

# Bailout for business in a no-deal Brexit



## About this report

As efforts to reach a withdrawal agreement with the EU reach a crescendo, government and business are also preparing frantically for the prospect of a no-deal Brexit. The government has promised business that it will develop measures to cushion the blow and support viable companies through the storm – but this commitment leads to a whole suite of policy dilemmas and trade-offs. This report discusses the variety of harms that the government may want to address, and highlights some of the challenges it faces in developing a response.

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# Summary

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**“One of the things we’re doing across government is developing a package called Operation Kingfisher. It will be there so any business that may be temporarily affected by changes in circumstances that are related to Brexit can be supported... so that fundamentally viable businesses that may have the occasional cash flow or other issue can be supported.”** – Michael Gove, chancellor of the Duchy of Lancaster and minister responsible for management of a no-deal Brexit, quoted in *The Times*

**“It’s like studying for an exam you don’t know if you will need to take.”** – Chris Wolfe, director of Southeast Flowers, a flower wholesaler based in Ashford, Kent, quoted in the *Financial Times*

Whether or not the government under Prime Minister Boris Johnson actually takes the UK out of the EU on 31 October, it has made clear that it regards a no-deal Brexit as an acceptable outcome.

The arrival of the Johnson administration has seen a marked increase in the pace and prominence of preparations for this. These preparations play two ostensible roles: first, to convince the European Union (EU) that Britain is serious about leaving “come what may, do or die” and, second, to ensure the country is as prepared as it can be for an outcome widely predicted to be disruptive and damaging.

As discussed in earlier reports, a no-deal Brexit would be far from an end to questions about the UK’s trading relationship with the EU. In the short term, it represents as sharp a rupture as has affected any trading bloc in recent history. The adjustment would affect thousands of businesses in a multitude of ways, some on the stroke of midnight on 31 October, and many more in the days and weeks that follow. Arrangements that had governed trade for decades would be rendered null, and replaced with nothing at all, a World Trade Organization (WTO) default, or whatever the governments concerned had managed to agree as a temporary improvisation.

For the years afterwards, it is inevitable that the economic agenda would be dominated by the need to establish better arrangements with the giant on our doorstep. But the short term would be all about the immediate disruption – in the words of our report *Preparing Brexit: No Deal*, the government will be occupied ‘with providing money and support to businesses and industries that have not prepared or are worst affected by a no-deal Brexit’. Chancellor of the Duchy of Lancaster Michael Gove, the minister in direct charge of no-deal preparations, has declared this a key objective of Operation Kingfisher in the words quoted above.

However, those words contain a number of choices and point to key execution challenges, which this report aims to unpack. How does the government intend to distinguish companies affected by Brexit specifically? What is its method for determining that the effect is temporary, or that the company so affected is “fundamentally viable”? Cash flow is key to business viability in the short term,

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but Gove holds open the idea that businesses with “other issues” might be supported – what might they be? Then there are all the questions about how the support should be delivered, the form in which money is provided and the level of government at which the systems operate. On top of this, there is the essential question of how the decisions made in the short run, in the heat of crisis management, ought to bear in mind the longer-term vision of the government in setting a new course for the country.

This is a daunting agenda. It is the nature of no deal that while some of the impacts might be understood in advance, there are plenty that are either known- or unknown-unknowns.

As *The Times* wrote in December 2018, when a no-deal exit began to appear as a serious possibility:

**Thousands of man-hours in Whitehall and Brussels have been spent war-gaming scenarios and drawing up contingency plans to minimise disruption resulting from the end of 40 years of political, legal and economic co-operation. There is only so much that can be done, however, because neither side has an accurate idea of what it will face.**

Since that was written, there have been thousands more man-hours devoted to the task. Progress has been made, for example in aviation and financial services, to avoid immediate short-term disruption.<sup>1</sup> UK and EU institutions will still be able to access each another’s clearing and settlement systems on the day after Brexit, and planes will still be able to fly between the blocs.

But no amount of preparation can eliminate all the risks. No deal is a step into the unknown. The language of preparation could lull us into seeing a no-deal Brexit in terms of a fiendishly long exam that with enough homework one might thoroughly master and plan for. It is not; too many of the questions and challenges are unknowable, and are dependent on the behaviour of all affected parties. For example, how long will it take for new arrangements at the French side of the border to be put in place? How long will large multi-national companies keep their supply chains based in the UK?

Time and again, businesses and their representatives have emphasised that there is only so far their preparations can go. Plans can be made, but to paraphrase the German general Helmuth Von Moltke, “no plan survives contact with the enemy”. Or in the cruder words of Mike Tyson, “everyone has a plan until they get punched in the mouth”.\*

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\* Typical story: Sharman J, ‘The Independent ‘Brexit: Impossible to prepare for “significant disruption” of no deal, Gove told after claiming businesses are ready to leave’ (with quotes from both the Society of Motor Manufacturers and Traders and the British Retail Consortium), *The Independent*, 25 September 2019, [www.independent.co.uk/news/uk/politics/brexit-no-deal-business-michael-gove-leave-eu-boris-johnson-a9120691.html](http://www.independent.co.uk/news/uk/politics/brexit-no-deal-business-michael-gove-leave-eu-boris-johnson-a9120691.html)

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This report does not pretend to set out a clear map for what exactly will happen, and to which businesses, after a no-deal Brexit. Some may actually benefit from the event – around 10% of smaller businesses expect it to improve their ability to do business, according to a survey by the Federation of Small Businesses. There might be growth in domestic tourism, for example, and the fishing industry hopes to exploit new freedoms after leaving the Common Fisheries Policy.

The purpose of this report is instead to explore the measures a government might put in place to address harm, and so that is where our focus will be. In spite of the intrinsic uncertainty, it is possible to set out in outline the broad categories of harm – those “changes in circumstances related to Brexit” – that the government might conceivably address and the alleviating measures it ought to be considering.

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# 1. Introduction

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The basic outline of this report is first to discuss in broad terms the ways in which no deal might damage business, culminating in a broad assessment of how different sectors might be affected over the immediate and longer term, and then the means by which they might be helped.

There is uncertainty and complexity at each stage, and so rather than a firm prediction and clear rulebook for intervention, the purpose of this report is to highlight the sort of policy decisions the government should expect and provide some principles that it should apply.

## Categories of harm

The effects of a no-deal Brexit are as complicated as the membership of the EU that it brings to an end. This report begins with a broad description of the various categories of harm that such an abrupt departure would bring about. While most attention is usually given to the effects of tariffs and congestion, it is important to consider a wider range of no-deal harms and a longer timescale. This is because any intervention has to consider the longer-term vision for the UK economy that the government is aiming towards, rather than just the immediate firefighting.

The major categories of harm we discuss are:

- sharply changed **tariff schedules**, on both the EU and UK side
- the imposition of **non-tariff barriers**
- the drag from **congestion** at ports and airports
- changes to the rules governing the movement of **data and people**.

Clearly nothing as complex as no deal can be so neatly drawn. Beyond those above, it would generate broader economy-wide effects, but most would usually fall outside the definition of an event the government might conceivably offer help for.<sup>1</sup> They include weaker demand growth, lower migration, a sharply lower currency, a changed competitive climate, possibly tighter credit conditions and restructured global supply chains. While it would be impossible for each of these effects to be compensated for, they will need to be taken into account when assessing the position of any one business or sector.

Each of these categories of harm might have a different time profile. Some represent sharp, transitory shocks that will eventually be dealt with; others, a shift to a different state of affairs.

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## Who is hurt? Types of business and sector affected

There has been discussion in the press of a "secret list of companies likely to be affected by No Deal".\* This report takes a more cautious approach, given the complexity and uncertainty detailed in the first section. We do not know which businesses are on that list. No document can anticipate all of the ways in which no deal will affect business, but useful pointers as to the kinds of sector and business likely to be of concern can be gleaned from the extensive evidence provided to Parliament and various business groups.

## How government should support business in a no-deal Brexit: the principles and dilemmas

The UK economy is based on free market principles, and direct intervention of the kind suggested by the government is the exception rather than the rule. Rules prevent politicians or officials from simply handing out support to whomever they choose, in order to protect the public purse from waste and corruption, and to maintain fair competition in the economy. Intervention, when it does occur, should not be ad hoc but based upon a clear rationale that reflects the aims intended, and with full awareness of the costs and policy pitfalls. Government documents such as the *The Green Book* and *Managing Public Money* set out in more detail how policy must be developed in light of objective analysis, in pursuit of a clear rationale and within the delegated powers set by Parliament.<sup>2</sup>

But the need for principles goes well beyond adherence to the law and best practice. The scope of any intervention to help business in the event of no deal is potentially limitless, and the first key decision the government faces is the set of principles that should guide the limits it has to impose.

Some of the principles will be general and timeless, such as the need for the intervention to be good value for money, effective and timely. But others are very much conditioned by the particular circumstances of no-deal Brexit and the policy choices it forces upon the government: the kind of economy it wishes to oversee and the trade-offs it has to confront in trying to produce it.

## How should the support be delivered?

Recent history provides numerous examples of new business support schemes, in particular those brought in after the financial crisis. Finance might be provided in the form of tax relief, a grant, a loan, a bank guarantee or even a direct equity stake. Government does not have a single shopfront from which it disburses aid, but operates at a variety of levels: departmental, local or regional; through arm's-length bodies; and often via the medium of the private sector.

In light of the aforementioned principles and the different situations the government means to address, this section sets out the schemes it ought to consider and how they might be designed.

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\* *The Times* understands that the government has drawn up a secret list of big British employers that are considered most at risk, with the worst affected expected to be in the construction and manufacturing sectors. 'Bailout fund to prop up businesses after Brexit', *The Times*, 10 August 2019, [www.thetimes.co.uk/article/bailout-fund-to-prop-up-businesses-after-brexit-8w2883fz2](http://www.thetimes.co.uk/article/bailout-fund-to-prop-up-businesses-after-brexit-8w2883fz2)

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There are three broad types for an immediate crisis:

- schemes to address cashflow emergencies
- support for one-off costs that address transitional problems with no deal, such as the cost of re-certifying goods for export
- support to keep businesses operating while rendered uncompetitive by changes in trading conditions that are expected to be temporary.

There is a longer-term agenda for the government to restructure the UK economy for the different post-Brexit conditions, which is where the bulk of support aimed at business usually sits. This report touches upon that topic, but we warn against attempting a wholesale redesign of the industrial strategy agenda during the turmoil of a no-deal Brexit. However, this longer-term vision must be kept in mind throughout the government's delivery of short-term support.

## **Complexity – this is harder than sheep meat**

**“If, as we anticipate, a common external tariff is placed on sheep meat exports, and therefore the price of sheep meat falls, we can support hill farmers, who do so much for our country, by producing high-quality food and safeguarding the environment we love.” – Michael Gove**

Having recently been secretary of state in the Department for the Environment, Food and Rural Affairs (Defra), Michael Gove is familiar with the details of how the sheep meat sector is likely to be damaged in the event of a no-deal Brexit. Without a trade deal, European importers that currently account for the bulk of the UK's sheep exports would face higher tariffs, estimated at between 38% and 91%.<sup>\*</sup> This might lead to downward pricing pressure of around 30%, according to evidence given to Parliament,<sup>3</sup> which would probably be catastrophic in an industry with small margins.

In this case, the losses to UK sheep farmers will be immediate, apparent and to a degree quite calculable. Gove was able to be fairly clear and certain in promising support, telling the House of Lords EU Committee: “we will calculate any potential loss of income from the decline of the value of sheep meat and support with headage payment”. Farming minister George Eustice has indicated that the goal is to keep the size of the national flock high, with income support as well as such headage payments.

This must be taken to assume that the industry will, with time, right itself through a fresh agreement with the EU that would render commercial conditions bearable once more.

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<sup>\*</sup> Channel 4, 'FactCheck: Will sheep farmers suffer in a no-deal Brexit?', July 2019, [www.channel4.com/news/factcheck/factcheck-will-sheep-farmers-suffer-in-a-no-deal-brexit](http://www.channel4.com/news/factcheck/factcheck-will-sheep-farmers-suffer-in-a-no-deal-brexit). Estimates are needed because it is not certain what access the UK will have to the EU's quotas that allow lower-tariff exports. See also *The Times*, 'No-deal Brexit: £500m plan to help farmers', 31 July 2019, [www.thetimes.co.uk/article/no-deal-brexit-500m-plan-to-help-farmers-bx5pnx9qq](http://www.thetimes.co.uk/article/no-deal-brexit-500m-plan-to-help-farmers-bx5pnx9qq)

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From this case study it is possible to construct an idealised model for why a government might temporarily provide the support Gove refers to – what is sometimes referred to as the 'Nike swoosh'; this envisages a short period of decline followed by a firm recovery.

**Figure 1: A simple 'swoosh'**



Source: Institute for Government analysis.

