Food Drink Ireland
Ibec

Adjusting to Brexit

Countering unforeseen and adverse consequences for the food and drink sector

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Introduction and summary

The food and drink sector is deeply resilient but now faces major disruption to its markets from Brexit in the midst of a global pandemic. The Irish food and drink sector is by far the most exposed of any sector in any country in Europe to Brexit. In 2019 over 37% of Irish food and drink exports went to the UK market with Irish food products accounting for seven of the ten most exposed country/ food and drink product matches in the EU. Ireland needs to maintain our market position in this high value, high quality market that has a substantial food deficit and not relinquish it to global competitors.

The sector, despite accounting for only 14% of Ireland's total exports, is by far its most interwoven with the domestic economy. The sector alone accounts for 31% of total indigenous exports and over 54% of indigenous manufactured exports. Over the past decade, the food and drink sector has spent over €120 billion in payroll and purchases in the Irish economy. This amounts to 45% of the total of all manufacturing exporters. €82 billion of this amount was purchases of materials from primary producers and other domestic firms in their supply chain. As a result, the sector has a high employment multiplier, which means it supports employment in other parts of the economy in a way that other sectors do not. The sector provides the exclusive outlet for much of the farmer/SME produce, providing extensive added value and is crucially important to farm incomes.

Even in the event of a deal between the EU and UK, there will be significant additional costs for Irish food and drink companies arising from additional customs procedures, regulatory burdens, and rising transport costs. Additional paperwork, certification and delays in trade would gradually erode the efficiency of interlinked supply chains, both with the UK and through the land bridge to the continent. This would add extra costs at each step of production and distribution. These issues would impact both importers and exporters.

A no deal Brexit would result also in significant tariff barriers plus additional non-tariff barriers. Each of the main food and drink sectors would see substantial falls in output. These falls would be long lasting and would persist over time, with many products having few alternative markets.

Market diversification involves considerable risk and expense. New market penetration is a long game, requiring significant investment with no guarantee of success. Even within the single market companies face barriers in establishing commercial relationships and supply chains. In addition, they must build cash flow, innovate and invest to tailor the product to consumer tastes and deal with new regulatory regimes. The further goods travel the tighter margins will be as transport costs increase. Significant resources will be needed to help companies meet these challenges.

Recognising the adverse consequences of Brexit and that some member states and sectors will be more affected than others, EU leaders have agreed to make €5 billion available to a special Brexit Adjustment Reserve. Already this year the European Commission has adopted for the second time a State Aid Temporary Framework recognising that the entire EU economy is experiencing a serious disturbance from the global pandemic.

It is clear that exceptional targeted policy responses are required to offset the impacts of Brexit. These measures include accessing the existing €4 billion in Brexit contingency funding set aside for the years 2020 to 2025, continued relaxation of state aid rules, substantial funding from the EU's €5 billion Brexit Adjustment Reserve and any increased tariff revenue from UK imports in order to maintain and sustain economic activity and jobs. Funds amounting to 5% of the value of current annual export sales to the UK will be needed annually from domestic and EU sources for at least three years. These state aid supports and funds from the Brexit Adjustment Reserve should be targeted as follows:

- Short term measures to allow the Irish Government to re-introduce the Employer Wage Subsidy Scheme for Brexit impacted companies in a no-deal scenario.
- Medium term measures to allow the Irish Government to introduce investment aids to support Irish food and drink companies.
- Introduction of a state supported export credit insurance scheme.
- Additional funding for direct grant supports for innovation, marketing and trade promotion for companies looking to build new markets in the EU and internationally.
- Ensure sufficient accompanied roll on / roll off capacity for direct ferry routes to the continent.
- Direct supports to cover the additional ongoing costs associated with developing and maintaining customs clearance capability.
- A Tariff Support Mechanism fund to offset the tariff amount imposed by the UK on the most exposed sectors. The fund should also offset the impact of EU tariffs on indigenous manufacturers importing critical raw materials.

The most exposed sector in the most exposed country

€4.5 billion exports to UK

Majority of €4.5bn exports to EU-26 uses land-bridge

Seven of the ten most exposed country/ food and drink product matches

54% of indigenous manufactured exports

Crucially important to farm incomes

Impact of tariffs and non-tariff barriers

What is needed...

Employer wage subsidy scheme

State backed export credit insurance

Investment aids to support competitiveness

Market diversification supports

State aid supports and funds from the €5bn Brexit Adjustment Reserve

Tariff support mechanism

The need for business supports

The increased threat of Brexit means that the outlook for 2021 is less certain. We continue to hope, at this stage, that a ‘bare bones’ trade deal will be agreed before the end of the transition period. If such a deal is not agreed, this would result in significant tariff barriers, additional non-tariff barriers, and a further blow to fragile confidence. Various studies have suggested that the difference between an end to the Brexit transition period on World Trade Organisation (WTO) terms rather than with a free trade agreement (FTA) would reduce GDP growth in the short-run materially and impair potential recovery in future years significantly.

