# What No Deal would mean for UK Manufacturing

***By Professor David Bailey, Professor of Business Economics at Birmingham Business School at University of Birmingham, Visiting Professor at Centre for Brexit Studies and Senior Fellow at UK in a Changing Europe.***

Despite Parliament legislating to avoid a No Deal Brexit next month, Prime Minister Johnson has said he would rather 'die in a ditch' than write a letter asking for another extension to Article 50. There remains considerable uncertainty about when and how the UK will leave the EU, and whether with a deal or not.

The possible impacts of No Deal have been set out in the recently released summary of Operation Yellowhammer, which corresponds with detailed analysis undertaken by the UK in a Changing Europe programme in its recent No Deal Brexit report.

That report stresses that No Deal will not "get Brexit done"; rather it will usher in a period of prolonged uncertainty for citizens, workers and businesses, and one which is unlikely to be resolved anytime soon.

In terms of goods and manufacturing, the immediate impact of No Deal would be felt keenly by manufacturing sectors which operate fine-grained 'just-in-time' (JIT) production, operations and logistics systems across Europe.

Think of aerospace firms such as Airbus, major automobile assemblers such as Nissan, Toyota, Honda, Jaguar Land Rover, BMW, Vauxhall and Ford (in the latter case engines), and automotive component suppliers such as GKN.

Honda itself warned at a Business Select Committee hearing last year that a No Deal Brexit poses big risks for the firm's Swindon operations in terms of tariffs, customs delays and bureaucracy pushing up costs.  When considering the impact of No Deal on manufacturing, we might also think of the impact on skills, regulation, and R&D.

The operations of many manufacturing firms run on short delivery and production schedules with inventory levels often kept at just a few hours so as to ensure low cost and high efficiency.

For firms like these, just-in-time systems underpin the whole logic of their activities, and they will face major challenges adjusting to the delays and uncertainty of customs and border checks in the event of No Deal.

While manufacturers undertook frantic stock-building in the run up to the original end-of-March deadline to mitigate some of these risks, there is a limit as to how far this can go as holding high levels of stocks undermines the very efficiency and quality of production and delivery systems.

In addition, rapid and widespread switching to local UK suppliers isn’t possible as so much of the value-added in sectors such as automotive is already imported (something like 60% of the components going into a UK assembled car are on average imported, mainly from the EU).

The UK’s supply base simply isn’t geared up to supply many of these components. ‘Reshoring’ component supplies is a long term business needing a dedicated industrial policy to back it up. That in turn requires some major policy developments.

Essentially, customs delays under a No-Deal Brexit would throw a big spanner in the works of JIT systems commonly used across UK and EU manufacturing.

Take the example of Honda: in evidence to the Business Select Committee, Honda said that it retained just an hour’s worth of parts at the Swindon production line, and it required 350 trucks’ worth of components to be delivered every day from Europe.

Honda stated that every 15 minutes of customs delay would cost it up to £850,000 a year, and that it would take the firm 18 months to set up new procedures and warehouses if Britain left the Customs Union.

Even then, with 2 million daily component movements, just minor delays at the Channel Tunnel and Dover would force hundreds of its trucks to wait for hours.

Honda’s government affairs manager stated that “outside of the customs union, there is no such thing as a frictionless border. I wouldn’t say that the just-in-time manufacturing model wouldn’t work, but it would certainly be very challenging.”

In short, No Deal is likely to mean short term disruption in the sector as firms run out of components after a few days. Stop-start production is likely, with rising costs and a hit to efficiency and profits.

There are similar issues in aerospace: for example, UK aerospace exports are highly dependent on participation in the EU supply chain, since the sector is highly specialised in a few key areas.

The bulk of exports are of parts (wings, fuselage, landing gear and engines) rather than whole aircraft. The OECD estimates that around 40 per cent of the value-added in UK aerospace gross exports originates abroad.

European aerospace supply chains compete in large part on speed as well as production cost. Airbus for example, has stressed to the House of Commons Business Committee that customs delays would be a “critically bad” issue for them.[1]

Another major issue in the event of No Deal would be tariff barriers for some manufacturing sectors; for example this would push up import and export prices of cars, and impact on exports and hence production in the UK.

The short run production hit arising in this way from No Deal has been estimated at around 175,000 cars a year (that’s not including the Honda closure), which is over 10% of UK car output.[2]

Longer term, there is a significant risk that some firms would consider shifting production activities outside of the UK. Honda and Ford have already announced plants closures in the UK for a variety of reasons; Brexit uncertainty being seen by many as one factor.

Other assemblers may follow in the event of a No Deal, especially when new model production is being planned. Peugeot has already stated bluntly that No Deal would mean no investment at Vauxhall at

Ellesmere Port (the current Astra model is due to be replaced in 2021).

Carlos Tavares, the Chief Executive of PSA Group, which owns Vauxhall, said recently that “No Deal cannot be considered. This would be very bad for the UK, very bad for Europe, very bad for all of us.”

It’s worth noting that there is plenty of spare capacity in the European auto industry. Other countries would jump at the chance to attract such assembly activity, hoping that that they could also pull in significant (especially higher value) parts of the value chain. In that sense the employment effects of losing assembly operations could be significantly higher than the jobs just associated with the big assemblers.

So longer term the effects of No Deal could be worse than the short term hit as investment in new models in the UK may be lost. If decisions on where to build new models go against the UK under a No Deal scenario then annual UK auto production could be over 500,000 units lower in the second half of the next decade than under a managed, orderly Brexit Deal.[3]

The shock to the auto industry of No Deal would have negative impacts on UK automotive and manufacturing, including its suppliers, workers and the places hosting such activity. Policy responses would need to draw on earlier experience in trying to cushion the blow – such as the Rover Task force and the Automotive Response Programme in the Midlands in the wake of the Global Financial Crisis.

A range of measures to anticipate and respond to shocks would be needed. Given that the production hit would cascade down the supply-chain, business support would need to include help for otherwise viable firms through measures such as loan funds, temporary wage subsidies, diversification advice, and tax and rate relief. Workers would need support in terms of training and retraining.

Places affected would need measures to remediate sites, improve connectivity and regenerate places, in turn raising questions over the degree of devolved powers to achieve this. While No Deal preparations are under way, it is not clear that government is prepared for such wide-ranging policy interventions to deal with such shocks.

[1] House of Commons Business, Energy and Industrial Strategy Committee (2018) The impact of Brexit on the aerospace sector. Sixth Report of Session 2017–19. HC380.

[2] See Bailey, D, A de Ruyter, N Fowler and J Mair, ed.s, (2019) Keeping the Wheels on the Road: UK Auto after Brexit, Bite Sized Books.

[3] See Bailey, D, A de Ruyter, N Fowler and J Mair, ed.s, (2019) Keeping the Wheels on the Road: UK Auto after Brexit, Bite Sized Books.