Perhaps this is correct in the case of sheep meat – although a great deal depends on the long-term deal struck with the EU and whether UK farmers can recapture their former markets after a period of dislocation.\* In this case, the UK government can go about preparing support with few of the complexities usually present. There is no moral hazard to speak of – the promise of future support does not discourage any useful activity now.

British sheep farmers are price-takers on the world market, which means their actions cannot conceivably change the conditions they face. They have no alternative business strategy available to them to cushion the blow. The scale of the damage caused by tariffs easily outweighs any countervailing advantage to be gained from a weaker currency. There are no other UK competitive concerns to weigh up in the matter.

However, the sheep meat example should be held up as a clear exception in what is otherwise likely to prove a far more cloudy and dilemma-strewn situation. To take an opposite extreme, consider the insolvency and liquidation of the travel agent and airline Thomas Cook from 22 September 2019. Unaffected by anything as direct as a raised tariff, the business could nevertheless point to a number of factors related to the Brexit vote and impending promised departure from the EU.

Its half-yearly results reported that uncertainty related to Brexit may have hit demand, and the fall in the value of sterling since the referendum would have hurt tourism from the UK, as well as raising costs usually denominated in a foreign currency (for example, to lease airplanes or buy jet fuel).

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\* 'However, farmers' leaders are concerned that the scheme may have to last for several years while trade deals are negotiated. It may never make up for the lack of market access to the EU, which will be hard to win back even if a trade deal is eventually struck.' *The Times*, 'No-deal Brexit: £500m plan to help farmers', 31 July 2019, [www.thetimes.co.uk/article/no-deal-brexit-500m-plan-to-help-farmers-bx5pnx9qq](http://www.thetimes.co.uk/article/no-deal-brexit-500m-plan-to-help-farmers-bx5pnx9qq)

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Yet were it that simple, the company's share price would not have enjoyed a strong two years immediately after the Brexit vote, and there might have been problems across the sector. It is clear that its problems stem as much from the structure of the business and idiosyncratic decisions that cannot be blamed on the one big external event of Brexit, such as its reliance on a high-street-led sales model and recent debt-funded acquisitions that left the company financially vulnerable.

And despite the damaging spill-overs likely to accompany the collapse of the tour operator, there were clearly considerable risks and costs to supporting the company in its distress:

- **Lack of effectiveness.** The support might merely have postponed the collapse, at the expense of the taxpayer.\* It might have been less of a Nike swoosh, and more of a toboggan ride; a brief period of artificial recovery, followed by another downturn.
- **Damaging the competition.** Other companies in this sector operated more competently, and benefited from the removal of a rival from the market. State subsidy for Thomas Cook would have provided a genuine cause for grievance.
- **Lack of strategic fit.** The government has finite resources – should it really prioritise a travel company operating a traditional business model, that is largely foreign owned?

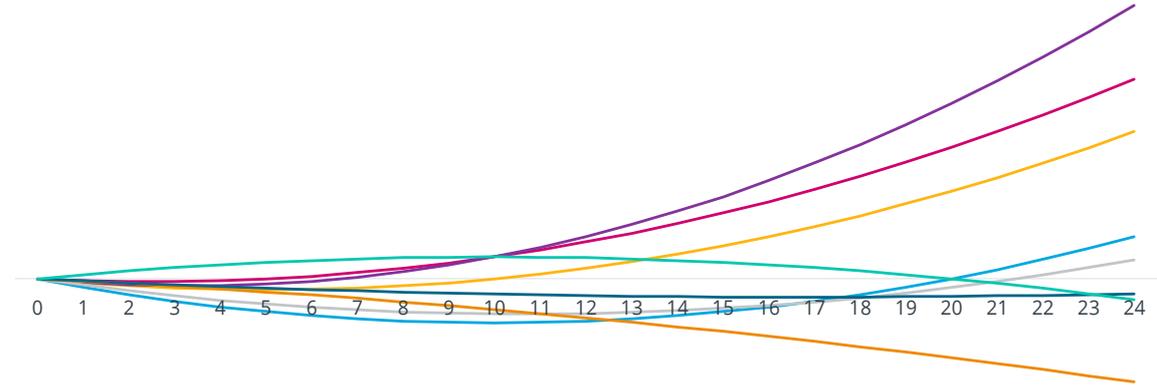
When making promises to support companies affected by no-deal Brexit, the government may hope it is facing difficult-but-manageable situations similar to the distress of sheep farmers in the face of adverse tariffs. Few cases ought to match the scale and difficulty of the collapse of Thomas Cook. But the government should expect situations to be spread along a spectrum: in terms of the nature of the Brexit harm and how clearly it can be measured; the knock-on costs of intervening to help; the certainty of medium-term recovery; and the likelihood of a successful intervention and its value for money.

The government felt it could or should not support one Thomas Cook situation – it certainly cannot do so with many more.

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\* The Secretary of State at the Department for Transport, Grant Shapps, said a cash injection from the state would only have kept Thomas Cook afloat 'for a very short period of time'. *Financial Times*, 'Thomas Cook collapses after knife-edge rescue talks fail', 23 September 2019, [www.ft.com/content/dd402b2c-dd9e-11e9-9743-db5a370481bc](https://www.ft.com/content/dd402b2c-dd9e-11e9-9743-db5a370481bc)

Figure 2: The messy reality



Source: Institute for Government analysis.

## 2. Categories of harm

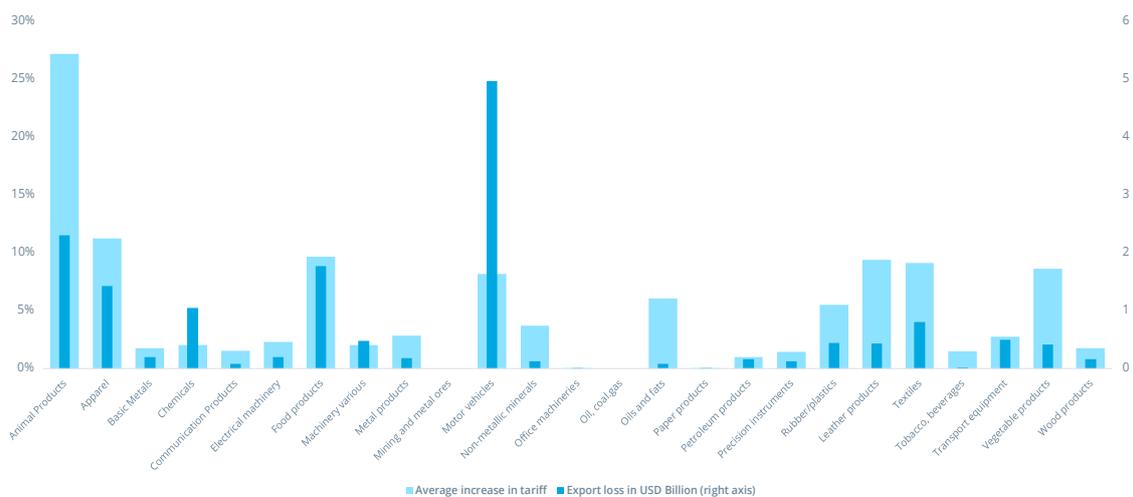
### Tariff changes

Leaving the EU will result in several interlocking changes in the tariff regime facing UK companies. Overall, they will represent a negative shock to the business environment, but with highly variable effects, depending on the nature of the business involved and its markets.

The biggest change is the **imposition of export tariffs** where there were previously none. This is mainly about tariffs on exports to the EU, but tariffs will also change for exports to third countries hitherto covered by a free trade agreement (FTA) that has not been rolled over.

### Tariff changes that would occur in a no-deal Brexit and their effect on EU markets

Figure 3: UK export losses in EU markets



Source: Institute for Government analysis of UNCTAD, "The trade cost of a no-deal Brexit to the United Kingdom," 2019.

The following chart is taken from the Institute for Government report *Taking Back Control of Trade Policy*:

**Figure 4: UK annual goods exports and average applied Most Favoured Nation tariff rates, 23 non-EU countries**



Source: Institute for Government analysis of World Bank Trade Barrier Index and Comtrade data.

Other effects will arise from the temporary new tariff schedule the UK government plans to impose in response. The majority of tariffs would be set to zero, but for 12% of goods some higher tariffs than before would arise. There would also be some lower tariffs on non-EU imports than had been in place against rest-of-the-world (RoW) imports. This might pose a new competitive threat to parts of UK industry.

There are three major categories of business that might suffer immediate damage:

- **Exporters to the EU whose applicable tariff has risen significantly.**
- **Companies that import from the EU or countries with trading relationship with the EU, where the tariff will rise.**
- **Companies experiencing new, lower-tariff competition from RoW competitors, either in the export market or selling into the UK.**

Against this, exporters might benefit from a fall in the pound widely expected in the event of no deal, and importers suffering from that an additional disadvantage. The likely size of the depreciation ranges widely and depends on policymakers' response; in its 2018 Financial Stability Report, the Bank of England assumed a 27% fall in sterling in its disruptive Brexit scenario, while other estimates put the likely fall at more like 10%.

Economic theory suggests that the imposition of a tariff would affect the exchange rate between two trading areas, and dull the effect of that tariff. The depreciation of sterling after a no-deal exit might in some cases outweigh the effect of new tariffs against UK exports, but also increase the pain felt by those UK companies reliant on

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imports. For some businesses – such as holiday companies with a UK cost base and importers of products made outside of the EU – the effect of a sterling depreciation might be the dominant effect of a no-deal Brexit.

For larger companies, all three effects might come into play. A manufacturer, for example, might find some imported components have risen in cost, the market for the final assembled product diminished by new EU tariffs, and new competition arising from RoW countries enjoying a lower tariff than before.

These effects might also generate beneficiaries. For example, a company that exported exclusively to markets outside of the EU and its current FTAs, or where the FTAs are being rolled over, might simply benefit from the fall in the pound. The domestic tourism sector might enjoy a boom, as holidays in the UK become a relative bargain.

### Exporters to the EU

Currently around half of the UK's exports of goods go to the EU, tariff-free; and perhaps a further 10–15% enjoy lower rates owing to preferential trade deals enjoyed via the EU, and not yet renegotiated between the UK and those countries.<sup>1</sup> Their re-imposition will be the first significant reversal of the long trend of tariff reductions that the UK has enjoyed in the post-war period.

For the great majority of businesses exporting into the EU, this will produce an adverse terms-of-trade shock – for the same underlying good, the same set of European customers will be obliged to pay an aggregate of between £4.5 billion (bn) and £6.0bn more. Overall, this represents only around 1.5% of the total value of UK exports to the EU, which if evenly spread would constitute a disadvantage, but not an existential one. However, the distribution of tariffs the UK will face is highly concentrated, with (for example) animal and food products facing between 10% and 25% on average, motor vehicles between 5% and 10%, and textiles less than 5%.

### Imports from the EU

There will also be a wholesale, temporary change in our current tariff regime.<sup>2</sup> Without this, purchases from the EU, which are around half of all our current imports and are currently tariff-free, would under WTO rules require the UK to apply the higher tariffs currently used for all countries with which it does not enjoy an FTA. The effect would be very costly, in the words of the government, “driving up prices for consumers and disrupting business supply chains”.<sup>3</sup>

In March, the government decided to apply a zero tariff to 87% of total imports by value in the event of no deal, but retain tariffs on the remaining 13% in order to protect key sectors from certain exposed sectors. These include a variety of animal products (beef, lamb, pork and poultry) and finished vehicles, but not automotive parts. It later updated this to 88%.<sup>4</sup>

Temporary increased import tariffs would disadvantage key categories of business, in particular classes of importers, such as car dealers importing from the EU. The Confederation of British Industry (CBI) offered the example of the fashion sector, which from Turkey (in a customs arrangement with the EU) alone imported almost £730 million (m) of products a year, tariff-free, and would face a 12% tariff.

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## Imports from beyond the EU

This new, lighter tariff schedule is to be introduced to forestall the damaging effect of higher UK import tariffs on the EU once it has become a 'third country' – outside the EU. However, their effect will knock on to other relationships, applying to imports from any country with which the UK does not enjoy a special FTA. So while the effect for the majority of EU imports will be a continuation of the current, zero-tariff status quo, it will for many other countries with which the UK trades mean a real elimination of the tariff altogether – and a whole new category of competition for UK-based producers.

This might apply to parts of UK agriculture; as the UK Trade Observatory, an academic research group, suggests, "liberalising these tariffs could result in a substantial increase in imports from new partner countries and increased competitive pressure on UK producer". In combination with the sharp rise in tariffs that would face UK food exports to the EU, the competitive position of UK farming would be put under severe strain.

Northern Ireland is where this might be extreme, with evidence to the Exiting the EU select committee warning of a "perfect storm" in which produce from north of the border would face tariffs moving south, while there would be none applied in the opposite direction.

Stephen Phipson, chief executive of Make UK, the manufacturers' organisation, said it was positive that some industries were now protected, but the overall effect would still be "decimating" for manufacturing as a whole.<sup>5</sup> The car manufacturer Nissan corroborated this when on 10 October it said the 10% export duties that would arise would render the business model of its entire European operation unsustainable.

