Ibec
For Irish Business

Brexit &
Future EU
An Ibec campaign

Economic stabilisation in a no-deal Brexit

The case for State aid supports

Ibec
For Irish Business

Brexit &
Future EU
An Ibec campaign

Contents

Key messages

A ‘no-deal’ Brexit would have immediate and negative impacts for many businesses in some of Ireland’s most economically vulnerable regions. Such an outcome requires a strategic response to support the industries, companies and regions that would be most impacted.

In the EU, there is precedent for State Aid supports at moments of crisis. These supports, while temporary in nature, have a track record of ensuring business and employment is sustained during periods of economic shock.

In this report, we outline the impact of a no-deal on business, why supports are required, and what supports are needed. Even if a Brexit deal with a transition period is agreed, many of these supports will still be necessary to help firms transition to a much less advantageous trading relationship with the UK.

Our key messages are:

1. **A no-deal Brexit will place significant pressures on Irish business.**
   A depreciation in sterling, cancelled investment, cashflow challenges and increased trade costs will all lead to significant pressure on companies in a no-deal scenario. However, the object of State intervention is not just to save companies but also the jobs, communities and downstream suppliers reliant on them.

2. **The impact of a no-deal will be a structural shock to the rural economy.**
   Those most vulnerable to job losses in a no-deal scenario are already living in areas with fewer opportunities, a lack of other viable employment and lower incomes. The companies most exposed are both capital intensive and low margin. If firms collapse in a no-deal scenario they will not be easily replaced. This will be a structural shock to the rural economy.

3. **A temporary State Aid framework will be necessary to offset any shock.**
   As in 2009, a temporary framework for aid will be needed to offset the worst impacts on vulnerable but viable firms. The European Commission must begin now to work with Member States to achieve this. The current rescue and restructuring State Aid rules will be of limited use given their extremely restrictive conditionality and limits on support.

4. **The Irish Government should put in place a multi-annual funding framework for Brexit beginning in Budget 2020.**
The annual resources required will be in the region of 5% of the value of current annual indigenous export sales to the UK (€500 million). This should be provided for at least a three-year period and would not present a challenge to the Single Market rules, as it would only bring Ireland temporarily in line with the average State Aid profile of other EU countries.

5. **Key supports need to be put in place now.**
Experience from 2009 shows that it took 10 months from agreement on a State Aid framework until companies could draw down supports. In a no-deal scenario, if supports were only activated in the Autumn of 2020 it would be far too late to sustain enterprises and jobs. It is vital that we introduce legislation and have structures in place to administer these schemes as soon as possible.

01 Introduction

As we approach the deadline for Brexit negotiations on Thursday 31 October 2019, the prospect of a 'no-deal' Brexit is increasing. Business has already spent millions on contingency planning and has been left dealing with costly uncertainty. For many of our most important economic sectors, the adjustment to a no-deal scenario will be rapid and painful no matter how well prepared they are. In the event of a no-deal Brexit, we expect significant impacts from continued depreciation in the value of sterling, cancelled investment, falling consumer confidence, rising costs and considerable trade disruption. As a result, it is imperative that we now begin to put in place the schemes and supports which will be necessary to protect business and jobs in the sectors most exposed to the negative implications of a no-deal. Companies will continue to make key decisions over the coming weeks and the Government can play a greater role in supporting them. In this document we set out the views of Irish business on how Government can support viable companies through the worst impacts of a no-deal Brexit and protect our indigenous sectors.

The recommendations in this document must be targeted at the most vulnerable but viable firms and sectors. This should not just extend to the agri-food sector, but also to the wider domestic economy; traditional manufacturing, retail, tourism, forestry, construction, energy, transport, utilities, and telecoms would all be affected either directly through the loss of trade or otherwise through disruption of their supply chain. The need for diversification not only applies to exporting companies, but also to those importing. To prepare for no-deal, we believe three arrangements will have to be put in place as soon as possible:

- It is vital that a temporary framework on State Aid is agreed as soon as possible with the European Commission.
- In parallel, we must begin to prepare the complex legislation and administrative functions that will be necessary to get schemes up and running as soon as possible.
- Finally, Budget 2020 must also outline provisions for a new multi-annual funding framework for State Aid supports to assist vulnerable companies and protect jobs in impacted sectors.