In the aftermath of the last recession, the one bright light for most of rural and regional Ireland was the growth in the exporting sectors. These sectors are now the most exposed to Brexit. If the worst occurs, it will fundamentally reframe the economic outlook for the region’s most reliant on Brexit-exposed sectors.

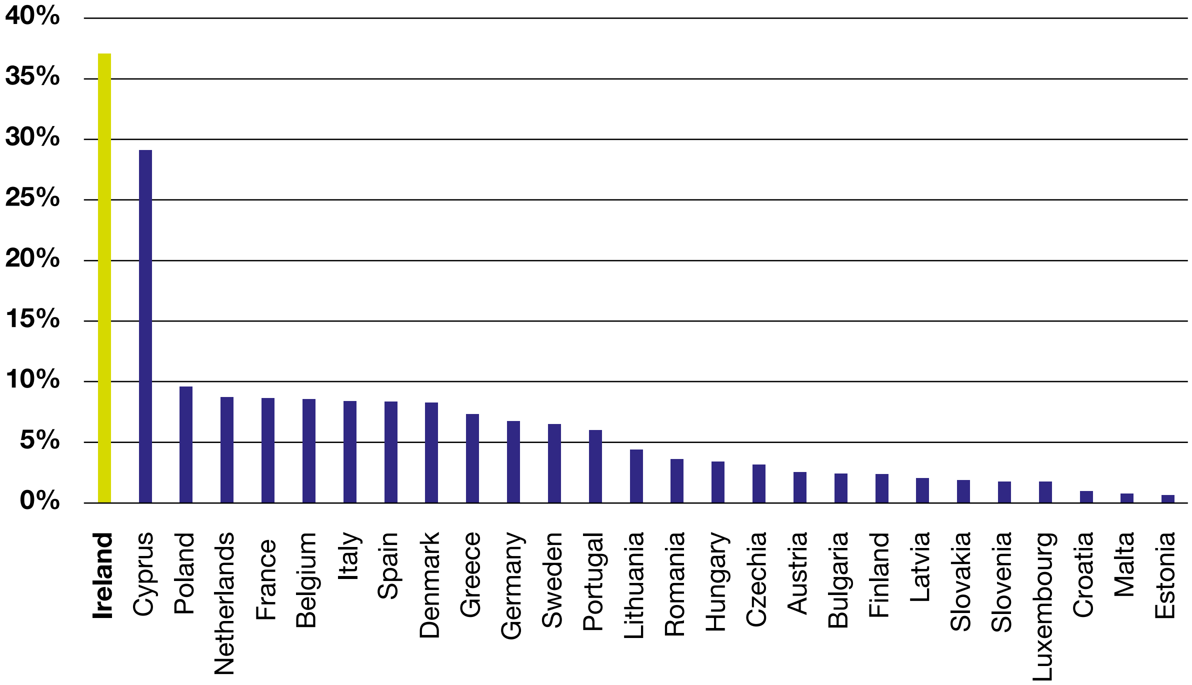
From a business point of view, supports are needed given the impact outlined above. However, the object of state intervention is not just to save companies, but also the jobs, communities, and downstream suppliers reliant on them, not to mention the impact on the farming sector and its longer-term sustainability. Ibec research has shown that those most vulnerable to potential job losses in a no-deal scenario are already living in areas with fewer opportunities, a lack of other viable employment and lower incomes. Supporting Brexit-exposed industries is also vital to limit a chain reaction in these most disadvantaged areas.

Given the capital-intensive and low-margin nature of the companies involved, these businesses can take decades to build and are very vulnerable to changing external conditions. They also require medium- to long-term financing facilities and certainty of demand. Consequently, due to both their capital-intensive nature and the time taken to get a return on capital, firms in these industries are unlikely to be rebuilt easily if allowed to collapse under the pressures that may come with a no- trade deal outcome. In short, if supports are not in place early and firms close their doors there will be little hope of resuscitating the industrial base of many rural areas in the medium term.

The Irish food and drink sector is by far the most exposed of any sector in any country in Europe to a no trade deal Brexit. In 2019 over 37% of Irish food and drink exports went to the UK market with Irish food products accounting for seven of the ten most exposed country/ food and drink product matches in the EU.

