Brexit: Implications for South Africa – United Kingdom Relations

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Introduction

What are South Africans to make of the United Kingdom's (UK) June 23rd referendum result? While the vote result was heard around the world, in the aftermath many things are unclear, notably the future of bilateral relations.

In order to make sense of it, this brief first sets out to discern what Brexit could mean for the UK's future trade and investment relations with the European Union (EU), given that these arrangements are at the heart of the issue. In the process a punt is taken on the most likely outcome. Since both the UK's famous bookies and, perhaps infamous, pollsters, got it wrong on the referendum result, this should obviously be taken with more than a pinch of salt. In fact, as whiskey is high on the list of South African (SA) imports from the UK, those inclined towards a tipple should reach for the single malt.

Then, potential implications for SA– UK trade and investment relations are briefly set out. The brief concludes with some thoughts on the wider implications for the bilateral relationship.

What is Brexit?

Opinions on what exactly Brexit means are sharply divided. Given the enormous complexity of the UK's relations with the EU, reducing it to s simple 'in or out' question was always going to be highly problematic. Nonetheless, it was in part a rejection of economic globalisation by more marginal members of UK society (such as Labour voters); a rejection of immigration, and/or more controls over immigration, by large parts of UK society across the political spectrum; and a strong desire to return sovereignty in many spheres, notably trade policy, back to the UK from Brussels.

These core drivers are accordingly reflected in the UK government's key objectives for negotiations with the EU, my sense of those being:

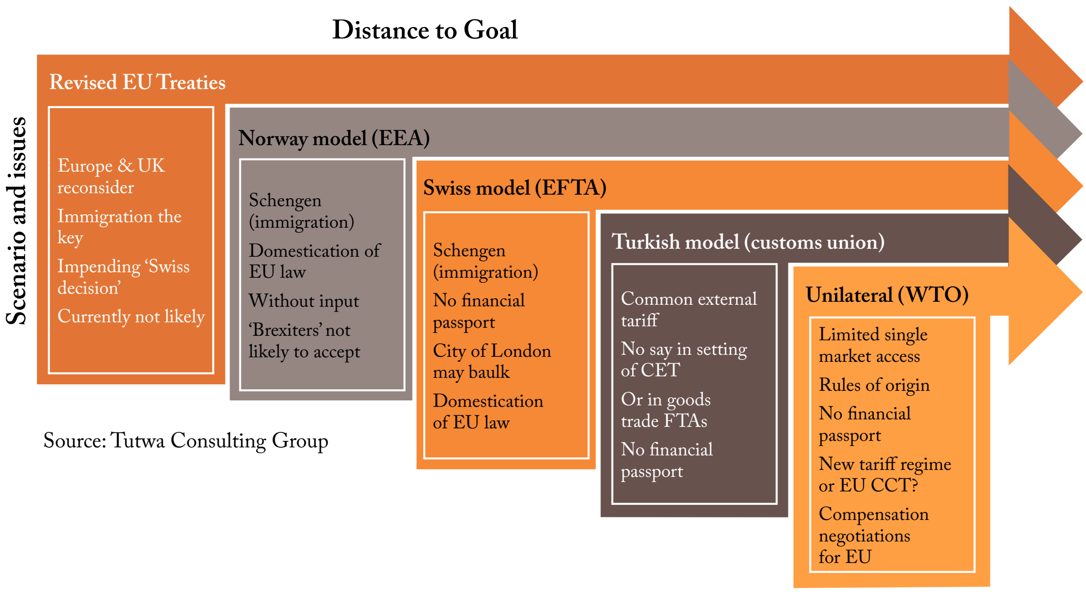
1. Control over immigration (box 1);
2. Returning legislative autonomy to London (box 2);
3. Restoring control over trade policy and negotiations (box 3); and
4. Retention of full access to the single market (box 4).