If the worst no-deal scenario occurs, it will fundamentally reframe the country's economic outlook. The fallout from a no-deal Brexit fall-out will be most significantly felt by our regional and rural economies. The introduction of these support schemes will ensure that the Irish economy is able to weather the impact of a no-deal Brexit. It will provide viable but vulnerable companies with a bridge across the immediate impact of no-deal Brexit and allow them to begin to re-align their businesses for a post-Brexit world. It will sustain jobs in rural and regional communities where there is often little other industry. No matter what the outcome of Brexit, companies will need support to diversify, innovate and re-align their business models. The education system will need support to provide the capacity for upskilling. Supporting our domestic industries will mitigate the worst impacts of Brexit domestically.

02 The impact of a no-deal Brexit on business

Macro-economic forecasts when it comes to Brexit are bound to significantly differ due to the unprecedented nature of a no-deal Brexit. As such, they should be taken with a note of caution. What we do know, however, is that a no-deal Brexit will have a significant negative impact on the Irish economy. Our latest assessment is that growth will still be positive, but it will be half what it would have been due to negative movements in sterling, investment and prices, and trade disruption. For many of our regions and indigenous industries, this will feel like a deep and scarring structural break. Many rural and border areas will experience a significant fall in economic activity.

The main avenue of impact, however, would be through the labour market. For 2020, Ibec forecasts that employment growth will slow to 2% as the global economy begins to slow. Ibec's expectation is that employment may still grow out to the end of next year even in the event of a no-deal Brexit. However, the pace of growth would slow significantly in 2020 to only marginally above zero in such circumstances. In the long-term, a weakening of our indigenous base would have significant negative implications for existing challenges, such as growth in our regions and the overreliance of the economy on too few companies.

There are several ways in which a no-deal Brexit would have an immediate impact upon the economy. In this section we outline, in brief, the main ways a disorderly Brexit would impact the economy. Given that any potential no-deal Brexit is hopefully a transition state rather than a permanent one, we will primarily focus on the short-term impacts.

2.1 Sterling weakness

The continued weakness and volatility in sterling is already putting acute pressure on the margins of Irish exporters. This has been most acutely felt by SMEs who are less diversified, have less market power and often cannot afford hedging products. We expect that there would be further significant volatility in the event of a no-deal Brexit.

Recent forecasts by the Bank of England paint a bleak picture for Irish exporters in the event of no-deal Brexit. In a no-deal scenario, the Bank has forecasted that sterling could depreciate by anywhere between 10% and 25%. All else equal, this could see sterling at an unprecedented 110p versus the euro in 2020. At the very least we would expect the euro-sterling exchange rate to near parity. At these levels, large numbers of Irish firms would not have sufficient profit margins to supply the UK market without complete price pass-through to British consumers.

In addition, there are other costs which will be imposed by sterling volatility. Companies will need to have shorter hedging timelines – often moving to month-to-month contracts – which will place significant additional costs on business, make planning more difficult, and potentially make hedging prohibitive for most SMEs.

2.2 Investment and consumer confidence

In the event of a no-deal Brexit, there would be an immediate sharp shock to both investment and consumer confidence. Already we are seeing signs of stalled investment amongst SMEs. This would rapidly spread due to the uncertain environment created by a no-deal. Political and trade uncertainty would make it impossible for companies with limited resources to take risks when they cannot accurately judge their potential return on investment. In addition, it is likely that investment would become more difficult with firms' margins put under pressure, increased costs of funding, and access to equity capital reduced.

A significant loss of margin for either exporting or importing firms would mean that they are less able to take on additional leverage to grow in existing markets or expand to new ones. Instead many firms would re-direct resources which could otherwise be used for investment and growth, to sustain their existing markets and deal with the costs imposed by trade disruption. In the same way, a no-deal Brexit would also make it more difficult for SMEs to fund market diversification.

From a consumer point of view, confidence surveys have shown consumers to be fearful about the future over recent months. We have seen this come through with significant reductions in the pace of purchases of some big-ticket items. New tariff and non-tariff barriers and general capacity constraints in the transport and storage sectors would increase trade costs between Ireland and both the UK and the continent. This would likely be only partly offset by cheaper sterling imports. Consumers would also be likely to respond to any further depreciation in sterling by increasingly purchasing goods cross-border. In the mid-1980s, when there were significant North-South price differentials and the UK was outside the Single Market, almost one-quarter of the alcoholic spirits consumed in this jurisdiction were purchased cross-border. Together, this would have a significant impact on the economy of regions most exposed to wider Brexit effects and those closest to the border.

