



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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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;
- Part-2: Brexit - SMEs - UK manufacturing sector.

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

Euro Area + Denmark, Sweden etc.

Free movement of Goods, Services

Capital and LABOUR

Monetary Autonomy;

Fixed Exchange Rates;

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

EUROPEAN UNION MACROECONOMIC FRAMEWORK

CURRENCY - EXCHANGE RATE RELATIONS

TRADE RELATIONS	Flexible	Fixed	Common
	Exch. Rates	Exchange Rates	Currency - Euro
World Trade Organisis.			
	Cliff-Edge		
Free Trade Area			
<u>Common</u> Internal	Very Hard		
Tariffs and Quotas	Brexit		
Customs Union			
Common Internal	Turkey ?		
<u>and</u> External	Hard Brexit		
Tariffs and Quotas			
Single Market	Soft Brexit -	Poland,	France, Germany
Common Internal	accessing Single	Denmark	Italy, Spain, Lux.,
and External Tarrifs	Market	Sweden	Austria, Ireland
and Quotas		Bulgaria	Belgium, Portugal
<u>PLUS</u>	UK	Romania	Finland, Cyprus
Coordination of		Hungary	Holland, Greece
Macroecon. Policies			Slovakia, Slovenia
and/or reduction of			Lihtuania, Latvia,
Exchange rate volatility			Estonia, Malta.

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

$$(230 - 46) = \text{£184 bn.}$$

- UK Total Exports to decrease £490bn to

$$(490 - 46) = \text{£444bn, or 9.4\%}$$

1. Brexit's Implications for UK-EU27 trade

- EU27 Exports - UK will be reduced 290bn to

$$(290 - 58) = \text{£}232 \text{ bn.}$$

- EU27 Total Exports will be reduced £1.812tn to

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

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.

UK Economy	Employees	GVA	Exports	Imports	Exports - Imports
Sector	mn	bn and %	bn	bn	
Agriculture	0.476	8.5	18	38.5	-20.5
Aviation	0.961	52 / 3.4	26		26
Chemicals and Plastics	0.277	17.5 / 1.1	26.9	27.8	-0.9
Construction	2.2	102.3 / 6.2	1.6	1.2	0.4
Creative Industries	1.9	87.4 / 5.3	19.8	8.7	11.1
Education	2.9	98.1 / 5.9	-	-	-
Energy	0.14	36.2 / 2.2	76.7 tn	154.8 tn	-
Financial Services	1.1	119.2/7.2	63.7	8.8	54.9
Food & Drink	0.444	26 / 1.7	18.2	38.5	-20.3
Hospitality & Tourism	3.1	121.1 / 7.1	22	42.4	-20.4
Housing and Real Estate	2.1	101.6 / 6.1	-	-	-
Life Sciences	0.053	6.4 / 0.4	20.7	19.6	1.1
Manufacturing	2.7	162.4 / 9.8	228.9	313.3	-84.4
Profession. & Bus. Services	5.8	204.4/12.3	70.5	40.4	30.1
Retail	5	182 / 10.9	11.4	6.1	5.3
Technology	1.2	95.5 / 5.7	20.8	29	-8.2
Transport and Logistics	1.5	76.8 / 4.6	24.1	21.7	2.4

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.

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