Unfortunately for the UK government, these objectives contradict prevailing EU norms. As is well known, the four freedoms are at the centre of the EU's *acquis*[1]:

free movement of goods, capital, services, and people. Equally well-known is the fact that freedom of movement for people has become very controversial in the EU, and so the current consensus amongst the remaining EU-27 heads of state seems to be that should the UK wish to reintroduce controls over immigration from EU members, then it must sacrifice the other three freedoms – in other words full access to the single market. Therefore objective 1 is incompatible with objective 4. Furthermore, objectives 2 and 3 are not compatible with objective 4 either, since those countries wishing to enjoy full access to the single market are also expected to implement the *acquis* and participate in the common European tariff[2]. These dilemmas explain why the City of London, substantially dependent on financial 'passporting' rights into EU member states, is very concerned. Needless to say many companies in other sectors, agriculture, manufacturing and services, both UK and foreigners invested in the UK, have similar concerns.

With this in mind, Figure 1 sets out the UK's options for negotiations with the EU.

Figure 1: Brexit objectives and scenarios (Goal defined as full Brexit)



Source: Tutwa Consulting Group

First, it is important to appreciate that Brexit, notwithstanding UK Prime Minister May's statement that 'Brexit means Brexit', is not a foregone conclusion. The bookies are reportedly taking 60/40 odds in favour of it occurring; at 40 percent the odds of it not occurring seem substantial. Space constraints do not permit a detailed consideration of the political dynamics behind this calculation, but suffice it to say that the UK Parliament, the fortunes of the UK economy, how the EU handles the 'Swiss problem' over immigration, the unpredictability of European reactions, and global pressures, inter alia, will all play a role. It is worth remembering that Danish voters rejected the Maastricht Treaty, so too did Irish voters reject the treaties of Nice and Lisbon. In both cases the countries secured concessions from their EU partners along the way, and so the prospect of the UK choosing to remain in a 'reformed' EU cannot be ruled out, even if it currently appears rather unlikely. After all, 'Brexit means Brexit', right?

Can Norway offer a solution? Being a full member of the European Economic Area, it has full access to the single market. Box 4 ticked. However, it participates in the Schengen Agreement and so allows for immigration of EU nationals, and implements EU laws without having any say in their formulation (crosses in boxes 1 and 2). This is likely to be unacceptable to the Brexiters currently leading the official charge out of the EU. Norway does, however, have control over its import tariff regime and trade negotiations through the European Free Trade Area[3] (EFTA) (box 4 ticked).

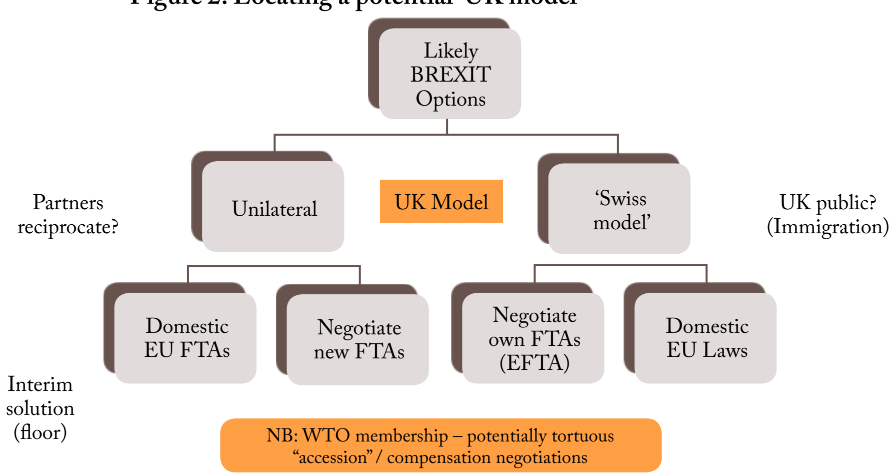
What about the Swiss model? As mentioned, there is currently an impasse between Switzerland and the EU that must be resolved by February 2017. This concerns the thorny matter of the Swiss referendum result, conducted three years ago, favouring controls over immigration from EU states. The Brexit result seems to have shifted the politics of this issue firmly against Switzerland, with talk of the country being made an example of, in order to stiffen the EU-27s resolve in its forthcoming negotiations with the UK government (cross in box 1). Furthermore, Switzerland domesticates most EU laws (cross in box 2) and does not have access to financial service passporting rights (cross in box 4). Like its EFTA partner Norway, however, it does have control over trade policy and negotiations (tick for box 3).