2.3 Trade, market access, and cashflow

In a no-deal Brexit scenario, additional tariff and non-tariff costs would significantly impact the competitiveness of some industries when selling into the UK. Tariff costs would particularly impact the agri-food and beverages industry, whilst non-tariff barriers would be an impediment to trade for all companies. Additional paperwork, certification and delays in trade would gradually erode the efficiency of interlinked supply chains, both with the UK and through the landbridge 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 transport and storage costs for all companies. The impact of this is already being seen with warehousing and storage costs increasing by almost 15% in the two years to Q1 2019. These issues would impact both importers and exporters.

It is likely that in a no-deal scenario the impact of increasing trade costs and lower demand for goods and services would be felt quite quickly. One impact of any negative shock of this kind would be to make cashflow more difficult for all companies. For both companies trading domestically and with the UK it is likely that business-to-business payment timelines would stretch significantly as firms seek to conserve their cash balances. A move from 30-day average payment timelines even to 40 days would increase the cash needs of an SME by one-third. It is quite possible that payment timelines could stretch much further in the initial shock. Even where payment delays are kept to a minimum, any erosion of margins would make existing cashflow provision more difficult for firms. The recent introduction of the deferred accounting scheme for VAT on imports would help in this regard, but more could be done by ensuring better provision for invoice discounting, factoring, and other cashflow arrangements.

Finally, many firms, particularly SMEs, do not have enough customs experience to deal with any new tariff and customs arrangements. What is more, the capacity of customs agents in Ireland, the UK and the broader EU is limited. This is a reality given the lower demand for these skills in the post-Single Market era. As it stands, only 31% of Irish exporters sell goods outside the EU. This leaves 69% of exporting firms with no experience of tariffs and customs arrangements. This could result in a serious disruption if close trading ties with the UK are not maintained over the coming years. It would also impose impossible costs on many SMEs. Even those who invest in training existing staff risk seeing them poached as demand for customs skills increases dramatically.

One of the main things companies can do to prepare for Brexit is to register for an Economic Operators’ Registration and Identification (EORI) number. Companies need this number to trade with any non-EU country, which will include the UK after Brexit. As such the run-rate of EORI registrations is a good indicator of how well-prepared companies are for Brexit. As it stands, take-up of the EORI has been extremely slow. Revenue data from the VAT VIES system shows that 90,000 firms traded with the UK in 2018, yet by September 2019 only 59% of these have applied for an EORI number, which they will need to continue this trade post-Brexit. Feedback from our members suggests these exposed firms are mostly smaller companies having small irregular trade with the UK. It is highly unlikely customs agents alone will be able to cover this volume of work on behalf of business.

03 Why are supports needed?

3.1 The importance of Brexit-exposed industries

From a business point of view, supports are needed given the impact outlined in the previous section. However, the object of state intervention is not just to save companies, but also the jobs, communities, and downstream suppliers reliant on them. 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-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.

