Brexit and the Caribbean

Much Ado About Nothing?

Jeetendra Khadan
Inder J. Ruprah

October 2016
Brexit and the Caribbean

Much Ado About Nothing?

Jeetendra Khadan
Inder J. Ruprah
Abstract

This report estimates the direct and indirect macroeconomic impact of the Brexit leave vote on the Caribbean during 2016 and 2017 in terms of economic growth, exports, tourism, and remittances. We consider six Caribbean countries (denominated as C6): The Bahamas, Barbados and Jamaica (tourism-based), and Guyana, Suriname and Trinidad and Tobago (commodity-based). We find the estimated quantitative impact of Brexit(v) to be very small if not negligible.

**JEL codes:** E600, F170

**Keywords:** Brexit, Caribbean, United Kingdom, European Union, macroeconomic impact, economic growth, exports, tourism, remittances, trade.
1. Introduction
On June 23, 2016, the United Kingdom (UK) voted to leave the European Union (EU). Dubbed Brexit, predictions of dire consequences for the Caribbean have dominated the region’s headlines. An example of the prophesied grim consequences is:

“Every aspect of Caribbean life will be adversely affected by this development; from trade relations to immigration, tourism to financial relations, and cultural engagements to foreign policy. There will be a significant redefinition and reshaping of CARICOM-UK engagements. The region’s fragile economic recovery is threatened.” Professor H. Beckles, Vice Chancellor UWI, Loop, June 26th.

However, at this time there is considerable uncertainty about what will happen, when it will happen, and how it will happen. The only certainty is the vote to leave. Uncertainty hovers over the post-vote landscape of a new relation of the UK with the EU and therefore with other countries. Nonetheless, there is consensus that the UK and the world (given that the UK is the fifth largest global economy) will be poorer, i.e. economic growth will decline as a result of Brexit than if the UK had voted to remain. The debate is by how much, and the quantification of such impact on the Caribbean. So far, this debate has been qualitative.

In this report, we present estimates of the direct and indirect macroeconomic impact of the leave vote Brexit(v) on the Caribbean for the period 2016 and 2017 in terms of economic growth, exports, tourism, and remittances. The six Caribbean countries (denominated as C6) included in this study are three tourism countries (The Bahamas, Barbados and Jamaica) and three commodity countries (Guyana, Suriname and Trinidad and Tobago). We find the estimated quantitative impact of Brexit(v) to be very small if not negligible.

2. Brexit(v)
Leading up to the referendum vote on whether the UK should leave the EU, debate was marked by hyperbole on both sides, as is typical surrounding major policy decisions. For the no-“remainners”, predictions abounded of dire economic consequences for the UK and the world economy. The UK and the world would plunge into recession. For the yes-“leavers”, it appears the argument of dire economic consequences did not resonate. Rather, what reigned were arguments that the UK would be “free at last” (from EU bureaucrats), monies
destined to the EU\textsuperscript{1} would instead divert to the National Health Service, and there would be no more immigrants. Unexpectedly, the leavers won.

The immediate consequence appeared to substantiate the remainers’ arguments. The UK’s Prime Minister, David Cameron, resigned, financial markets entered into turmoil and the Pound Sterling lost one-tenth of its value, and the stock market performance indicator FTSE-250 dropped by 14 percent. This indicator is a much better gauge of fears about the UK economy as it includes smaller and more domestic-focused companies than does the FTSE100. However, that sentiment changed by end-August: the pound stabilised and the FTSE 250 has surpassed pre-referendum levels, and a new prime minister has been elected. Calamity has not occurred. Further, the central bank has announced a series of measures to prevent a recession.\textsuperscript{2} The Chancellor of the Exchequer, Philip Hammond, has said he is ready to “reset” Britain’s fiscal policy if needed to respond to turmoil caused by the leave vote. However, going forward it is uncertain what conditions of the divorce would look like or even when it will be finalised. Divorce proceedings that will, as announced by the new Prime Minister Theresa May, begin next year and may take two years or more. Rather than speculate on the outcome, we focus on the macroeconomic effect of the leave vote, Brexit(v), in 2016 and 2017.

