

Impact of Brexiton India’s Economy, Indian Businesses and Education Sector

Dr. Manohar Kacharu Sanap
Associate Professor of Commerce
Ness Wadia College of Commerce
Pune-411001 (Maharashtra)

Abstract

As far as India is concerned, it is incontrovertible that the outcome of the 23 June referendum will affect the fastest growing economy in the world which also happens to be one of the EU's biggest trading partners. Some analysts say that Britain leaving the EU could set the stage for a Free Trade Agreement between Britain and India. Indian companies are the third largest source of foreign direct investment for the UK and the FICCI has warned about "considerable uncertainty for Indian businesses" and "adverse impact on investment" if Brexit were to occur. British Indians are the single largest ethnic minority population in Britain, and the 1.4 million-strong community will no doubt be affected by the vote. Prime Minister Narendra Modi has spoken in favour of Britain remaining in the EU, calling the UK India's "gateway to Europe" and affirming that “India always stands in support of a strong and united Europe.”

This article focuses on the ‘what and why’ of the Britain’s exit from the European Nation and its impact on India’s Economy, Indian Businesses and Education Sector. It explains how the Brexit was overstated and how its real impact on the economy can be gauged only after the treaty that Britain will sign. The article illustrates how the various sectors are going to be affected by this.

I) Introduction:

The Brexit referendum on June 23, 2016 was an unprecedented global development. The United Kingdom (UK) voting for the ‘Leave’ from the European Union (EU) is expected to have considerable socio economic and political ramifications in the years ahead. The decision assumes greater significance in context of the changing global order which is moving towards greater multilateralism and where countries are striving to lower their boundaries.

As far as India is concerned, it is incontrovertible that the outcome of the 23 June referendum will affect the fastest growing economy in the world which also happens to be one of the EU's biggest trading partners. Some analysts say that Britain leaving the EU could set the stage for a Free Trade Agreement between Britain and India. Indian companies are the third largest source of foreign direct investment for the UK and the FICCI has warned about "considerable uncertainty for Indian businesses" and "adverse impact on investment" if Brexit were to occur. British Indians are the single largest ethnic minority population in Britain, and the 1.4 million-strong community will no doubt be affected by the vote. Prime Minister Narendra Modi has

spoken in favour of Britain remaining in the EU, calling the UK India's "gateway to Europe" and affirming that "India always stands in support of a strong and united Europe."

This article focuses on the 'what and why' of the Britain's exit from the European Nation and its impact on India's Economy, Indian Businesses and Education Sector. It explains how the Brexit was overstated and how its real impact on the economy can be gauged only after the treaty that Britain will sign. The article illustrates how the various sectors are going to be affected by this.

II) Objectives:

The present study is done with following objectives:

- 1) To understand and analysis the impact of Brexit on India's Economy.
- 2) To understand and analysis the impact of Brexit on Indian Businesses.
- 3) To understand and analysis the impact of Brexit on Indian Education Sector.

III) Methodology:

The research paper is an attempt of exploratory research, based on the secondary data sourced from journal, magazines, articles, internet and books. Looking into requirements of the objectives of the study the research design employed for the study is of descriptive type.

IV) Impact on India's Economy:

While UK has put across its decision to exit from the EU, the actual process of leaving the European Union will be long drawn. The announcement has spelled out more uncertainty for now which is expected to continue with the invoking of the Article 50 and as and when the real negotiations take place. This would at least take a couple of years to shape up. Therefore, the actual ramifications will become clearer in the long run when a tangible working model of the UK-EU relationship is drawn out and established.

Given that, the announcement of the Brexit referendum drew an immediate reaction from the stock markets and currencies world over. India was no exception from this contagion effect. The Sensex tanked by 450 points (from the opening value) on June 24, 2016 falling below the 26000 mark and the Rupee value crossed 68 for a US Dollar. Nonetheless, both the stock market and the Rupee were quick to recover and find a stable ground. Both the Government and Reserve Bank of India have been on a tight vigil.

India is positioned fairly well at present vis-à-vis its peers. The macro-economic fundamentals have improved and the strong orientation displayed towards reforms over the past two years has given us an edge. The persisting ambiguity in the global economic environment reaffirms the need to remain focused on further strengthening the domestic economy and continuing the reform process.

1) Gross Domestic Product:

Most of the estimates indicate India holding on to its growth path even in the post Brexit scenario. This will be backed by a host of favourable conditions on the domestic front. The performance of the agriculture sector is expected to improve in the current fiscal year. The prediction for monsoons is favourable this year and rains are expected to pick up over the next two months (July-August 2016).