Figure 1: Direct expenditure and net exports in the manufacturing sectors

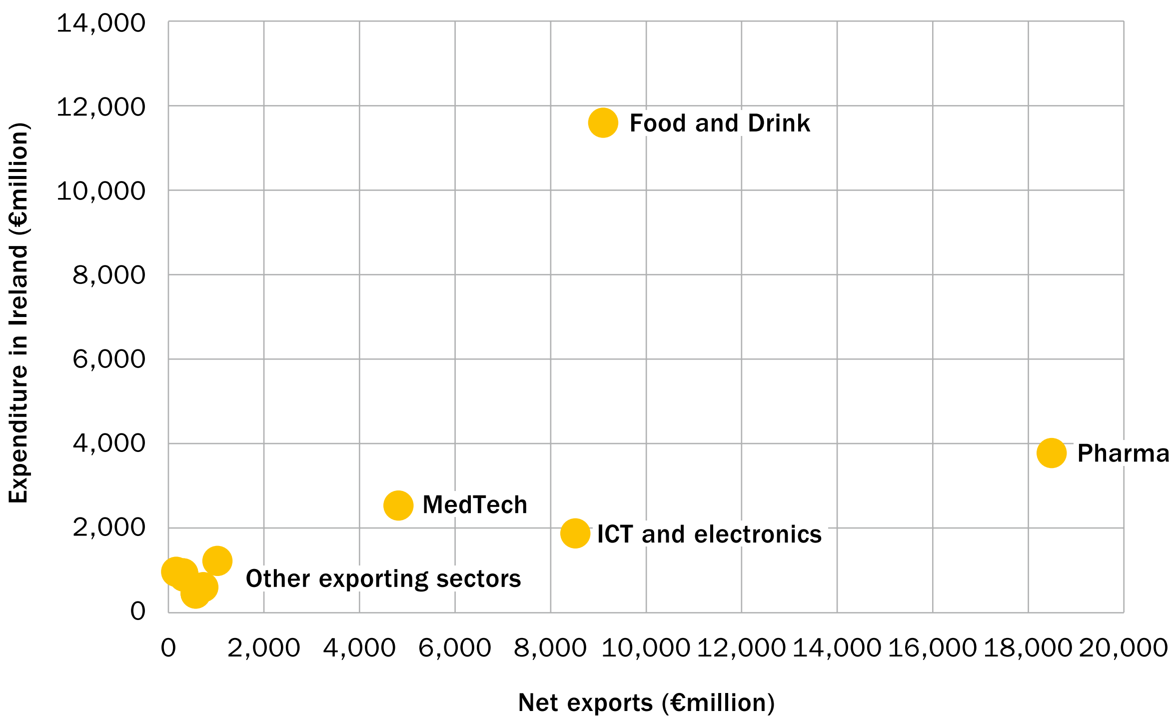


Figure 1 outlines the importance of the largest exporting sectors domestically. Although the indigenous industries, which are most exposed to Brexit, account for only 11% of total exports, they are responsible for more than half of all direct employment and domestic spend of exporting companies in the Irish economy. For example, the food and beverages sector alone spends almost €12 billion annually in the Irish economy on wages and purchases from suppliers. This is more than the MedTech, ICT, and BioPharma manufacturing sectors combined. Some of these most Brexit-exposed companies are spending upwards of 70% of their turnover on purchases from Irish intermediate suppliers in primary industries and in their wider supply chains. Loss of market share in the UK and squeezed margins will eventually be experienced materially by these producers and suppliers, even if they are not directly exposed to Brexit themselves.

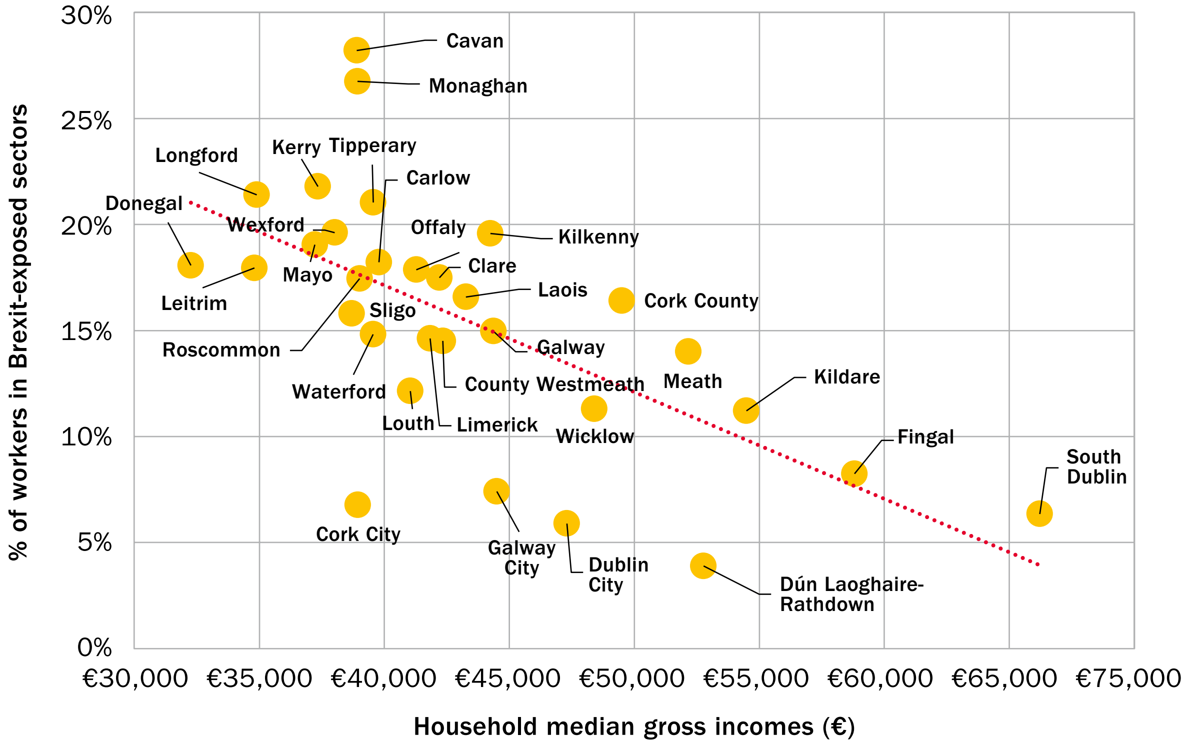
It is not only exporters, but also importers that will be impacted. Many companies which rely on either UK suppliers or the landbridge for vital parts, components, and goods for sale, would be equally impacted by non-tariff and tariff barriers in the event of a no-deal Brexit. The knock-on impact of these additional costs on importers would be reduced supply chain efficiency, higher import costs, and consequently higher overall costs to domestic consumers and producers here in Ireland.

