Brexit impact on transportation industry
March, 2017
Brexit means Brexit

The UK Government has invoked Article 50 of the Lisbon Treaty, meaning Britain’s exit from the EU will be complete by the end of March 2019. Earlier in the year, British Prime Minister Theresa May delivered a speech that unequivocally outlined plans for a ‘hard Brexit’:

*We seek a new and equal partnership… Not partial membership of the European Union, associate membership of the European Union, or anything that leaves us half-in, half-out.*

The speech contained significant plans on trade, immigration and customs that will determine the risk landscape for many transportation companies as Britain pursues its separation from the European Union. Given the uncertainty facing the industry and the challenges of navigating fluid geopolitical events, it is perhaps unsurprising that geopolitical instability and regulatory uncertainty was the top rated category of risk in the Willis Towers Watson Transportation Risk Index.
Geopolitical instability and regulatory uncertainty

- Post Brexit, it has been confirmed that the body of existing EU law will be converted into British law. It will then be for the British Parliament to scrutinise and decide on changes through Parliamentary debate. While the UK will remain subject to its obligations under any international treaties such as the Convention on International Civil Aviation 1944 and the International Convention for the Prevention of Pollution from Ships, many other EU policies governing the air, land and sea sectors may need to be renegotiated by Parliament.

- The UK’s supply chain community with business in the EU – across road, rail, sea and air – will be warily watching changes on the regulatory front. Any new regulations that fortify borders and customs procedures at the expense of logistical efficiency could make them less competitive vis-a-vis their EU rivals; the same can be said for the implementation of any new trade tariffs.

- The EU is the single biggest destination market for passengers leaving the UK, accounting for 49% of the market. Currently, UK airlines can fly to, from and in between any country in the European Common Aviation Area (ECAA). As a non-EU member, the UK’s unrestricted access to the ECAA countries may have to be renegotiated and may well require the UK to accept EU aviation laws. Airlines also benefit from arrangements with third-party countries as parties to regional pacts such as the EU-US Open Skies Agreement. It remains to be seen if a post-Brexit UK can maintain its influence with the US, EU and other important partners such as China with the commercial value and attractiveness of its home market having declined.

- Also affecting airlines are European regulations that require them to vest majority ownership and control in EU nationals. When Britain exits the union, many airlines will be in breach of this regulation. For example, 60% of Ryanair is currently owned by EU nationals; this will fall to 40% once Brexit occurs. Non-EU shareholders may be forced to divest their interests to EU nationals, as failure to restore majority control to EU citizens could result in revocation of operating licences.

- UK rail operators’ freedom to participate in tender processes for franchises in the EU, and vice versa, will also depend on whether the UK will continue to participate in the liberalisation and integration of the EU’s rail system.

- What regulatory talks will bring, no one knows. But uncertainty heightens the perception of risk and is the bane of the long-term infrastructure planning that is vital to the profitability of asset-intensive industries such as transportation.

Complex operating models in an interconnected world

- In the white paper on Brexit released in February 2017, the government states they will “prioritise securing the freest and most frictionless trade possible in goods and services between the UK and the EU”, but will exit the single market.

- Nevertheless, the UK’s wide freedom of regional trade as a member of the EU is likely to be curtailed by its exit. Exports to EU countries account for about 12% of UK GDP and about 45% of total UK exports; for imports, the EU is an even more important partner. With close to £500 billion in two-way trade with the EU subject to negotiation, the transportation industry’s strategic position as the mover of people and goods makes it particularly vulnerable to these changes.

- While Brexit may not impede the right of British shipping companies to carry goods to or from the EU, sea transport will be affected by any change in trading patterns. Some 31% of the UK’s lift-on/lift-off container port volume comes from EU trade and this figure rises to 78% for roll-on/roll-off. In land transport, 99% of international road freight for the UK is to and from the other EU27 nations. As a result, any new tariffs and concurrent trade slowdown could present significant risks to both sea and land transport operations.