Further, the Government has awarded the Seventh Pay Commission Award and this will give impetus to the domestic demand. The consumer durables goods segment, the auto-sector especially the passenger two wheeler segment and housing & allied sectors are likely to benefit from this Pay Commission decision.

According to FICCI's latest Economic Outlook Survey, the median GDP growth forecast for 2016-17 has been put at 7.7%.

2) Exports:

India's exports to the UK have been around 3% of our total exports and exports to the European Union are around 17% of total exports. Our exports to both UK and Europe have been on a downtrend in the past two years on account of subdued demand led by a frail and scattered recovery in the region. Post Brexit there is a heightened chance of this trend being amplified over the near term given the possibility of disturbances in currencies and UK facing a further slowdown in growth. However, some safeguards are expected to be put in place to deal with the volatility in currency in the UK. Also measures to boost growth might be rolled out. The situation is expected to even out over the medium term. Also, much would depend on the currency movement (extent of appreciation vis-à-vis Pound) for countries that are competing with India to export to UK.

3) Foreign Direct Investments (FDI):

UK's decision to leave EU is expected to impact the confidence level of the business and the investor community and there might be a temporary arrest in outbound investments from India to the UK until more clarity is obtained on the working framework between the EU and UK.

However, the Government has considerably liberalised the FDI regime in the country and there has been an increase in FDI inflows over the last two years. This trend is expected to continue. With the slew of measures announced in June 2016, India has opened up almost all sectors for foreign investors barring a very small negative list. India has once again strengthened its position on the investment radar and the growth prospects in the country remain strong. India is expected to get continued attention from the investors including investments from the UK. UK is third largest investor in India and accounts for about 8.0% of the total FDI inflows in the country. In fact, several British companies have exhibited interests in India post launch of the Make in India campaign.

4) Rupee can remain precarious:

The Rupee can witness some volatility in the coming weeks as there is still anxiety in the global markets. However, RBI has been quick to intervene to manage liquidity through open market operations and use the foreign exchange reserves to tackle currency volatility and capital outflows in case of any skewed movements. Respondents expect this to continue.

5) Inflation to remain range bound:

Oil and commodity prices have been subdued and there is no intermittent risks at present that will make the prices shoot. Global growth remains muted and an upward pressure on that account is suppressed for now. On the domestic front, good monsoons have been as predicted. Prices of food articles are likely to remain manageable.

V) Impact on Indian businesses:

UK has been a valued economic partner for India and the decision to leave the European Union has created some amount of ambiguity for the Indian businesses. The same has been reflected in the survey conducted by FICCI as well. Even though over half of the respondents have reported that they don't intend to set up separate operations in any other EU country because of Brexit, they seemed concerned about the impact on intra company transfers/movement of professionals and Indian migration over the medium term. Also, the participants indicated that they expect investments to the UK to take a beating over the course of next three to five years.

Furthermore, it is anticipated that the companies that have operations in the UK and the EU will have to face significant translation losses with the probability of volatility in currencies remaining high. The exposure on account of un-hedged borrowing abroad will also impact the company balance sheets.

Also, post Brexit some concerns have been raised by companies about facing investigation from competition authorities both in the UK and the EU. Until now, a majority of the competition law in the UK was derived from the EU. The companies have also pointed out that in event of a merger/acquisition, a notification may have to be made both at the UK and EU level leading to an increase in compliance costs.

Indian parties in cross-border contracts commonly include English jurisdiction and governing law clauses. Post-Brexit, there may be uncertainty over the recognition of English judgments in EU countries. In an extreme case, the impact might also lead the parties to invoke 'force majeure' and 'material adverse change' clauses, leading to a surge in litigation.

There will be greater clarity on these technicalities and legalities once the details of the negotiations are spelled out. However, companies are anticipating an increase in compliance and administrative costs going ahead. At present, most of the companies have their corporate offices in the UK and are able to operate in other countries of the Union through their UK office

only. Nonetheless, the companies do have a cushion period to work out the mitigation strategies as the deal between EU and UK will take some time to materialize.

Some Sectors likely to face the heat:

India businesses have presence in a wide array of sectors in the UK which include automobiles, auto components, pharmaceuticals, gems and jewellery, education and IT enabled services. Most of these sectors will be vulnerable to changes in demand and currency values.

1) Auto components:

India is a major supplier of auto components to the EU region. The region accounts for about 36% of India's total auto component exports, while the share of UK is about 5%. The UK Passenger Vehicle market is highly export oriented and the segment has close linkages with the EU automotive market. The anticipated slowdown in the UK and the EU region will have a dampening effect on the sector. Also, the depreciating Pound will impact the revenue stream companies of over the near term. The real impact will also depend on imposition of any trade restrictions between the EU and UK, which will become clearer over the medium term.