3.2 Who is most exposed?

The most Brexit-exposed sectors are concentrated in the most economically disadvantaged 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 to a no-deal Brexit is lowest, as expected, in urban areas. The least exposed areas include Cork and Galway cities along with the four Dublin local authorities and their surrounding counties (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 2: Household incomes and employment in Brexit-exposed sectors, by county



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. Three-quarters of them are also male, due to the predominance of agri-food and manufacturing industries. In all, one in every five male workers is employed in one of these sectors, with much higher rates in rural areas.

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% have a higher qualification of technical or vocational training. Both age and educational factors would have consequences for retraining 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.

04 What supports are needed?

4.1 Why a temporary State Aid framework?

Brexit involves an unprecedented fracture of the Single Market, with Ireland particularly exposed. As such, it is vital that the EU institutions and national governments recognise the potential for economic disruption and take decisive steps to offset such risks. In this context, the potential supports outlined in the recent European Commission communication (2019, 394) through the European Solidarity Fund and the European Globalisation Adjustment Fund are welcome. Despite this, we continue to believe that the EU will need to do more to allow Member States to use their own resources to deal with the fall-out of either a hard or no-deal Brexit.

The accession process for new EU members is structured, takes place over a period of years, and supports are put in place for the economies and sectors most affected. A similar adjustment process is required to manage the departure of an EU Member State. The principle underpinning EU State Aid rules is that efficient operation of the Single Market is undermined by government interventions, except for clearly defined circumstances such as market failures.

However, Article 107(3) of the Treaty states that the Commission may declare aid compatible with the Single Market when it promotes “the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State”. There is no doubt that Brexit is a serious disturbance in the European economy and that mitigating its impacts is an important project of common EU interest. This serious disturbance will be most acutely felt in Ireland, both from a social and economic perspective, and therefore flexibility and support will be needed from our European partners.

In 2009, the European Commission adopted the communication, ‘A European Economic Recovery Plan’; this emphasised providing maximum flexibility in tackling crises, while maintaining a level playing field and not placing undue restrictions on competition. In this context, the Court of First Instance of the European Communities has ruled that the disturbance must affect the whole of the economy of the Member State(s) concerned and not merely that of one of its regions or parts of its territory. This, moreover, is in line with the need to interpret strictly any derogating provision such as Article 87(3)(b) of the Treaty. This was the basis for the introduction, by the European Commission, of the Temporary Framework in 2009 which, amongst other things, allowed for an increase in *de minimus* levels and state-backed credit insurance.

A European Commission staff working paper written in 2011 noted that “the Temporary Framework of aid to the real economy complemented the framework put in place to allow a swift and coordinated response during the crisis.... it has been a useful safety net allowing for an emergency response during the crisis”. The reaction of the EU States and the European Commission to the financial crisis should guide the reaction to what is now a fundamental shift in the future of the EU with the exit of its second largest market. Failure to do so would compound the political, social and economic fallout for the remaining EU Member States and most particularly Ireland.