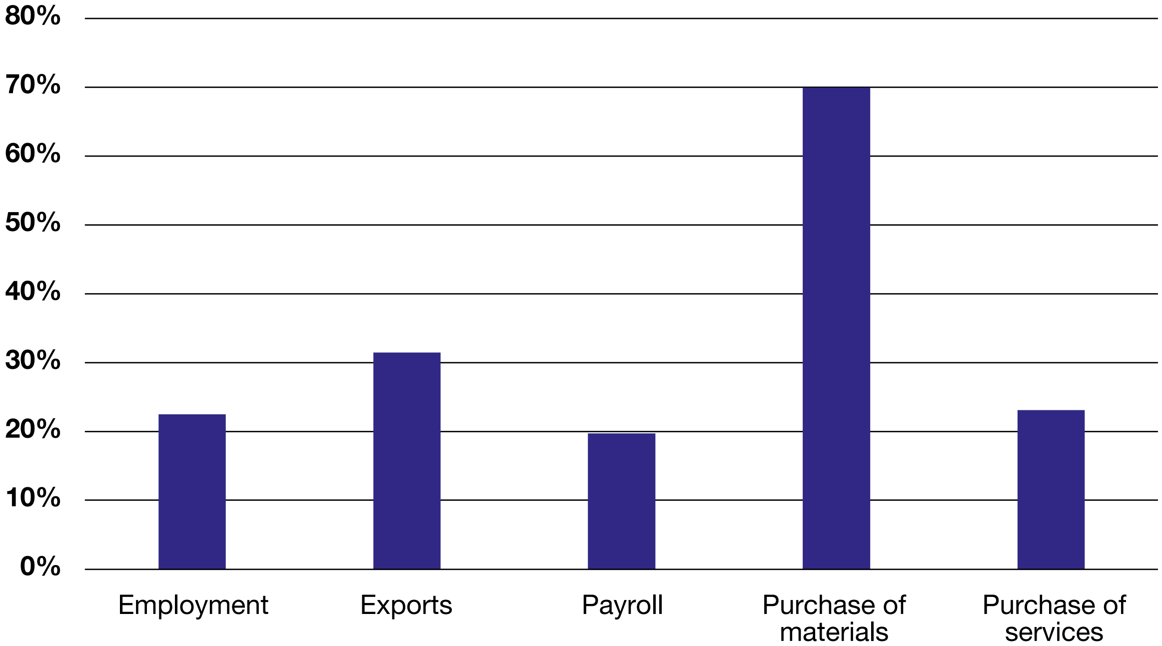
The food and drink manufacturing sector was Ireland’s largest indigenous exporting sector in 2019 accounting for 23% of employment of Irish-owned exporting firms. The sector alone accounts for 31% of total indigenous exports and over 54% of indigenous manufactured exports.

Figure 1: Exposure to Brexit and domestic links



Source: Ibec analysis of Eurostat data

Figure 2: Share of the F&D industry amongst indigenous exporters, %

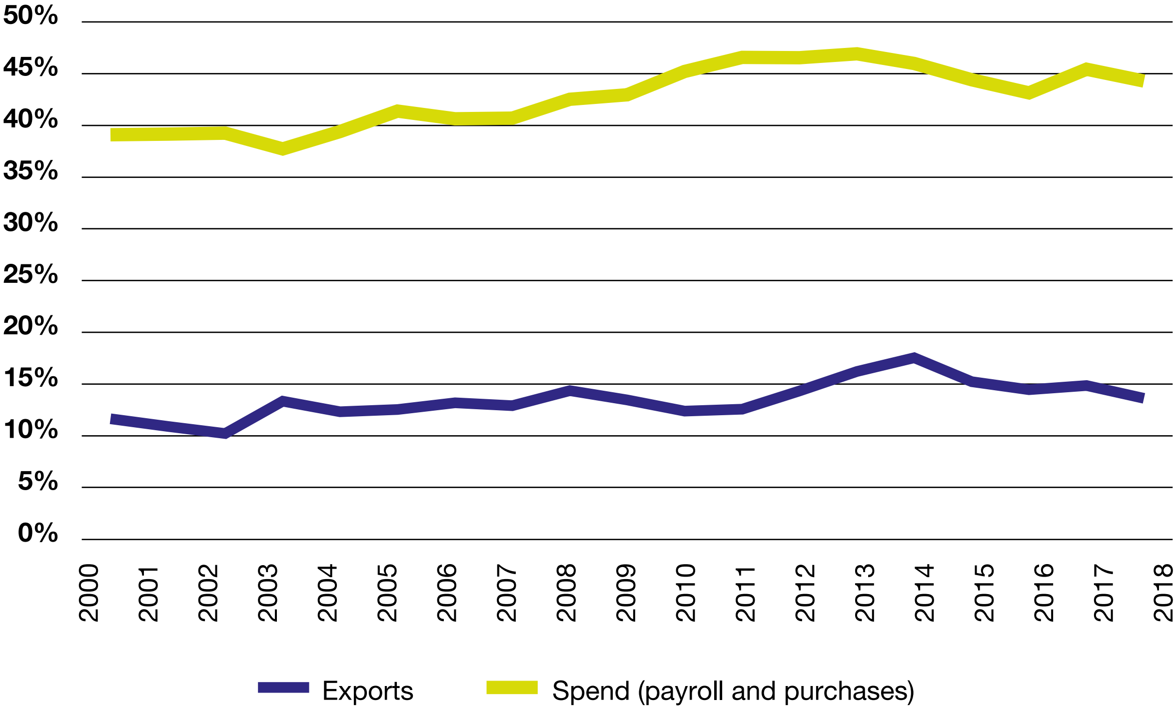


Source: Ibec analysis of ABSEI data

In 2018, the sector spent €1.7 billion on payroll in Ireland, along with €8.4 billion on materials from domestic suppliers, and €1.3 billion on domestic services. This makes the food and drink sector by far the largest purchaser of goods and services in the Irish economy of any exporting sector.

