



Brexit – the challenge for the food and drink sector

Safeguarding
business, jobs
and trade

Foreword

Ireland's largest manufacturing sector is facing a set of unprecedented challenges following the UK vote to leave the EU. Over the longer term the entire basis of our trading relationship with our most important export market will be renegotiated. Immediately however, we face a currency shock that is structural rather than cyclical. Urgent action is now required to protect our vital exports to the UK market, limit damage in the domestic market from imports and address competitive pressures arising from the decline of Sterling. Action and significant measures are needed now to avoid the undermining of Irish food exporters' preferred supplier position in the UK food and drinks supply chain and the erosion of our €4.4 billion export business. Failure to do so will severely damage our exports, result in substantial job losses and weaken our trading position in the post-Brexit environment.

Executive summary

The UK vote to leave the EU is the largest and most immediate challenge facing the Irish agri-food sector. The UK is our largest trading partner for food and drink. 41% of food and drink exports go to the UK (€4.4bn) and Ireland is the UK's second largest supplier of food and drink.

Whilst the outcome of exit negotiations between the EU and UK will potentially have a huge impact on our trading relationship with the UK and the fundamental basis of our export model and domestic market, the sector already faces one major challenge – a large and rapid weakening of Sterling with a significant further weakening of the pound against the Euro in prospect.

This report outlines the severe impact on exports and jobs that this currency shift will have on a UK focused export sector like food and drink. The current change in currency value is structural not cyclical and there have also been many fundamental changes to the economic and business environment domestically and in the UK which make this very different to previous Sterling weaknesses. These include:

- Brexit means that the current Sterling weakness is different from the normal exchange rate cycle and things could get much worse;
- Limited capacity for Irish exporters to drive further efficiencies in their businesses;
- Total export values to the UK have grown strongly in recent years, so losses could be greater;
- Pricing strategy of UK retailers in a deflationary environment for food;
- Impact on supply chain policies of UK retailers and food services sector on food and drinks companies;

- Market renationalisation – domestic sourcing policies growing across Europe;
- Much more competitive retail food sector in UK – hard discounters have doubled market share to 10%;
- Risk of loss of domestic market share – retailers have supply chains in place to do this;
- Complication of operations and administration for all island food and drinks businesses.

Ibec's Brexit survey of more than 450 companies found that food and drink companies were much more worried than other business sectors about the downside risks brought about by Brexit despite twice as many having hedging or pricing arrangements in place.

An analysis of the historical exchange rate and agri-food export relationship shows that a 1% weakness in Sterling results in a 0.7% drop in Irish exports to the UK. If Sterling was to weaken further towards the £0.90 mark, this would translate to losses of over €700 million in food exports and about 7,500 Irish jobs.

A structural shift in exchange rate relationship, combined with Brexit related trade risks means that UK buyers are planning significant supply chain restructuring – the real threat is a loss of confidence in Ireland as a competitive supply base resulting in loss of markets and exports.

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The Irish agri-food model is dependent on stability in currency exchange rates. But it is also dependent on a cost-competitive manufacturing environment, access to finance, access to export markets and a state support network.

There are two areas in particular where Irish companies are at a significant competitive disadvantage to their UK counterparts – labour costs and capital costs. Past research has shown these are also the major costs items for manufacturing business. As a result Ireland already has significant cost disadvantages from both an Opex and Capex point of view for food and drinks companies when compared with the UK.

The market impact will be felt not just in reduced exports to the UK but also the overall growth and export targets of Food Wise 2025. It will cause damage domestically where imports (and cross border trading) will displace indigenous products and in other export markets where UK food exports are competing with Irish exports – continental European and international markets.

The exit negotiations between the EU and the UK will have major implications for our trading relationship with the UK. The main objective must be to maintain full unfettered access to the UK market. In addition UK access to the EU single market is much more preferable to UK bi-lateral agreements with third countries.

In the short term however, the Government's objective must be to put in place mitigating measures to help companies manage their businesses and safeguard farmer incomes through the ongoing uncertainty caused by the currency shift and the exit negotiations. The focus must be on maintaining markets in the UK, developing other markets as well as ensuring that in the domestic market, companies remain competitive against imports and the threat of cross-border shopping. Issues related to specific problems faced for example with regard to 32 county Geographical Indication's also need to be considered.

This requires an immediate Brexit response package that includes:

- A review of the impact of Brexit on the objectives contained in the national agri-food strategy, Food Wise 2025;
- A Government established taskforce led by the Department of the Taoiseach to engage with the food and drink sector on the implementing immediate measures that will safeguard today's business and trade flows in the face of this major challenge to our competitive position;
- The re-introduction of the Employment Subsidy Scheme and the Enterprise Stabilisation measures which were last applied in 2009-11;
- €25m in funding for market diversification and product innovation measures;
- An access to finance package that includes sustainable financing via funding from the Irish Strategic Investment Fund and improved State Aid rules;
- An intense ongoing focus on cost competitiveness led by the Department of Jobs, Enterprise and Innovation in areas such as labour, energy and insurance;
- A fully 'Brexit-proofed' Budget which will address tax competitiveness against the UK.

01 Introduction

Food and drink is Ireland's largest indigenous sector with 230,000 linked jobs has seen exports grow by over 50% since 2009 to reach €10.8 billion in 2015. The sector's continuing ambition is reflected in the €19 billion export target in Food Wise 2025.

Whilst the sector faces many challenges in reaching this target, the most immediate however is the UK vote to leave the EU. The UK is our largest trading partner for food and drink. Ireland is the UK's second largest supplier of food and drink. 41% of food and drink exports go to the UK (€4.4bn). This includes:

- 70% of prepared consumer foods (PCF) exports;
- 56% of total meat exports;
- 30% of dairy exports (including 60% of cheese exports);
- 32% of alcohol exports.

The outcome of exit negotiations between the EU and UK will potentially have huge market access issues with associated trade and regulatory implications. Many of these cannot yet be foreseen. However the sector already faces one major challenge – a large and rapid weakening of Sterling with a significant further weakening of the pound against the Euro in prospect. This differs from previous currency shifts being structural rather than cyclical.

The analysis undertaken by the Ibec Economic Unit and detailed in this report clearly indicates the severe impact on exports and jobs that this currency shift will have on a UK focused export sector like food and drinks. The report looks at the following:

- Why the current weakening of Sterling against the Euro is more problematic for Irish exporters now than in the past;
- Economic analysis
 - Margin and pricing pressures
 - Exchange rate impacts of food and drinks exports
 - Business cost comparisons;
- Market impact and business implications
 - UK market
 - Displacement by imports
 - Other export markets
 - Cross border shopping;
- A new trading relationship;
- Recommendations.

“ Urgent action is now required to protect our vital UK exports. Failure to do so will severely damage our exports, result in substantial job losses and weaken our trading position in the post Brexit environment.”