As in 2009, a temporary framework for aid will be needed to offset the worst impacts of Brexit on vulnerable but viable firms. The European Commission must begin now to work with EU Member States to achieve this. The current rescue and restructuring State Aid rules will be of limited use given their extremely restrictive conditionality and limits on support. Any new framework must introduce a Compatible Limited Amount of Aid Scheme of up to €5 million over three years for investment or working capital. This high level of compatible limited aid is necessary in recognition of the concentrated and capital-intensive nature of the firms involved. This should take the form of direct grants through an enterprise stabilisation fund, but should also include guarantees, interest rate subsidies and rescheduled debt for companies in distress.

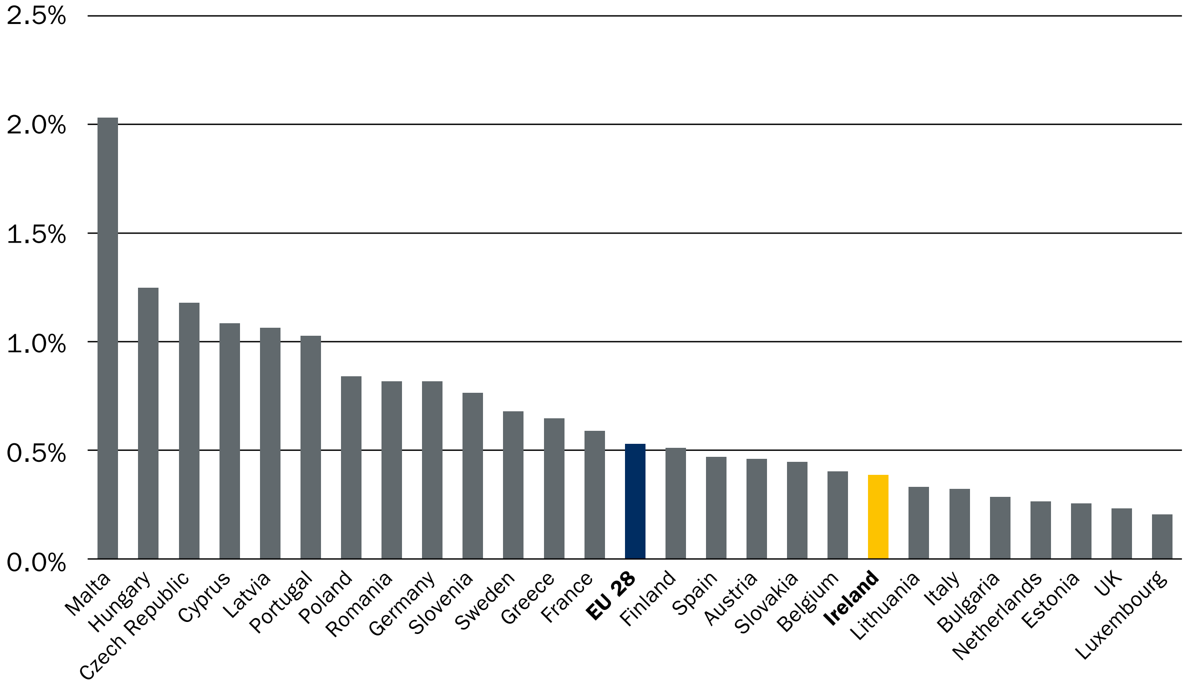
In addition, a temporary framework would allow funds to be made available in a timely manner; currently, approval of individual/scheme applications for aid are costly and time-consuming. Intensity ratios in regional aid guidelines may also need to be re-examined given the significant regional impacts of Brexit.

4.2 How much is needed?

To support businesses during this difficult period, the Irish Government should put in place a multi-annual funding framework for Brexit beginning in Budget 2020. The annual resources required will be in the region of 5% of the value of current annual indigenous export sales to the UK (€500 million). This would be provided over a three-year period to help companies trade through any period of disruption, adapt and succeed into the future.

These supports could be partly funded from the tariffs which will be collected on UK exports to the EU in a no-deal Brexit scenario. The average most favoured nation tariff on UK exports to the EU would amount to around 4.5% on a trade-weighted basis. As such, we would expect that EU Member States would collect in the region of €20 billion in tariffs on UK goods over the next three years. The EU, in turn, would collect €16 billion of this money from Member States. Of the €20 billion, the Irish Government would collect, through its 20% share of tariffs on Irish imports, between €700 million and €1 billion over three years. Both the EU and Irish Government should ringfence these funds to support the sectors and communities worst impacted by a no-deal Brexit.