The sector, despite accounting for only 14% of Ireland's total exports, is by far its most interwoven with the domestic economy. Over the past decade, the food and drink sector has spent over €120 billion in payroll and purchases in the Irish economy. This amounts to 45% of the total of all manufacturing exporters. €82 billion of this amount was purchases of materials from primary producers and other domestic firms in their supply chain. The downstream impact therefore of not completing a trade deal with the UK would cause disruption on a massive scale in the wider supply chain and particularly at farming level which accounts for the majority of raw material purchases.

Figure 3: Food and drink exports and domestic spend



Source: Ibec analysis of ABSEI data

Finally, the CSO's most recent I-O tables show that purchases from the agricultural sector made up 35% of total ex-industry intermediate consumption of the food and beverage production sector in 2016. On the other hand, intermediate purchases made by food and drinks producers from the agriculture sector in 2012 made up 85% of the total external product flows from the agricultural sector.

This level of purchasing is the main facilitator of farm incomes and investment in the Irish economy. Loss of market share in the UK and squeezed margins will quickly and materially impact the the primary processing sector, depressing farm incomes and reducing primary investment. Teagasc have estimated that this shock to primary incomes could be worth over €330 million annually.

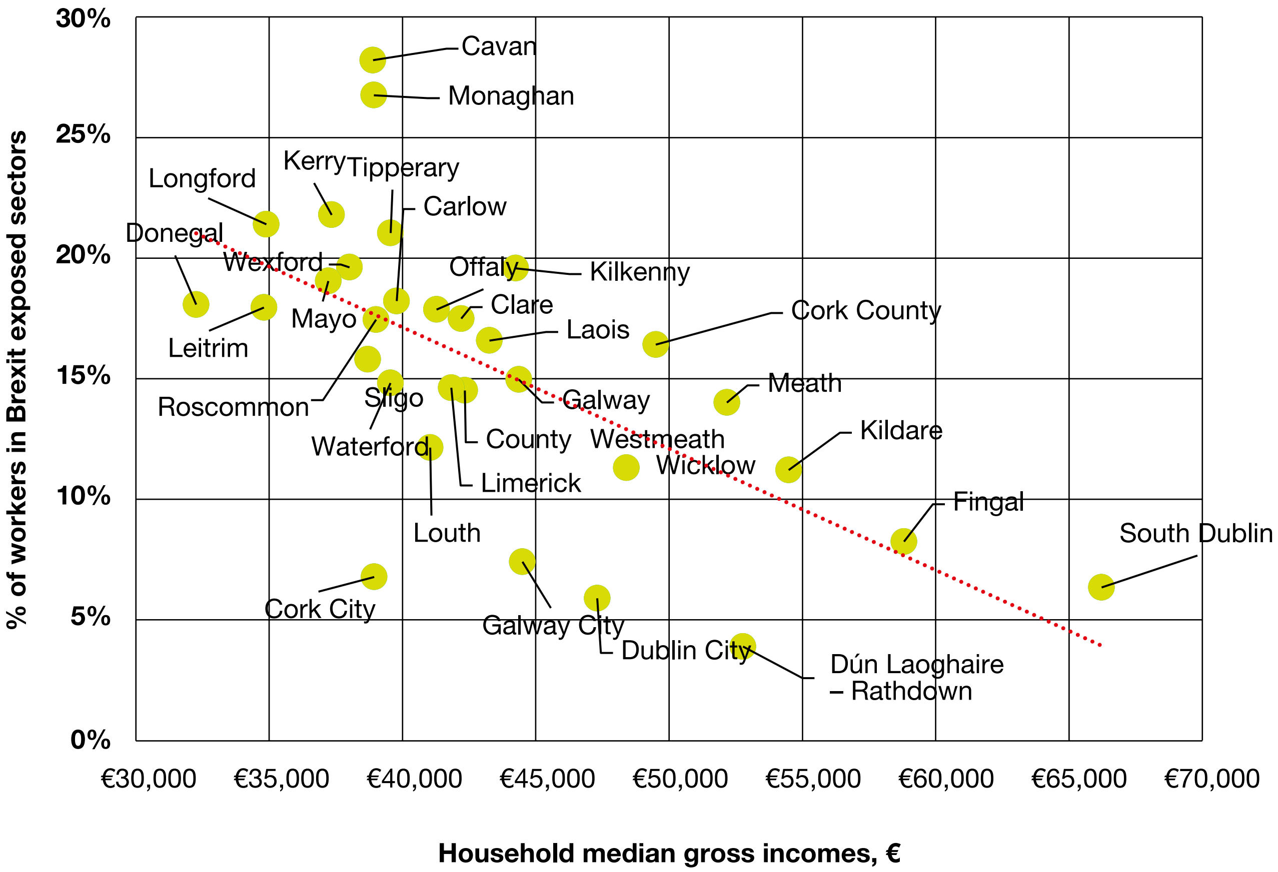
Regional economies and reliance on the sector

