WORKSHOP

SMEs in a changing Europe

Manchester Metropolitan University

Thursday 29th June
Session II

Economic Impact and Manufacturing: The Implications of Brexit

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FINANCE & ECONOMICS
Background

- The Brexit outcome of the UK’s EU Referendum on June the 23rd 2016 has led to:
  
  i. Uncertainty in the UK economy;
  
  ii. Political challenges to be faced in the process leading to Brexit’s realisation (election 2017 etc.)
Background

- The structural changes will involve new trade relations and lower capital mobility with the remaining 27 EU member states (BE, 2016).
Background

- The presentation consists of two parts:
  - Part-1: Brexit and the UK-EU27 trade relations;
1. The UK – EU27 Trade relations

- The European Commission perceives flexible exchange rates as a major barrier to the completion of the Single Market. The relations between EU27 and the UK are presented below:
United Kingdom

Free movement of Goods, Services

Capital and LABOUR

Monetary Autonomy;

Value of the Pound (£/€ exchange rate volatility)

Euro Area + Denmark, Sweden etc.

Fixed Exchange Rates;
<table>
<thead>
<tr>
<th>TRADE RELATIONS</th>
<th>Flexible Exch. Rates</th>
<th>Fixed Exchange Rates</th>
<th>Common Currency - Euro</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>World Trade Organis.</strong></td>
<td>Cliff-Edge</td>
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<td>Free Trade Area</td>
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<tr>
<td>Common Internal</td>
<td>Very Hard</td>
<td></td>
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<tr>
<td>Tariffs and Quotas</td>
<td>Brexit</td>
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<td>Customs Union</td>
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<tr>
<td>Common Internal and External Tariffs and Quotas</td>
<td>Turkey ? Hard Brexit</td>
<td></td>
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<tr>
<td>Single Market</td>
<td></td>
<td>Soft Brexit - accessing Single Market</td>
<td>Poland, France, Germany</td>
</tr>
<tr>
<td>Common Internal and External Tariffs and Quotas</td>
<td>PLUS</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Coordination of Macroecon. Policies and/or reduction of Exchange rate volatility</td>
<td>UK</td>
<td>Romania, Holland, Greece</td>
<td>Slovakia, Slovenia, Lithuania, Latvia, Estonia, Malta.</td>
</tr>
</tbody>
</table>
1. Brexit’s Implications for UK-EU27 trade

- A ‘hard Brexit’ causes a 20% reduction in intra EU27-UK volumes of trade. This will cause:
  - **UK Exports – EU27** to decrease £230bn to $(230 - 46) = £184\text{ bn}$. 
  - **UK Total Exports** to decrease £490bn to $(490 - 46) = £444\text{ bn}, or 9.4\%$
1. Brexit’s Implications for UK-EU27 trade

- EU27 Exports - UK will be reduced £290bn to

  \[(290 - 58) = £232\text{ bn}.\]

- EU27 Total Exports will be reduced £1.812tn to

  \[(1.812 - 58) = £1.754\text{ tn},\text{ or }3.2\%.\]

If 2016 is a base year = 100, the UK’s exports will drop to 90.6 and the EU’s to 96.8.
2. Brexit’s impact on SMEs

- As a result, in the medium run the post-2016 Pound’s depreciation will lead to a re-allocation of resources from SME’s (and sectors of the economy) that are exposed to the increase in import-push inflation to SMEs (and sectors of the economy) that are not.
2. Brexit’s impact on SMEs

- Assume an SME-A less exposed to import-push inflation and not dependent on labour from EU. It would be in a competitive advantage in relation to SME-B, exposed to import-push inflation and dependent on (less skilled) labour from EU.
2. Brexit’s impact on SMEs

- In terms of timely and adequate preparations for a smooth adjustment to a Brexit environment SMEs must assess, their exposure to Brexit negotiations. A summary of responses is presented below:
2. Brexit’s impact on SMEs

- **Short-run:** Maximise benefits from the Pound's decline - Minimising cost from import-push inflation - oil dependency
- **Medium-run:** Identify problems-break down in supply lines
- **Long-run:** Contingency plans for higher cost of financial services and

