ANALYSIS & COMMENT

BREXIT: INS AND OUTS

The construction industry has been reluctant to get involved in the debate over whether or not the UK should leave the EU. But with the referendum looking likely for the summer, the implications of a Brexit are becoming starker – and time is running out for the industry to take a stand. By **David Blackman**

It's the issue that will define 2016: whether Britain opts to remain in the EU in the referendum expected to take place later this year.

Next month, prime minister David Cameron is expected to finalise the terms of the renegotiation of Britain's membership which the electorate will then be asked to cast its vote on. The outcome of the poll will have far-reaching ramifications, potentially ending the open trading arrangements that the UK has enjoyed with much of Europe since 1973.

Economists are in no doubt that the stakes are high, judging by a poll conducted by the Financial Times earlier this month, which showed overwhelming concern that UK withdrawal from the EU would be damaging for the British economy.

The industry seems to agree. A recent survey, carried out by accountants Smith and Williamson, showed that an overwhelming proportion (85%) of construction and real estate companies backed the UK's continued membership of the EU.

However, the construction industry is nervous about nailing its colours to the mast in public. Illustrating the sensitivities surrounding the topic, the spokesperson for one leading contractor says: "It is an emotive and politically charged subject and will be a decision for the British people. We prefer not to take part in a public debate, where any comment we make could be used in a political context."

But by refusing to take part in the debate, there is of course the chance the industry may wake up to find the UK out of the European Union. So can construction safely switch channel whenever the EU vote comes on the news? Or is the health of construction so intimately bound to that of the wider economy, that it's time the industry took a stand?

Martin Curtis, a director of the political consultancy Curtin & Co, isn't surprised that companies are unwilling to talk about an issue that splits opinion across society. "A lot of businesses don't want to get involved in what will be a tough political bunfight and you can see the sense in that."

Richard Threlfall, head of infrastructure, building and construction at KPMG, agrees: "Although it potentially affects them quite significantly, there's always a reluctance by business to take a position on something they see as political."

In addition, contractors at least are "not particularly exercised" about the referendum, according to Suzannah Nichol, chief executive of Build UK, who notes that "the phone is not ringing off the hook" on the issue.

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MARTIN CURTIS, CURTIN & CO

One reason is no doubt that most construction companies work exclusively in the UK. A study into the implications of British withdrawal from the EU, carried out recently by the CBI, showed that construction is the second most domestically focused major UK sector, a whisker behind the government. "It's a domestic market, so while there are some that operate internationally, what really affects them is what they do in the UK," says Nichol.

The knock-on effects of a Brexit

But this view is by no means universal. David Cash, chairman of architects BDP, is one of many who worries that the UK economy would suffer as a result of a Brexit. "In the modern world in which we are living, international co-operation is more and more necessary. A component of that is Britain's membership of the EU: the general consensus is that our current strength would be damaged by an exit from the EU."

"Anything which is damaging to the UK economy is not going to be positive for the construction industry," adds Cash, who is also export issues lead on the Construction Leadership Council.

The CBI estimates that leaving the EU would, "conservatively" have a significant net negative impact on the UK economy of £78bn annually, or about 4-5% of GDP. However, others have made more dire predictions, including the Centre for Economic Performance at the London School of Economics, which says the impact could be as much as 9.5% of GDP – the same as the 2008/9 banking crisis. It is important to note that some have also suggested that in the right circumstances the economy could potentially see a small benefit – the Open Europe think tank said this could total 1.6% annually by 2030. The problem is, as Noble Francis, economics director at the Construction Products Association, says, it is difficult to quantify the impact of UK exit from the EU, partly due to the unprecedented nature of the exercise. Added to that, he says there is no certainty about what trading relationship the UK would have with the rest of the EU. Some states, which have never joined the EU, enjoy access to the EU's markets as members of the European Free Trade Area. It is unclear though, whether that option would be available to the UK. The fear is that the EU would punish the UK for leaving by dictating highly undesirable terms – this will be partly to ensure that other EU countries do not try to follow the UK's example.

An obvious concern is that inward investment from the rest of the EU would slow down, with knock-on consequences for both commercial and residential development. A London no longer within the EU is likely to be a less attractive European headquarters location for multinational companies. Deutsche Bank has »

Siemens opened the Crystal in 2012 as a global hub for debate on sustainable living and development – the architect was Wilkinson Eyre Architects

» reportedly warned that it will scale back its UK workforce if there is a "no" vote, a sign that the City's position as Europe's major financial hub could suffer once Britain is no longer covered by EU regulation. And after all, why would Europe want its financial centre in a country that was no longer even in the union?