Why the current weakening of Sterling against the Euro is more problematic for Irish exporters now than in the past

Currency risk is a factor that Irish food and drink exporters have had to deal with for our nearest and largest market for a number of decades. However the rapid and recent change in currency value is different and more serious than that experienced during the major depreciation of Sterling in the late 2000s. The current change is structural not cyclical. There are also many fundamental changes to the economic and business environment. These differences are outlined overleaf.

Analysis of business conditions 2016 V 2010

	2010	2016
Brexit means that the current Sterling weakness is different from the normal exchange rate cycle and things could get much worse	Monetary policy cycle and economic issues in the UK and Eurozone were the main issues impacting on the exchange rate.	Further weakening of Sterling is likely as the full economic consequences of Brexit become clearer.
Capacity for Irish exporters to drive efficiencies	From the start of the great recession in 2008, Irish manufacturers and in particular food processors implemented very effective productivity and change strategies through lean and other measures. This greatly improved the overall competitive position of Irish exporters.	Following a number of years on intensive efficiency measures, capital deepening and business transformation, most food processors now have limited opportunities for further productivity gains. This means that the exchange rate movement cannot be offset through business efficiency improvements.
Total export values are higher, so losses could be greater	Food exports to the UK in 2010 were €3.4bn.	Irish food exports to the UK in 2015 were €4.4 bn and the gains made since 2010 could easily be reversed, hence resulting in a greater overall negative impact for the economy.
Pricing strategy of UK retailers	Currency and commodity related import food inflation in 2010 was passed through to UK consumers in the form of higher prices – UK retail food prices increased by over 5% in 2010.	UK retailers have already flagged that they will cut food prices in response to Brexit and are strongly refusing currency-related price increases of any level. UK retail food price inflation is currently negative.
Impact on supply chain policies of UK retailers and food services sector	No real long-term impact as UK buyers saw Sterling weakness as cyclical.	Concerns about a more structural shift in exchange rate relationship, combined with Brexit related trade risks means that UK buyers are planning significant supply chain restructuring – a loss of confidence in Ireland as a competitive supply base will accelerate this.
Market Renationalisation	With the exception of beef, origin labelling was voluntary.	In UK and other EU states, there is a growing move by some retailers towards domestic sourcing policies for meat and dairy. Piloting of mandatory country of origin labelling for meat and dairy ingredients is starting in France and proposed in other states. It has the same objective of favouring domestic production. Mandatory original labelling is also required by EU law for other meat products.
UK retail food and drinks sector now more competitive	Market dominated by traditional big four retailers.	Strong growth by hard discounters who have doubled their market share to 10% at the expense of larger retailers.
Displacement by imports – the Prepared Consumer Foods example	The depreciation of Sterling was the main trigger for a fundamental realignment of supply chains in the domestic grocery sector which saw PCF imports rise from €1.96bn in 2006 to €2.35bn in 2010 and to €2.75bn in 2012 – a period of decline in the overall grocery market.	The conditions have now been created in supply chains for this realignment to accelerate at the expense of domestic producers.

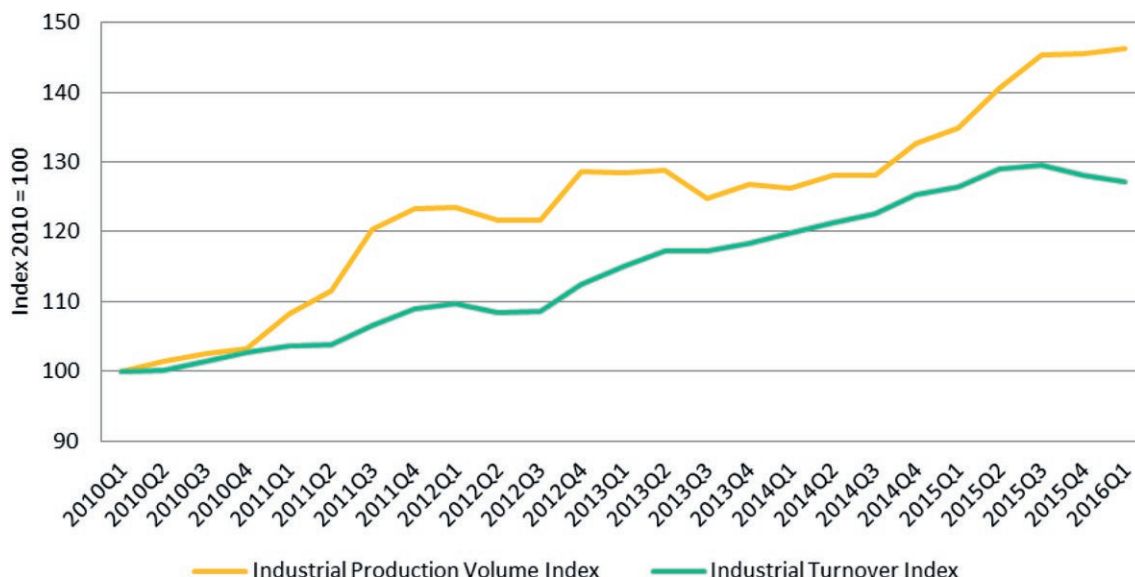
Economic analysis

3.1 Margin and pricing pressures have increased

Brexit has pushed the Euro/Sterling exchange rate which is key for Irish companies in the agri-food sector from an average of 0.73 in 2015 to 0.85 today. Most analysts expect that the Euro will continue to strengthen versus Sterling over the coming months and move toward 0.90. If the UK economy weakens over the coming years there is a growing possibility the exchange rate could reach parity.

There are a number of ways in which the market for Irish food and drinks producers has changed since the last sustained period of similar exchange rates in 2010. In the first instance, margins in the Irish industry are much tighter than in 2010, in addition the potential to reduce costs in the industry is much more constrained with most companies having gone through significant restructuring during the last decade.

Figure 1: Industrial production in food indices (2010 Q1 = 100)



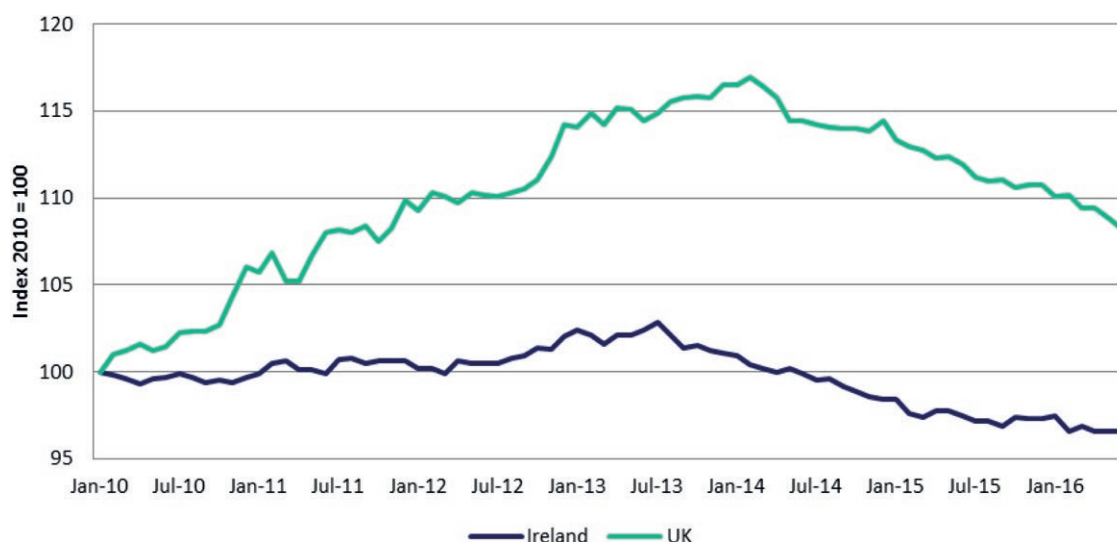
In addition to the constraints on companies' ability to internally adjust in the face of a weak Sterling their ability to pass through price in both of their main markets is now significantly weaker than in 2010. Since 2010 much of the food and drinks industry has seen a period of sustained growth in both volumes and turnover. This, however,