**Outcome depending on final Brexit agreement:**
2. Brexit’s impact on SMEs

1. Soft Brexit: Access to customs union maintained – modest EU market losses

2. Hard Brexit: A free trade area with EU
   Considerably losses in EU markets – further declines in the Pound likely

3. Very Hard WTO rules - losses in EU markets
   Brexit: from tariffs and non-tariff trade barriers further declines in the Pound – exchange exposure – inflation 4–5%
   Balance of Payments crisis?
2. UK manufacturing sector – New Strategies

• Manufacturing in the UK has long been in decline (de-industrialisation, competition from Asia and East Europe, IT innovations). Despite its decline manufacturing remains vital for the UK economy. This is illustrated in the table below.
<table>
<thead>
<tr>
<th>UK Economy</th>
<th>Employees</th>
<th>GVA</th>
<th>Exports</th>
<th>Import</th>
<th>Exports - Imports</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sector</td>
<td>mn</td>
<td>bn and %</td>
<td>bn</td>
<td>bn</td>
<td></td>
</tr>
<tr>
<td>Agriculture</td>
<td>0.476</td>
<td>8.5</td>
<td>18</td>
<td>38.5</td>
<td>-20.5</td>
</tr>
<tr>
<td>Aviation</td>
<td>0.961</td>
<td>52 / 3.4</td>
<td>26</td>
<td>26</td>
<td></td>
</tr>
<tr>
<td>Chemicals and Plastics</td>
<td>0.277</td>
<td>17.5 / 1.1</td>
<td>26.9</td>
<td>27.8</td>
<td>-0.9</td>
</tr>
<tr>
<td>Construction</td>
<td>2.2</td>
<td>102.3 / 6.2</td>
<td>1.6</td>
<td>1.2</td>
<td>0.4</td>
</tr>
<tr>
<td>Creative Industries</td>
<td>1.9</td>
<td>87.4 / 5.3</td>
<td>19.8</td>
<td>8.7</td>
<td>11.1</td>
</tr>
<tr>
<td>Education</td>
<td>2.9</td>
<td>98.1 / 5.9</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Energy</td>
<td>0.14</td>
<td>36.2 / 2.2</td>
<td>76.7 tn</td>
<td>154.8 tn</td>
<td>-</td>
</tr>
<tr>
<td>Financial Services</td>
<td>1.1</td>
<td>119.2/7.2</td>
<td>63.7</td>
<td>8.8</td>
<td>54.9</td>
</tr>
<tr>
<td>Food &amp; Drink</td>
<td>0.444</td>
<td>26 / 1.7</td>
<td>18.2</td>
<td>38.5</td>
<td>-20.3</td>
</tr>
<tr>
<td>Hospitality &amp; Tourism</td>
<td>3.1</td>
<td>121.1 / 7.1</td>
<td>22</td>
<td>42.4</td>
<td>-20.4</td>
</tr>
<tr>
<td>Housing and Real Estate</td>
<td>2.1</td>
<td>101.6 / 6.1</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Life Sciences</td>
<td>0.053</td>
<td>6.4 / 0.4</td>
<td>20.7</td>
<td>19.6</td>
<td>1.1</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>2.7</td>
<td>162.4 / 9.8</td>
<td>228.9</td>
<td>313.3</td>
<td>-84.4</td>
</tr>
<tr>
<td>Profession. &amp; Bus. Services</td>
<td>5.8</td>
<td>204.4/12.3</td>
<td>70.5</td>
<td>40.4</td>
<td>30.1</td>
</tr>
<tr>
<td>Retail</td>
<td>5</td>
<td>182 / 10.9</td>
<td>11.4</td>
<td>6.1</td>
<td>5.3</td>
</tr>
<tr>
<td>Technology</td>
<td>1.2</td>
<td>95.5 / 5.7</td>
<td>20.8</td>
<td>29</td>
<td>-8.2</td>
</tr>
<tr>
<td>Transport and Logistics</td>
<td>1.5</td>
<td>76.8 / 4.6</td>
<td>24.1</td>
<td>31.7</td>
<td>3.4</td>
</tr>
</tbody>
</table>
Conclusion

- Post-Brexit, the adjustment of the manufacturing sector would depend on:

  i) whether the UK retains access to specific areas in the EU27’s Customs Union;

  ii) industrial policies pursued by the UK authorities.
Conclusion

The UK should develop an industrial strategy that:

I. ensures trade volumes with EU-27 do not decline considerably;

II. Allow a considerable depreciation in the value of the pound and put in place policies described above;

III. join free trade areas with other countries.
References


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THANK YOU FOR LISTENING