The Turkish model does not offer much hope. On the one hand, Turkey has full control over its immigration and economic policies (boxes 1 and 2 ticked), but does not have free access to EU capital and services markets (cross in box 4). Access to the EU's goods markets is secured at the price of participation in the CET, with no say in the setting of tariffs or external trade negotiations (cross in box 3).

Finally, and in light of the foregoing analysis, the 'unilateral' or 'hard Brexit' option seems to be the most likely point of gravitation, unless the politics of Brexit move against this outcome and in favour of rapprochement with the EU. In this model boxes 1 through 3 would be ticked, but at the cost of full access to the single market, including for financial services (box 4). It would also require introduction of complex rules of origin to condition the UK's access to EU goods markets, and vice-versa (box 3 partially ticked). There would also be a likely messy accession negotiation to navigate in the WTO[4], which could take years to complete.

Overall, as Figure 2 shows, the most likely outcome is somewhere between the unilateral and Swiss models. This is my punt.

Figure 2: Locating a potential 'UK model'



Accordingly, should this model prevail then, in order to avoid trade disruptions owing to potential abrogation of its trade treaties with current EU free trade agreements (FTAs) partners, the UK should simply domesticate existing EU FTAs so as to create an interim solution and establish a floor for future trade negotiations. The issue is whether its trading partners would reciprocate, or simply choose to bank this unilateral UK move with the result being a disruption in trade relations (dynamics around this are briefly explored below in relation to SA). Nonetheless, the UK would of course be free to negotiate new FTAs, with potentially interesting and favourable outcomes as we have canvassed elsewhere.[5]

Implications for South Africa – United Kingdom Trade and Investment Relations

Figure 3 sets out the issues and options pertaining to the future of SA-UK trade relations, in the event of a 'UK model' for Brexit.

The first, crucial, point is that in the arena of trade in physical goods, SA is a member of its own CET via the Southern African Customs Union (SACU). Therefore, any future goods trade arrangements with the UK would need to be concluded with the other SACU member states[6] on board. However, SACU has its own issues and complexities, notably the future of its revenue-sharing arrangements[7] and whether SA is really prepared to devolve decision-making over the CET to a supra-national institution (currently it is not). These issues are complex, and have led this author to refer to the politically incorrect possibility of a 'Sexit' (South African exit from SACU).

Since approximately 85 percent of SA's exports to the UK currently attract no duties, SA need only concern itself with the 15 percent that do. Furthermore, the UK only accounts for around 4 percent of SA's global goods exports, and is our sixth largest trading partner , so the potential costs of this option to domestic exporters are conceivably manageable.

Nonetheless, assuming that SACU gets its act together, and it is currently negotiating various FTAs collectively[8] so this seems likely, then there are three options, the latter two of which are not mutually exclusive.

The first, of course, is to do nothing, and accept the UK's decisions concerning its own trade arrangements, which may well be to unilaterally adopt zero or very low import tariffs. Since approximately 85 percent of SA's exports to the UK currently attract no duties, SA need only concern itself with the 15 percent that do.[9] Furthermore, the UK only accounts for around 4 percent of SA's global goods exports, and is our sixth largest trading partner[10], so the potential costs of this option to domestic exporters are conceivably manageable. However, should the UK go our recommended route of adopting all EU FTAs, in our case the Economic Partnership Agreement (EPA), then it will expect SA to reciprocate. Failure to do so could result in UK retaliation and, therefore, loss of export opportunities on both sides. Obviously this would also substantially damage bilateral relations. The desirability of this option is another matter, since there could be substantial export opportunities in the 15 percent of currently taxed exports to the UK, and particularly in agriculture that, on the UK side, could be unshackled from the EU's highly distortive Common Agriculture Policy. There is also a wide range of possibilities in services trade, both imports and exports, which would be foregone should the SA government go the 'do nothing' route.