has been built on much tighter operations and lower unit prices. Since 2010 volumes in the Irish food industry have grown by 46%; on the other hand turnover has grown by 27%. The gap signifies a significant tightening of unit prices on their 2010 levels.

Irish food exporters in 2010 were selling into a market where rising food prices meant that exchange rate led margin erosion could be passed on to the consumer. In 2010 average food prices in UK retail rose by 3% year-on-year. Thus far in 2016 they have been falling by 3% on the previous year. As a result it is now impossible to pass on

the increased exchange rate cost. This makes Irish goods less attractive relative to their peers in the UK market. An additional pressure point is that UK imports are also becoming cheaper, in a cost sensitive Irish environment, increasing the probability that major retail outlets will begin to source outside their Irish market.

Figure 2: Food prices in Ireland and the UK



Ibec Brexit Survey – food and drink more worried, even though better prepared



- Ibec's Brexit survey of more than 450 companies found that food and drink companies were much more worried about the downside risks brought about by Brexit.
- Overall 45% of companies said that exchange rate movements would have a negative impact on their business but a much higher proportion (64%) of food and drink companies felt this.
- In terms of exports, 42% of food and drink companies said Brexit would have a negative impact on the value of export sales, while only 26% of total companies said this.
- 42% of food and drink companies said exchange rate volatility was their main challenge, compared to 22% of total firms.
- More food and drink companies had a hedging or pricing arrangement in place – 51.5% compared to 24% overall.

3.2 Exchange rate impacts on demand for Irish food and drinks exports

In the coming years the Irish agri-food sector will be shadowed by a UK political decision which will have significant implications for Ireland and Europe over the medium to long term. Expectations of a slowdown have emerged in the UK as businesses and consumers re-evaluate their position. Early post-Brexit Purchasing Managers Index (PMI) and consumer data, although in no way comprehensive, has been sufficiently weak as to warrant concern. While this means that the outlook for Ireland in 2017 is now considerably more uncertain, it is still too early to tell what the full effect of Brexit will be, either domestically or internationally.

This depends as much on the ability of the political system in the UK to engender confidence in consumers and business over the coming months as on any external factor. As of now, little has changed in the Ireland-UK trading relationship at a fundamental level. In the immediate the major item of concern for Irish exporters is the deterioration of Sterling and the consequences for Irish export competitiveness in the UK market.

Previous exchange rates

Although the level of volatility and uncertainty in Sterling is unprecedented it is worth looking at how Irish agri-food trade has reacted to past movements in the Euro/Sterling exchange rate. The challenge from a planning point of view is that the events over the coming years are likely to be 'out of sample' in a sense. This means forecasts of potential impacts must come with appropriate health warnings. Past relationships may provide some guide to the future but can only go so far.

Figure 3 looks at relationships between Euro/Sterling and Irish agri-food exports since the introduction of the Euro. It shows three distinct periods in the Euro/Sterling relationship and its impact on the growth of Irish good exports. The most striking period is the consistent year-on-year fall in Irish food exports during the 2009-10 period as a confluence of factors damaged UK consumer confidence and the Euro/Sterling exchange rate turned against Irish exports.

Figure 3: Euro/Sterling exchange rate and annual growth in Irish agri-food exports, 2003-2016

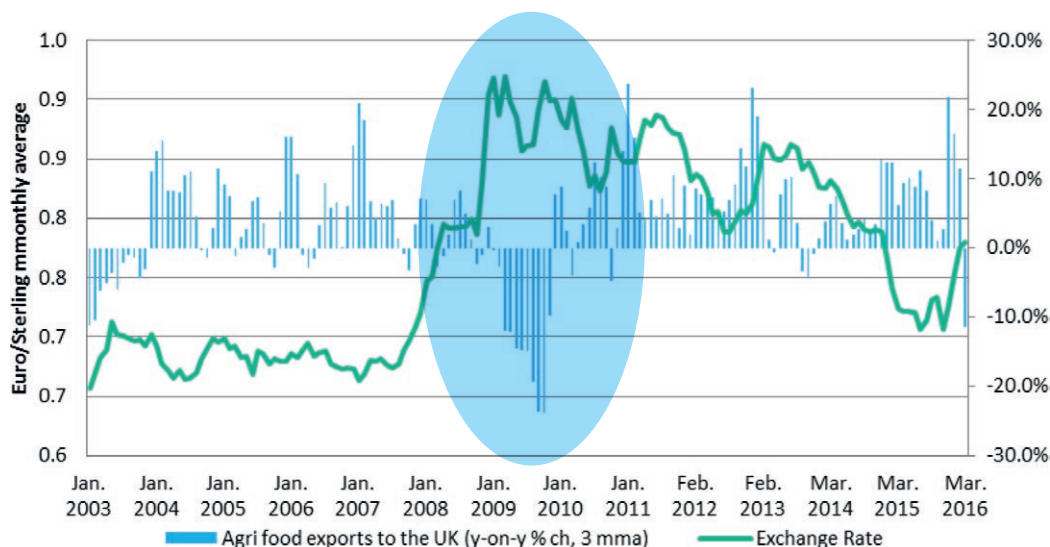
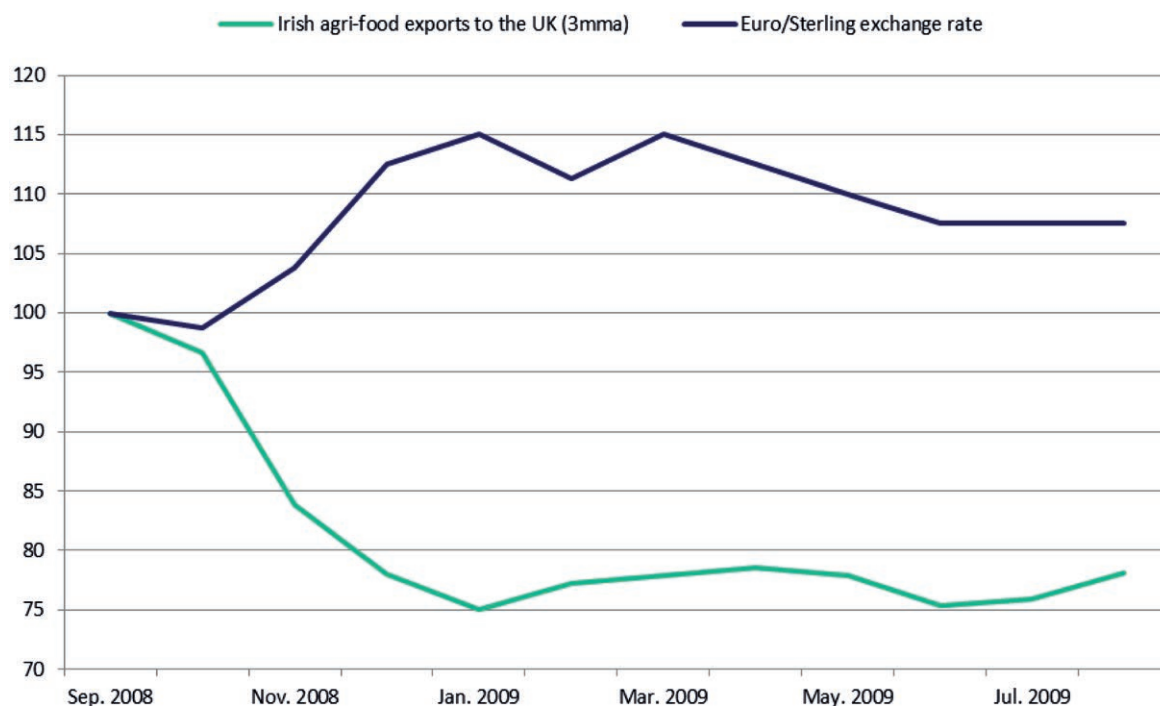


