WHAT WILL BREXIT MEAN FOR KOREA?

Op Ed by Dr Rory Knight

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JOONGANG SUNDAY

JoongAng Sunday is the Sunday edition of the leading Korean language daily newspaper JoongAng Ilbo. It is one of the three largest newspapers in South Korea. The paper also publishes an English edition, Korea JoongAng Daily, in alliance with the International New York Times.

Global trade is in the grip of a mega-tsunami that threatens to overturn the existing world order and possibly render the WTO obsolete. As President Trump rips up NAFTA and TPP trade agreements and UK Prime Minister May states that Brexit means the unequivocal withdrawal of the UK from the European Single Market, bilateralism could be the new face of globalization dominating international trade over the next decade. But rather than threat, this represents opportunity for Korea.

Filtering the noise surrounding Brexit

In order to understand the uncertainties lying at the heart of Brexit it is first necessary to blank out the barrage of opinion, confusion and political rhetoric surrounding the issue. Korean companies that trade with the UK need to address three key questions: What is the current status of Brexit? What is likely to happen next? And what will be the uncertainties in trading with the UK in the immediate and near future?

UK Prime Minister May's position is that 'Brexit means Brexit' - namely abandoning all elements of the EU that constitute membership. Despite all the outcries and legal challenges she has made it clear that the UK will leave the Single Market and the European Customs Union by 2019 and no longer be subject to the European Court of Justice. (As to the Euro, the UK was already more out than in regarding the common currency.)

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A recent UK Supreme Court ruling that Parliament should be consulted before triggering the procedures leading to exit (known as Article 50 of the Lisbon Treaty) has actually made the path to Brexit clearer. Importantly, it precluded any involvement of the devolved parliaments of Scotland, Wales and Northern Ireland - the hotbeds of opposition to Brexit. Given a Parliament now placated by Mrs May's offer to allow it to debate any finally negotiated Brexit terms (but not its ultimate implementation), it is a fair bet that that Article 50 will be triggered by April 1. The countdown will then begin to departure on 1 April 2019. During this period the UK will still remain a full EU member. Thus, all Korean trade with the UK will continue to be governed by the EU's current South Korea Free Trade Agreement (the EUSKFTA) for the next two years. In the short-term therefore it will be business as usual for Korean companies, but it would be reckless to assume that this situation will last beyond two years.Article 50 dictates that the UK and the EU should jointly negotiate the terms of departure and the trade arrangements for the UK once outside the EU. Three outcomes are possible: firstly, a failure to agree and Britain walking away with no special deal; secondly, an agreement by which Britain exits the EU to become a third-party country with a trade agreement much like Korea's with respect to the EU; thirdly, an agreed transitional period intended to phase in either the first or the second outcomes. The upshot for Korean companies is that, whatever the outcome, they will eventually be subject to a new trading arrangement with the UK. Therefore Korean companies need to start planning for change now.

What are the cards stacked against Britain?

At stake is the UK's trading relationship with the EU currently worth some £223 billion in exports - nearly 44% of total UK exports. However this figure has been falling for several years from its all-time high of over 52%. Furthermore, UK exports to the US are now in excess of £100 billion, dwarfing the figure for exports to any one EU country. Indeed UK exports to the US now exceed the UK's combined exports to its three leading EU partners. It is also worth noting that Britain enjoys a trading surplus with the rest of the world outside the EU.

Balanced against the outlook for UK exports to the EU is the scale and trend in imports from the EU to Britain. In 2015 these were running at 130% of exports. This deficit has been increasing over the last several years and should provide some leverage to the UK in the forthcoming negotiations. The EU has more to lose by disrupting trade with Britain, and the costs could be steep for individual EU members. German car manufacturers, for instance, are unlikely to welcome the imposition of WTO-style tariffs on their sales to the UK.

Negotiating a complex set of trade deals which require the unanimous agreement of all 27 member states within a two-year period will not be easy, however. Furthermore, a major cost for the UK lies its inability during the negotiations to strike trade deals with non-EU members as proscribed under existing EU membership rules. Thus, a new UK-Korea trade deal could only be negotiated after the UK exits. This is likely to prove a major hurdle for the UK and will increase pressure on it in the course of the negotiations.