Alternatively, SA and the UK could agree to domesticate the EPA, by legally scrubbing the existing text and turning it into a bilateral instrument with no reference to the EU. This would be the simplest option, but it would not be simple, as the BLNS, Mozambique, and Angola – all co-signatories– would need to participate and presumably sign off too. The ensuing treaty would also need to be ratified by all Parliaments before it came into effect. In the interim all parties could agree to continue implementing the EPA, so that trade is not disrupted.

> *Increasing the capacity of the economy to generate new jobs by encouraging labour-intensive sectors to expand is thus crucial, and would have significant economic and social benefits.*

This could serve as a building block for future bilateral negotiations, which, in our view, should encompass services, as these are the most dynamic sectors in both economies. Alternatively, the parties could negotiate a new FTA entirely, particularly if the EPA domestication option proves to be too complex. Such an undertaking would be time consuming, however. Furthermore, SA is likely to engage reluctantly in services negotiations since the Department of Trade and Industry is leery of negotiations in this area in general. Furthermore, the entrenched political economy of protection in SA makes this likely to be a fraught route. Interestingly, the same political economy may make SA gravitate towards the 'do nothing' option.

Figure 3: South Africa – United Kingdom Post Brexit Trade Options

SACU Concurrence	• Prerequisite for all scenarios • Different interests; complicated negotiations • SACU has deep problems of its own
Do Nothing	• South Africa's default position; strong political economy of protection • UK could withdraw market access • Lost opportunities (agriculture) • Bilateral relations suffer
Domesticate EPA	• Simplest option if UK reciprocates • Legally complex (eg includes Mozambique and Angola) • May require separate, bilateral, ratified FTAs.
Negotiate New FTA	• With EPA as the base? But UK will want to include services/regulations – problematic for SA • May take a long time, UK will have more pressing priorities • Could open up new opportunities – and threats

One thing is certain, though, that discussions about the future relationship cannot be seriously entered into until the UK has decided what its post-Brexit future with the EU will be, and has moved to implement those preferences through triggering Article 50 of the Lisbon Treaty. Projecting into the future, then, what are the wider implications of Brexit for SA-UK relations?

Wider implications

Once again it is important to begin with an assessment of the geopolitical consequences of Brexit for the UK itself. Three key and connected issues immediately arise. First, will Brexit be amicable and constructive, or will a messy divorce ensue? Second, will Scotland remain part of the UK? And third, how will Washington react and, therefore, what is the future of the 'special relationship'?

If Brexit is amicable, then question two probably answers itself, ie Scotland is likely to remain in the UK. This means that 'Great Britain' will remain relatively great in terms of economic size and influence, and with a substantial role in a post-Brexit EU, albeit probably not as a full member. Therefore, the answer to question three is that the US will likely look to maintain the special relationship, but probably at a somewhat lower level, and will look to elevate its influence in the post-Brexit EU by forging closer ties with, inter alia, France, Germany, and the East European states (with a keen eye on Russia). Should candidate Trump win the US Presidential elections, however, the future US foreign and trade policy stances are anything but clear, but that subject is for another forum.

Should the divorce prove messy, however, then Scottish exit from the UK becomes substantially more likely, and the prospect of 'Little Britain' on the global stage would rise substantially. Washington is likely to react unfavourably to this development through downgrading the special relationship in favour of stronger ties with the EU.

The primary losers are therefore young workers and women, the less skilled, and workers in small firms.

In the first scenario, the prospects for 'continuity with change' are reasonably high, and it is unlikely that the UK would look to dramatically overhaul its foreign policy. Undoubtedly strategic recalibrations would be in order, but not in an existential sense since the 'triangular transatlantic architecture' envisaged for UK foreign policy by then Prime Minister Harald MacMillan, via membership of the EU, would still be retained, albeit in modified form.[11]

In the second scenario, existential strategic recalibrations would be urgently required, if 'Little Britain' were not to slip into relative international irrelevance. This would not necessarily be a precipitous decline, since the UK would still remain a major economy and military power, but if some pundits' gloomy predictions about the future of the City of London[12] – which accounts for around a third of UK GDP – were realised under this scenario then a relatively quick decline could materialise. Of course pundits have been wrong before. Moreover, having lost its voice in the EU, the UK would be substantially less attractive as a foreign policy conduit for states seeking to influence the EU.

