Unit 18. Brexit- How does it affect India and the World?

Everything you need to know about the Brexit is summed up here after much research. We hope our readers would get clear answers to many questions like 'What is Brexit?', 'What is the European Union?', Why the 'Leave EU' campaign?', 'Brexit referendum and the result', 'positive and negative impact of Brexit referendum to India and the world' etc.

What is Brexit?

- It is the abbreviation of "British Exit" from the European Union (EU).

- Brexit mirrors the term Grexit — a term which was coined and used by two Citigroup's economists in February 2012 to refer to the possible exit of Greece from the EU.
- Britain has had a troubled relationship with the EU since the beginning and has made various attempts in the past to to break away from it.

What is the European Union?

- The EU is a political, trade and economic union founded in 1957.
- The EU evolved over decades and reached its present model in 1992.
- There are 51 countries in Europe, out of which 28 countries have signed a treaty to become a part of European Union.
- So, clearly, there are countries in Europe which are not part of European Union.
- The EU treaty provided for a European Parliament and European Council which consisted of representatives of the member-states.
- EU members account for 16 per cent of world imports and exports.
- It is the largest trading bloc in the world surpassing the US.
- In 2012, the EU was awarded the Nobel Peace Prize for advancing the causes of peace, reconciliation, democracy and human rights in Europe.

What is the Euro Area?

- The Euro Area (EA) is a subset of the EU, which is a monetary union of 19 of the 28 countries which use the common currency, Euro.
- Not all EU members use the Euro. Britain is an EU member, it is not part of the EA. It does not use the Euro and has retained its own currency, the Pound Sterling.

Why the 'Leave EU' campaign?

- The Leave Campaign argues that Britain is losing out a big deal by staying in the EU.
- It has to pay millions of pounds each week as a contribution to the European budget.
- The extremely bureaucratic nature of the European parliament is hurting British exporters
- Migration from the European Union into Britain (mainly PIGS economies) is creating an imbalance in the welfare schemes of the UK government.
- But, those who oppose the campaign say that Britain is a net gainer if She stays in EU.

About the referendum and the result

- Referendum are votes in which everyone (or nearly everyone) of voting age can take part, normally giving a 'Yes' or 'No' answer to a question. The side which gets more than half of all votes cast is declared a winner.
- Prime Minister David Cameron (Conservative Party) had promised to hold a referendum for Brexit if he won the 2015 general election. But, he led the campaign for 'stay' vote.

- There were growing calls from many MPs of Conservative Party and the UK Independence Party (UKIP), for a new referendum. (In 1975, Britain had voted to stay in the EU in a referendum).
- A referendum was held on June 23, 2016, to decide whether Britain should exit or remain in the European Union.
- Eligible voters: All British, Irish and Commonwealth citizens over 18 who are resident in the UK, along with UK nationals living abroad who have been on the electoral register in the UK in the past 15 years.
- 51.9% of voters favored exit of Britain from EU. It is the first time since the EU was founded in 1957 that a member country is leaving.

India, UK, and the European Union

- India is one of the top investors in the UK.
- There are about 800 Indian-owned companies in the country employing roughly 110,000 people. (Eg: Jaguar Land Rover is owned by the Tata group)
- Many of these firms made the investments with the wider European market in mind.
- Together, the UK and Europe account for over-a-quarter of the country's IT exports, worth around $30bn.
- The UK is the third largest source of foreign direct investment in India and India's largest G20 investor.
- India is the third largest source of FDI to the UK in terms of numbers of projects. India invests more in the UK than in the rest of Europe combined, emerging as the UK's third largest FDI investor.
- The key sectors attracting Indian investment include healthcare, agritech, food, and drink.

- In November 2015, Prime Minister Modi has said, "As far as India is concerned, if there is an entry point for us to the EU, that is the UK."
- But, UK is only India's 12th largest trade partner, well behind other European countries such as Germany and Switzerland.
- Interestingly, UK is also among just seven in 25 top countries with which India enjoys a trade surplus.