Figure 4 shows in greater detail the increase in Euro/Sterling between Sept 2008 and mid-2009 and its effect on Irish agri-food exports to the UK. Between September 2008 and January 2009 in particular the Euro/Sterling exchange rate climbed by almost 15% while monthly Irish

agri-food exports fell by 25%. It is worth noting that UK food retail sales fell by only 2.6% over the same period. Of course due to other factors it is difficult to say how much of a role the exchange rate played on its own. What is clear, however, is that role was significant.

Figure 4: Euro/Sterling exchange rate and annual growth in Irish agri-food exports, 2003-2016

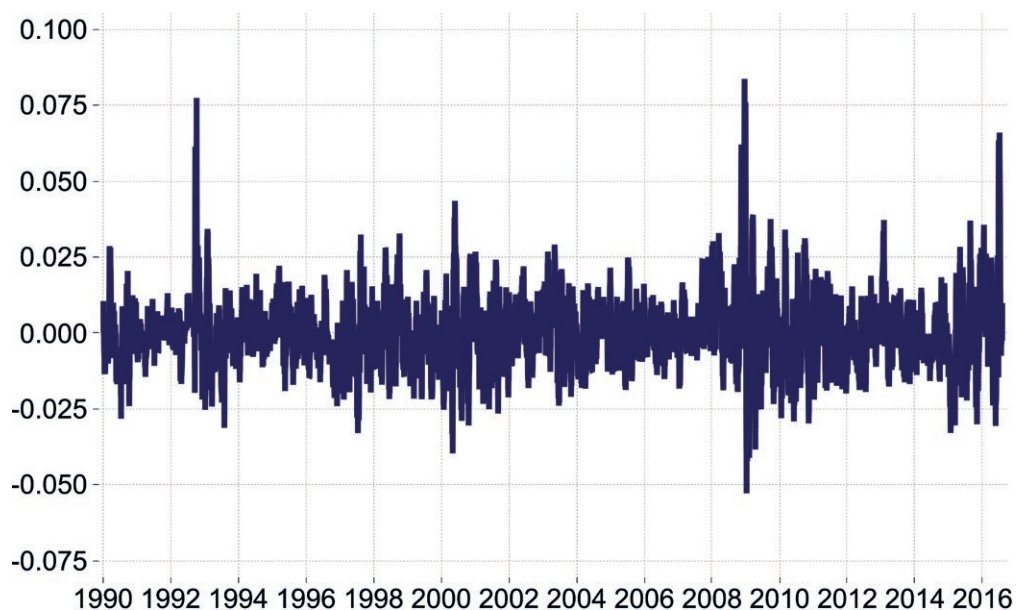


The pace of change

Another element to the problems facing Irish companies is the pace at which the Irish position versus Sterling has changed. *Figure 5* is a proxy measure of the 'shock effect' of the referendum result. On only a handful of occasions since 1990 has the daily exchange rate (either

in Euro or Sterling) between Ireland and the UK moved by more than 2.5% away from its moving average over the month previous. The two previous examples, in both 1993 and 2009, signalled severe downturns in Irish food exports over the months to follow.

Figure 5: Ireland/UK exchange rate – difference between daily rate and its monthly moving average



When compared to the monthly averages the pace and scale of movement in the daily exchange rate since Brexit is on a scale which is comparable with Ireland's currency crisis in 1992/3 and only marginally below the exchange rate shock which accompanied the financial crisis in 2009. Given many companies have little or no hedging or pricing protection the pace of change poses serious challenges. The current exchange rate level, although high by historical standards, may not fully reflect the pain being felt by exporters.

Econometric estimates

In order to get a better idea of the relationship between Irish agri-food and drinks exports and exchange rates over the long term we have performed some econometric analyses. The results point to some major challenges facing Irish agri-food exporters in the months ahead.

Firstly we performed a panel regression containing data on 12 of our largest export partners¹ across 13 years from 2002 to 2015. These countries accounted for 79% of Irish food and drinks exports in 2015. We include other variables in our model such as GDP per capita, population, EU membership, presence of a common language and distance between capital cities along with the exchange rate. Various specifications of our model suggest that Irish food and drinks exports have a log-log elasticity of between -0.3 and -0.95 with the most robust specifications suggesting an elasticity of around -0.7. This