## From the short to medium run

Decisions about import tariffs constitute a classic trade-off between consumer and producer interests. These are not new: they lay at the heart of the great Corn Laws debate of the 19th century, between the rural producers favouring a high tariff, the urban consuming class (workers and the manufacturers that employed them) campaigning for its abolition. Where we may identify industries exposed to new, lower-tariff competition, it should be borne in mind that consumers might benefit. Many of those consumers are themselves producers, a part of UK industry.

It is not always obvious what is in the interests of a particular industry faced with these contrary effects. It would not be surprising if the government revisited the decisions made by the previous administration in March 2019, in light of new strategic imperatives. After it published the no-deal tariff schedule, Canada made it clear that a major incentive to pursue a low-tariff trade deal with post-Brexit UK had gone.\* Given the centrality of new trade deals to the Brexit narrative, this may well be looked at again.

A company trading across UK borders therefore faces a number of knowable unknowns for actions that play out over a medium timeframe. The temporary tariff schedule might itself be subject to change, while the government puts in place its strategy for

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\* See Owen J, Rutter J and Thimont Jack M, *Preparing Brexit: No Deal*, Institute for Government, 29 July 2019, retrieved 14 October 2019, [www.instituteforgovernment.org.uk/publications/preparing-brexit-no-deal](http://www.instituteforgovernment.org.uk/publications/preparing-brexit-no-deal)

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agreeing new trade deals – with the EU but also with other key strategic markets, such as Japan and the USA.

The timing of any new deal with the EU itself is highly uncertain, and the likelihood of enduring 'interim' arrangements for specific markets is quite high. The level of tariffs set in such a deal will be subject to several kinds of uncertainty: the tussle between consumer and producer interests, when settling its negotiating objectives; the relative weight given to different markets (the US versus the EU); and then the success of the UK in achieving what it set out to do.

The 'Nike swoosh' assumes a definite, upward trajectory after the "bumps in the road".\* Uncertainty around the medium-term destination for tariffs means the chart resembles less of a swoosh than a widening fan, with probabilities ranging from a permanent state of higher tariffs to a resumption of something closer to the position from being in the EU.

### Conclusions on tariff changes

The sheep meat example focused upon by Michael Gove might suggest that tariff changes are among the more definite and calculable harms that might arise from a no-deal Brexit. Perhaps they are, but only in relative terms. Even an analysis limited purely to tariff changes reveals a more complex picture:

- Tariffs generate **winners and losers**, sometimes within the same sector.
- The effect of an **exchange rate** move will amplify some effects and dull others.
- The **medium-term position is inherently uncertain**, and subject to politics and negotiating hazard.
- **Not every business employs the same business model:** different companies facing the same headwinds can prepare themselves very differently, for example in how they source their products, their currency hedges and financial strategies, and the mix of different markets they choose to sell into – all commercially sensitive details.

The length of time and depth of analysis that is needed to construct a normal FTA gives us some indication of the sheer complexity of the calculation involved. If it takes many years for countries to weigh the benefits that may arise from lowering tariffs in a single bespoke agreement with a country the size of Canada, the challenge in doing the same but in reverse for an event like no deal, with the EU, is daunting. The clarity of those analyses implying an easily isolated harm, as with the UK's sheep meat industry, makes them the exception rather than the rule.

The UK has had just three years to build the capabilities needed to analyse the effects more broadly. The Institute for Government has advised in the past that it needs an independent analytical body to advise on trade; had this existed, it might have been

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\* For "bumps in the road" quote, see "Gove: No-deal Brexit will mean 'bumps in the road'", Reuters, 18 August 2019, <https://uk.reuters.com/article/uk-britain-eu-gove-nodeal/gove-no-deal-brexite-will-mean-bumps-in-the-road-idUKKCN1V80HR>

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able to produce an outline of the overall effects of the tariff and exchange rate changes upon various key sectors and thereby provide some guide as to where the most pressing harms for no deal might arise. But even if this had have existed, its conclusions would have to be tentative, no matter how well prepared.

While it is not feasible to assemble an exact list of all the effects from a sudden change in tariff policy (and certainly not at the level of granularity of the individual business), it ought to be possible to produce a rough and ready guide to the markets, both import and export, that will see the most dramatic change in tariff rates, and weigh them according to size and the exposure of the UK. The key is not to aim for an impossible level of precision *ex ante*, but to provide a starting point for analysis that needs to take into account a host of other factors, before any decision is made to ameliorate the harm if possible, or offer support if wise.

### **Loss of certification/regulatory approval and other non-tariff barriers**

Trading within the EU requires products and services to conform to EU rules and standards, underpinned by a regime of testing. There are thousands of these, together constituting a variable non-tariff barrier (NTB) for third countries newly attempting to export into the EU. Michael Gove has said that “the single biggest challenge in a no-deal exit is of course the existence of those [no deal] tariffs”.<sup>6</sup>

But experts such as UK in a Changing Europe assess the impact of NTBs to be more significant than tariffs:

**The bulk of the cost of doing business across borders comes from non-tariff barriers such as border checks, custom controls and compliance with different product standards and regulations across countries. These barriers cannot be removed unilaterally because they require trade partners to agree on a set of rules and regulations which they can both accept.**<sup>7</sup>

The UK Trade Observatory has assumed, in attempting to model the effects of a no-deal Brexit, that NTBs would increase the cost of trading between the UK and the EU by 3.5% of the value of a transaction. This is significantly higher than the cost from tariffs, estimated above to be 1.5% for the exports the UK makes to the EU. As with tariffs, the costs vary considerably by sector, and some analysts put the average burden considerably higher than 3.5%. For a thorough description of the range of effects by sector, see the Institute for Government’s report, [Understanding the Economic Effect of Brexit](#), Figure 4. For example, analysts put the impact of NTBs on chemicals and plastics at 12–13%, and food at between 14 and 20%.

Even more than tariffs, the possible harm caused by NTBs can be highly granular and dependent on the actions taken by the businesses affected. The manner in which this will hit a UK exporting business depends on the sector. The impact will range between the inconvenient and costly, such as a need to register a product in two jurisdictions rather than one, to the total elimination of a market as a commercial proposition. The reintroduction of a customs border also brings a general cost that will affect nearly every exporter, one that the government’s impact assessment puts at £15bn a year.<sup>8</sup>

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For a more qualitative sense of the scale of possible inconveniences, consider the guidance notes produced by the UK government for businesses to help them prepare for the UK's new trading relationship with Europe after Brexit. The webpage has over 190 documents, each of them covering some situation, sector or policy issue or regulatory imperative that is due to change in the event of Brexit.<sup>9</sup>

Their qualitative nature means it is hard to produce a straightforward figure for the impact upon any one sector. Evidence given to parliamentary committees and business organisations can only give a flavour of the kinds of impact to be expected:

- For **manufactured goods**, the requirement for a CE Mark (Conformité Européene) would in many cases require that products are re-authorised using notified bodies set up in EU member states. Failure to do this risks products placed on the EU market after Brexit being unsaleable. Many companies have already undertaken the work to do this, but given the scale of the task there would be many that lose access to the EU market.
- For **automobiles**, the UK's Vehicle Certification Agency would fall out of the EU ambit, and its approvals would no longer be valid on the European market, leading UK manufacturers needing to establish an approval with an EU-based body.
- For certain kinds of **food products**, the impact would likely arise from the need for more checks at the border, and the considerable burdens such as those of completing the Export Health Certificate process needed to put goods onto the EU market (the UK government has produced a useful, 15-stage flowchart to guide exporters through the process).
- **Chemicals and pharmaceutical companies** will need to have established approval for products in both UK and EU markets; the EU's Registration, Evaluation, Authorisation and Restriction of Chemicals (REACH) regulations will still apply, as well as the 'UK REACH' that the UK intends to put in place. The absence of the data needed for re-registering into the UK system might hold this up. The UK government has set out the processes for ensuring chemicals can still be put on the EU market<sup>10</sup> – two of them (checking for a valid REACH registration and Prior Informed Consent or Drug Precursor Chemicals checks) might take over two weeks, suggesting the risk of a short-term hiatus even for the most organised exporters.
- The CBI is stark on the risks to the UK's large **professional and business services sector**: many firms "will lose the legal basis to export to the EU overnight". The EU single market is much less complete for services, and rule-setting often more significant at the level of member states. The loss of mutual recognition of professional standards, new regulatory barriers and the need to set up new arrangements such as subsidiaries, would add an estimated 5–18% to the cost of doing business, according to the government's own analysis (these include

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restrictions on movements of business people and of data, discussed below).<sup>\*</sup> Industry representatives were unanimous in predicting a big increase in uncertainty, as professionals hitherto able to operate widely across the single market become at risk of acting unlawfully.

- **Aviation** provides an example of a sector where the UK and EU have together taken sufficient steps to diminish or even eliminate disruption in the days after a no-deal exit.<sup>11</sup> This does not remove all uncertainty, as industry still needs a longer-term agreement to replace one due to run out in October 2020, and a regulatory framework to replace membership of the European Union Aviation Safety Agency (EASA). Moreover, the interim measures will still represent a step down from current arrangements, for example because UK airlines will not have as much access to 'Fifth Freedom rights'.<sup>12</sup> Legal experts Maples argue that for the UK to build an independent framework would be a "Herculean task", one that would optimistically take from five to 10 years to produce.<sup>13</sup>

Exports to the EU will suffer a greater degree of harm, because they will undergo the most abrupt change in circumstances, shifting from a no-check, no-tariff environment straight into third-country status. However, it is always important to recall that the UK imports much more (in terms of goods) than it exports – in 2017, there were 117,000 companies exporting £162bn's worth of goods, with 160,000 companies importing £256bn's worth.

Recognising this, the government has taken several important unilateral actions in order not to impede imports unnecessarily, including the recognition of EU regulations both for products, key categories of services and data (see below).<sup>\*\*</sup> Long-term, the unilateral recognition of all EU standards is clearly not viable, not least in political terms, but it will make a big impact in terms of reducing disruption for the many businesses reliant on EU products and services, as well as flow of traffic at the border. As with the swathe of zero-rated tariffs to be introduced temporarily, this might pose some risks for companies in the UK that need to compete against EU-based rivals: a European company will have unimpeded access to both markets, unlike its UK equivalent. In any business where scale is an advantage, this may begin to weigh.

## Congestion at the border

Splitting the UK and EU into two customs territories will generate delays at the borders between the two; not just in order to ensure the correct tariffs have been applied and paid to the correct parties, but also to enforce the rules and standards that apply in the different areas.<sup>\*\*\*</sup>

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\* Found in 'The consequences of "No Deal" for UK business', 16 July 2019, House of Commons Exiting the EU Committee, <https://publications.parliament.uk/pa/cm201719/cmselect/cmexeu/2560/2560.pdf>, but reproducing work in HM Government, 'EU Exit Long-term economic analysis', November 2018, [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/760484/28\\_November\\_EU\\_Exit\\_-\\_Long-term\\_economic\\_analysis\\_\\_1\\_.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/760484/28_November_EU_Exit_-_Long-term_economic_analysis__1_.pdf)

\*\* There is a good discussion of this in Walsh D, 'Manageable but Material: The consequences of No Deal and how the Government should respond', OpenEurope, 4 October 2019, <https://openeurope.org.uk/today/blog/manageable-but-material-the-consequences-of-no-deal-and-how-the-government-should-respond>

\*\*\* For a fuller introduction to the topic, see Owen J, Shephard M, Stojanovic A, *Implementing Brexit: Customs*, Institute for Government, September 2017, [www.instituteforgovernment.org.uk/publications/implementing-brexits-customs-september-2017](http://www.instituteforgovernment.org.uk/publications/implementing-brexits-customs-september-2017)

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To quote the [Institute for Government's earlier report](#), these checks are all about:

preventing smuggling, making sure that animals aren't carrying diseases, checking that food is safe to eat, ensuring that chemicals are properly handled and car parts aren't faulty and, crucially, making sure that their domestic traders aren't being unfairly undercut.<sup>14</sup>

The operational challenge cannot be overstated. Two years ago, the Institute for Government reported that there are 180,000 traders who will need to make customs declarations for the first time after Brexit. The Dover crossing itself sees over 4m lorries passing through every year by ferry or Channel Tunnel. In ports facing the EU, where goods used to flow freely with barely a pause, there might be a hundred-fold increase in the number of customs checks required. While the UK may have some discretion over how it treats inward-arriving goods, the French side of the border is bound to treat goods arriving from the UK with much more onerous procedures.

