

2017

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Recommended Citation

Simons, Gerry (2017) "What Does Brexit Mean for West Michigan?," *Seidman Business Review*. Vol. 23: Iss. 1, Article 5.
Available at: <https://scholarworks.gvsu.edu/sbr/vol23/iss1/5>

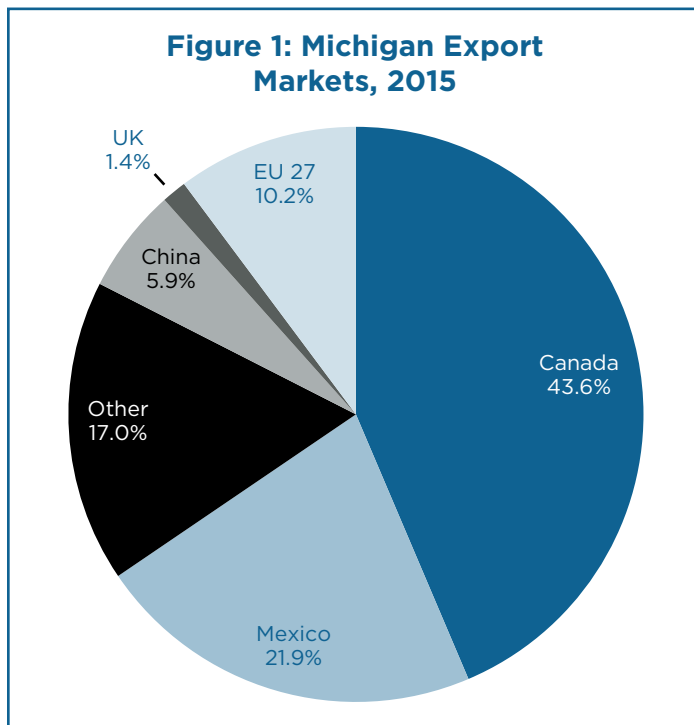
What Does Brexit Mean for West Michigan?

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On June 23, 2016, British voters passed a referendum 52-48% in favor of the United Kingdom (U.K. – England, Northern Ireland, Scotland, and Wales) leaving the European Union (E.U.). Although the referendum is not legally binding, the British government has announced that it will abide by the people's wishes and begin the process of "Brexit" – a British exit from the 28-country E.U.

As Figure 1 shows, about 1.4% of Michigan exports in 2015 were to the U.K. and another 10.2% to the remaining 27 E.U. nations, for a combined value of about \$6.3 billion. Comparable data for West Michigan are not available, but figures from the U.S. International Trade Administration indicate that around 23% of West Michigan's exports are to the E.U. as a whole. For the Grand Rapids-Wyoming Metropolitan Statistical Area, exports to the E.U. in 2015 amounted to about \$1.1 billion.



Source: International Trade Administration, U.S. Department of Commerce

Note, however, that the above data underestimate the full extent to which area companies sell products in the E.U., as these statistics only count the movement of goods from Michigan to Europe and do not include, for example, a West Michigan company's production of goods *within* Europe.

So, what does the Brexit vote and process mean for West Michigan? Here, I try to address some of the main areas of concern. Be aware, though, that no individual country has ever left the E.U., and that the interpretation of some of the laws governing the process are being questioned, with their outcomes still to be determined. I will also not cover everything – the U.K. and E.U. laws, regulations, and economies are so intertwined that disentangling them will be extremely complex.

When will the U.K. actually leave the E.U.?

If you had asked me this a few months ago, I would have said, "Probably in March 2019." That is because British Prime Minister Theresa May has said that the U.K. will initiate the formal process for leaving the E.U. by the end of March 2017. At that point, the clock starts ticking – E.U. rules (Article 50 of the Treaty of the European Union) give the E.U. countries two years to negotiate the withdrawal agreement once the formal process has been initiated. However, in November 2016, the British High Court ruled that the Prime Minister cannot initiate the formal process without an act of Parliament. At the time of printing, this ruling hasn't been overturned by the British Supreme Court, and it is unclear if Theresa May will be able to start the formal process by her desired date.

Whenever the formal process is initiated, it is unlikely, though theoretically possible, that the negotiations will take less than two years. Nevertheless, the U.K. will be out of the E.U. once the two years are up, whether or not the countries have reached an agreement. (It is possible for the remaining 27 members of the E.U. to grant an extension to this two-year process, but that too is unlikely).

What trading arrangements will the U.K. have with the U.S.A.?

As long as the U.K. is part of the E.U., it must abide by the E.U.'s trade policies with respect to the U.S.A. (and other non-E.U. countries). After Brexit, the U.K. and the U.S.A. would be free to negotiate a trade deal independently of the E.U.