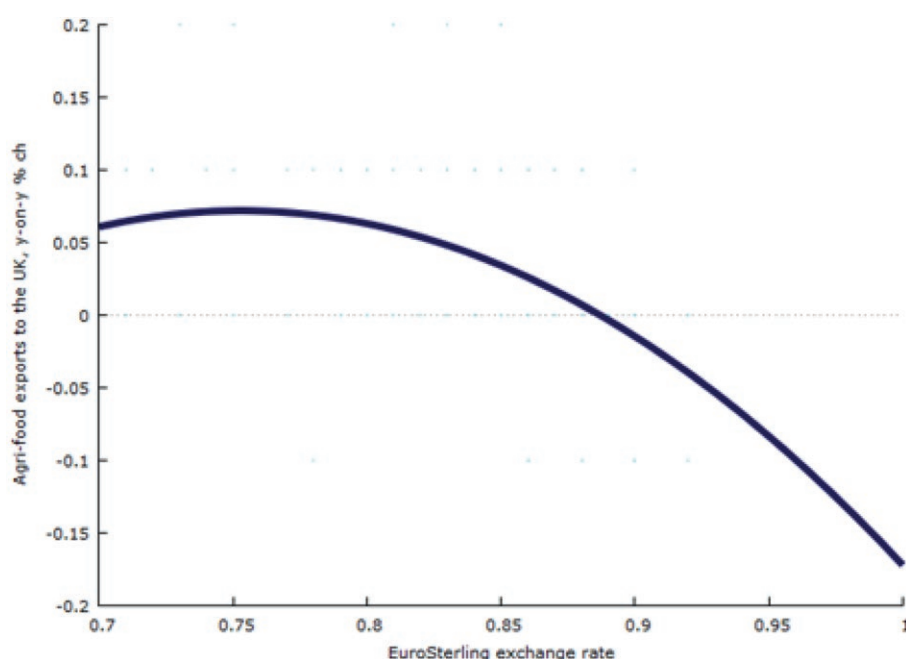
means that on average a 1% increase in the strength of the Euro against a trading partner's currency reduces Irish food exports to that country by 0.7%.

This elasticity would imply that a move in the Euro/Sterling exchange rate from an annual average of 0.73 (avg. for 2015) to the 0.9 last reached in 2009 would reduce Irish food and drinks exports by around 16% (€721 million). Given the agri-food sector has an employment intensity of around 10.5 per €1 million in output (Matthews et al, 2005) this would result in the loss of almost 7,500 jobs across the economy. This represents an immediate threat to the Irish food and drinks sector, even before any negotiation commences on the future longer term trading relationship with the UK post-Brexit.

Given a cost to Government of €20,000 for each job lost, the potential impact on the national exchequer of losing 7,500 jobs will run to €150 million.

Of course, the relationship between exchange rates and exports may not be linear. The rate at which exports fall may accelerate above some tipping point for example. Anecdotal evidence from company feedback suggests the point of pain for Irish exporters in the UK is generally in the region of 0.80 Euro/Sterling or above. To examine this, taking 157 months of data since January 2003, we regress the Euro/Sterling exchange rate and its quadratic form (the rate squared) on the annual growth in Irish food exports to the UK.

Figure 6: Fitted values of Irish food exports to the UK and the Euro/Sterling exchange rate



1. Those for whom a full series of exchange rate data is available – UK, France, Netherlands, Germany, Italy, US, Belgium, Spain, Hong Kong, Poland, Sweden and Denmark

“ Analysis of the historical exchange rate and agri-food export relationship shows that a 1 % weakness in Sterling results in a 0.7% drop in Irish exports to the UK. If Sterling was to weaken further towards the £0.90 mark, this would translate to losses of over €700 million in food exports and about 7,500 Irish jobs.”

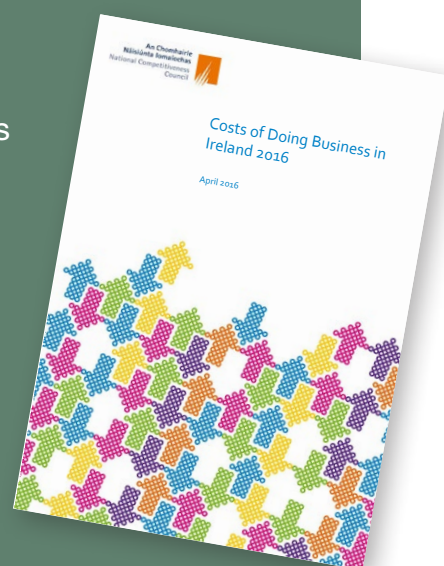
The results are displayed in *Figure 6* – they indicate that the tipping point for Irish food and drinks exports is somewhere approaching a Euro/Sterling exchange rate of 0.8. The growth rate of Irish agri-food exports to the UK begins to fall at an exchange rate level of around 0.8. Approaching 0.88 Irish agri-food exports to the UK begin to fall, with annual falls of around 17% predicted at parity in Euro/Sterling. Of course given this is only based on past data future impacts may vary from these values.

A common trend is clear from each of these separate pieces of statistical work. Both our econometric results suggest that a move toward a Euro/Sterling exchange rate of 0.90 from its 2015 level of 0.73 would see Irish agri-food exports to the UK decline substantially. They show that it is likely the growth of Irish food exports has already slowed somewhat and that further exchange rate movement beyond the current exchange rate (0.85 average in August) will put us above the inflection point for Irish agri-food exports to the UK. Furthermore given the export intensity of the sector it is likely that there will be substantial impacts for both employment and household income in predominantly rural communities as a result of the relative weakened Sterling.

3.3 Business cost comparisons

The National Competitiveness Council in the Costs of Doing Business in Ireland 2016 report² found that:

- The EU is among the most expensive locations for electricity and gas globally, and within the EU, Ireland is one of the most expensive countries for electricity for both large and small users – it is the 5th most expensive location in the Euro area 17 for large electricity users;
- The cost of credit continues to act as a drag on the enterprise sector, inhibiting investment and growth, particularly amongst start-ups and SMEs;
- In November 2015, the interest rate in Ireland on loans of up to €0.25 million was more than 80% above the Euro area average rate for new business; the rate on loans of up to €1 million was more than 60% more expensive in Ireland;
- Furthermore, Irish interest rates for commercial loans have been noticeably more volatile than Euro area rates. Irish and Euro area interest rates diverged further in 2014 and 2015;
- Ireland remains an expensive location in which to do business with a price profile which can be described as “high cost, rising slowly”.



There are two areas in particular where Irish companies are at a significant competitive disadvantage to their UK counterparts – labour costs and capital costs. Past research has shown these are also the major costs items for manufacturing business. As a result Ireland already has significant cost disadvantages from both an Opex and Capex point of view for food companies when compared with the UK.

Labour costs

On the back of the circumstances outlined above control over costs is more important than ever. KPMG data quoted by the National Competitiveness Council in their recent report on the cost of doing business in Ireland showed that typically labour costs (including income tax) can constitute between 49% and 72% of business costs in manufacturing. In this context the existing labour cost differential between Ireland and the UK will put Irish firms at a further cost disadvantage when competing in the UK market post-Brexit.