In addition, given how much migration concerns have fuelled the referendum debate, it is hard to see how the free flow of labour with the rest of the EU could survive, which would have some knock-on consequences for housing demand.

Adam Challis, head of UK residential research at property consultant JLL, believes that although the impact of Brexit is unlikely to be significant overall, it will be more marked in prime areas of London, due to the greater share of London's population that is foreign than in the rest of the UK. However, while the short term outlook is a little uncertain, confidence is widespread that any post-Brexit dip in construction activity will be masked by the strong growth predicted by the likes of Global Construction Perspectives over the rest of the decade.

APATHY RULES, OK

One of the Conservatives' most intellectually brilliant ministers told me this month that he would vote for Brexit if he thought this was a country that had the buccaneering spirit to go for a high risk, high reward strategy. However, Britain will not, he reckons, accept perhaps a decade in the economic doldrums on the promise of a more agile, freer future.

He hasn't decided whether to vote in or out at the referendum, but it's pretty clear this minister has figured the country will vote to remain, so there's no point risking political capital on arguing for out.

In Lord Anthony Bamford, the chairman of construction vehicles group JCB, construction has business' most prominent Eurosceptic. He wants out, hating the European Union's bureaucratic burden and spying better trade possibilities to the east.

Likewise small-scale entrepreneurs, particularly those from the technology sector, wonder what the concern is about – they reckon going it alone is worth a punt. So Lord Bamford isn't alone. However, he is in a minority among British business leaders, certainly among the biggest firms. We can't all be entrepreneurs and most construction businesses are small "c" conservative. You have to be, in an industry where 2% margins are considered ok.

This silent majority has little to worry about from the Conservative Party. The Independent's John Rentoul believes only around 30 of 330 MPs will vote for Brexit. My guess is 50 to 70, possibly a touch higher if the out campaign gets better organised.

Nearly every Conservative I speak to says they are undecided, that they don't really like the EU but, provided David Cameron gets a reasonable deal, which he almost certainly will, there is no reason to vote out. In short, like most of the public, the EU is not a big deal for them. They didn't become MPs to fight for Brexit and even those who did are not guilty of the jingoism that infested the eurosceptic Tories of the 1990s. This is important. Without widespread Conservative support, the most effective electoral machine in England, the Brexit campaign will not succeed.

I don't think Lord Bamford will win this fight. That will please the broader industry and business in general. Apathy will succeed – which, given the British nature, is not necessarily a bad thing.

Mark Leftly is deputy political editor at The Independent on Sunday and a business commentator for The Independent

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RICHARD THRELFALL, KPMG

Ending the free movement of labour

Against this background, a more pressing concern for the industry is the impact that an end to the free movement of labour will have on construction's skills shortages. Threlfall says: "We have made the numbers stack up over the last 10 years by an influx of labour, particularly from Eastern Europe. The last thing the industry needs is to have that supply choked off, because it will make it even harder to deliver projects. It would be deeply unhelpful if we create more barriers to entry for labour into the UK."

The inevitable rejoinder to these concerns is that the UK should be doing more to train an indigenous construction workforce. But although apprenticeship numbers are finally starting to rise, they are unlikely ever to make up for the shortfalls in an industry that has always relied on overseas labour, according to Arcadis' head of strategic research and insight, Simon Rawlinson. He says the loss of freedom of movement will impact on this industry more than others.

With overall unemployment just over 3%, he doubts whether an industry that he estimates draws more than 10% of its workforce from outside the UK will be able to plug its skills gap domestically.

Concerns over availability of labour are echoed by small builders. Sarah McMonagle, head of external affairs at the Federation of Master Builders, says that the skills shortages, which are already a "significant problem" for her members, will worsen if British companies can no longer tap the wider pool of EU labour.

"A lot of our members rely on free movement of workers: if that was impacted, it would make things quite difficult. It's really important that we have the flexibility of labour market that EU membership brings," she says, warning that more severe skills shortages would push up wages, increasing bottom line pressure on small contractors. "If we no longer have the ability to source labour easily across EU boundaries, the price will go up," agrees Ann Bentley, global chairman of Rider Levett Bucknall.

YES! WE HAVE NO BANANAS – AN END TO RED TAPE?

Ever since the directive stipulating that bananas should be straight, alleged over-zealous regulation by Brussels has been central to the euro-sceptic case for withdrawal from the EU.