What is the probable evolution of the UK’s economy for the next two years? There is a range of forecasts from deep recession to a boom. We take as our baseline the conservative projections in the IMF Update (July 2016), which forecasts reduced economic growth of the UK and USA in relation to their pre-Brexit(v) forecasts (WEO April 2016). Figure 1 shows the pre and post Brexit(v) forecasted growth rates. The pound sterling devaluation with respect to the USA dollar has been about 10 percent (Figure 2) and like the Update, we assume it settles at that rate.

\textsuperscript{1} An example of exaggeration is that the “leavers” claimed was £55 million a day based on claimed £17.8 billion per year was transferred to the EU. But with the rebate-effectively deducted at the source transfers are less £12.9 billion, that represents a tenth of National Health Service’ annual budget, and is equivalent to £200 per capita and £35 million per day.

\textsuperscript{2} The four measures announced consist of: a cut in official interest rates to 0.25% from 0.5%, plans to pump an additional £60bn in electronic cash into the economy to buy government bonds, extending the existing quantitative easing (QE) programme to £435bn in total; another £10bn in electronic cash to buy corporate bonds from firms “making a material contribution to the UK economy; £100bn of new funding to banks to help them pass on the base rate cut. Under this new “term funding scheme” the Bank will create new money to provide loans to banks at interest rates close to the base rate of 0.25%. The scheme will charge a penalty rate if banks do not lend. Bank of England (2016). Bank of England’s Monetary Policy Summary, published 4\textsuperscript{th} of August.
3. Impact on the Caribbean

A key feature to keep in mind in discussions on the impact of Brexit(v) is the declining importance of the direct relation between the UK and the Caribbean. One measure of the importance of the relation is the direct elasticity, i.e. the percentage change in Caribbean economic growth for a given percentage change in the UK’s economic growth. It has fallen substantially (see Figure 3). It decreased from about 0.56 in the early-eighties to about 0.08 in the mid-2000s, a sizable decline in the influence of the UK’s economy on the Caribbean economy.

Using a Structural Vector Auto-Regression Model, the forecasted changes of economic growth in the USA and UK reveal a small downward impact on the economic growth of the Caribbean of about -0.16 percentage points, an average of 2016 and 2017. This represents -0.11 percentage points for tourism countries and -0.07 percentage points for commodity countries (see Figure 4). Although it is a small effect, the absolute size of the effect is substantial within the context of countries forecasted to have low or negative growth rates.
We now turn towards the estimates of the impacts on three main channels of influence: trade, tourism and remittances.

### 3.1 Trade

It is important to keep in mind that nothing structural has changed yet in the Caribbean’s relationship with either the UK or EU due to Brexit(v). Only whence a new relationship is negotiated, perhaps two years or more from now, will it change. The Caribbean’s relationship with the EU on trade will continue unchanged until then, through the Economic Partnership Agreement (EPA), and associated development support.

Further, the direct trade in goods between the Caribbean and the UK has been falling during the last three decades. Exports to the UK were a third of total exports and imports from the UK were about a quarter of total imports in mid-sixties but since then both have fallen to less than 2 percent by the 2000s (see Figure 5 that provides individual countries on reliance of exports to the UK). Using the IMF’s Brexit(v) scenario and an elasticity of Caribbean exports to the UK of 0.55 reveals a marginal impact—either exports as a percentage of GDP or in USA dollar terms-on Caribbean exports to the UK (Figure 6). The decline in exports as a percent of GDP is estimated to be an average of 0.004 percentage points (equivalent to a fall of 0.3 percentage points in terms of USA dollars). The largest decline in terms of exports to GDP is for Guyana but even that is only 0.016 percentage points. The impact on Caribbean exports is, therefore, negligible.

---

3 These results are based on three separate SVAR; available on request from the authors.
4 Development assistance, another issue often raised regarding the impact of Brexit, will not be affected until Brexit actually occurs.
Figure 5: Declining Caribbean Trade with the UK

Figure 6. Brexit (v)’s Impact on Caribbean Exports

Source: World Integrated Trade Solution database. Note: We used UK imports from the Caribbean as Caribbean export to the UK and UK exports to Caribbean as Caribbean import from the UK.

Source: Authors. Note the calculations use an elasticity estimated from a pooled regression of Caribbean exports to the UK as a function of UK’s GDP and the real effective exchange rate.