2. <http://www.competitiveness.ie/Publications/2016/Costs%20of%20Doing%20Business%20in%20Ireland%202016.html>

**Table 1: Relative Significance of Location Sensitive Costs
(% of total location sensitive costs), 2016**

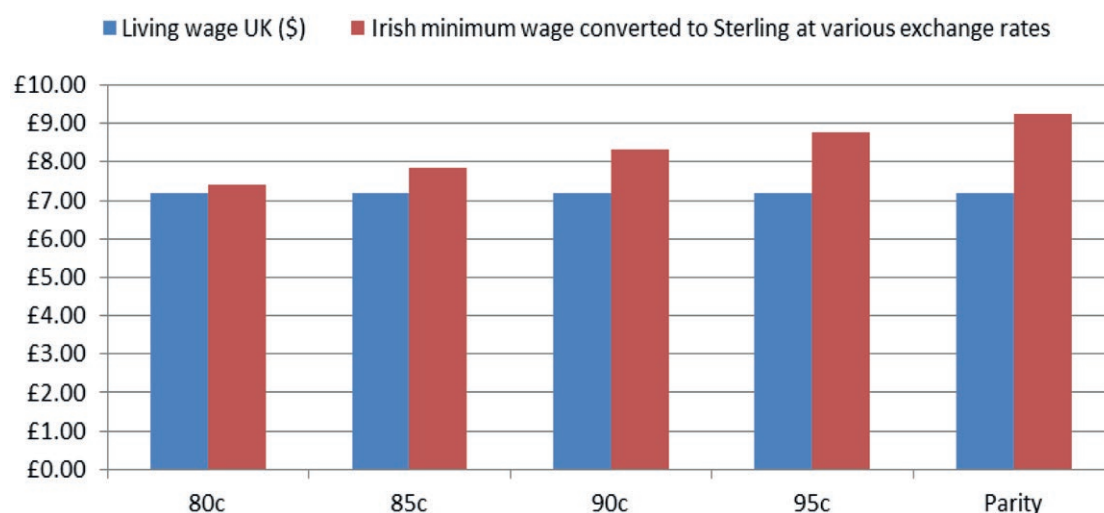
	Services	Manufacturing
Labour & Benefits	72-86%	40-57%
<i>Of which: Salaries & Wages</i>	52-61%	28-40%
<i>Statutory Plans</i>	8-10%	5-7%
<i>Other Benefits</i>	12-14%	7-10%
Facility Costs	4-15%	2-5%
Transportation Costs	–	6-21%
Utility Costs	0-1%	2-7%
Capital Costs	0-8%	11-25%
Taxes	3-16%	10-18%
<i>Of which: Income Taxes</i>	10-15%	9-15%
<i>Property Taxes</i>	1-2%	1-2%
<i>Other Taxes</i>	0-1%	0-1%

Source: KPMG Competitive Alternatives 2016, National Competitiveness Council

For small trading companies in Ireland Brexit would have a number of effects including regulatory divergence with a main trade market, cost competitiveness and product sourcing issues, energy cost increases and possibly reductions in trade between Ireland and the UK. In

addition to this, if Euro/Sterling moved to parity, as many commentators are predicting, this would leave the wage floor for Irish exporting firms at 29% higher in Sterling than its UK equivalent.

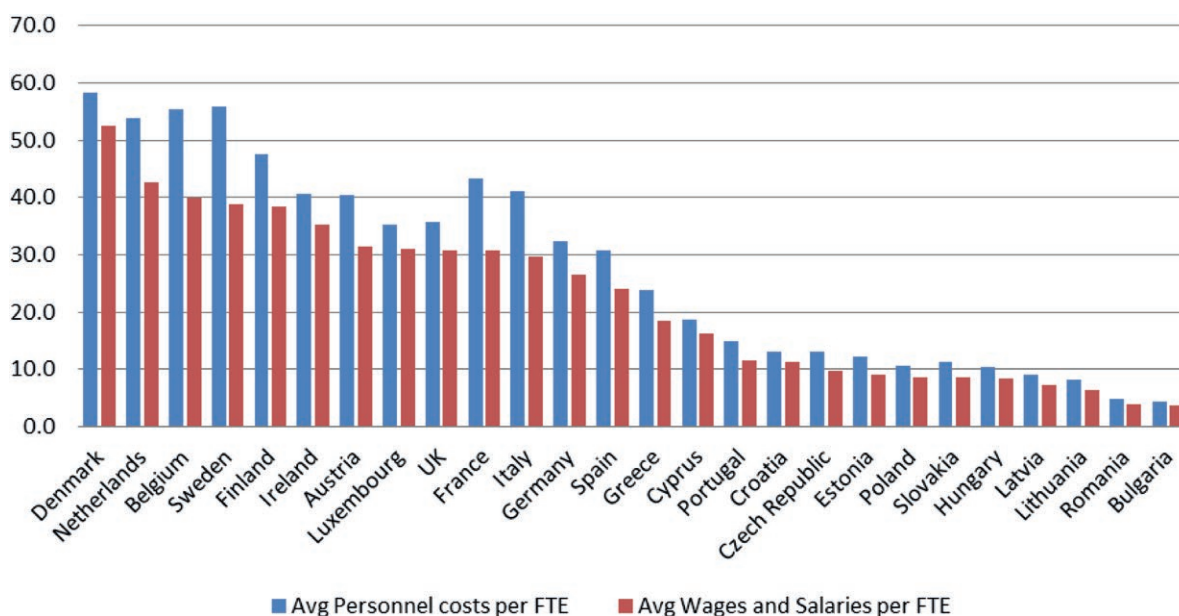
Figure 7: Irish minimum wage and UK living wage in Sterling



When it comes to manufacturing wages Ireland there are at current exchange rates about £6 per hour higher than their UK counterparts. At a 90c exchange rate this would increase to £7.50. Wages in the Irish food manufacturing sector are the 6th highest in the EU and €5 per hour (14%) ahead of their UK counterparts (latest data 2012). A similar

difference exists for overall personnel costs (13.7%) once social security costs are included. Given these differentials there is no doubt that Ireland is a very high cost location for the majority of food and drinks manufacturing companies and much higher than their UK counterparts.

Figure 8: Average wage and personnel costs per FTE in EU food manufacturing



Insurance costs

The rising cost of personal injury claims as a result of excessive judicial awards and a litigation culture is putting pressure on insurance premiums. A recently published report from Ibec³ found that average employer liability (EL) insurance premiums in 2015 for firms in the manufacturing sector were 1.6% of payroll. The report also found that across a range of minor injuries, Irish compensation guidelines are typically double that of the UK – and Irish court judgements are often far higher than the guidelines. This is reflected in the report which found that the average annual cost of EL insurance (expressed as a proportion of payroll) rising by 5% in 2012, remaining static for the following two years, and then rising by a further 7% in 2015.