Estimates of how bad the congestion will prove are themselves highly variable. The recent Project Yellowhammer release envisaged as a 'reasonable worst case' scenario<sup>15</sup> that between a half and five-sixths of all lorries might be unprepared for new customs procedures at the Dover crossing, leading to trade flows being cut by 40–60% from current levels. Some of the delays in Kent would reach 1.5–2.5 days. But research disclosed in January 2019 suggested trucks would face six-day queues if each were to be delayed by just 70 seconds for checks, with no noticeable queues if the delay were just 40 seconds.<sup>16</sup>

Most of the focus has been on the ports in Kent, with Operation Yellowhammer documents stating that outside of that county the risk of significant queuing is low. However, leaked Department for Transport documents suggest this benign outcome depended on a majority of vehicles simply not being allowed into the port area for a lack of compliant documentation.<sup>17</sup> Even where ports and other points of entry have improved or more lenient procedures, the upstream burden on companies to put in place the correct procedures for ensuring the right paperwork and payments have been completed will be considerable.\*

With the correct paperwork, such issues ought to be avoided, but one recent assessment is that just one in five companies are prepared.<sup>18</sup> Since the change of leadership, the government has greatly accelerated preparations and communication to the private sector, meaning any such survey may already be out of date.

The effect on business of congestion at the border, should it occur, would depend on the company in question. Goods stuck on a Kent motorway are a waste of working capital, tying up scarce cash. For businesses used to just-in-time standards, such as car

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\* In a letter to the *Financial Times*: "The responsibilities for fulfilling tax, duties, tariffs, customs declarations and clearances and passport requirements will all fall on trading companies, most of which are small companies with limited, if any, capacity to absorb or pass on the additional costs. There are approximately 220,000 trading companies in the UK — the majority of which only trade with Europe — and they have done no preparation at all." [www.ft.com/content/ca41fc50-2acd-11e9-88a4-c32129756dd8](http://www.ft.com/content/ca41fc50-2acd-11e9-88a4-c32129756dd8)

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manufacturing, it would risk raising the cost of doing business in the UK to a degree that would render it entirely uneconomic.\*

## Loss of access to personnel

To operate internationally, service companies need to use one of four different methods:

- selling directly across the border
- movement of the consumer to the service
- establishing a commercial presence in another country
- sending a worker to provide that service in the other country.

The last of these, 'Mode 4', is often raised as a risk to professional business services in a no-deal Brexit. The CBI mentions engineers, legal workers, technology experts and even sound technicians as the kinds of employee used to travelling freely where the work takes them, who might in future be impeded.

## Disruption of data flows

The smooth exchange of data is facilitated by the UK being part of the EU legal system. The sudden switch of the UK into a third country for this purpose would, in the view of the CBI, be as impactful as the widely anticipated disruption at ports, with the effect felt through the loss of contracts in an environment of legal uncertainty.<sup>19</sup> The government has taken steps to warn companies of their need to review contracts in light of a no-deal Brexit.<sup>20</sup> This is a reminder that the UK's state of preparedness depends very much on how aware companies are of the problem, and how energetic they are in addressing it proactively.

It is expected that the UK and EU will agree a data-adequacy decision over the medium term – one of the tasks set aside for the transition period if the UK leaves the EU with a deal. The shortest period in which a third country has agreed such an agreement with the EU so far is 18 months, according to UK trade body TechUK.

The UK is a global leader in the business of data itself, hosting data centres and leading technology clusters in London and elsewhere. The McKinsey Global Institute has estimated the value of cross-border data flows at 3.8% of global GDP;<sup>21</sup> the UK's own data centre market is worth an estimated £73bn, according to the CBI. But practically every services company is now in some sense a data company too, and so anything impeding the flow of information might hurt a much wider variety of companies; from architectural practices and legal firms, to tour operators and the conduct of clinical trials.

In the words of *The Times*, intra-EU flows of data 'allow online banking, e-commerce and the back-office functions of thousands of businesses to continue. In a no-deal scenario it will become illegal for European bodies to transfer such personal

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\* SMMT, 'EU Automotive leaders unite to say "no" to 'no deal' Brexit', September 2019, [www.smmmt.co.uk/2019/09/eu-automotive-leaders-unite-to-say-no-to-no-deal-brexit](http://www.smmmt.co.uk/2019/09/eu-automotive-leaders-unite-to-say-no-to-no-deal-brexit) quotes the cost of one minute's delay at £50,000, worked out from £70m a week.

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information to the UK.<sup>22</sup> The disruption does not impact service businesses alone, for example, the chemicals industry raised the matter of data sharing for ensuring what they call 'pharmacovigilance', and the rules underpinning the creation of unique barcodes that prevent the distribution of unsafe medicines.\*

The nature of the harms caused via data flows if there is a no-deal Brexit are hard to assess. A recent *Wired* magazine article warned that 'if no-deal happens, the UK could spend years in a data limbo'.<sup>23</sup> Transfers of data to the EU would proceed as before, owing to a unilateral decision of the UK government. But the opposite flow would be impeded by legal uncertainty, and organisations would have to take steps to agree particular legal mechanisms to ensure it could continue, at a high cost in terms of money, resources and bureaucracy.<sup>24</sup> The costs would be proportionally heavier for smaller companies to bear, a particular problem in a sector dominated by small- and medium-sized enterprises. A failure to comply with new procedures would put companies at risk of enforcement action and fines from EU regulators.

Wired concludes that an 'apocalyptic data freeze' is unlikely on the day after a no-deal Brexit; the massive tech companies will have the resources to put in place the new procedures and legal protections required to keep EU–UK data flowing. The impact is more likely to manifest itself in terms of legal uncertainty, added cost and lost business for smaller companies. This is another policy area where the timeline will be dependent on the uncertain question of a longer-term EU–UK agreement.

In the short term, some activities will cease while their legal status is explored, and then restart or not depending on whether the added costs and risks are deemed to be worthwhile. In the medium term, the damage might be felt as much through the loss of competitive rigour as smaller companies balk at the added burden; a TechUK survey in mid-September reported 87% of large businesses being fairly or well prepared for no deal, but just 43% of smaller companies.<sup>25</sup>

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\* In evidence to the House of Commons Exiting the EU Committee.

### 3. Who is hurt?

Given the variety of sources of harm, it would be impractical for government to design its support according to what exact channel of disruption has hit a business; from this point of view, the sheep headage payment for tariff damage is very much the exception to the rule. Instead we have attempted a division of the harms in terms of what kind of distress they will be in: short-term cash issues, and demand and supply concerns over a longer period.

**Table 1: Illustrative no-deal harms for selected sectors**

Sector	Cashflow crisis	Temporary demand problem	Temporary supply problem	Longer-term demand problem	Longer-term supply problem
<b>Foodstuffs and agriculture</b>	Tariffs for exporting to the EU, higher cost inputs, possible slow borders tie up product.	Yes – immediate terms of trade hit for exposed agricultural sectors, uncertainty around certification, rollovers of FTAs.	Short-term issues with availability of labour, disruption from perishable goods at the border.	Depends on the nature of the EU trade agreement and broader FTAs.	Depends on the sub-sector, but loss of access to personnel could hamper, loss of subsidies (key part of agricultural business model).
<b>High-value manufacturing e.g. cars, aerospace</b>	Tariff issues on both import and export side. Problems at border. Possible immediate non tariff barrier issues. Hundreds of millions has been spent in preparation by large firms but cannot rule out issues in broader supply.	Yes – immediate terms of trade hit through tariffs, uncertainty around certification, and loss of place in EU-wide supply chains.	Yes – just-in-time manufacturing techniques put under pressure by slower borders and more checking, and loss of viability if excluded from EU supply chains. Figure of £70m a day for automotive.	Depends on the nature of the EU trade agreement and broader FTAs. Position in global supply chains uncertain in e.g. aerospace.	Depends on multiple sectoral agreements and ability to source from elsewhere competitively. Automotive costs up to £1bn a year more through tariffs if no deal persists.

Sector	Cashflow crisis	Temporary demand problem	Temporary supply problem	Longer-term demand problem	Longer-term supply problem
Professional business services	No – services businesses generally lower in working capital.	Definite hiatus while new regulatory arrangements are tested and established, provisional agreements in sub-sectors.	Hurt by short-term loss of agreements in data and personnel such as Mode 4 (less for movement into UK, but some functions require easy movement into EU).	Possibly, depending on access to EU services market and success building non-EU position.	Depends on the sub-sector, but loss of access to highly skilled personnel could hamper growth. Could lose staff with specific language skills and familiarity with others' national rules. Possibly better access to non-EU staff as a mitigation
Transport: haulage	Yes – queues lead to capital tied up. Sudden loss of contracts in the absence of permits.	Yes – expect precautionary slowing of business, particularly during the time needed to become familiar with new procedures, and establish whether customers will cover costs	Depends on ability of widely dispersed industry to adapt to new procedures at the borders. Currently expecting >50% fail to execute correctly. Loss of cabotage will make the business more expensive.	Slight. Some loss of transit from the UK losing position in global supply chains.	New operating procedures ought to be manageable over a longer time period.
Transport: aviation	No – short-term arrangements in aviation rolled over, although EU unilateral action and therefore less stable.	No	No	Possibly, depending on the agreement struck with the EU.	

Sector	Cashflow crisis	Temporary demand problem	Temporary supply problem	Longer-term demand problem	Longer-term supply problem
<b>Health and social care</b>	Has stockpiled medicines to considerable degree, so less risk than average, but largely dependent on private sector supply chains.	No	Possible. Some drugs cannot be stockpiled so border congestion puts business at risk. Testing of new products at risk from loss of easy movement of data. There are around 500,000 different devices and medicines, which makes planning hard.	Loss of access to EU projects likely (the Innovative Medicines Project).	UK has structural strengths in the R&D environment and clusters but additional frictions from exclusion from European Medicines Agency will likely bite. Duplicate costs, loss of easy movement of personnel.
<b>Financial services</b>	No – short-term access rights have been assured, considerable investment made in preparing.	Some. Some markets like insurance still suffer from inconsistent regulatory approaches across EU.	Some, as uncertainty around ease of movement of people and data around the EU likely to have an effect.	Possibly: UK could lose status as financial hub for the EU longer term, depends on unknowable changes in future regulation at EU and UK level as well.	Very dependent on personnel, long-term agreements on movement of highly skilled.
<b>Technology, media, telecoms</b>	Probably less risk – technology firms tend to be lower capital.	Yes. Immediate third country status, requiring possible country-by-country agreements in EU member states.	Yes – short-term loss of agreements in data and personnel such as Mode 4. Requirement to duplicate compliance adds cost.	If failure to re-establish data rules is longstanding, UK could lose attractiveness as destination for data-rich companies. Could suffer from standing outside the Digital Single Market strategy.	Possibly, depending on course of regulation and data rules, though UK's structural strengths are good. Rules for digital content could become more expensive to enforce.
<b>Retail</b>	Possibly: higher import tariffs, product stuck in queues, general loss of confidence. Difficult time of year to stockpile.	Depends upon macroeconomic response and general economic confidence.	Serious: depending on success at clearing up issues at the ports, success of stockpiling. Delays at border cost hundreds of pounds per lorry.	No – largely dependent on domestic demand (although structural adjustment to online ought to see high degree of churn anyway).	Possible, depending on final tariff agreements with the EU. Personnel issues if migration tight. Ability to establish alternative sources of supply.

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## **Conclusions: nothing as simple as a list, not as straightforward as a tariff**

The foregoing discussion is only a brief *tour du horizon* of the impacts likely to arise from a sudden no-deal Brexit. There is still considerable uncertainty about the overall impact; indeed, the fact of irreducible uncertainty is one of the clear conclusions from the report thus far.\* There are two areas of particular uncertainty that will condition the government's response.

The first concerns which businesses will be affected. Given the multiple sources of harm, varying degrees of preparedness and wide-ranging business models, a clearly demarked list of companies at risk is not even a theoretical possibility. A great many businesses themselves do not yet know their own vulnerability and many would not know until after Brexit happened. The government cannot expect to either. There are over 200,000 UK businesses who trade internationally, and many more that might be indirectly affected. A finite list of companies to be attended to after no-deal Brexit is also an inherently pro-big-business policy, because it is impossible to list the tens of thousands of smaller companies affected.

This is not to advise against government departments taking steps to learn which companies they think will be at greatest risk – perhaps this is all that is meant by the rumoured, secret, list of companies considered vulnerable – but they should expect issues to arise from beyond what they prepare for.<sup>1</sup>

The second is the range of impacts, in terms of quantum and persistence. At a macroeconomic level, economic models assume an immediate impact from tariff and non-tariff barriers that is gradually overcome in the years afterwards. At a sectoral and business level it will be much messier. For some companies, the disruption brought about by a no-deal Brexit will be merely a passing inconvenience, or even an opportunity. For some others, it may signal an unavoidable need to exit a market altogether. Between these extremes lie the situations where the case for support is strongest.

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\* See for example, International Monetary Fund, *World Economic Outlook report*, April 2019, [www.imf.org/en/Publications/WEO/Issues/2019/10/01/world-economic-outlook-october-2019](http://www.imf.org/en/Publications/WEO/Issues/2019/10/01/world-economic-outlook-october-2019)

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# 3. How government should support business in a no-deal Brexit: the principles and dilemmas

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In a free-market economy, the government is prevented from unconstrained support for business by a variety of rules and self-denying ordinances. These are in place for good, common-sense reasons that range from the need to guard against corruption or favouritism, the requirement to consider value for money and alternative means of policy delivery, through to the national and international rules against unfair subsidy and distortion of the market.