It is also the case that the most Brexit-exposed sectors are concentrated in the poorest parts of the country. Analysis of Census 2016 data by Ibec shows that there are 243,000 workers (13.2% of the employed population who declared a sector) working in the sectors most directly exposed to Brexit.

By examining employment in these sectors across different counties we can estimate which areas of the country are most exposed in the event of a no-deal Brexit. The counties with the highest exposure are Cavan (28%), Monaghan (27%), Kerry (22%) and Longford (21%), with over one in five workers in each of those counties employed in exposed sectors. The Border and Midlands regions in which three of these counties are located are both in the bottom 50% of European regions when it comes to GDP per capita adjusted for purchasing power.

Meanwhile exposure is lowest, as expected, in urban areas. The least exposed counties include Cork and Galway cities along with the four Dublin local authorities and their surrounding counties (Louth, Meath, Kildare, and Wicklow). In nominal terms, Cork County has the highest numbers of jobs in the exposed sectors, at 28,000. This is over twice as high as the next county but is still less than 14.5% of employment in the region.

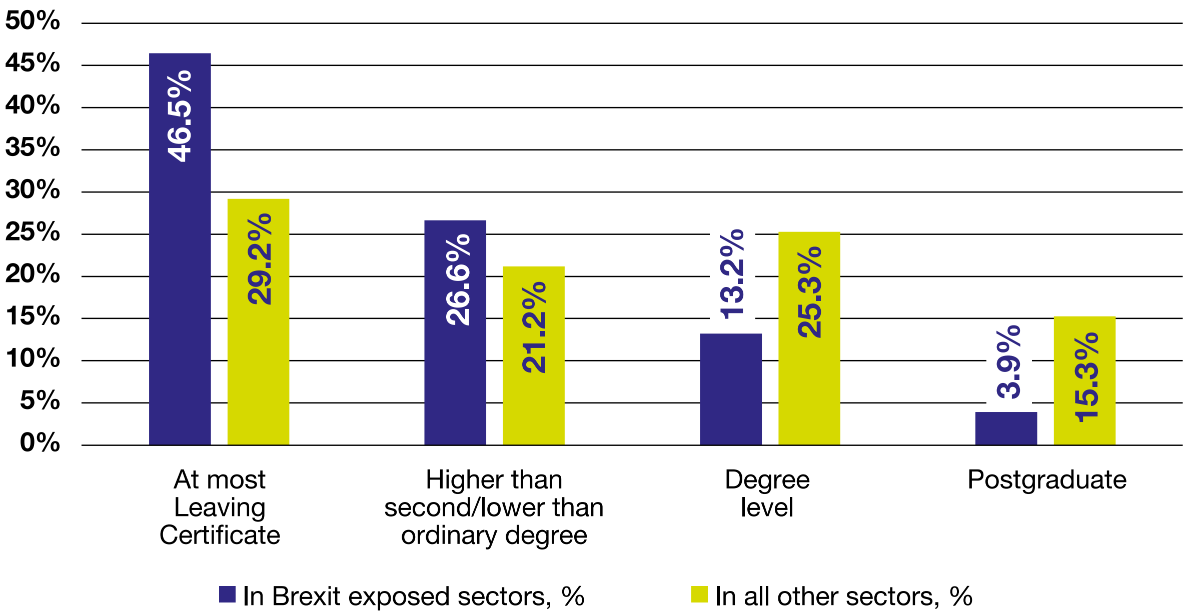
Figure 4: Household incomes and employment in Brexit-exposed sectors, by county



Source: Ibec analysis of CSO data

It is also the case that those working in the most Brexit-exposed sectors tend to be older than average. One in three workers in the most Brexit-exposed sectors are over the age of 50. Workers in the most Brexit-exposed sectors also finished school younger than the national average. For example, only 17% have a third-level qualification; this is compared to 40% of workers in all other sectors. The most common level of qualification for workers in the most Brexit-exposed sectors is a Leaving Certificate or lower, with just under 60% having a higher qualification of technical or vocational training. Both age and educational factors would have consequences for re-training and ability to move to find work. This will be a significant challenge for regional skills and industrial policy no matter what form Brexit takes.

