

# Effect of brexit on the food manufacturing industry



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**Economic report on how leaving the EU will affect the food manufacturing industry.****Overview of the industry:**

The food manufacturing industry includes the processing of the products of agriculture, forestry and fishing into food for humans or animals, and includes the production of various intermediate products that are not directly food or feed products such as animal hides. The food manufacturing industry also includes the manufacturing of beverages, such as non-alcoholic beverages and mineral water, and the manufacturing of alcoholic and distilled alcoholic beverages, but however excludes manufacture of fruit and vegetable juices, of milk-based beverages and of coffee and tea products.

European Commission (2016)

**What type of firms make up the industry?**

The food manufacturing industry in the UK contains mainly global firms that organise production for a profit, while similarly being influenced by competition from other firms and consumer demand. An example of one of these firms is Nestle. Nestlé enjoyed strong sales growth during the first three months of 2017 confirming its guidance, and flagged higher restructuring costs in an effort to drive future profitability. Financial times (2017) In 2015, before the implications of Brexit on the UK economy, Nestle had a market share in EMENA of 16.4 billion Swiss Francs. Statista (2016) However following the result of the Brexit referendum on 26<sup>th</sup> June 2016 Nestle had a market share in EMENA of 16.2 billion Swiss Francs. Statista (2016). Providing evidence to the fact that Brexit will not have a significant affect of the Food and Drinks industry in the UK. However, this cannot be recognised as reliable due to the fact that these figures also consider the

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market share for the middle east and Sub – Saharan Africa. Therefore, we can recognise the fact that the result of the Brexit referendum in the UK may affect the competitive structure of the food and drinks industry in the UK and the EU.

### **What is the competitive structure of the industry?**

The food manufacturing industry is mainly divided by a few high profit, large corporations, therefore we can recognise that this industry has a Monopolistic competition competitive structure. A monopolistic competition is an industry that has characteristics of competition and monopoly. The industry comprises many firms, which offer substitute products, and many buyers. Although the products are substitutes, they are differentiated on the basis of physical attributes, image, advertisements and accompanying services. Gilani (2018) To provide evidence for this I measured the concentration ratio of the food manufacturing industry in the UK. The UK food manufacturing industry had a market size of £28. 8 billion in 2017. (GOV. UK 2017). The top 5 companies in the industry had a combined market share of £12. 5 billion. Robinson (2014) Therefore we can determine that the concentration ratio of the UK food manufacturing industry is 43%. Ultimately determining that the UK food manufacturing industry has a Monopolistic competition competitive structure, but furthermore this degree of competition currently in this industry is an indication of a fall in competitive pressures. And could also lead to a rise in prices for consumers.

### **Product Pricing:**

Edward Chamberlin the developer of the monopolistic competition model, recognised that within a monopolistic competition such as the food

manufacturing industry the products of rival firms are not at all homo-geneous, for example each brand has its own personal characteristics, often set out through marketing campaigns to establish a brand identity, though the composition and the basics remain the same. This is the reason that each, individual brand is sold pricing decisions individually in the market, this shows that each brand is highly differentiated in the minds of the consumers. Under monopolistic competition the firm has some freedom to fix their price, due to the fact that differentiation between firms will not lose all customers as it increases in price. For example, the demand curve for the food manufacturing industry, with its monopolistic competition structure, would be less than perfectly elastic due to the fact that no firm dominates the industry due to product differentiation. The product of each firm seems to be a close substitute, though not a perfect substitute for the products of the competitors. Due to this, the firm in question has high elasticity of demand. Providing further evidence to the fact that firms in the food manufacturing industry has its own share of monopoly power, meaning that prices are mainly controlled by the firm, resulting in rising prices as competition rises in the market. JBDON (2017) Relating back to Brexit, the results could mean that prices in the food manufacturing industry could potentially rise, this is due to the fact that export and import prices could see a downturn, therefore in order to survive firms in the market will start profit maximising to reverse the adverse effects of an economic downturn, firms will rise their prices at an uncapped rate due to the competitive structure of the industry being a monopolistic competition.

## **Overview of the macro economy**

The macro economy refers to how governments and other policy makers compensate for market failures in order to improve economic performance over time. Economics online (2018) The UK leaving the EU can have great affect on the macro economy in a number of different ways. For example, a change in EU membership could potentially hinder government objectives such as economic growth, Stable prices, maintaining high levels of employment and having favourable balance of trade. Membership of the EU includes benefits to member nations such as the fact the EU is a customs union, its members impose common tariffs on imports from non-EU countries and can trade freely with each other. Cadman, Tetlow (2017) In contrast Leaving the single market will diminish UK trade with the EU and cut inward investment. 44% of Britain's exports go to the EU – £220bn out of £510bn. Higher tariffs would make UK exports more expensive. Tutor2U (2015) Ultimately benefiting the food manufacturing industry in the UK due to exports being at £9. 4 billion in 2017, providing growth to the UK economy.