Nevertheless, billions of pounds manage to flow from government to business in pursuit of various important policy objectives, from the need to boost workplace skills or research and development; regional regeneration; or the pursuit of social or environmental objectives. Often the role for politics is distant and strategic: the political process approves the overall spending and its objective, the creation of the organisations directly responsible and rules for their accountability; but then the actual turning of the wheels takes place at arm's length. Funds are sometimes competed for, making the need for distance between politicians and participants especially important.

In the case of no-deal Brexit support, it is clear that much will have to be decided reactively, as its impact is hard to predict in advance. This makes the establishment of principles to guide the intervention essential, and for the scheme to have a wide scope, as there may be thousands of different situations to appraise and manage.

This report does not intend to dictate what these principles should be, but highlight the decisions the government needs to take to establish them, and the dilemmas it will face.

First, the **broad objectives** of the support should be made clear. There are several possible candidates:

1. To keep **businesses operational that otherwise might fail** because of a no-deal-induced cash crisis. The economic rationale is that it is wasteful for capital, labour and knowledge to be scrapped if not really obsolete. An industry's long-term viability may be damaged if allowed to operate far below its potential for a number of years. Workers lose skills, supply chains cease to operate, markets and important implicit knowledge are lost – what might be called 'business hysteresis'. There might be a political rationale too: business failure is invariably hard for the owners and people concerned, and the government may understandably want to keep such disruption to a minimum.

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2. To **maintain the UK's place in key EU markets** that might be lost because of the sudden imposition of one-off costs, such as the need to recertify goods as conforming to EU standards, or to train staff and invest in the IT needed in new customs procedures.
  3. To cover a **loss-making period (expected to prove temporary) while new deals are agreed**. For example, an industry might be hit by extra procedures or tariffs that can be expected to go away once some sectoral or trade agreement is struck. In the meantime it operates at a loss, but as in the first category, the government might judge a permanent loss of market position as a waste.
  4. To **reorient the UK towards new markets post-Brexit**: higher barrier to EU trade and a more competitive currency might open up opportunities in other non-EU markets, but this may require investment.

These objectives would each normally require a different policy suite, which we discuss in the next section.

Each objective is attractive on its own merits, but they will in places clash against one another. For example, the process of insolvency is impeded by objective 1, but may be a key part of objective 4 (creative destruction is a natural process for any economy, particularly one undergoing a transition). They are also expensive, and will compete with one another for limited resources.

There are other values and objectives that will constrain the pursuit of these objectives:

- The need for **the support to be effective**. In other words, will the support make a difference? As discussed earlier, no-deal situations will range from mere bump in the road to terminal decline. Support funnelled towards businesses that do not need it to survive is a waste, but so too is any directed where the company is going to fail come what may. This makes business case appraisal unavoidable.
- This has to be weighed against the need for support to be **timely**. For companies facing a cash crunch, it is little use for the support to go through the painstaking appraisal that would usually attend an equity investment aimed at expanding into a new market.
- The need for effectiveness also means that the support has to be designed **with a realistic assessment of the UK's likely post-Brexit trajectory**. This has to go beyond a simple macroeconomic forecast – different sectors will face very different short-term harms and medium-term recoveries. In political terms, this is harder than it may sound; it would take a brave politician to announce in advance that a particular sector is unlikely to be competitive in the next five years, and so cannot expect support. Against this, if the UK or some sub-sector is expected to resume normal relations with the EU in quite a short period of time, some kinds of support might prove a waste, for example, setting up an overseas office that is not then needed.
- Support will also need to be weighed up against **state aid constraints**. The UK will not be free of all state aid rules after Brexit and, even if free of the direct

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jurisdiction of the EU, will need to bear in mind WTO rules, and its need to strike a future agreement with the EU.<sup>1</sup>

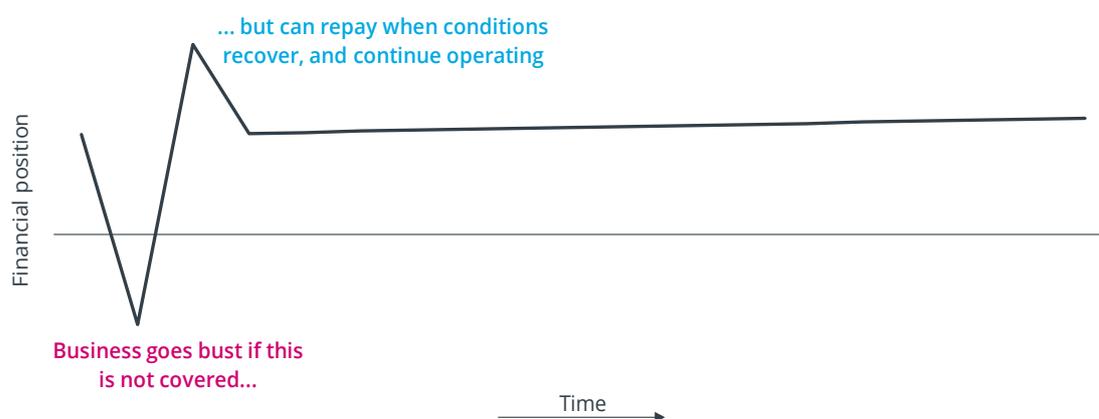
- State aid rules are just the formal manifestation of the imperative to **maintain fair competition within the UK**. Help from the government may provide an unfair advantage to the beneficiary. Imagine, for example, a company that competes across the UK that is provided with financial support to help with the new additional costs needed for accessing the EU market. This might well help it retain a foothold in the EU, but also provide it with the means to compete harder in England against some of its rivals there.
- Related to this is the risk of **moral hazard**. There is a vast amount of preparation required for no deal, but *ex-post* compensation for its damaging effects may discourage companies from undertaking the expense. The suggestion that the government will 'make good' on any harm that is caused is akin to an insurance company promising the cover without demanding the premiums up front. No-deal preparations are costly, and any hint that they might not need to be borne will be picked up by cost-constrained business. Moral hazard might apply beyond companies: if no deal is a real possibility, banks ought to be taking a more cautious approach towards lending, but they will be less inclined to do so if they think the sort of cashflow risks they are meant to guard against will be handled by the government later. Promising to step up just as banks or other sources of private finance are stepping back, without sufficient conditions, would run the risk of the government becoming a lender of first recourse rather than last resort.
- The government should remember the saying in the financial markets that a long-term position is just a short-term gamble that went wrong. Government short-term relief may well, if unsuccessful, morph into long-term support. This possibility, and constraints that will inevitably force it to prioritise, means that the **government should weigh up its long-term industrial strategy** even when designing its short-term schemes.
- Finally, there is the question of **fairness**. Government support that is not justified by strong objectives is unfair to all the non-recipients. It is easy to imagine that in a crisis a government can be blithe and adopt an all-hands-to-the-pump style generosity. It really cannot. Badly designed, a cheap loan or grant enriches business owners to no useful end, and from scarce public resources. As set out in a recent chapter from the Institute for Fiscal Studies' *Green Book*, even in a benign no deal the deficit is likely to hit 4% of GDP in the fiscal year 2021/22, which would require further fiscal tightening in the subsequent years.<sup>2</sup> This will happen as the UK enters a long period where its ageing population is forecast to add 9% of GDP to public spending over 50 years, or around £3.6bn a year. Business support also competes against other kinds of economic support that might be more effective at reaching people. Whatever one's fiscal stance, funds being sent to business unnecessarily is done at the expense of other important calls on the public purse.

## 4. How should the support be delivered?

Government already has in its armoury a variety of channels for business support, from cash grants and tax reliefs to direct loans and equity, delivered at every level of government and with very different objectives in mind. None, however, match up to the unique circumstances of a no-deal Brexit. The case for each is very different; it makes sense to divide the nature of support into broad categories to match the situation.

The first category is for those companies complaining of a sudden cashflow problem: one key difference between a disorderly no-deal Brexit and a managed exit is the real risk of liquidity crises for companies with insufficient time to prepare. Such crises could arise from the sudden need to adjust to tariffs, the temporary loss of a contract, congestion at the border tying up capital, glitches in the VAT system – or simply being a part of a supply chain that has experienced a variety of these.

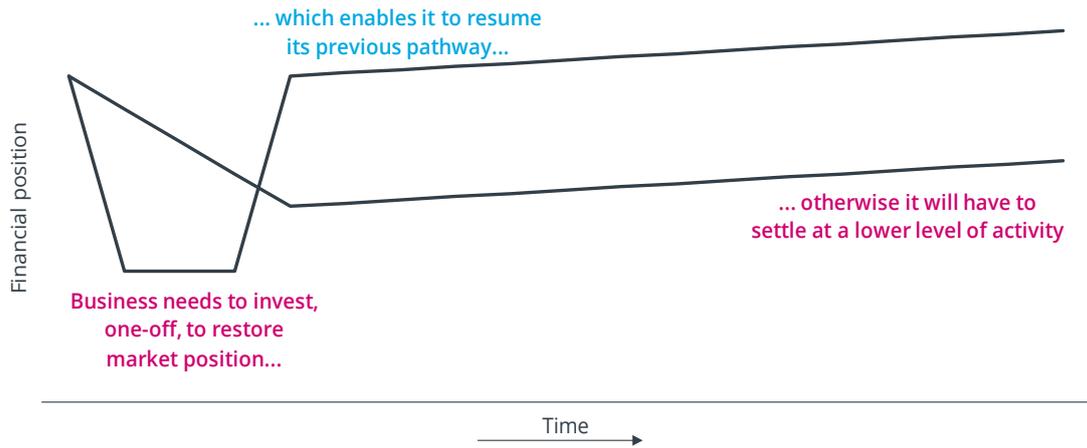
**Figure 5: Category 1 – cashflow crisis**



Source: Institute for Government analysis.

The second category is the provision of one-off cash grants to help companies take the steps to restore their competitive position in the face of (presumably) temporary impositions: for example, the need to establish a new overseas licence or training to adapt the workforce to new procedures.

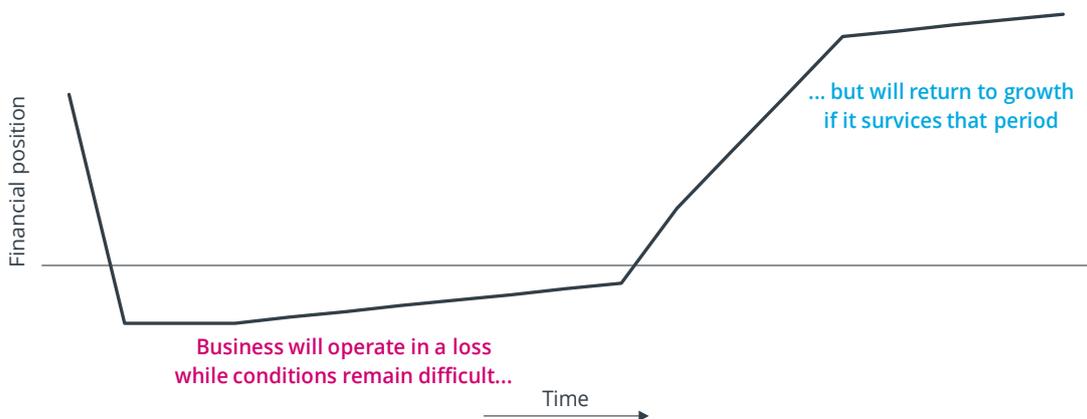
**Figure 6: Category 2 – support to restore market position**



Source: Institute for Government analysis.

The third category is support while the ongoing costs of business are higher, for as long as those costs continue, on the assumption that they will come to an end when more stable arrangements are made with the EU or other trading partners.

**Figure 7: Category 3 – support while adverse conditions remain**



Source: Institute for Government analysis.

Finally, as a longer-term agenda, the government needs a fresh look at the schemes it has in place to reorient the economy and restore the position of businesses hit by a permanent supply problem in the face of Brexit. But here the topic of emergency government support blends into the broader question of industrial strategy. It will be intrinsically linked to the question of what kind of deal the UK eventually strikes with the EU and other trading partners, and deserves a fuller treatment.

Each of these categories need to operate in a different way.