Figure 3: State Aid % of GDP, 2000-2016



Note: Expenditure refers to all active aid measures to industries, services, agriculture and fisheries, for which the Commission adopted a formal decision or received an information sheet from the Member States in relation to measures qualifying for exemption under the General Block Exemption Regulation.

This would not require abandonment of Single Market principles, but would amount to targeted aid interventions operating on reasonably short and fixed timelines. In all, €1.5 billion over three years in direct aid would amount to an increase of 0.2 percentage points on Ireland's long-term State Aid to GDP ratio of 0.4%. As it stands, the level of State Aid given to Irish companies for things like innovation, market diversification, upskilling and capital expenditure in equipment and machinery, remains moderate in an EU context. Ireland's long-term State Aid to GDP ratio stands at 0.4%. Ireland would remain just above the EU average and be comparable for a three-year period to the long-term State Aid profiles of other EU countries, such as Germany, Sweden and France, which give significantly more support to their energy and industrial sectors.

4.3 Outline of the necessary supports

Necessary Brexit supports would require complex legislation and would take several months to administer. Experience in 2009 shows that it took 10 months from EU agreement on a temporary framework for State Aid until companies could draw down supports under the Employment Subsidy Scheme. In a no-deal Brexit scenario, supports which are activated in the Autumn of 2020 would arrive far too late. As such, it is vital that the Government introduce the necessary legislation now and have structures in place to administrate these schemes before 31 October 2019 and in advance of negotiations on a temporary State Aid framework. The following outlines the schemes we think should be part of a stabilisation package in the event of a no-deal Brexit:

Short-term measures in the event of a no-deal Brexit:

- **To assist with cashflow in SMEs:** Accelerate the current SME credit guarantee scheme's coverage of invoice discounting and factoring arrangements in Brexit impacted firms, in line with State Aid rules.
- **To help companies diversify:** Introduce a new scheme covering export credit insurance. This would necessitate temporary changes to the EU's 'Short-term Export Credit-insurance Communication' to exempt schemes which are aimed at companies impacted by Brexit and diversifying away from the UK. This could include some private risk (up to 20%).
- **To support companies trying to invest:** Loosen the criteria for the existing loan schemes. These criteria and their overt focus on technological innovation are completely inappropriate for firms in sectors most impacted by Brexit.
- **To save viable but vulnerable companies in trouble:** Reintroduce an enhanced Enterprise Stabilisation Fund in the same vein as was available during the financial crisis in 2009. This would fund companies in difficulties because of Brexit, and would, by achieving a sound, robust and sustainable business plan, allow them to be financially viable in the medium-term.
- **To help workers and companies stay connected, even during a temporary shock to demand:** Prepare a short-time work subsidy scheme (for two years initially) for vulnerable workers in the event of a no-deal Brexit. This would mean a subsidy to the worker of up to 60% of the worker's reduced net wage, for up to 12 months. This would allow workers to go part-time into training/re-training for a temporary period where hours are reduced and would give companies greater flexibility in the case of a demand shock. It would be available only to impacted firms.
- **To maintain jobs in viable but vulnerable firms where short-time work is not possible:** Introduce an employment subsidy scheme, with subsidies of up to €10,000 over 24 months for employees in firms in distress.

Medium-term measures for diversification:

- **To help companies invest in long-term resilience:** Ongoing support will be needed for many sectors worst impacted by Brexit. Investment aid should be targeted at supporting Irish companies investing in enabling technology, management training and upskilling, plant renewal and expansion, refinancing, market development and innovation, to regain competitiveness.
- **To support companies looking to retool and reinvest in plant and machinery to produce product lines for new markets:** Introduce a pre-approved accelerated capital allowance scheme for projects which are deemed necessary under a clear Brexit-related contingency plan. Provision must be in line with those already available for energy efficient equipment, with allowances available to be claimed at an accelerated rate of 100% in year one.
- **To support companies in adapting to new market realities:** Introduce additional marketing and innovation supports for companies looking to reformulate, re-package or innovate their product lines for new markets.

Brexit &
Future EU
An Ibec campaign

ibec.ie/brexit