3.2 Services-Tourism\(^5\)

Tourism, as claimed in recent headlines\(^6\), is uniquely exposed to the short-term economic effects of Brexit(v). This is due to the devaluation of the Pound Sterling against the US Dollar rate, and consequent decline in relation to all dollar-related currencies in the Caribbean. This implies that holidays in the Caribbean have become more expensive for the British—already the average nominal cost of a week on the beach in the Caribbean was more expansive than other destinations around the world; add to this a lower outflow from the UK of tourist due to the UK’s forecasted lower economic growth.

However, tourism from the UK was already declining (see Figure 7) as a share of total world tourism. Arrivals from the UK as a percent of total tourist arrivals had fallen from about 55 percent in early 2000 to about 43 percent in late 2000s; the decline also holds for Barbados, which has the lion share of UK arrivals in the Caribbean. Add to that a decline in sensitivity of tourism to prices and income elasticities. Tourism to small islands is less sensitive to changes in the country’s real exchange rate, but more susceptible to the introduction and removal of direct flights (see Culiac, 2014). Further, Laframboise et al

\(^5\) Note we only look at tourism and not any other services, for example professional services.

(2014) find that both price and income elasticities of tourism have decreased since 2008 and that price elasticity is statistically insignificant for “high-end” destinations like those in Barbados (see also Culiac, 2014). Using their estimates, the calculated effect of Brexit(v) on tourism, see Figure 8, during 2016 and 2017 is a fall for Barbados and Jamaica of 3.1 and 1.1 percentage points respectively of UK tourism (in terms in the number of arrivals). The effect for the Bahamas was practically zero. The effect on Barbados and Jamaica is small but significant.

3.3 Remittances

Remittances are important for Caribbean countries as a percent of GDP and in their role in reducing the current account of the balance of payments. Large remittances reflect that the Caribbean countries are marked as exporters of qualified labour, particularly teachers, nurses and other health professionals rather than uneducated migrants. However, geographic proximity and a common language have increasingly made the United States and Canada a preferred destination rather than the UK (United Nations, 2006). As a consequence, remittances from the UK have fallen as a percent of total remittances.\(^7\)

Dependence, as measured by remittances from the UK as a percent of total remittances, ranges from 23 percent for Barbados, 14 percent for Jamaica, 6 percent for Trinidad and

\(^7\) The increase in hate crimes against immigrants in the UK post Brexit vote may further accentuate this shift.
Tobago, to 5 percent for Guyana. For Suriname, it is insignificant. The impact of Brexit(v) on remittances from the UK, as percentage points of GDP and in terms of US Dollars, is given in Figure 10. In terms of the ratio of remittances to GDP, the decline is 0.012 percentage points for Jamaica, and 0.003 percentage points for Barbados and Guyana. The impact on Suriname and Trinidad and Tobago is effectively zero. The estimated impact of Brexit on remittances is therefore negligible.

Figure 9. Declining Remittances from the UK to the Caribbean

![Graph showing declining remittances from the UK to the Caribbean.]


Figure 10. Brexit(v)’s Impact on the UK’s Remittances to the Caribbean

![Graph showing the impact of Brexit(v) on UK’s remittances to the Caribbean.]

Source: Authors, using changes in remitting countries’ GDPs on changes in remittances elasticity of 0.54. This is the high end of estimations of the elasticity that range from a low value of 0.08, mid-point value of 0.31 to high value of 0.54 estimations that differ from different model specifications.\(^8\)

4. What to Do

Over time, the economic and political consequences of Brexit(v) are sure to impact in different ways, the majority of which may be negative for the Caribbean’s economic and political future. The question is, by how much? We limit the question to macro-economic consequences for 2016 and 2017. To answer this more restricted question we use the IMF’s World Economic Outlook Update scenario and estimate the impact of the downward revision of economic growth in the UK (direct effect) and USA (indirect effect) and the Pound Sterling’s devaluation on Caribbean economic growth, exports, tourism, and remittances.

