too on economic development as building SME capacity and capability to be competitive in the global economy with the benefits in local supply chains, upskilling that this brings, it is important that shaping markets and

creating competitive markets are also included in this view of competition (rather than the danger of locking out new players).

Shared Prosperity Fund

An ongoing concern is the lack of clarity around the Shared Prosperity Fund. This is an issue of significant importance to FSB Wales members in Wales. The previous EU funding regime had an impact on many areas of policies that relate to SMEs include business support, infrastructure and skills funding, and it is necessary to understand the detail of what is to replace it.

Our organisation in Wales has not yet been involved with any substantive consultation with the UK Government on this subject about which we have previously stated our disappointment. This is a matter of significant concern for us and supposed publication dates for the consultation have come and gone and we now find ourselves with limited time for proper analysis. We know that many of the business support services provided in Wales operate with EU funding adding value to their activities. We are concerned that UK Government is yet to provide any clarity on the Shared Prosperity Fund despite the transition period towards EU exit effectively coming to an end this year. The crisis around Covid-19 is likely to exacerbate this situation further still.

We would urge UK Government to clarify its thinking urgently on this matter, particularly in relation to the quantum that will be available to Wales under the new regime and how the new regime will reflect the nature of devolved competencies. For instance, economic development is clearly a devolved competence and we have a long-standing relationship with well-developed business support infrastructure including existing providers Business Wales that has helped us to critique, inform and improve the service over time. Should the level of funding be reduced, or the control for funding rest with UK Government in Wales, or city regions, our concern is that duplication will prevail and precious resources will be wasted.

This would confuse businesses and could serve to undermine the reputation and regard for the effort. Furthermore, it is likely to lead to a far more complicated marketplace for public sector support services than currently exists (indeed this is to some extent also the case with the City Deals at present around business support).

By giving a clear statement as to the level of funding available to Wales and making clear what 'respecting devolution' means in practice with the Shared Prosperity Fund, we can avoid this potential outcome arising.