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## **Drawing the line: what counts as 'affected by no-deal Brexit'?**

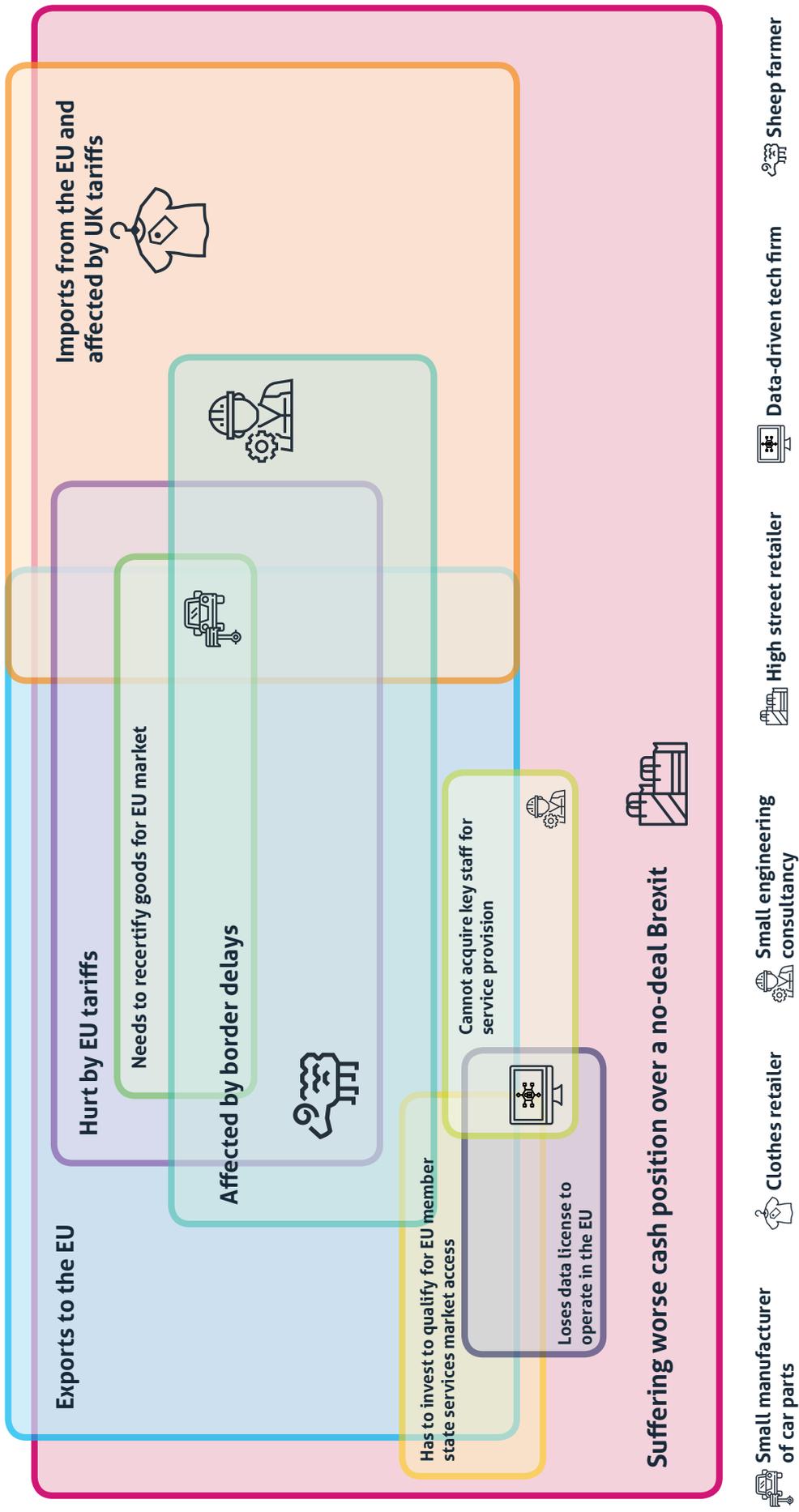
When deciding how expansive to be in its support, a key factor is the government's judgement on the impact of a no-deal Brexit. Companies in a vibrant economy like the UK's are continually undergoing cash crises; needing to invest in new skills or marketing, paying for legal advice, or gambling on a new overseas market. They often find themselves suffering a competitive disadvantage and must decide whether to endure it for a period of losses, exit entirely, or invest heavily in a programme of restructuring.

In other words, categories 1 to 4 are situations typical of what business constantly has to go through. A no-deal Brexit should not mean the government must suddenly share the burden of all this normal private sector activity, which would be ruinously expensive, slow and terrible for competition. It needs to know where to draw the line.

The discussion of varieties of harm ought to make clear that this is a matter of judgment. A no-deal Brexit is widely expected to trigger a spell of macroeconomic weakness; forecasts from the Office for Budget Responsibility (OBR) and the Bank of England put the short-term loss in real GDP at between 2% and 5%, depending on the severity of the scenario. Such weakness would normally be met by a high-level monetary or fiscal response – not measures aimed at individual businesses. It will also coincide with other structural changes to the economy, such as the decline of the high street or the ongoing fall in diesel car sales.

The criteria to be used must therefore be narrower than the business in question having a rough month or even year. Ideally, the business ought to be able to show some kind of link to the effect of tariffs, non-tariff barriers or border congestion in order to justify government support. Figure 8, overleaf, is highly stylised, but shows the number of overlapping categories that may need to be taken into account when the government's frontline staff has to decide on offering support.

Figure 8: Overlapping effects of a no-deal Brexit



Source: Institute for Government analysis.

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## 1. Cashflow support

Cashflow support must above all be simple and quick to administer, and with clear conditions, targeted on the companies that need it most. When the point is to avoid businesses needlessly going bust, the scheme cannot take months to operate. But it must have enough conditionality to reach the companies that really need it. Generally this will mean smaller companies, that are directly affected by a no-deal Brexit, which in most cases will mean those exposed to EU trade through the Short Straits or across the Northern Irish border.

There are two obvious channels that come closest to fulfilling these conditions.

### Support through the tax system

Most companies in financial distress owe the taxman money. As in the financial crisis, the government can help HMRC be more lenient in its operation of the 'Time to Pay' scheme, which after being introduced in November 2008 helped over 440,000 businesses spread £7.5bn of payments over a longer timetable, with an average amount owed around £17,000. Most of the arrangements were for 6–12 months. A clear advantage of this kind of help is that HMRC already has a relationship with every business, and is one of the bodies likely to become aware of a cashflow crisis with a company.

The Time to Pay scheme came with a number of conditions and clear discretion on the side of HMRC in assessing who should qualify. The basic judgement concerns whether the company has a viable plan for resuming tax payments.<sup>1</sup> In particular:

- Can the company forecast sales to the requisite level?
- Does it have plans for cutting costs?
- Is the business in a high-risk area?
- Has the company a decent record of compliance and account-keeping?

These are all difficult judgements, and could be complicated by a no-deal Brexit, which itself might make forecasting sales, costs and the riskiness of a business line impossible.

### Support through the banking system

Banks will generally be the first to know about a company in distress. No matter what leniency the government urges them to show to companies, most banks facing an unpredictable situation like a no-deal Brexit will tighten lending criteria, and will need support if they are to judiciously extend loan terms. During the financial crisis, banks were able to extend the help they provide through guarantee schemes like the Enterprise Finance Guarantee (EFG). This guaranteed three-quarters of a loan amount in return for a fee. The average loan size in 2009 was close to £100,000, significantly more than the HMRC scheme, and in 2013 over 6,000 businesses were helped in this way, to a total exposure of £668m.

Evaluations found the EFG to have been effective.<sup>2</sup> The government and the British Business Bank (created in 2014), which is effectively the delivery arm for the EFG, are

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considering options for its expansion.<sup>3</sup> In doing so, they need to make a decision about fees (the charge is 2% at present) and scope (currently only companies with a turnover less than £41m are eligible). Andrea Leadsom, the business secretary, and John Glen, the economic secretary to the Treasury, have recently set up a Business Finance Council, broadly representative of the UK lending industry. This would be an ideal forum to establish answers to the points above, and ensure consistent communication of the purpose and scope of any such schemes the government launches.

This first category of cashflow support always comes with conditions. The businesses in question need to show a clear plan for recovery – currently the case both for Time to Pay and the EFG. In this case, they also ought to be able to show that the distress leading to the cashflow problem has a clear link with a no-deal Brexit. However, both these conditions come with a clear trade-off against the speed of decision required. The backdrop of no deal will also make adjudicating the quality of business plans much more difficult, since the companies in question will have to evaluate the probability of circumstances returning to a more normal situation within a reasonable length of time.

The government could consider raising the £41m revenue limit, if it is prepared also to raise significantly the financial cover it has provided to the EFG. But we would caution against operating without any limit at all. There is a well established case for intervening in the provision of finance to smaller companies – their size means the fixed costs behind establishing their creditworthiness are often not commercial for a bank. For larger companies the case is less clear.

Finally, **the schemes must not be so generous that they are preferred to ordinary private sector support.** As the recovery becomes apparent, uncertainty reduces and banks resume their normal behaviour, the government should retain the right to raise the rates and fees it charges, so that companies that draw on its support enjoy no advantage and transition back towards the private sector.

The Resolution Foundation has called for an expansive approach, calling for '£20 billion in government-guaranteed loans of up to one year (2020-21) to help viable firms cope with temporary disruptions.... HMRC could also extend grace periods for the payment of VAT and employer National Insurance Contributions'.<sup>4</sup>

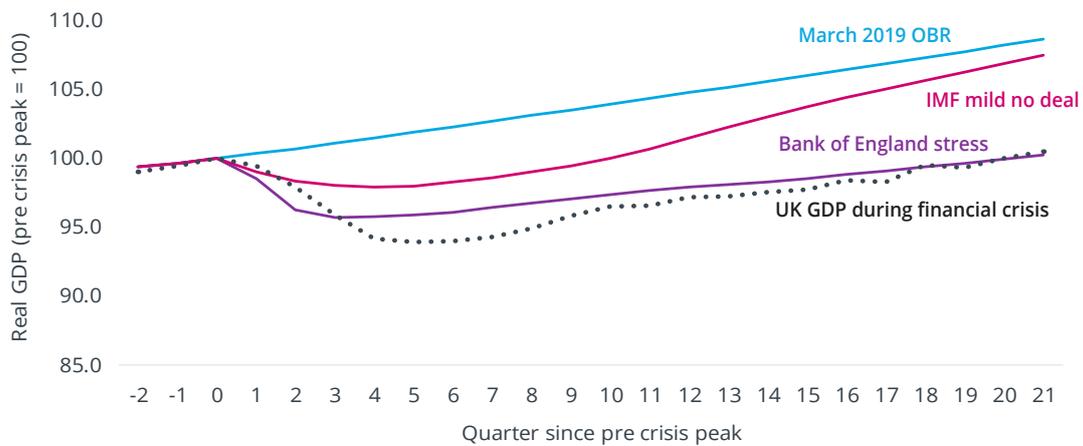
Having made such a promise to help companies, and being acutely aware of the political imperative behind making a success – or less of a disaster – of a no-deal Brexit, it will be tempting for the government to design its cashflow support schemes in as expansive a manner as possible. We would caution against such a course. An amount of £20bn represents over 20 times what was set aside for the EFG during the financial crisis, which was a worse macroeconomic event than most estimates regarding even a difficult no deal (see Figure 9). The more a scheme is extended, the worse value for money it is likely to prove, as its extent shifts from clear qualifying candidates to marginal cases.

Badly designed, such support might be expensive, help the less efficient companies at the expense of the better prepared and damage the UK's single market. It can also put

the government, or one of its agents, on the hook for the decision as to whether a business survives or falls, an invidious position and politically very hard to handle. The prudent approach is to plan for the worst: a simple, short-term recovery is far from the most likely scenario, at least not for every sector affected.

The broader macroeconomy may take a sustained hit. Analysis from the Bank of England and the OBR portray scenarios in which a disruptive exit might see the UK take between two and five years to recover its previous levels of real GDP. Note that while serious, most estimates of the immediate fallout of a no-deal Brexit would not produce a contraction as deep as that which accompanied the financial crisis, which saw GDP fall by over 6% in less than a year.

**Figure 9: Two macro pathways for no deal**



Source: Institute for Government analysis.

As discussed earlier, different categories of harm would deliver impacts along very different time profiles. This means very different judgments would need to be made for each of the sectors affected. The guidance the government would need to provide would have to be much more granular: a different assumption for a chemicals exporter versus a car importer, for example. It should be remembered that loans or forbearance from banks or HMRC are meant to be repayable with a high degree of certainty. HMRC is not a grant-providing body. If the support looks likely to last too long, other forms of support are more appropriate.

## The Enterprise Finance Guarantee

The Enterprise Finance Guarantee (EFG) is a scheme that was expanded during the financial crisis.\* It worked by guaranteeing bank loans, removing some of the 'tail' risk for banks. Its rationale reflected the context of the credit crunch – 'to address the market failure in the provision of debt finance, whereby viable businesses are unable to obtain normal commercial loans, because they lack adequate security or a proven financial track record'. Loans come with considerable conditionality.<sup>5</sup> It was originally meant for companies with a 'sound borrowing proposal but inadequate security', and was aimed more at companies considering an expansion but disadvantaged by banks' risk-averse criteria.

## The aftermath of the 2008/09 crisis

One of the immediate effects of the financial crisis that was at its worst 10 years ago was a sharp contraction in lending to the business sector by banks, in particular for smaller companies.