The tricky part is that the E.U. says that its rules prohibit the U.K. from officially engaging in any trade negotiations until Brexit is complete. However, some constitutional specialists argue that E.U. law does not actually prohibit negotiations during the two-year withdrawal phase. If any agreements are negotiated prior to Brexit, they could then be signed into law as soon as the Brexit process is finalized.

All of this means that the U.S. and the U.K. could enter into a preferential trading arrangement. In light of the recent floundering of talks for the U.S.-E.U. Transatlantic Trade and Investment Partnership (TTIP), it is even conceivable that a trade deal with the U.K. is reached before an agreement is reached on the TTIP. However, this is all speculation. Although Australia and the U.K. have informally expressed an interest in a joint free trade agreement, no public statement has been made concerning a possible U.K.-U.S. trade deal.

How will this affect business trips to the U.K.?

Until Brexit actually happens, nothing will change in this regard, and it is likely that things won't be any different than now for American business people even after Brexit – no visa requirement for business visits of up to six months for U.S. citizens. Once the U.K. leaves the E.U., it is free to change its rules regarding visa requirements. However, it is extremely unlikely that it will add restrictions for U.S. business visitors.

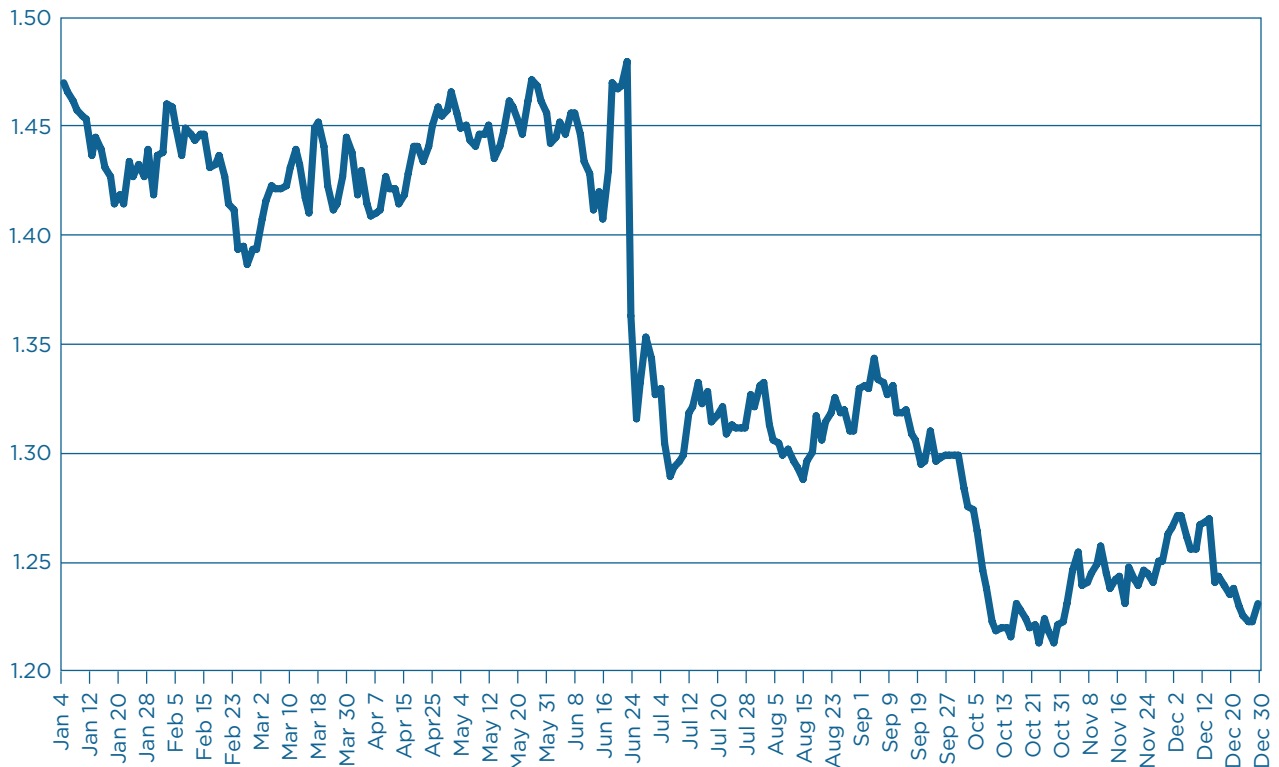
If your employees are citizens of E.U. countries who will be traveling in and out of the U.K., then they might face new restrictions on the duration of visits to the U.K. once Brexit is complete, as the U.K. will no longer have to abide by the E.U.'s "free movement of people" principle. Also, if your employees are British citizens, then they are likely to incur additional fees to visit Schengen Area countries. The U.K. is not part of this bloc, for which there are no border controls between the 26 E.U. and non-E.U. members. The E.U. is considering a program similar to the U.S.'s E.S.T.A. (Electronic System for Travel Authorization) for non-E.U./non-Schengen citizens who want to enter the Schengen Area. This would involve an online visa waiver application process as well as payment of a fee. If adopted, this would mean that a British