Negative Impacts of the Brexit referendum to India

- India will have to adjust to a changing world order.
- There may be foreign fund outflow and dollar rise.
- Rupee may depreciate because of the double effect of foreign fund outflow and dollar rise.
- This may increase petrol and diesel prices to an extent.
- The government then may want to reduce additional excise duty imposed on fuel when it was on a downward trajectory. This may increase fiscal deficit unless revenue increased.
- Prices of gold, electronic goods, among others may also increase.
- Sensex and Nifty may tumble in the short-run.
- Falling value of the pound could render several existing contracts loss making.
- The vote is also bad news for Indian outsourcers.
- Foreign funds are likely to move out of the if the world outside thinks that investment in India is risky.
- India's Forex (currently a record 363 billion dollars) may diminish, particular if the currency is stored in Euros or Pound (this comes around 20% of total forex).
- Brexit will have a negative impact on the $108 billion Indian IT sector in the short term.
- Many Indian companies are listed on the London Stock Exchange and many have European headquarters in London. Brexit will take away this advantage.
- Due to fall in the value of Pound sterling, Indian exports to the UK will suffer. Cheaper rupee will make Indian exports, including IT and ITeS, competitive. Indian import companies operating in the UK may also report a loss. Also, note that India is exporting more than what it is importing from Britain.

Positive Impacts of the Brexit referendum to India

- There are many who think a weakening British currency might be good news.
- India being more of an importing country than an exporting nation, the overall effect may turn out positive for India (if the dollar doesn't appreciate much against rupee).
- With lower pound value, Indian companies may be able to acquire many hi-tech assets.
- As investors look around the world for safe havens in these turbulent times, India stands out both in terms of stability and of growth.
- Brexit might give a boost to trade ties between India and the UK.
- Britain will now be free to discuss a bilateral trade pact with India.
- Due to fall in the value of Pound sterling, those who import from the UK will gain. Indian export companies operating in the UK may also gain.

- More Indian tourists can afford to visit Britain in coming days as the currency value has fallen.
- More Indian students can afford to study in Britain (for higher education) as the fees may seem cheaper.
- Britain will need a steady inflow of talented labour, and India fits the bill perfectly due to its English-speaking population.
- The fall in the prices of commodities like crude, which will help India save a lot on its import bill(every $1 drop in crude prices leads to roughly $1 billion savings in India's oil import bill), reducing its trade and current account deficits (CAD).
- Brexit would weaken global growth and lead to a meaningful decline in commodity prices. This is only going to enhance both the relative and absolute appeal of India.
- Lower commodity prices will help the macro fundamentals: be it fiscal deficit, current account deficit or inflation, which will give the government more levers to pump up the investment cycle.

Brexit: What does it mean to Britain?

- As per International Monetary Fund (IMF), a vote to exit the European Union in the referendum could leave Britain's economy more than 5 percent smaller by 2019 than if it stays in the 28-nation club.
- Brexit could cause the country's economy to be between 3.8 and 7.5 percent smaller by 2030.
- The pound expected to fall by around 20 percent. This would mean that exports to the UK will suffer and imports from the UK will gain. Export companies operating in the UK will gain, while import companies will lose.
- More foreign tourists will visit Britain in coming days as the currency value has fallen.
- More foreign students may prefer Britain for higher education as the fees may seem cheaper.
- EU citizens in Britain and Brits living in other EU nations would have to update their immigration statuses.
- Companies operating in both the UK and the EU would have to verify that they're compliant with two sets of laws.
- US President Obama has warned that it could take 10 years for Britain to negotiate a new trade deal with the US.
- The referendum results (52:48) is very close. This means a major division of opinion in Britain which has social implications too. While the less educated and the old seems to favour the 'leave EU' campaign, the young and the employed are more in favour of Britain staying in EU.
- Brexit could encourage England, Wales, Scotland, or Northern Ireland to appeal for quitting the United Kingdom.

Brexit: What does it mean to the World?

- Remittance from the UK to countries outside in terms of Pound will fetch lesser returns compared to the past.
- Export dominated countries may be affected, whether exporting to the UK or not. If the UK is the major trading partner, the effect will be more.

- The United States will bear the major brunt of a Brexit being UK's biggest trading partner.
- A direct impact on Asian economies from Brexit is unlikely in the **longer term** because as a percentage of GDP, exports to the UK is less than 2% for most economies.
- But businesses in some major Asian economies – like India and Japan- will be hit.
- Companies which have set up operations in the UK to gain access to EU markets will be affected.
- BREXIT would likely allow any US Dollar strength to play out. This may cause other currencies to decline in value.

Is India ready to handle the Brexit?

- The finance ministry said that the country has sufficient foreign exchange reserves to handle any impact.
- RBI Governor Raghuram Rajan said the central bank will infuse whatever liquidity is needed into the Indian market to keep it "well behaved".
- SEBI and stock exchanges have beefed up their surveillance mechanism to deal with any excessive volatility.
- If exports to the UK are costly and imports are cheaper, India can think of utilizing the import-advantage by reversing the present trade scenario.
- Once the dust settles, India may be seen to be a net gainer and inflows would continue to gravitate towards the Indian shores.