We estimate that the direct and indirect macroeconomic impacts of Brexit to be small if not negligible. Thus, the recent headlines have been misleading, Much ado about nothing. The UK is no longer the Caribbean’s main economic partner. There are no estimated dire

---

\(^8\) See Lueth Ruiz-Arranz (2006).
consequences during 2016 and 2017 on remittances, exports, or tourism, and therefore no significant effect on economic growth. This follows largely due to the Caribbean having dramatically reduced its direct economic dependence on the UK since gaining independence from the UK as a colony.

Although the impact on economic growth is small for the Caribbean countries in percentage point terms, for those that were already forecasted to have low-to-negative economic growth the absolute effect of Brexit(v) is considerable. Furthermore, firms that export their products exclusively to the UK, or that depend solely on UK tourists, and households that depend critically on remittances from the UK, may face a reality opposite to our conclusions, which have a macroeconomic focus.

Brexit itself, of course, is still to come, perhaps in two or more years, but our results do not imply that Caribbean policymakers should do nothing meanwhile. Many commentators correctly argue that policymakers need to engage urgently with the UK in defining a post Brexit landscape that would favour the Caribbean. Humphrey (2016), for example, recommends the following during the interregnum (Humphrey, 2016): “…

1) **Undertake extensive consultations with public and private sector interests, followed by serious reflection and eventual conclusion on what should be the region's development priorities**;
2) **Taking those priorities into consideration, make a realistic determination of what the region would like to get out of mutually beneficial relationships with the EU, UK and other development partners**;
3) **Review areas of concern with respect to key aspects of the existing relationships with the EU and the UK respectively and develop proposals for addressing the problem areas …** ;
4) **Be proactive in initiating early engagement with the EU and UK concerning the existing areas of concern in order to secure adjustments, where necessary, or assurances where there is uncertainty or ambiguity; and**
5) **Mindful of the region's new or updated priorities and moving beyond the problem areas referred to in step three (3) above, Caribbean countries must develop strategies for achieving the identified priority goals, where necessary with the support (at both the input and output stages) of development partners in the UK, the EU and other partner countries or regions.”
Sound advice but easier said than done. The attention of UK and EU policymakers is almost exclusively on their divorce. Amongst the suitors queuing up and clamouring for attention, the Caribbean would be near the tail if the queue were ordered by trade importance for the UK. However, for small economies like the Caribbean, the challenge of being heard is nothing new.
References
Previous Policy Briefs on the Caribbean

Does Size Matter? Yes, If You Are Caribbean! (IDB-PB-201)

Don’t Talk to Me about Debt. Talk to Me about Growth (IDB-PB202)

The Question is Not Whether “To Devalue or Not to Devalue?” But Rather “What to Devalue?” (IDB-PB-204)

Laments of the Caribbean Businessperson are Based on Facts? (IDB-PB-205)

Spillovers of Global Shocks Over Caribbean Countries: So Large That There is Little Room to Maneuver: An Impulse Response Analysis. (IDB-PB-206)

Okun and Jamaica at 50: How Does Unemployment React to Growth? (IDB-PB-208)

The Business Climate in Jamaica: What Does the Enterprise Survey Have to Say? (IDB-PB-211)

Fiscal Unruliness: Checking the Usual Suspects for Jamaica’s Debt Buildup (IDB-PB-213)

To Cut or Not to Cut: Does the Caribbean Follow the Advice of Multilaterals? (IDB-PB-214)

Finding New Tourism Opportunities: Finally Looking South? (IDB-PB-218)

Mothers Are Right: Eat Your Vegetables And Keep Away From the Girls (Boys): Bullying Victimization Profile in the Caribbean (IDB-PB-225)

Unemployment and Growth: Does Okun’s Law Apply to Trinidad and Tobago? (IDB-PB-229)

Remittances as a Safety Net in Jamaica (IDB-PB-235)

To Bind Or Not To Bind: A Fiscal Policy Dilemma in the Caribbean (IDB-PB-236)


Caribbean Economic Alchemy: Has Magic Returned to Bauxite? (IDB-PB-238)

How Much Anti-Money Laundering Effort is Enough? The Jamaican Experience (IDB-PB-242)

Going for Growth: Pilot Benchmarking in the Caribbean (IDB-PB-243)

Debt, Fiscal Adjustment and Economic Growth in Jamaica (IDB-PB-249)