No Deal Brexit and UK Automotive

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Introduction

Despite Parliament legislating to avoid a No Deal Brexit, Prime Minister Johnson has said he would rather 'die in a ditch' than write a letter asking for another extension to Article 50. Unsurprisingly, at the time of writing, 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 a No Deal Brexit have been set out in the released summary of Operation Yellowhammer, which corresponds with detailed analysis undertaken by the UK in a Changing Europe programme in its latest No Deal Brexit report. The latter 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. For manufacturing the uncertainties are particularly pronounced. This paper will look at the short and longer tern impacts of what a No Deal Brexit might mean for UK automotive and what sort of industrial policy might be needed going forward.

No Deal and UK Automotive: Immediate impacts

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 Research and Development (Bailey and De Propris, 2017). 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 (Bailey et al, 2018).

While manufacturers undertook frantic stock-building in the run up to the original end-of-March Brexit 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 (Bailey and De Propris, 2014). 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 (House of Commons, 2018a). 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" (ibid). 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 (House of Commons, 2018b). 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 the 2 hour turn-around time of wing exports: customs delays would be a "critically bad" issue for them (ibid).

The trade body, the Society of Motor Manufacturers and Traders (SMMT) has reiterated the risks of No-Deal bringing tariff barriers for imports and exports of cars, border delays, production stoppages and additional costs through things like stockpiling and form-filling. A 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.

In our recent 'Bite-Sized Brexit' book *Keeping the Wheel on the Road: UK Auto post Brexit,* Ian Henry forecasts a short-term production hit from a No-Deal of at

least 175,000 cars a year (that's not including the Honda closure), which is over 10% of UK car output (Bailey et al, 2019). It should be noted that the UK auto industry is on a downwards trajectory despite some recent good news from JLR and Ineos over investments in the UK. So far this year, Nissan has reversed its 2016 decision to assemble the X-Trail SUV in Sunderland, Jaguar Land Rover has announced 4,500 job losses plus a £3.6bn loss, and Honda has confirmed that it will shut its UK assembly and engine plant in Swindon. Ford's recent announcement that it will close its Bridgend engine plant adds to a growing sense of crisis in the UK auto industry. In total, we have seen over 10,000 job losses announced by big auto players over the last year, and that's before we consider the impact on the supply chain.

There's a sense that the industry is at a tipping point, squeezed by diesel's demise, falling sales in China, and Brexit uncertainty hampering growth – plus the need to invest heavily in new technology like electric cars going forward, which is prompting auto industry mergers and alliances on a major scale. JLR's recently announced tie-up with BMW on electric motors is one example of this.

No deal and UK Automotive: Longer Run impacts

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). 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. Investment in UK auto has effectively stalled, down by 80% in the last three years according to SMMT figures, as auto firms sit on their hands given the undetermined outcome of Brexit.

The uncertainty over the future of the UK's trading relationship with the EU means that it is difficult for firms to commit to producing in the UK in the future – and there are big investment decisions looming at firms like Peugeot over their Vauxhall brand at Ellesmere Port, where current Astra model production ends in 2021. That's before we get to Toyota, which began new Corolla production last year at its plant in Burnaston, Derbyshire (an investment decision which goes back before the 2016 Referendum). Like Honda, the plant has been operating below capacity in recent years, and there are big question marks over its future when production of the current Corolla ends in 2024.

Henry (2019) notes that beyond his short term estimate of the impact of Brexit on UK auto output there is likely to be a worse impact in the longer run, as investment in new models in the UK would be lost, a point also explored in Cox and Oakley (2019). They stress that 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. In short, the stakes for UK auto from ongoing Brexit uncertainty are very high indeed, just at a time when the industry is starting to transform itself towards an electric and autonomous future.

Wider Impacts and Industrial Policy Needs

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 (Bailey and De Ruyter, 2015). 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.

Of course, avoiding No-Deal should be a priority. Staying inside the Customs Union is essential for fine grained automotive supply chains to run efficiently, and avoiding non-tariff barriers will be key longer tem; the aim should be to effectively give UK auto something like access to the Single Market. And beyond this, the UK will need to more than just a new trade relationship with the EU. For example, Britain will need to do much more to create and develop its own skills given that 1 in 10 manufacturing workers in the UK come from another EU country; this means developing better systems for education, skills training, and re-training as part of a wider industrial policy, and one which is determined much more locally than it is now. Sadly, on the latter – despite much early hype – the May government's Industrial Strategy was something of a damp squib, seemingly killed off by a hostile Treasury that was anti-intervention and anti-devolution to the regions. There was little effort to join up industrial policy with 'place'.

But in automotive there is still something to build on. What has been particularly encouraging over the last decade has been the work of the Automotive Council, which started at the end of the Labour administration and which developed under the Coalition government (thanks to Vince Cable) into an effective body in fostering public – private cooperation. The Council's work has, for example, set out clear priorities for key automotive technologies that need to be developed (such as on powertrains, lightweighting and intelligent mobility) which has both aligned government support and funding and has underpinned business confidence and investment. The Council's work was backed up by a range of (modest) interventions to boost skills, rebuild supply chains, and encourage investment in the industry, such as through the Regional Growth Fund, the Advanced Manufacturing Supply Chain Initiative, the Manufacturing Advisory Service (MAS), and MAS' Tooling up Fund to support investment in tools in the Supply Chain.

Sadly most if not all of these policy interventions were scrapped after the Conservative majority government was elected in 2010. That was a mistake as where policy was reasonably well developed, it really did make a difference. And while the subsequent Industrial Strategy put in place 'sector deals', the funding on offer was a fraction of previous support.

So going forward, what is to be done?

Firstly, the work of the Automotive Council should be continued but backed up with far greater resources, to support innovation, skills development and supply chain building.

Secondly, sector and place need to be combined: the government needs to look again at the degree of devolved powers. It will need to return to development bodies that can intervene more widely and strategically at a regional level, and do 'smart specialization' through regional level industrial policies. Combined Authorities may be one way to do that (in cities at least). Beefing up the local growth hubs to fill the vacuum left by the abolition of MAS could be part of this 'Combined Authority Plus' model, as would devolution of skills funding to the regional level.

Thirdly, there is much more that the government could be doing in really trying to 'rebalance' the economy and reduce Brexit-induced uncertainty, for example by stimulating investment in manufacturing such as through enhanced capital allowances, by resurrecting something like the Advanced Manufacturing Supply Chain Initiative (preferably on a much wider scale), and by plugging funding gaps for small firms in the supply chain.

Fourthly, there is a need to support to modernise and reorientate the sector so as to find new development paths in terms of market reorientation, value chain optimization, strategic corporate reorganisation and so on (Bentley et al, 2017).

Finally and more broadly, there is a strong case for UK industrial strategy to be afforded an institutional status similar to both UK monetary and fiscal policies. At the very least, it should be the subject of regular strategic long-term reviews. By giving it that sort of priority, the new government would send out the kind of powerful message that British industry and foreign investors need to hear given recent uncertainty.

None of this is a panacea for a messy No Deal Brexit. But regardless of the form of Brexit, a more interventionist industrial policy will be required for UK auto going forward, building on the public-private cooperation that has been developed over the last decade, and in contrast to what some deregulation-minded Brexiters might suggest.

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