Figure 5: Highest level of education of workers in the most Brexit-exposed sectors, %

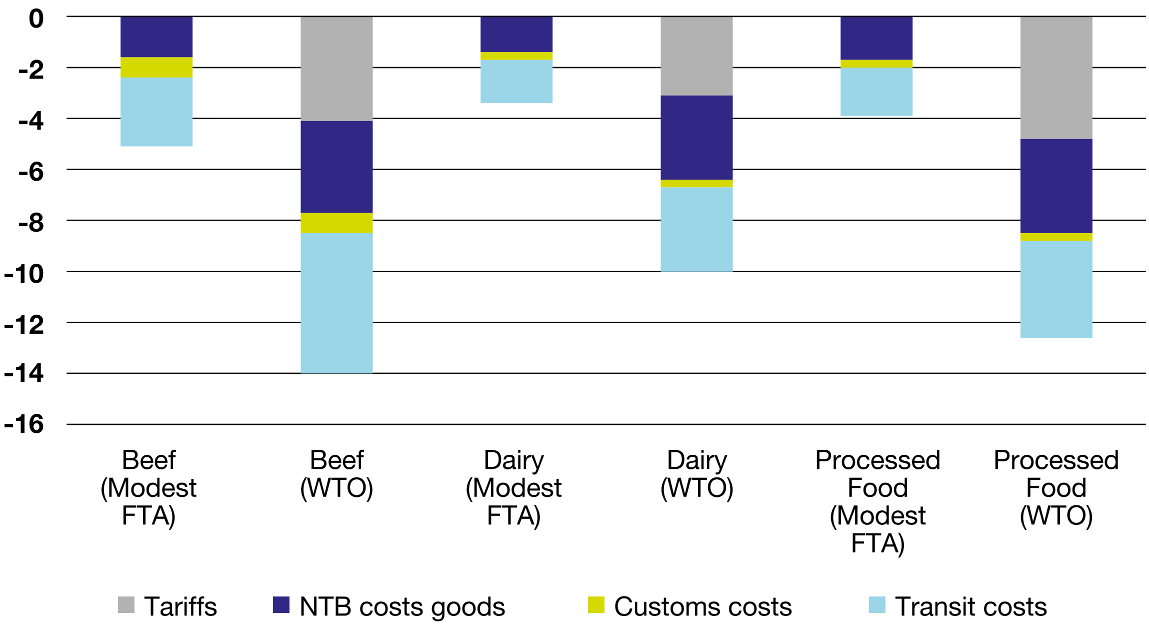


Source: Ibec analysis of CSO data

Impact of tariffs and non-tariff barriers on the sector

The figure overleaf shows the impact of different forms of Brexit transmission on output in the Irish food and drink sector. The estimates from Copenhagen Economics show that a WTO outcome would have quite significantly worse impacts on the sector with total output for beef (-14%), dairy (-10%), and processed food and drink falling substantially (-12.5%). What is notable about these impacts is that the fall in output would be long lasting and would persist over time, with many products (and particularly beef) having few alternative markets.

Figure 6: Impact of Brexit transition end points on Irish food and drink



Source: Copenhagen Economics

These falling levels of output would consequently flow down the supply chain in the form of reduced demand for intermediate goods and services of suppliers, as well as reduced demand for product from primary producers. This in turn would depress prices for those producers.

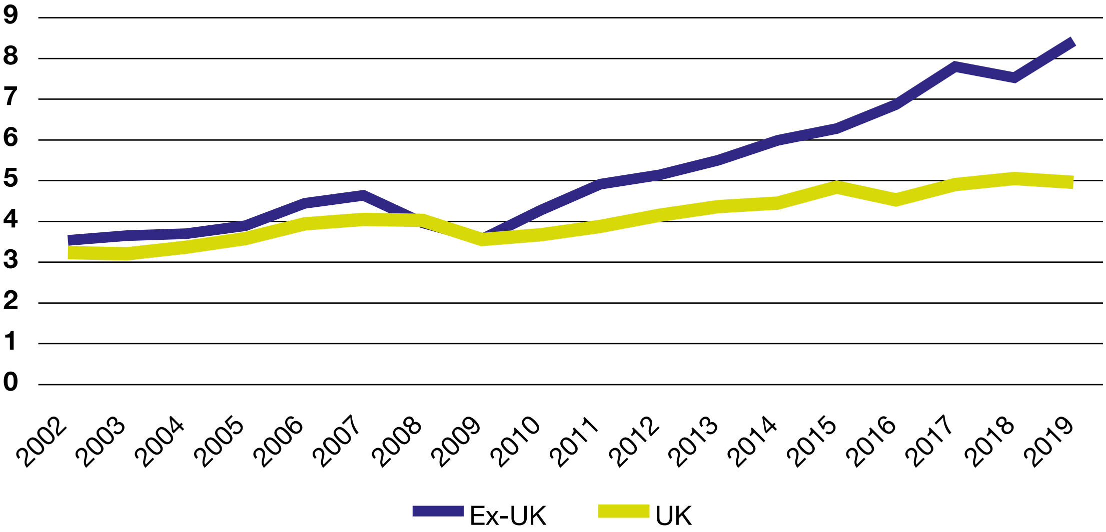
Even in a 'bare bones' FTA scenario, there would be significant additional costs for Irish food and drink companies arising from additional customs procedures, regulatory burdens, and rising transport costs. Additional paperwork, certification and delays in trade would gradually erode the efficiency of interlinked supply chains, both with the UK and through the land bridge to the continent. This would add extra costs at each step of production and distribution. The knock-on impact of non-tariff barriers would also likely increase capacity constraints in transport and distribution. This would result in higher costs of transport and storage for all companies. The impact of this is already being seen with warehousing and storage costs increasing by 14.3% in the three years to Q2 2020. These issues would impact both importers and exporters.