What cards favour Britain?

The cost saving of £350 million in UK weekly contributions to the EU (which is some 10% of the value of UK exports to the EU in gross terms) will help cushion the costs of disentanglement. Moreover, Britain as a member of NATO and a permanent member of the Security Council at the United Nations is an important contributor to European defence and security. Although much has been made of Brexit's threat to the City of London, because of the loss of so-called 'passporting rights' (the ability to sell financial services freely across EU states) the reality is that each country has its own financial regulations and such passporting has had little effect in practice. The true costs of barriers to trade would in fact be borne by EU financial institutions which would lose frictionless access to the City of London, the world's leading global financial centre. The City is therefore probably the UK's strongest negotiating chip.

Another big plus for Britain is Donald Trump – a trump card indeed. Mr Trump is stridently in favour of Brexit and of shaking up world trade generally. In fact his appointee as EU ambassador has estimated a new trade deal between the US and the UK could be developed in ninety days. The mood music across the Atlantic has swung signally in favour of the UK.

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Finally, in the eventuality of no deal being agreed, Britain could paradoxically be in a stronger position to negotiate a third-country trade deal like that enjoyed by Korea. Indeed the current EUSKFTA might well be the model for any new arrangement.

A Prisoner's Dilemma

Regrettably, however, the Article 50 negotiations could also trap both sides in a version of the classic prisoner's dilemma leaving neither emerging with their most preferred outcomes.

The EU position, as articulated by its Brexit negotiator Guy Vanhofstadt, is that a trade deal should be imposed on the UK that is signally worse than the terms enjoyed by member states. This position the UK Foreign Secretary Boris Johnson has likened to the 'punishment beatings' handed out to prisoners who dared to try to escape in WWII movies! From the other side Mrs May claims that 'no deal is better than a bad deal' and is prepared in that eventuality to walk away empty-handed. The battle lines appear to be drawn indeed.

The exit negotiations will be a race against time and events. A key consideration in them will be the respective economic and political strengths of the two parties. If the EU suffers another crisis such as a break-up of the Euro or the departure of another member, its hand will be greatly weakened. There is no doubt that an agreed and orderly exit is in everybody's best interests, including Europe's. As Theresa May commented 'A punitive deal...would be an act of calamitous self-harm for the countries of Europe.' Moreover the political landscape in Europe is changing fast. Caught between an aggressively expansionist Putin to the east and an unsupportive President Trump to the west, and with elections pending in France, Germany and the Netherlands that could give further expression to anti-federalist sentiment, the EU can ill afford a disorderly Brexit.

What are the implications for Korea?

The main interest post-Brexit for Korean companies will lie in enhanced opportunities to trade with Britain. Korea, which ranks in the top ten of EU countries in terms of imports and exports, is an important trading partner of the UK. The UK already provides a ready market for Korean products and a source of financial services and defence equipment for Korea. Indeed the UK does more business with Korea than the UK does with most EU countries. In 2015 UK-Korea trade was roughly in balance involving exports of nearly £5 billion.

Brexit will result in a Britain seeking to position itself as a leading advocate of free trade and striving to rebuild existing relationships directly rather than working through Brussels and the EU. To this end it will offer a highly competitive tax jurisdiction and the world's leading centre of global finance.

The aim over the next two years should therefore be to judiciously prepare for a new trade deal tailored to the needs of both partners, rather than continue the one-size-fits-all arrangement currently controlling their trade. The bonds between Korea and Britain on which it could draw are long and deep – running from the introduction of soccer in 1882 when British sailors left behind their football on the beaches of Incheon to the sacrifices made by allied forces on the very same beaches in the Korean conflict in 1953 from whose ashes Korea has risen to be the economic superphoenix it is today.

EUSKFTA
EU South Korea Free Trade Agreement

NAFTA
North American Free Trade Agreement

NATO
North Atlantic Treaty Organisation

TPP
Trans Pacific Partnership

WTO
World Trade Organisation

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