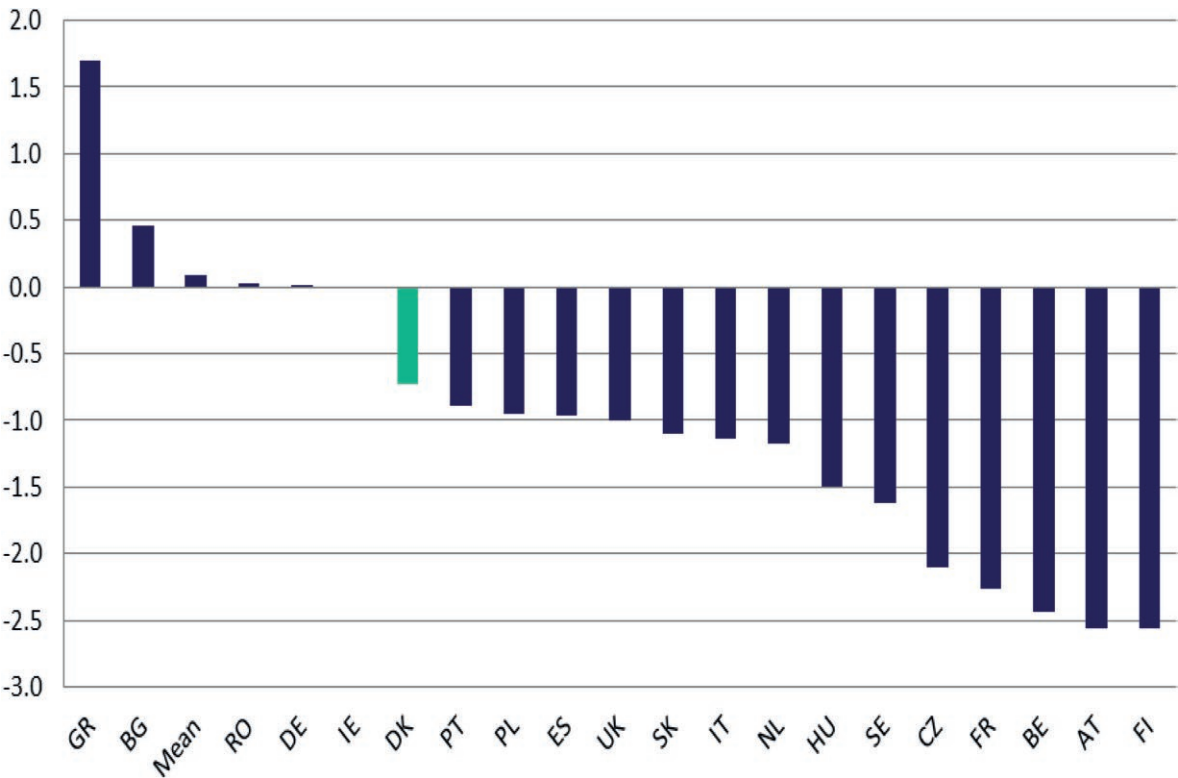
Capital costs

The second largest cost item for many manufacturing businesses is the cost of capital. This can take up between 11 and 25% of a company's total cost base. Central Bank research (2016) has shown that adjusting for company specific variables such as turnover size and change, sector, age and numbers employed that Irish companies paid a significant interest rate premium when compared to similar companies in most other EU countries

“ There is no doubt that Ireland is a very high cost location for the majority of food and drinks manufacturing companies and much higher than their UK counterparts.”

3. http://www.ibec.ie/IBEC/DFB.nsf/vPages/Occupational_Health_and_Safety~News~ibec-personal-injury-claims-report-july-2016-22-07-2016!OpenDocument&SK=T&Click=#.V7n9LvkwiIU

Figure 9: Country specific interest rate premium once company-specific issues removed (relative to Ireland)



Compared to their UK counterparts Irish firms paid an interest rate premium of over 1% once other factors has been adjusted for adding significantly to their cost of capital and expansion costs within the Irish market.

Market impact and business implications

4.1 UK market

As our analysis of the historical exchange rate and agri-food export relationship shows that a 1% weakness in Sterling results in a 0.7% drop in Irish exports to the UK. If Sterling was to weaken further towards the £0.90 mark, this would translate to losses of over €700 million in food exports and about 7,500 Irish jobs in that sector alone. The analysis has also determined that the structural and fundamental changes to the economic and business environment, within the Irish food industry and within the UK market, mean that a weakened Sterling is more problematic for exporters now than it was in the past. Key issues include:

- A structural shift in exchange rate relationship, combined with Brexit related trade risks means that UK buyers are planning significant supply chain restructuring – the real threat is a loss of confidence in Ireland as a competitive supply base resulting in loss of markets and exports;

- €4.4bn of trade to the UK is threatened including the €1bn growth in exports in recent years. This volume growth was hard won in the highly competitive UK market through a combination of process and product innovation and improved competitiveness and now has the potential to be reversed;
- Exporters trying to respond to Sterling losses, need assistance from Government, as currency costs cannot be passed through to customers due to the structural and fundamental changes in the UK economic and business environment.

“ Currency impacts are felt not just in export markets, but by displacement by imports in the domestic market as well.”

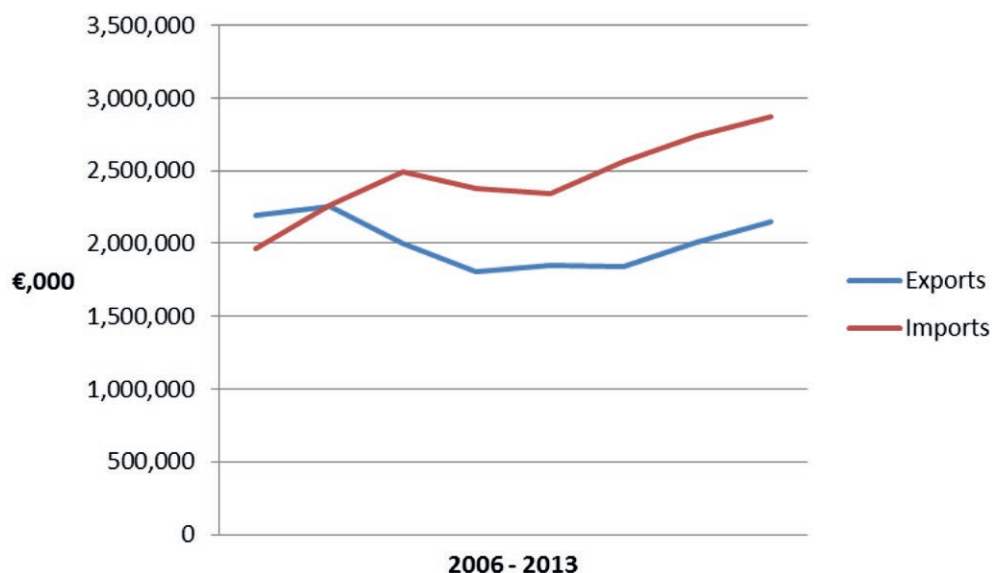
4.2 Displacement by imports – the experience of prepared consumer foods

The Prepared Consumer Foods (PCF) Sector has a domestic market that is almost as large as its export market. As a result currency impacts are felt not just in export markets but by displacement by imports in the domestic market as well.

This is illustrated by the performance of the PCF sector over the period 2006 – 2013 during which imports grew from just under €2bn to €2.85bn. PCF imports now have a 60% market share of the domestic market. Much of market share growth was initially achieved during the 2007-2009 period when Sterling depreciated. PCF exports suffered and it is clear that domestic PCF sales suffered in the face of displacement by cheaper imports.