employee on a business trip to Germany, for example, faces no restriction while the U.K. remains part of the E.U., but would have to pay the fee and use the E.U.'s E.S.T.A. once Brexit is complete.

What about exchange rates?

As Figure 2 shows, there was a tremendous drop in the value of the pound following the Brexit referendum on June 23rd. The pound fell by 10% against the U.S. dollar in the three trading days after the referendum. Subsequent concerns about the impact of Brexit and the uncertainty about the trading relationship between the U.K. and the E.U. post-Brexit have pushed the pound lower. The relative strength of the U.S. economy compared to the U.K. (and the impact on Federal Reserve and Bank of England policy) has also dampened the pound and strengthened the dollar, with the pound falling by about 17% against the dollar from the time of the referendum to the end of 2016. It is likely that the pound will remain below its pre-referendum levels for some time. This, of course, is bad news for American businesses – British products will have a competitive edge, sales of American products in Britain will be hurt, and the dollar value of the profits of American subsidiaries in the U.K. will also drop.

Figure 2: 2016 Daily Exchange Rate: U.S. Dollars per British Pound



Source: Bank of England

How will Brexit affect intra-European trade?

The U.K. will have the same business rules and regulations as the rest of the E.U. until Brexit actually takes place. Some fear, though, that once the U.K. leaves, it would be free to change regulations, including industry standards. An American business which is currently selling the same product across the E.U. might then face the problem and cost of having to satisfy different standards for selling to the U.K. However, the U.K. is a member of C.E.N - the European Committee for Standardization, which creates standards and specifications across 33 European nations. As it is not an E.U. organization, British entities will continue to be subject to C.E.N standards even after Brexit.

The problem is not a change in standards, but rather a change in the bureaucracy concerning the shipment of goods into and across the E.U. If you transport British-made products from the U.K. to France and from there through Germany and into Poland, you currently have relatively little bureaucracy to deal with. After Brexit, though, the bureaucracy could increase substantially, with added costs and delays at ports of entry. To get around the issue of border checks, Britain would need to have a Mutual Recognition Agreement on conformity assessment with the E.U. as well as an agreement on Customs cooperation. These might or might not be negotiated during the two-year withdrawal period.

You will likely face additional problems if your business involves the import or export of goods between Britain and the E.U. Britain's post-Brexit trading relationship with the E.U. will be part of the negotiations taking place during the two-year withdrawal phase. The best case scenario for the U.K. is that it will continue to have free trade with the E.U. (for example, by joining the European Free Trade Association). However, some E.U. leaders have threatened a "hard Brexit" - not agreeing to free trade with the U.K. In that case, the most likely (and worst case) scenario would be that the trade relationship would be as Most Favored Nations under World Trade Organization rules. So, for example, your business might then face tariffs on raw materials that you are buying from Germany for your production plant in England, or on finished goods that you manufacture in Scotland and sell in Italy.

Speaking of Scotland, will it also leave the E.U.?

Yes, but... As part of the U.K., Scotland will leave the E.U. along with the rest of the country. However, there has been a growing push in Scotland for it to leave the U.K. and be an independent nation. In 2014, a referendum in Scotland resulted in a 55-45% vote to stay in the U.K. Ironically, one of the reasons for voting to stay was so as to not jeopardize E.U. membership. Of course, that is now changed with the Brexit referendum, in which the majority of Scots voted to remain in the E.U. In October 2016, the Scottish government published its plans for a second independence referendum. If it takes place, it would likely be held after Brexit. The independence vote has a greater likelihood of passing the second time around. If it does, it will lead to a whole host of other issues. How will a split from the rest of the U.K. actually happen? What would it involve? How long would it take? Would Scotland be able to get fast-track entry into the E.U. as an individual member, or would it have to go through the lengthy application process? There are just too many unknowns at this point.

What's the bottom line?

The bottom line is that there is a lot of uncertainty about what a British exit from the E.U. will involve. But what we do know is that this is not just a "British problem" or even a "European problem." Businesses in the U.S. must keep up with the changing landscape and evaluate and respond to the uncertainty as best as they can. ■