- Brexit could give Theresa May’s government an opportunity to reposition bilateral trade and the associated regulations in ways that could improve the UK’s economic fortunes and boost local employment. But, so far, most analysis is focused on the potential pitfalls associated with Britain’s split from the Union. The intergovernmental Organisation for Economic Co-operation and Development (OECD) has forecast that the UK’s departure could see its trade volumes fall 10-20% by 2030.

- The UK will no longer have the weight of the EU economy behind it when attempting to negotiate bilateral trade deals, customs agreements and tariff regimes. Instead it will be operating alone as the world’s 5th largest national economy. Depending on the prospective partner, it will require shrewd negotiating to compensate for decreased economic leverage.
Changing market dynamics and business model insecurity

- Since the Brexit announcement in June 2016, the pound has witnessed a period of turbulence that remains ongoing. As companies gradually stop benefiting from currency hedges implemented before the referendum, earnings will be hit. One US organisation that serves as Britain's biggest engine maker recently announced a $600 million setback to their earnings as a result of currency volatility.

- If the pound continues its slide relative to the US dollar a silver lining for airlines and cross-Channel rail operators could be a boost in tourist arrivals. Nevertheless, as British nationals face economic uncertainty they may be less inclined to travel abroad. As the primary facilitators of tourism and high-value trade, airlines have much at stake. The International Air Transport Association suggests that Brexit could see air passenger traffic fall 3-5% by 2020, “driven by the expected downturn in economic activity and the fall in the sterling exchange rate.”

- As rail industry growth is closely tied to population increases and economic success, any macroeconomic turbulence following Brexit could see demand for rail travel fall. Furthermore, price rises in regulated UK rail fares are tied to inflation, and current UK inflation rates are their highest since June 2014. Analysts are attributing this to the somewhat delayed economic impact of the Brexit vote.

Digital vulnerability and rapid technological advancement

- On 25 May 2018 the European General Data Protection Regulation (GDPR) will come into effect. Any UK company processing the personal data of EU citizens will continue to be bound by the regulation post-Brexit. Companies will therefore have to manage these obligations while also ensuring compliance with any new UK-specific legislation. With GDPR enforcement fines of up to €20 million – or 2-4% of global turnover – non-compliance poses significant financial and reputational risk.

- According to the Transportation Risk Index transportation executives in Europe perceive an “inability to keep up with the pace of technological development” as a top 10 risk facing their businesses over the next 10 years. A lack of available technology talent will therefore be a critical challenge to the UK transportation industry in coming years, potentially made worse by a tightening in the free movement of labour.

Talent management and the complexities of a global workforce

- Perhaps the most impactful of all post-Brexit shifts will be to immigration policy. Transportation executives rely heavily on immigration to staff their workforces. When they hear assurances about tighter controls on post-Brexit immigration, they naturally envision labour shortages. These fears will have been accentuated by a recent lack of clarity about whether exiting EU expatriates will be allowed to remain working in the UK.

- According to one report, 1.2 million additional workers will be needed to meet demand from the UK transport and storage sector by 2022. For rail operators, any reduction in the available talent pool or uncertainty surrounding the status of EU workers could cause delays in major infrastructure projects, such as High Speed 2. Labour shortages in the sea transportation sector are less likely to have wider economic ramifications, given that UK ownership of the merchant fleet has declined for the past two decades.

- The hardest hit of all the transportation sectors would be trucking, where an acute shortage of UK drivers is being worsened by the prospects of an ageing workforce. Trucking relies heavily on drivers from the EU; truck owners are simply not able to recruit enough British drivers to keep pace with demand. Of the 290,000 drivers of heavy goods vehicles in the UK, approximately 60,000 are from the EU. Any reduction of the sector’s recruitment options will compromise its ability to serve the economy. Any reduction in supply will raise trucking costs for manufacturers.

Opportunities

- Increase trade with the rest of the world. The government’s white paper states that “By boosting trade and opening markets and attracting the world’s most successful companies to invest in the UK, we will create jobs and enhance productivity and GDP.” If this is a success, transportation companies will be afforded access to new markets and new paths to growth.

- Improve industry engagement with regulatory process. Increased autonomy over regulation means UK transportation companies may have greater engagement in the regulatory process. This could allow for businesses to operate more effectively.
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