In the wake of the government's across-the-board support for the banking sector (from direct recapitalisations, subsidised lending and lending guarantees to the broader effect of quantitative easing), there was considerable pressure on the banks to continue to support the small business sector.<sup>6</sup> This led to policy ideas such as Project Merlin, a broad agreement to impose lending targets on the largest banks. The targets were generally missed.<sup>7</sup> The government also stepped in with its own schemes. In the early days of the crisis, these attempted to address specific parts of the financial system that had ceased to function, such as trade credit insurance, before (under the coalition government) moving onto specific schemes aimed at the small- and medium-sized enterprise (SME) sector itself, culminating in the creation of the British Business Bank as a single focal point for all SME lending schemes. There were also attempts to diversify the sector away from a reliance on banks alone, as investigated in a 2012 report by insurance executive Tim Breedon.<sup>8</sup>

The continuing fall in SME lending makes it tempting to judge these schemes a failure, but this would ignore the number of different factors that need to be unravelled. Banks certainly became more risk-averse towards lending in general, in light of the existential threat to their own liquidity and solvency – this was essentially the first major effect of the financial crisis. They also had to battle increased regulatory standards, including higher capital requirements, and a weaker economy and property market that rendered most lending ideas less attractive. These macroeconomic effects will have also manifested themselves in the form of lower demand from the SMEs for loans, and hence a contracting quantum of outstanding lending. A National Institute of Economic and Social

\* See Smallbusiness.com, 'Government mulls small business funds to limit impact of no-deal Brexit', 2 September 2019, <https://smallbusiness.co.uk/government-mulls-small-business-funds-to-limit-impact-of-no-deal-brex-2548398>

Research (NIESR) study found a reduced enthusiasm from banks for SME loans, but this is almost inevitable given the trouble caused by their poor lending decisions before the crisis.<sup>9</sup>

The British Business Bank is generally judged a success, but it is not a bank in the traditional sense of an entity capable of expanding its balance sheet through money-creation.<sup>10</sup> Rather, it is a centre for expertise, an organisation capable of bringing together the administration of myriad schemes, and co-funder of fund managers who themselves seek out growth ideas. It is likely to play a key role in the delivery of longer-term finance for the UK economy post-Brexit, but it was not set up principally for emergency or working-capital funding.

The response to the financial crisis provides the best recent episode to learn from policy makers when designing measures for a no-deal Brexit. However, the comparison is far from perfect. The financial crisis was a bank-centred event, and the measures overwhelmingly focused upon that channel. Going into Brexit, the UK banking system is much better capitalised and safer in terms of liquidity than it was in 2008.<sup>11</sup> In 2008-10, there was little risk that the government might be 'crowding out' the banks in offering support to business; the banks were retreating anyway, and support from the state needed to fill a gap. This time around, a lack of support from a bank might indicate a genuine concern, a situation where even a bank with perfectly adequate capital and liquidity might balk at offering finance.

## **2. One-off spending to restore competitiveness/market access**

A no-deal Brexit will see the sudden imposition of a variety of non-tariff barriers (NTBs) for companies exporting to the EU. As set out above, experts such as UK in a Changing Europe see these as making up the 'bulk of the cost of doing business across borders', listing as examples border checks, custom controls and compliance with different product standards and regulations across countries, and noting that such barriers cannot be removed unilaterally, given the need for trade partners to agree the rules and regulations. Together, these NTBs are expected to increase the cost of trading between the UK and the EU by 3.5% of the value of a transaction, or over twice the estimated impact of tariffs.

The variable impact of NTBs makes their mitigation a highly complex challenge. Sometimes the damage will be one-off (such as the need to open an extra office in the single market, or train staff in how to manage new customs procedures) and sometimes ongoing (for example a permanent expectation of slower movement of goods across borders). The harm brought about will often be more frictional than the urgent cashflow crisis, but longer lasting. The most straightforward way to help with temporary, one-off costs of this nature is through a simple grant. There are no situations similar to a no-deal Brexit in recent history, but an analogy might be found in how the government typically goes about helping a region hit by a localised shock, such as the closure of a big industrial plant.

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One example, in 2015, is the Department of Business, Energy and Industrial Strategy providing £80m to help local workers and businesses adjust to the liquidation of the Redcar steel plant.<sup>12</sup>

The harm brought about here is less acute than an urgent cashflow crisis, but still important, as a failure to ameliorate it might permanently damage the UK's trading position.

According to a survey from the Federation of Small Businesses (FSB), smaller businesses that import and export have already spent £3,000 in preparing for no deal. The FSB has called for Brexit vouchers worth around that much to be made available to small firms, including as a way to support small companies trying to expand into global markets. A year ago, the Institute of Directors suggested something similar – 'Brexit planning vouchers' to be spent on advisory services from approved suppliers.<sup>13</sup> If just half of the 200,000 or so smaller companies that trade with the EU were included, the cost of such a scheme would be £300m. To put that figure in context, the entire programme budget of the Department of International Trade is currently just less than £300m; however well-designed, it is difficult to disburse such a quantity of money well.

The government might consider grant support in the mode of what the FSB has called for, but it is unlikely that a broadly spread, unconditional voucher scheme will be very effective. In many cases it will be non-additional – companies have already spent varying sums preparing. In other cases it will be ineffective – if the ongoing cost of a non-tariff barrier is around 3.5% of exports, a £1m exporter will suffer a detriment of £35,000 a year, and it is unlikely that one-off investments of just a tenth of that will be able to mitigate whatever brought about that impediment. £3,000 is around the amount the government usually grants to a company to help attend a trade show, not address a serious legal or regulatory barrier to doing business at all.<sup>14</sup> Against that, the existence of a voucher scheme might be enough to prod smaller companies towards investigating their no-deal risks and preparing for them.

While remaining restricted to smaller companies, a better designed scheme would be **conditional**: first on evidence of the specific no-deal Brexit harm, and second on proof that a one-off grant would permanently address it. It would need to be very **well targeted** – it is better that support is concentrated where export sales have greatest potential than spread evenly.

Nevertheless, as with most growth-based support schemes, such a scheme would suffer from the risk of deadweight (many businesses will ask for help even though they can really afford to pay themselves) and optimism bias (companies assuming they can recapture a market that they cannot). It is also the case that one-off costs are not always really one-off; for example, a professional business services company may need to establish an EU presence, but that presence then has an ongoing cost to maintain.

For all these reasons, such support tends to be disbursed slowly, as business cases are checked and improved. For example, in the case of Redcar, a year later only around half the support – including redundancy payments – had been disbursed. Even though grant money is free to the recipient, this does not mean it flows out on schedule; in

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August, the BBC reported that just 741 companies had applied for grants to help UK companies cope with the customs system in a no-deal Brexit, a tiny fraction of those that would be affected.<sup>15</sup>

This is one of the types of support at risk of moral hazard and competition-distortion concerns. Should a scheme aim at maximising additionality – that is, targeting support where companies have not already acted, but might be induced to – then it will provide an advantage to those that failed to prepare over those that did. It is important that the support helps companies intending to re-establish their position in the market they are at risk of losing. For these reasons, the government should consider insisting that its recipients match-fund anything they receive.

### **3. Compensation for ongoing loss of competitiveness during no deal**

Many of the non-tariff costs expected to accompany a no-deal Brexit would be expected to continue for as long as no deal is the state of affairs, even once companies have taken all the steps they can to adjust. Some might even outlast the completion of a comprehensive deal with the EU, if the UK remains outside the customs union and single market. For example, on 7 October 2019, HMRC released an impact assessment that estimated the ongoing cost of additional customs forms at £15bn per year, for importers and exporters together.<sup>16</sup>

Others follow straightforwardly from the imposition of tariffs, such as the 30% price pressuring expected to hit the sheep meat industry referred to earlier. The Society of Motor Manufacturers and Traders (SMMT) estimated that new tariffs would put up the cost for a UK-built car sold in the EU by £2,700.<sup>17</sup> All in all, the government's own analysis from last year put the total impact on GDP at 9.3%, with 4.5 percentage points coming from NTBs, 1.5 percentage points from tariffs, and the rest largely from customs checks and lowered migration.<sup>18</sup> That amounts to about £190bn a year.

It is possible, in theory, that support to keep an industry afloat during a competitive trough can be justified. It would require a high degree of confidence that a no-deal situation is temporary and the industry in question is capable of recapturing its previous position. However, examination of cases in detail makes the expense and difficulty of doing so clear.

The following examples are illustrative and involve our own rough calculations as to the amount of harm brought about by specific ongoing no-deal Brexit impacts.

#### **Sheep meat**

Ongoing income support for sheep farmers is in essence what Michael Gove appeared to promise with regard to a headage payment for sheep meat, which the industry also called for.<sup>19</sup> In fact, it is possible that what the government is contemplating may simply be compensation for lambs already born or due to be born, and therefore time-limited, rather than a permanent commitment to keep sheep farming afloat. On the other hand, the farming minister George Eustice has spoken of a bright future for the sheep sector and that the correct approach is 'to supplement farmers' incomes through the headage payment schemes',<sup>20</sup> which suggests a continuing commitment.

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Whichever route is taken, there are legal and financial limits to this. In legal terms, even the National Sheep Association has acknowledged that it would 'be illegal under WTO rules for the government to simply offset the cost of tariffs' and has called for more creative thinking.<sup>21</sup> An ongoing promise to keep paying a full 30% of the value of the sheep meat is of questionable affordability; sheep meat exports were £384m in 2017, 94% of that going to the EU.<sup>22</sup> A 30% income support might cost over £100m a year, for what is quite a small industry. It is for the government to decide whether this is a price worth paying to avoid the slaughter of the flock and loss of livelihoods that would follow the sudden loss of competitiveness in no deal.

Against that, there ought to be political concerns with a steady stream of support. In effect, the UK government would be forking out cash at one end (to farmers) to compensate for lower prices caused by EU governments receiving more money through tariffs: an indirect payment from UK taxpayers to EU taxpayers. There is no certainty as to when the support would end, or if the UK sector would re-establish its position, although the minister mentioned other support that opens new markets to UK sheep.

### **Logistics**

Another possible candidate for this kind of ongoing support is the logistics sector. Owing to the asymmetric nature of arrangements after a no-deal Brexit (UK recognition of EU standards not being reciprocated), the flow of traffic across the Channel might prove similarly asymmetric. Lorries might flow easily into the UK, but not so easily out again, if full of goods for the EU market that now require extensive checks. A truck that cannot easily return might not be economic to send in the first place, which could produce serious loss of flow either way. Aware of this, the think tank Open Europe has suggested the UK government consider a compensation scheme for empty-leg journeys. This may be rational, but it is certainly expensive: 10,000 lorries currently pass through Dover every day, and the cost of operating a truck and taking it across the Channel is several hundred pounds.\* If just a quarter of the normal lorry flow needed to be compensated, the cost might reach £1m a day.

### **Cars**

For the automotive sector, the financial strain is on a whole different scale. With over 650,000 cars exported to the EU,<sup>23</sup> the government would need to find £1.8bn to make good the £2,700 per car disadvantage. This is clearly unaffordable, even before the costs associated with higher NTBs such as the automotive sector's share of that £15bn customs declaration bill, or a higher cost of imported parts. To put the number in perspective, the amount initially committed to the Advanced Propulsion Centre, a key plank of the government's automotive industrial strategy, was £500m over 10 years.

### **SME exporters in general**

In 2017, SMEs exported some £55bn to the EU. If the purpose of support in this category was to make up for the impact of the NTBs purely upon exports, and they amount to 3.5% of export value, such a package would have an initial ongoing cost of almost £2bn.<sup>24</sup>

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\* The cost of hiring a lorry and paying two lorry drivers each £100–150 daily. Ferry ticket prices are similar, and fuel for a 100-mile trip is around £50.

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## Services

For services, as discussed earlier, the government's estimates of the additional costs to trade in a no-deal scenario are 5–18% of the value of trade. Services trade with the EU amounted to £265bn in 2016. If one took the middle point of that range (11%) and applied it to the whole of the trade, the cost of keeping services competitive would reach almost £30bn a year. Clearly this would not be affordable even for a few months.<sup>25</sup>

Given the clear affordability constraints, compensation for ongoing loss of competitiveness that is expected to last any more than a year or two will face a very high bar and require extreme selectivity. To be blunt, it is far from clear that any support of this kind is a good idea. If no-deal conditions are set to last, then the open-ended cost of making good on tariffs or NTBs can add up to several percentage points of the value of the business; filling such a gap is both unaffordable and unfair. Depending on where the line around no deal harms is drawn, the ongoing costs might amount to several tens of billions of pounds a year.

This is a high multiple of what is currently set aside for industrial strategy, and suggests the government has to prioritise ruthlessly. A far better use of the government's resources is to go about addressing the underlying causes of competitive disadvantage, than paying vast amounts in order to paper them over for a while. That means striving for a low-tariff deal, and placing an urgent priority on agreements with the EU that bear down on the NTBs, such as on data adequacy and mutual recognition of professional standards.