Diversification challenges

There has been a significant focus in recent years on accelerating the pace of diversification of exports from those sectors most exposed to Brexit. The food and drink sector, which is the single most exposed on the export side, has had some success in diversifying away from the UK. The value share of food and drink exports going to the UK has fallen from 44% in 2015 to 35% in the first half of this year.

Amongst the main product categories, we have seen the most significant decrease in the share of our dairy exports going to the UK. In volume terms, the share of cheese being sold to the UK has fallen from 61% in 2014 to 44% in the first half of this year. The decreases in milk (58% to 28%) and butter (39% to 13%) have been even more pronounced. On the other hand, progress in diversifying the beef sector has been more difficult with 47% of the volume of Irish beef still reaching the UK market, down just marginally from 50% in 2014.

Figure 7: Irish food and drink exports by location, €bn



Source: Ibec analysis of Eurostat data

There are reasons why the UK has always been attractive for Irish producers – it is a large, close market, with a shared retail footprint and similar tastes. Building new markets, on the other hand, involves considerable risk and expense. New market penetration is a long game, requiring significant investment with no guarantee of success. Even within the single market companies face barriers in establishing commercial relationships and supply chains. In addition, they must build cash flow, innovate, and invest to tailor the product to consumer tastes and deal with new regulatory regimes. The further goods travel the tighter margins will be as transport costs increase. Significant resources will be needed to help companies meet these challenges.

Table 1: Export shares going to the UK by product

	Beef	Milk	Butter	Cheese
2014	50%	58%	39%	61%
2015	54%	52%	31%	58%
2016	56%	37%	32%	52%
2017	56%	42%	25%	50%
2018	57%	44%	22%	52%
2019	48%	30%	21%	46%
2020 (H1)	47%	28%	13%	44%
Growth in tonnes exported, 2014 to 2019	12%	52%	60%	61%

Source: Ibec analysis of Eurostat data

Policy recommendations

In July, at the Summit on the EU Multi-Annual Financial Framework and the COVID-19 Recovery Instrument, EU leaders agreed to make €5 billion available to a special Brexit Adjustment Reserve[1] to counter the adverse consequences of Brexit on the most affected Member States and sectors. The European Council's Final Conclusions states that *"a new special Brexit Adjustment Reserve to be established to counter unforeseen and adverse consequences in Member States and sectors that are worst affected"*. The Commission will make a legislative proposal for the new reserve in November 2020.

In the Brexit Readiness Action Plan[2], the Irish Government noted *"As one of the Member States most impacted by Brexit, Ireland is working with the Commission to ensure Irish businesses and sectors benefit from the Reserve, to the maximum extent possible" and that "Government will remain actively engaged in promoting Irelands' interests in relation to the Brexit Adjustment Reserve"*.

In March of this year the European Commission adopted for the second time a Temporary State Aid Framework[3] to enable Member States to use the full flexibility foreseen under State aid rules to support the economy in the context of the COVID-19 outbreak. Together with existing State aid rules the Temporary Framework enabled Member States to ensure that sufficient liquidity remained available to businesses of all types and to preserve the continuity of economic activity during and after the COVID-19 outbreak.

This State aid Temporary Framework to support the economy in the context of the COVID-19 outbreak, based on Article 107(3)(b) of the Treaty on the Functioning of the European Union, recognises that the entire EU economy is experiencing a serious disturbance. The Communication noted *"this shock is affecting the economy through different channels. There is a supply shock resulting from the disruption of supply chains, there is a demand shock caused by lower consumer demand and there is the negative effect of uncertainty on investment plans and the impact of liquidity constraints for undertakings"*. To remedy that, the Temporary Framework provides for five types of aid including direct grants, loan guarantees / subsidies and short- term export credit insurance.

37% (€4.5bn) of Irish agri-food and drink exports go to the UK each year. Typically, less than 10% of other member states food and drink exports are to the UK. This highlights the unique circumstances

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1. European Council Conclusions July 2020, EUCO 10/20 CO EUR 8 CONCL 4, Article 26
2. Brexit Readiness Action Plan, September 2020
3. C(2020) 1863

faced by Irish industry and the need for these exceptional aid measures. Ireland needs to maintain our market position in this high value, high quality market that has a substantial food deficit and not relinquish it to global competitors.