2) Information Technology:

India is one of the largest exporters of IT-enabled services and the sector has significant exposure to the European market especially the UK. UK accounts for about 17% of India's total IT exports. India's IT exports to other European countries is at about 11%. The IT companies thus are expected to face the heat in light of the Brexit. Given the risk of further moderation in growth in the UK and EU, there is an increased probability that the companies lower their IT budgets (a discretionary spend). This would have an impact on the domestic software companies.

Further, the depreciation of Pound does not augur well for the sector and can negatively impact the growth in the sector. Majority of the costs by the IT companies are incurred in INR owing to the off-shoring model deployed by the Indian IT services player. So a sustained depreciation of Pound might call for a renegotiation of the contract, as the profitability of these contracts might fall below the expected levels.

Uncertainty on account of pricing of contracts spanning European Union which currently enjoys zero tariffs cannot be ruled out. Skilled labour mobility issues can arise as the multi-location contracts will get deferred on account of lack of clarity at present. Further, the overhead expenses are likely to increase if restrictions are imposed on the mobility of professionals between UK and EU as the companies might have to open an additional office in the EU.

Besides, the Indian IT sector has had some issues with the EU data security policies, including rules on transferring personal data. So, on the positive side the UK could look at abandoning the stringent stance on data management post Brexit. Also, UK would be under no obligation to adhere to restrictive localization norms adopted by EU.

3) Metals:

With the global recovery remaining frail and an evident moderation in China, the steel and aluminium sectors are already facing the issue of overcapacity. Demand in the EU has been subdued and this latest development is expected to further dampen demand. This might lead to a greater weakening of metal prices giving rise to earning pressures for companies.

4) Pharmaceutical:

United States is India's biggest market for Pharmaceutical exports, while EU accounts for 10-13% of India's total pharma exports. The share of UK in India's pharma exports is about 3-4%. The pharma companies do not really expect a big hit following the Brexit and have indicated a limited impact of Pound depreciation. The pharma companies reported having hedged their exposure to the Euro. Further, the companies pointed out that the rules, regulations and product registrations are already different for UK and EU and hence any adverse impact on the sector can be ruled out.

5) Garment:

Readymade garment is one of the key export items to the UK from India. Readymade garments account for about 20.0% of the India's total exports to the UK. The sector is expected to feel the pinch on account of moderation in demand; the spend on readymade garments is primarily discretionary. Also, the drop in the Pound is expected to impact the un-hedged export contracts with British counterparts. Nonetheless, some of the garment exporters have also opined that they might be insulated if a Free Trade Agreement is negotiated with the UK post Brexit.

6) Financial Services:

There are currently bond issuances planned of range USD100-150m in USD and INR. Brexit is making it very hard for UK and other markets (like Singapore, Paris and Frankfurt as green bond investors are mainly EU) are being looked. UK's credit rating has been cut, and given most buyers of the bonds are from the EU there is nervousness around these bond issuances. This is important for India as it would be difficult to imagine financing India's huge infrastructure appetite through debt finance in London as aggressively as currently planned. Again, this would depend on what Brexit scenario that plays out. But in the meantime, greater uncertainty will impact the bond pricing.

VI) Impact on Education Sector:

Britain's exit from the EU is expected to open up significant business and economic opportunities for the Indian Education Sector. Education in UK will likely become more affordable and we might see UK wooing candidates with more incentives. For Indian students studying in the UK, Brexit might result in a more level playing field compared with other EU students who hitherto had an informal edge over the rest of the world in the job market. India being one of the largest skilled labor markets, with a population well versed in the English Language could have a distinct advantage.

VII) Conclusion:

India is the third largest FDI investor of UK. We invest more in UK than all other European countries put together. As per the data available for fiscal year 2015-16, the trade which we did with Britain was worth \$ 14.02 billion, out of which \$8.83 billion was export only, rest \$5.19 was import. Thus our trade balance was a positive. UK will decide its own trade policy when it goes out of the European Union and when it is legally entitled to enter into trade agreements it will start entering in various countries of the world. As per the vision of the Finance Minister there is a huge amount of opportunity between India and United Kingdom.

Many of Indian firms operating in European countries; have offices in Britain. This will change once Britain leaves the union, it would mean additional expenditure of setting up an office in some other European country, as these Indian firms may not be able to enjoy the free border access then.

The adverse effect is already reflecting in British currency as pound touched 31 year low and the volatility will be there in near future which would risk Indian business engaged with UK. The dramatic fall in the value of pound will eventually mean less purchasing power for businesses and consumers as the price of imports increases.