## 4. Funds to restructure the UK economy

Finally, the government needs to ask what support it should provide to reorient the UK economy longer term for the structural changes wrought by Brexit. The Resolution Foundation has called for a massive (£100bn) fund that would support companies during a transitional period as they adjust to permanently higher barriers to trade with the EU, towards more trade with the rest of the world. The premise is simple: hobbled in its dealings with one suite of markets, UK Plc needs to reorient itself towards other opportunities.

Much of this will merge with general industrial strategy planning, and it would be ill-advised to attempt to do this too quickly in the wake of no deal when uncertainty is at its peak. It will require the co-operation of the private sector, and a clear and confident sense of where the UK is going after the immediate turmoil is over.

Such an agenda inspires questions as numerous and detailed as the whole topic of industrial and economic strategy, and cannot be lightly covered. The UK government in the past 20 years has instigated an unaccountably large number of funds aimed at economic transformation in some form; the pursuit of new markets, balanced growth, growth industries, more exports and better paid jobs are the explicit or implicit purpose of virtually all its industrial strategy funds.

One might go back to the 'Strategic Investment Fund' launched by Lord Mandelson in 2009 as part of his 'New Industry, New Jobs' programme, the £1bn Regional Growth Fund of 2010 (which grew to £2.6bn, and was meant to cover the withdrawal of the

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Regional Development Agencies), or three waves of Industrial Strategy Challenge Funds, aimed at specific technological and economic challenges.

There are pots of money aimed at commercialising ideas that are spun out of universities, and many funds managed by the British Business Bank that operate with the support of the venture capital industry, all of which are by definition about 'new directions'. The recent £1bn Future High Streets fund is about one kind of economic transformation, the mooted £2bn Shared Prosperity Fund another, as were its predecessors that stemmed from European structural funds.

The length of time it has taken for the consultation around the Shared Prosperity Fund to come to light is some indication of the difficulty that attends the decisions around a fund that is expected to amount to just £2bn a year.\* decisions about geographical allocation, governance, accountability and the broad policy goals are all contentious. For example, should the fund be capital only, or could it fund 'softer' investments such as in skills and training? Can local authorities decide how it is spent? If yes, how does the government prevent them simply replacing their own economic growth funding and using the money to cover other pressures? How much risk can be taken? How much 'skin the game' should the private sector offer?

From its early moves, the government under Boris Johnson appears to be bought into much of the industrial strategy bequeathed to it by his predecessor, Theresa May, at least in how it backs new industries: the run-up to the Conservative Party Conference saw big announcements around electric vehicles and fusion energy as an example of this.

But it should be clear that the current suite of industrial strategy interventions are not designed for emergency support. **One of the persistent lessons of government is quite how hard it is to spend money both well and quickly.** Even once agreed, the time between a fund being announced and the money being disbursed is often measured in years: for example, the £400m Charging Infrastructure Investment Fund, unveiled in late 2017, took over a year to settle on its fund management partners, and will take many more years to invest. The Regional Growth Fund, launched in 2010, operated through several 'rounds' with £2.6bn eventually allocated to it, but by 2014 the National Audit Office could report that only £492m had actually reached projects.<sup>26</sup>

The key piece of advice for the government is not to rush this agenda, or be tempted into a wave of sudden invention by the urgency of no deal. It may well be that a sudden Brexit provides the urgent pretext for structural adjustment; ironically, it would also be the worst possible time to try to map a new course.

In particular, while there may well be a need for fiscal stimulus to counter a severe demand shock, government funds to restructure the corporate world are a poor way of achieving it. The record of the Regional Growth Fund ought to make that apparent: it is neither sufficiently timely, targeted nor temporary enough to have a clear

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\* This research briefing is useful: [Parliament.uk](https://researchbriefings.parliament.uk/ResearchBriefing/Summary/CBP-8527), The UK Shared Prosperity Fund, 3 September, <https://researchbriefings.parliament.uk/ResearchBriefing/Summary/CBP-8527>. The fund was a feature of the Conservative 2017 election manifesto.

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macroeconomic effect. The best industrial strategy goes with the grain of the private sector and secures its financial contribution, which takes time.

But in the immediate wake of a no-deal Brexit, the government will be intensely preoccupied with the companies most affected by it. They will not necessarily be the ones likely to sit within the long-term strategic picture, particularly if the purpose is to reorient from the EU market. A company that sells food products to Italy, for example, is not likely to pursue new opportunities in south-east Asia.

Above all, for a robust strategic plan to work, its architects need a clear sense of the UK's medium-term direction, and a no-deal Brexit is almost perfectly designed to obscure that vision. Neither the external trading environment, fiscal position nor political context will be clear for many months. To take just one policy area, government will need to take a clear view on its approach to competition; one of the presumed opportunities of leaving the EU is to escape its state aid rules, which can be slow to change.

It is possible that the agenda of any government after no deal will be dominated by a need to re-establish smooth access to the EU single market, and too flagrant an abuse of state aid conventions will make that much harder.

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## 6. Conclusions and recommendations

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Most national crises come out of nowhere; think of the fall of the Soviet Union, the collapse of the Greek economy or the turbulence that followed the Arab Spring. It is extremely rare that a country gets to anticipate and prepare for one. A no-deal Brexit is already a well-studied phenomenon, ever since it first became a serious possibility over 12 months ago. Preparations have grown more intense since, especially in the months after Boris Johnson became prime minister.

The mental image of no deal that appears to be lodged into the political mind is of a disruptive and even chaotic event, but one that is nevertheless transitory: a passing storm, or a period of 'scarring and burning' as the UK disentangles itself from an arrangement that has held it close for 45 years.\* After all, it is about leaving the EU, and you can only do that once – by definition, a transitory event that will sooner or later be over. Seen from this point of view, it fits into the classic conception of what a difficult spell of structural adjustment should look like: a spell of hardship and turmoil, but followed in the long term by the fruits of reform. This would be a fair portrayal of what the UK underwent through the early Thatcher years, for example.

The presumably transitory nature of no deal lends support to the idea that whatever damaging effects it might produce can to some degree be ameliorated. That we can anticipate and prepare for this event reinforces this view: if you know you will go through a period of turmoil, you can husband your resources especially for that time and face a better chance of surviving, and even thriving.

But this conception is optimistic, and schemes that might support or compensate business, let alone fuel a post-crisis rebound, are fraught with difficulty.

First, the harms likely to hit the economy are of multiple kinds, vague, interrelated and open-ended. They are, mostly, not as straightforward as a simple tariff with a calculable harm attached. Macroeconomic researchers are able to collate all the costs into a single, alarming number; for example, non-tariff barriers (NTBs) costing 3.5% of a trade, or a no-deal Brexit costing 9% of GDP. But this is not how individual business would experience the event. It would present itself in all sorts of ways: activities that become illegal, unfamiliar new paperwork, the loss of a contract, an inability to hire the right person or share data, or the withdrawal of a multinational from the supply chain. The distinction between a company damaged specifically by no deal, and one simply suffering the rigours of free-market competition, will not always be obvious.

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\* "Scarring and burning" is an evocative phrase of Michael Gove's: see Oliver C, 'Brexit will "be crushed like the toad beneath the harrow"' The dynamite text in which "flip-flopping" Boris Johnson told Cameron he thought Brexit would be crushed, *Daily Mail*, 25 September 2019, [www.dailymail.co.uk/news/article-3805954/The-dynamite-text-flip-flopping-Boris-Johnson-told-Cameron-thought-Brexit-crushed.html](http://www.dailymail.co.uk/news/article-3805954/The-dynamite-text-flip-flopping-Boris-Johnson-told-Cameron-thought-Brexit-crushed.html)

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Government has to draw a line around its support, but where that should be is impossible to say.

Second, government support for business is difficult. Even in normal times, it comes wrapped in processes and conditions, for many good reasons. It is easy for money to be wasted, or to damage some other objective of government policy, such as the maintenance of fair competition. There is a very small space between the projects that the private sector would fund anyway, and those that the private sector would not touch with good reason, where the government might make a useful difference. Finding that space takes time. This means such funds are usually slow to be spent – fine for normal times, but a real problem when the money is meant to help in an emergency.

Third, the ongoing costs of a no-deal Brexit are so large that to talk of ameliorating them is often quite fruitless. To take only one example, the automotive industry is forecast to take a near-£2bn-a-year hit from export tariffs alone, a figure that dwarfs what the government would normally commit to its industrial strategy. The figure for services exports – a far larger part of our economy than manufacturing – is correspondingly much larger. Because the length of time during which the UK would have to endure no-deal conditions is hard to know, it risks subjecting itself to an open-ended, financially ruinous commitment.

Finally, it is tempting to picture no deal as a clarifying moment during which the UK finds its new long-term direction, but it would be anything but. Short-term political and economic volatility would be at a peak. This means that restructuring the UK economy for its post-Brexit future would be extremely hard to plan for. Should the UK crash out suddenly, it is unlikely to know what its medium-term tariff regime would be, let alone all the different arrangements that might soften the edge of all the NTBs. It would be far from an ideal moment to plan for long-term investments.

Nevertheless, we offer some recommendations for how the government might best deliver support in the wake of a no-deal Brexit:

- The government should prepare to use 'Time to Pay' leniency on tax bills to help out smaller companies caught in a cashflow crisis, and also broaden the scope of loan-guarantee schemes like the Enterprise Finance Guarantee. A temporary cashflow problem really is a transitory event, and these schemes worked well during the financial crisis.
- There is a case for considering grant-based or voucher support for smaller companies facing one-off costs to adapt to no-deal conditions. The business organisations tend to call for broadly-based schemes for which everyone can apply. We would argue for schemes to be more targeted and conditional, and encourage companies to contribute their own resources too.
- We struggle to recommend any ongoing support to keep companies afloat during a period of competitive disadvantage, for the simple reason that most of the cases we examined were very expensive, with no certainty around their ending date. They

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would be intrinsically unfair; the rest of the economy has to face the competitive conditions that exist, and isolating certain parts for protection is never easy to justify.

## Recommendations

- The effects of no deal are complex – there would not be one cause, clearly limited harm or clear route to mitigation.
- Any intervention needs to keep in mind the long-term vision of the economy.
- Do not expect a definitive list of companies hurt by no deal. Any such list is biased against small companies.
- With the scope of the effects of no deal being limitless, the first key decision for government is where it draws the line, so as to stop it being government's job to support everyone.
- Situations are as likely to resemble the dilemma around supporting Thomas Cook as the more straightforward aid for sheep farmers.
- The mental image politicians carry for no deal is a 'Nike swoosh', but expect instead a widening fan of possibilities.
- Even tariffs are complicated to work out, given three distinct effects (higher tariffs for some importers, higher tariffs on some exporters, some new overseas competition).
- We reiterate the need for an independent analytical body to advise on trade.
- Non-tariff barriers may be much larger than tariffs as a cause of harm – we assume 3.5% of the traded amount but some analyses have it much higher.
- Unilateral acceptance/recognition of EU standards will help in solving short-term border issues, but creates difficulty for UK competitors and is not sustainable in the long term.
- Data issues are a little-explored harm that may hurt small and medium-sized enterprises (SMEs) disproportionately.
- Government has to apply strong principles in how it settles on a policy for supporting business.
- Many of the harms that arise from no deal are in the same ballpark as the sort of turmoil all companies come up against from time to time, so government has to be clear where its responsibility lies – that is, no-deal-specific harms.
- Cashflow support needs to be designed so it is simple and quick to administer, although that does not mean it is unconditional.

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- The backdrop of no deal will make the adjudication of business plans' feasibility particularly challenging.
  - Cashflow support must not be so generous that it is preferable to the private sector support available.
  - An increase in the normal generosity of government support is warranted, but not without limit; the more a scheme is extended, the more bad ideas it will envelop.
  - Most analyses do not expect a no-deal Brexit to have as deep and lasting an impact as the financial crisis – this can help calibrate expectations, although there are important differences in the nature of the crises.
  - A grant is the simplest way to address the challenge of one-off costs associated with reacquiring a market position after a no-deal Brexit. But any grant needs to be well targeted and conditional, not just handed out to whoever turns up. And expect it to be disbursed slowly as conditions are checked.
  - The cost of ongoing loss-of-competitiveness support is so high and open-ended that it is hard to make a case for it.
  - Do not attempt radical surgery to industrial strategy during a no-deal crisis. It is hard to know what long-term situation to aim for
  - The experience of the Regional Growth Fund, Shared Prosperity Fund and many others is that it is extremely hard to spend money both well and quickly

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## About the author

**Giles Wilkes** is a senior fellow at the Institute for Government. Before joining the Institute, Giles spent two and a half years as special adviser to Theresa May on industrial and economic policy, and four years in a similar role to Vince Cable in the Department for Business, Innovation and Skills.

He has also been a writer of editorials for the *Financial Times*, chief economist at the think tank CentreForum, and spent 10 years in the financial markets.

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☎️ +44 (0) 20 7747 0400 📠 +44 (0) 20 7766 0700

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