Of even greater concern is that PCF import growth accelerated post 2009 as a result of structural shifts in supply chains that were given impetus by the initial currency shift.

Figure 10: Imports v Exports (PCF)



4.3 Other Export Markets

Apart from the direct impact of the weakening Euro/Sterling exchange rate on reciprocal trade flows between Ireland and the UK, the weaker Sterling has a secondary impact where UK food exports are competing with Irish exports in continental European markets. UK food exports into Eurozone countries have had a significant boost in competitiveness as Sterling weakens. An example of this is Irish lamb exports to France and other northern European markets which have suffered

in recent months from an increasingly competitive UK offering as Sterling progressively weakens. Similarly Irish whiskey competing in continental European and international markets will face an increasingly competitive Scottish whisky offering. In addition, reduced exports to the UK would further reduce competitiveness in a wider Eurozone context through lower capacity utilisation in Irish factories – resulting in further market erosion.

4.4 Cross border shopping

A weakened Sterling also presents the threat of an increase in cross border shopping. In 2009 a report was prepared for the Minister for Finance by the Office of the Revenue Commissioners and the Central Statistics Office on the implications of cross border shopping for the Irish Exchequer. It estimated the potential loss in Exchequer revenues due to cross-border shopping arising from

reduced VAT and excise yields in 2008 at between €58m and €90m. It also tentatively estimated a possible corporation tax revenue loss in the range of €15m to €24m. This reflected the negative impact on businesses such as food and drinks companies and grocery retailers due to decreased consumer transactions south of the border with resulting job losses.

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A new trading relationship

The exit negotiations between the EU and the UK will have major implications for the Irish agri-food sector. The UK market is by far our most important export market and is almost always the first export market for SME food and drinks producers. Ireland also competes with the UK in other EU and international markets.

Irish agri-food is also in a unique position within the European Union with deeply entwined business and trade relations with the UK. The two way flow trade flow between Ireland and UK comprises raw materials, ingredients and finished products and takes place internally within companies as well as between businesses.

The main objective must be to maintain full unfettered access to the UK market. In addition UK access to the EU single market is much more preferable to UK bi-laterals with third countries.

Specific trade and regulatory issues that will need to be addressed include:

- Avoidance of tariffs or other import quota regimes;
- Avoidance of requirements for certification / customs which would introduce barriers and administrative costs;
- Addressing all-island ingredient sourcing and labelling issues;
- Addressing all-island Geographical Indications;
- Minimising food regulation divergence. Over time this would be problematic and potentially become a non tariff barrier.

Recommendations: an immediate Brexit response package

To help the Irish food and drink industry manage these unprecedented challenges and safeguard farmer incomes, Government must urgently create the conditions to provide certainty to business in the new exchange rate environment so that it can maintain its most important export market.

We acknowledge the existing Department of Agriculture Consultative Committee of Stakeholders on Brexit which will address the longer term post-Brexit elements of the trading relationship with the UK; however, a review should now be undertaken of the impact of the objectives contained in Food Wise 2025.

The Government should also establish a taskforce led by the Department of the Taoiseach to engage with the food and drink sector. The taskforce should comprise high level representatives from relevant Government departments and agencies as well as business leaders from across the food and drink sector. The remit of the taskforce should be to monitor the implementation of measures that will safeguard today's business and trade flows in the face of this major challenge to our competitive position.

Specific immediate measures should include:

1. Financial measures

An enterprise stabilisation and employment support fund available to the worst affected firms, similar to the measures introduced following the 2008 crisis. In the period 2009-11, the Irish Government supported Irish companies to the tune of €200m through the Employment Subsidy Scheme (€116m) and the Enterprise Stabilisation Fund (€80m). These now need to be re-established and supplemented by an employers PRSI exemption applying to new employees for a period of five years.

Access to sustainable long term finance via a €500m agri-food fund from the Irish Strategic Investment Fund to support plant renewal, expansion and the introduction of enabling technologies.

A concerted drive to secure exemptions to EU state aid restrictions to allow the Irish government to match grant aids for plant renewal expansion and the introduction of enabling technologies which will be available to UK-based manufacturers without EU state aid constraints after Brexit.

2. Markets – safeguarding, diversifying, developing

"In order to achieve the growth opportunities which are available to the Irish agri-food sector over the next ten years there needs to be a focus on market development underpinned by appropriate resources to prioritise market opportunities and the development and protection of Ireland's credentials and systems of producing high quality, safe and sustainable food".

Food Wise 2025

Food Wise 2025 identifies market development as one of the key strategic pillars to deliver growth. Brexit has put that aspiration into sharp focus with a fundamental challenge on the currency front and the likelihood post Brexit of a different trading relationship requiring greater efforts to maintain UK market share.

A market diversification and product innovation strategy is required which focusses particularly on maintaining UK market share, increasing exports to other EU and international markets and investing more in product development.

Government should allocate €25m in Budget 2017 to support the following:

- Government departments must be provided with the necessary resources to support rapid market access;
- State agencies (Bord Bia and Enterprise Ireland) must be provided with the necessary resources to support market development – in-market intelligence; in-market promotion, and in market trade support in the UK and other markets;
- Enterprises must be provided with support through the state agencies for market development and investment in international sales and marketing in the UK and other markets. This should include support for placement of marketing executives in international markets by food and drink businesses;
- State supported trade financing should be examined as part of a wider ‘access to finance’ package.

3. Cost competitiveness

An intense ongoing focus on cost competitiveness in areas such as labour costs and the minimum wage, on policy decisions that would adversely impact energy costs and on insurance costs. The Department of Jobs, Enterprise and Innovation should establish and lead a taskforce, with industry participation to take specific responsibility for ensuring measures to improve cost competitiveness are implemented, specifically:

- An increase in the National Minimum Wage is not justifiable in the current economic environment and would only intensify cost pressures on businesses;
- Business energy costs should be reduced to the EU average and in addition policy decisions that impact on the scale of PSO levies should minimise the cost burden on industry. Further support can be given to food and drink businesses by excluding them from PSO levy costs;
- Measures to reduce the burden of personal injury claim cost as outlined in the Ibec insurance report (*see Section 3.3*).

4. Taxation

A fully ‘Brexit-proofed’ Budget which will address tax competitiveness challenges against the UK and facilitate Ireland to take advantage of any FDI opportunities which will arise. See www.ibec.ie/0/budget2017 for full details.

Notes

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FDII is the main trade association for the food and drink industry in Ireland.

It represents the interests of over 150 food, drink and non-food grocery manufacturers and suppliers.

FDII is committed to ensuring an environment exists that is conducive to the success and further growth of the food and drink industry in Ireland.

FDII provides leadership and direction on a number of key strategic issues, including the economic importance and reputation of the sector, competitiveness, innovation, trade, skills, regulation and general food chain policy.

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