Clearly the first scenario does not hold immediate, and major, implications for SA-UK relations. The second, however, does. Interestingly, all the adjustment, at least initially, would come from the UK side. In essence the UK would be looking to shore up strategic ties around the world, using instruments such as the Commonwealth, aid payments, and FTAs, but is likely to find itself adrift in a sea of scepticism.

Calculations on the SA side clearly matter too. It would be fair to say that the African National Congress (ANC)-led tripartite alliance has become increasingly ambivalent about relations with the west in general, and so some may see Brexit as an opportunity to forge stronger ties with groupings such as the BRICS.[13] Countervailing voices are likely to come from within the modernising wing of the ANC in particular, as well as key components of the bureaucracy and big business. This jostling will occur in increasingly contested domestic political economy circumstances in which the Jacob Zuma led ANC is in electoral decline, with some, perhaps optimistic, commentators predicting that should the current President remain in power then the 2019 elections could usher in an opposition coalition in the Union Buildings and Parliament. Quite what the balance of forces will be here when the Brexit chips are down is anybody's guess.

Do I hear the call of a bookie?

NOTE

1 The acquis communautaire is 'The body of common rights and obligations that is binding on all the EU member states.' European Commission website, available at ec.europa.eu/enlargement/policy/glossary/terms/acquis_en.htm, accessed September, 30th, 2016.
2 A common external tariff refers to the fact that all countries that are parties to the arrangement forego sovereignty over their import duty/tax regimes, and agree to set the CET collectively, and to apply it in full. This means that free trade will apply within the CET area, and parties exporting to the CET area will pay the same import duties no matter which member state they export to.
3 Members are Iceland, Liechtenstein, Norway, and Switzerland.
4 While the UK is a member of the WTO in its own right (being a founder member of the WTO's precursor, the GATT), since it would have left the EU's CET it would have to negotiate new tariff concessions for all non-EU WTO members since the latter would have lost market access and would be entitled to 'compensation'. In addition, the EU would have to enter into compensation with all other WTO members, bar the UK, since access to its common market would also have diminished pursuant to Brexit.
5 Peter Draper and Andreas Freytag (2016) "UK still has a strong hand so EU must handle Brexit deftly", Business Day, August 26, available at http://www.bdlive.co.za/opinion/2016/08/26/uk-still-has-a-strong-hand-so-eu-must-handle-brexit-deftly
6 Botswana, Lesotho, Namibia, and Swaziland (BLNS).
7 SA provides a large annual fiscal transfer to the BLNS. Since 1910 the quid pro quo was that SA set the CET on the basis of its own industrial policies, and in return compensated the BLNS for foregoing any say in it. Now the SA Treasury wants to reduce the size of the transfer, in return for which the BLNS want greater say in the setting of the CET. The member states are at an impasse over these trade-offs.
8 The Tripartite FTA; preparations for the Continental FTA; the SACU-India FTA; and it has recently concluded negotiations with the EU.
9 See the presentation by Matthew Stern, Managing Director of DNA Economics, at the recent SACCI-Tutwa Consulting Group seminar on Brexit, September 29th, 2016.
10 Ibid.
11 See the perceptive article by Philip Stephens (2016) 'Britain sets off in search of a role – again', Financial Times, September 29th.
12 The one I have found most persuasive to date is Nicolas Veron (2016) "The city will decline – and we will be the poorer for it", Prospect Magazine, August 18th, available at http://www.prospectmagazine.co.uk/features/capital-flight-london-economy-brexit-business
13 Brazil, Russia, India, and China.
14 See Peter Bruce (2016) 'Maimane, enters stage right ... er, psst, Mmusi?', Business Day, September 30th, available at http://www.bdlive.co.za/opinion/columnists/2016/09/30/thick-end-of-the-wedge-maimane-enters-stage-right--er-psst-mmusi