In addition, in the event of no deal, Irish agri-food and drink will also see tariffs of up to €1.5bn imposed on exports to the UK. In turn imported food and drink from the UK will face tariffs which will be collected by the Irish Exchequer / EU. Some or all of this should be used to offset the tariff impact on Irish exporters and indigenous manufacturers who import critical raw materials.

Ireland and in particular the food and drink sector now faces a serious economic disturbance as outlined by the analysis in the previous chapter. What was also demonstrated by that analysis is the unique position and importance of the Irish food and drink sector in the overall Irish economy and the challenges it now faces. This means that the fracture to the single market and its deep and unique impact on the food and drink sector in Ireland have an economy wide impact.

Unique position and challenges

- The Irish food and drink sector is, by far, the most exposed of any sector in any country in Europe to a no trade deal Brexit.
- The sector alone accounts for 31% of total indigenous exports and over 54% of indigenous manufactured exports.
- The largest purchaser of goods and services in the Irish economy of any exporting sector.
- Intermediate purchases made by food and drinks producers from the agriculture sector in 2012 made up 85% of the total external product flows from the agricultural sector. This level of purchasing is the main facilitator of farm incomes and investment in the Irish economy.
- The most Brexit-exposed sectors are concentrated in the poorest parts of the country.
- One in every five male workers is employed in the most Brexit exposed sectors, with much higher rates in rural areas.
- A WTO outcome would have quite significantly worst impacts on the sector with total output for Beef (-14%), Dairy (-10%), and processed food and drink falling substantially (-12.5%). The fall in output would be long lasting and would persist over time with many products having few alternative markets.

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- Even in a 'bare bones' FTA scenario, there would be significant additional costs for Irish food and drink companies arising from additional customs procedures, regulatory burdens, and rising transport costs. These would gradually erode the efficiency of interlinked supply chains, both with the UK and through the land bridge to the continent.
- Building new markets involves considerable risk and expense. New market penetration is a long game, requiring significant investment with no guarantee of success. Even within the single market companies face barriers in establishing commercial relationships and supply chains. In addition, they must build cash flow, innovate, and invest to tailor the product to consumer tastes and deal with new regulatory regimes. The further goods travel the tighter margins will be as transport costs increase. Significant resources will be needed to help companies meet these challenges.

Accordingly, exceptional targeted policy responses continue to be required. These should include accessing the existing €4 billion in Brexit contingency funding set aside for the years 2020 to 2025, an extension beyond December 2020 of the Temporary Framework for State aid supports as well as substantial funding from the Brexit Adjustment Reserve and any increased tariff revenue from UK imports in order to maintain and sustain economic activity and jobs. The supports should be targeted at the food and drink sector and their scope should not be restricted to SMEs but should include all companies in the sector.

Recommendations

Funds amounting to 5% of the value of current annual export sales to the UK will be needed annually from domestic and EU sources for at least three years. These state aid supports and funds from the Brexit Adjustment Reserve should be targeted as follows:

- **Enterprise stabilisation**
  Short term measures to allow the Irish Government to re-introduce the Employer Wage Subsidy Scheme for Brexit impacted companies in a no-deal scenario. The scheme should be put on a scenario-contingent footing and be reintroduced on a temporary basis where firms are struggling due to immediate loss of income or substantial cost increases due to Brexit.
- **Investment in competitiveness**
  Medium term measures to allow the Irish Government to introduce investment aids to support Irish food and drink companies invest in enabling technology, management training and upskilling, plant renewal and expansion, refinancing, market development and innovation to regain competitiveness following single market fracture
- **Improve export capability**
  Introduce a state supported export credit insurance scheme to ensure the expected gap in supply of export credit insurance does not impact on the ability of Irish firms to export.

- **Diversification and Innovation**
  Additional funding for direct grant supports for innovation, marketing and trade promotion for companies looking to build new markets in the EU and internationally. Ensure state agencies make full use of the new state aid guidelines to fund up to 50% of research and development projects which support future business growth.
- **Direct connectivity to continental markets**
  Ensure sufficient accompanied roll on / roll off capacity for direct ferry routes to the continent.
- **Customs skills**
  Provide direct supports to cover the additional ongoing costs associated with developing and maintaining customs clearance capability. These supports will be required throughout 2020 and 2021.

In addition, a **Tariff Support Mechanism** will be required in the event of no deal:

- A fund to offset the tariff amount imposed by the UK on the most exposed sectors. This would allow industry to keep trading with our UK customer base, maintain our UK market position and avoid massive displacement of produce onto EU markets with consequent price collapse. The fund should also offset the impact of EU tariffs on indigenous manufacturers importing critical raw materials.
- It would not drive additional volumes as the Tariff Support Mechanism would be at a rate comparable to the tariff applied to the products exported/imported and conditions could be applied to ensure it only operates for the most exposed sectors.

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