However, in terms of the food manufacturing industry Nearly a third of British food and drink businesses have had non-UK EU workers leave their employment since the Brexit vote, according to a survey of more than 600 businesses representing nearly a quarter of the food chain's 4 million workforce. Butler (2017) Therefore placing greater strain on the food manufacturing industry post – Brexit as a whole new workforce has to be employed, with potential skilled labour shortages. On the other hand, Leaving the single market will allow the UK economy to limit net inward migration from EU. This has the potential to provide opportunities for UK

people to find work and also lead to a slower growth of house prices and rents for the majority of the UK. Furthermore, the economy has been doing quite well since the Brexit vote, unemployment is at a 40 year low of just 4.6% of the labour force. Tutor2U (2015) Ultimately there is mass uncertainty of the effectiveness of the workforce in any manufacturing industry in the UK, let alone the food manufacturing industry, one fifth of migrant workers in the UK work in the food and drink manufacturing industry. Butler (2017)

Following the Brexit vote on June 26<sup>th</sup>, 2016, the UK's trade position worsened. The trade in goods deficit widened unexpectedly to £12.7bn, from £11.3bn in May 2016 as exports fell by 2.8%. Monaghan (2017)

Overall, we can recognise that the UK's trade deficit increased by £2 billion from May 2016 to June 2017, as a result of this consumer spending is likely to be weighed down by slow wage growth and investment spending held back by the Brexit uncertainty. Monaghan (2017) Therefore it is advised that many businesses, certainly in the food manufacturing industry will have to adjust their supply-chains and some will re-locate investment to mainland Europe where there are cheaper and more efficient labour costs. However, in the long term there is highly likely to be a successful pivot in the economy and manufacturers will sell more goods and services to fast-growing emerging countries including China, India and sub Saharan Africa, to balance out the deficit in trade caused by leaving the EU. As a result, expanding the market for the UK food manufacturing industry due to the fact that new trade deals are available to countries who usually received tariffs for trading outside of the EU single market, in the long run, benefiting the food manufacturing industry in the UK.

Brexit has the potential to have a substantial impact on the prices households pay for food. Currently around 30% of the value of food purchased by households in the UK is imported, and the major source of food imports is the EU. Levell, O' Connor, Smith (2017) Ultimately the degree to how much prices will change is uncertain to economists in the UK, currently the UK still has access to the EU single market, meaning that the majority of consequences or benefits are unseen. However, leaving the EU will allow the UK to make many free trade agreements with other nations, free trade deals with fast-growing emerging economies might see a surge in UK exports which will add to GDP growth and ultimately help to maintain prices at a stable rate. Alternatively, the UK could fail to make effective trade deals in time, before the damage is done to the British Sterling, for example the recent EU-Canada free trade deal took seven years to agree. Tutor2U (2015) In terms of the food manufacturing industry if the UK ceased to be a full member of the EU single market, it would be able to apply different regulatory standards to food imports, leading to the possibility of importing hitherto banned produce. Such changes would serve to lower the price of foods imported from non-EU countries. Providing a pivot to the rise of prices that is forecasted post Brexit. As a result we can recognise that a change in prices could go either way following the UK's departure of the EU, it is currently unclear what the UK government has proposed to combat the issue of rising prices, however, in order to keep food prices and manufacturing low, the UK would have to substitute the quality of the goods that it imports, or alternatively look at building stronger trade agreements with alternative, EU and non-EU countries which could take long periods of time, with potential to hinder the UK economy during that time.

## Conclusion

All in all, there is a great deal of uncertainty over what the nature of the UK's post-Brexit trading arrangements will be. Decisions over post-Brexit membership of the single market and participation in the customs union will have profound effects on the price and import mix of the foods on UK supermarket shelves and the effectiveness of the UK food manufacturing industry. It is also unclear whether sterling will depreciate further – or appreciate – as Brexit proceeds. These uncertainties over tariffs and the exchange rate mean that UK households are potentially going to be affected by considerable and unpredictable changes in food prices, with the poorest households much more exposed to this risk than the richest households. Furthermore, there is mass uncertainty of the effectiveness of the workforce in any manufacturing industry in the UK, let alone the food manufacturing industry, one fifth of migrant workers in the UK work in the food and drink manufacturing industry, therefore in order to stay efficient, the UK food manufacturing industry should prioritise replacing migrant workers, with skilled UK workers, as a result of this unemployment levels will decrease further in the UK, driving the economy, and providing a positive ripple post Brexit. The UK food manufacturing industry is currently a very competitive, monopolistic competition. Post Brexit there is potential that internal competition in the UK may decrease in the food industry due to the departure of the single market, therefore giving UK food manufacturing corporations more power to control their prices, and drive food prices down. Are we about to see a labour exodus that the food and drink industry cannot handle? This could well be the case, but with change comes opportunity. The



British food and drink industry is famously innovative and is particularly good at exploiting new niches.

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