The prospect of less red tape must be appealing, particularly for those smaller builders who find complying with Euro-regulations "quite burdensome," says the FMB's Sarah McMonagle.

The requirement, under the Energy Performance in Buildings Directive (EPBD), that all construction must be "near" zero carbon standard by 2020 is giving small contractors particular headaches. "If we were not part of the EU, that would be advantageous for small housebuilders for whom going further could be quite problematic," says McMonagle.

However, for those contractors groaning under the euro-yoke, life post-Brexit may be less rosy than imagined. While construction is subject to a lot of EU regulation, much has already been incorporated into the UK's own building standards. Added to that, it is not certain that the UK would escape Brussels' regulatory tentacles if it exited the EU.

Even the EU's staunchest opponents want to keep free trading arrangements with the rest of the bloc. But the quid pro quo of access to EU markets for non-member states is compliance with the union's trading standards, meaning that the existing regulatory framework is likely to remain in place post-Brexit.

Worse still, the UK's voice in how these rules are shaped will be a diminished one, warns former Association of the Conservation of Energy chief executive Andrew Warren, who spent years at the heart of the EU regulatory process.

Chairing meetings of the steering group which shaped what was to become the EPBD, he was steered by European Commission officials to give less heed to non-EU member states Norway or Switzerland than member states. This was despite the considerable expertise these countries had in building energy efficient homes. "You don't have any clout even if you have a good record in the area," Warren says. "In order to be part of the trading market, which I understand even the most xenophobic anti-Europeans accept, you have to stick by the rules and they are made by the members. It's the worst of all worlds."

In addition, Arcadis' Rawlinson argues that even in emerging markets it is helpful for the UK to be aligned to the EU's construction standards. "A lot of the costs of harmonisation have already been sunk," he says, pointing out that across areas like energy efficiency and health and safety operate within an EU framework.

Materials world

The erection of trade barriers looks less of a concern for the industry's other big input: materials. The CPA's Francis says the vast majority of products used in UK construction are produced domestically with imports mainly used to help plug sudden surges in demand. However, he acknowledges, the proportion of products sourced from overseas suppliers is greater at the high end of the construction market.

Rawlinson points to estimates that approximately one-fifth of construction value in high-end London projects is euro denominated, including much of the specialist plant and high-end curtain walling used in such projects.

For consultants though, the impact of Brexit on exports is a bigger potential headache than for their contractor colleagues. British architects have built a strong reputation worldwide – Bentley estimates that around 20% of the turnover at RLB's London office is sourced from non-UK contracts.

Euro-sceptics dream that a Britain that has turned away from what they see as Europe's sclerotic economy will be better equipped to trade with the wider world. But the picture is not so simple, Bentley warns, explaining that withdrawal from the EU will put at risk the UK's participation in the international agreements that govern so much global trade nowadays. "If we want to trade elsewhere in the world we would need a unilateral as opposed to a multilateral agreement. If we didn't have the protection of some of those trade agreements, we would find it almost impossible to work in some of these markets," she says. "North America has some really stiff trade barriers and only countries or groups of countries that they have agreements with can export to the US. The EU has those in place which allows us to operate."

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While the UK could renegotiate these agreements, as a standalone nation it would have a weaker hand than the pan-continental trade bloc, she believes. In the meantime, Bentley warns that competitor firms from EU countries with strong building consultancy sectors will exploit the uncertainty that would hang over UK-based competitors.

It all adds up to too big a leap in the dark for BDP's Cash, who believes that the combination of continued EU membership and retention of the pound gives the UK the best of both worlds.

And while the European economy is currently in the doldrums, Cash sees no sense in the UK turning its back on what remain by far its closest and most important trading partners. "Over a longer period, they will undoubtedly get stronger again," he says. Despite increasing trade with the rest of the world, the EU still accounts for around half of total UK exports and imports.

Construction firms, like most businesses, are nervous about putting their head over the euro-referendum parapet. The risk though is, if industry does not speak out, that the measured case for continued membership of the EU will be drowned out by the shriller voice of the "out" lobby.

KPMG's Threlfall worries there is a risk of the industry burying its head in the sand. "A lot of UK businesses seem to be sleepwalking into this in much the same way as in the Scottish referendum," he says. "I think businesses ought to start taking it more seriously because whether it affects an individual business in this industry or not, the overall context of separating from the EU in any material way can't be something that is good for the long-term future of the country."

In the short term, the CBI has warned that uncertainty over the EU referendum may lead to a slowdown in spending and investment in the second half of this year. That's one issue that the industry is comfortable talking about: the need to get the referendum over as soon as possible.