Example of Tata Motors can be sighted which has a subsidiary in Jaguar Land Rover in UK. Jaguar Land Rover is the Britain's biggest car maker and accounts for nearly 90% profit of Tata Motors. With BREXIT EU will impose new tariff for car made outside its boundary, which will make Jaguar less competitive than Mercedes, Audi and BMW which may eventually affect the profit of Tata Motors.

Another Indian sector which will take a hit is software industry as Britain and other European countries would not be spending on technology in this uncertain economic environment. Presently Europe including UK, accounts for nearly 30% of business for five top most Indian software firms. The effect can be seen in many other sectors such as Metal, Capital goods, Pharmaceutical, Automobile as Indian companies like Mother's Union, Sun Pharma, Lupin, Tata Steel, Cummins India have substantial business exposure in European Market. But overall the Brexit impact was overstated as we saw the share markets only reacted for a day or two and then stabilised. According to the UK Economic Index the business confidence jumped in September after the shock of June vote. Almost half of the business leaders are optimistic about the UK's economic outlook for the coming years. So, as per the current scenario Brexit has a mixed effect on the world economy in general and Indian economy in particular. The impact of Brexit on the Indian economy will be dependent on the treaty of trade policy which UK will sign and the rights they will get out of this treaty.

The exit of Britain from the European Union has created quite turmoil globally- be it developed markets or be it emerging markets. However, India seems resistant to this turmoil on many fronts; though some fields viz. IT sector may have a negative or a positive effect. According to the strong position that India has maintained in last 6-8 months in global volatility, it can be said that BREXIT will have no major effect on India and its economy.

VIII) References:

- 1) <http://www.livemint.com/.../Brexit-impact-on-India-when-elep...>
- 2) <http://www.livemint.com/.../Early-Brexit-vote-results-shake-u...>
- 3) <http://indianexpress.com/.../post-brexit-currency-volatility.../>
- 4) <http://www.thehindubusinessline.com/.../br.../article8714878.ece>
- 5) Baier, S. L., J. H. Bergstrand, P. Egger and P. A. McLaughlin (2008) 'Do Economic Integration Agreements Actually Work? Issues in Understanding the Causes and Consequences of the Growth of Regionalism', *The World Economy* 31(4): 461-97.
- 6) Berden, K., J. Francois, S. Tamminen, M. Thelle and P. Wymenga (2009) 'Non-Tariff Measures in EU-US Trade and Investment – An Economic Analysis', Ecorys report prepared for the European Commission, Reference OJ 2007/S180219493.
- 7) Berden, K., J. Francois, K. Tamminen, M. Thelle and P. Wymenga (2013) 'Non-tariff Barriers in EU-US Trade and Investment: An Economic Analysis', Technical Report, Institute for International and Development Economics.
- 8) Bloom, N., P. Romer, S. Terry and J. Van Reenen (2014) 'A Trapped Factors Model of Innovation', Centre for Economic Performance Discussion Paper No. 1261 (<http://cep.lse.ac.uk/pubs/download/dp1261.pdf>).
- 9) Breinlich, H., S. Dhingra and G. Ottaviano (2016) 'The Impact of Trade Agreements on Consumers', Centre for Economic Performance mimeo.
- 10) Crafts, N. (2016) 'The Growth Effects of EU Members hip for the UK: A Review of the Evidence', University of Warwick mimeo.
- 11) Dhingra, S., H Huang, G Ottaviano, J Pessoa, T Sampson and J Van Reenen (2016) 'The Costs and Benefits of Leaving the EU', Centre for Economic Performance Technical Report.
- 12) HM Treasury (2013) 'European Union Finances 2013', 19th November.
- 13) Holehouse, M. (2015) 'Major Blow for Brexit Campaign as US Rules Out UK-Only Trade Deal', *The Telegraph*, 29 October 2015 (retrieved from: <http://www.telegraph.co.uk/news/worldnews/europe/eu/11962277/Majorblow-for-Brexit-campaign-as-US-rules-out-UK-only-trade-deal.html>).
- 14) LSE Growth Commission (2013) 'Investing for Prosperity' (<http://www.lse.ac.uk/researchAndExpertise/units/growthCommission/documents/pdf/LSEG-C-Report.pdf>).
- 15) Wadsworth, J. (2015) 'Immigration and the UK Labour Market', Centre for Economic Performance Election Analysis No. 1 (<http://cep.lse.ac.uk/pubs/download/EA019.pdf>).
- 16) <http://capitalmind.in/2016/06/brexit-need-know-impact-india/>