

Much ado about Nothing? BREXIT and its Potential Impact on the East African Community

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Abstract

Brexit has caused considerable concern in Africa regarding its potential impact on trading and investment relations with both the United Kingdom and the European Union. This paper looks at the empirical evidence about the existing strength and depth of those links. We then use a Computable General equilibrium (CGE) model to simulate a hard Brexit scenario, and see how this impacts on trading relations with Africa. We also focus on the potential impact on a sub regional block - the East African Community (EAC). The paper finds that a) direct links through trade and investment are unlikely to be impacted substantially and indeed may even benefit marginally b) indirect links, through Brexit's impact on the global economy, may be more important and c) a reduction in UK development cooperation is extremely likely over the mid- to long term, which could represent a serious problem for aid-dependent countries. Finally, we argue that the real impact could be in a negative 'demonstration' effect, undermining confidence in 'deep' regional integration processes like that of the EAC.

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1. INTRODUCTION

On the 23rd June 2016, in a referendum on the continued British membership of the European Union, the British electorate delivered a largely unanticipated vote to leave the EU, sending shock waves around the global economy. Speculation has continued ever since about its impact both on Europe and the rest of the world. Africa has not been immune to these concerns.² The United Kingdom continues to have important investment and trading links with Africa, and is a major donor. This paper looks at the potential impact, focusing particularly on another regional block with long-standing historical³ and economic ties with the United Kingdom – the East African Community. The EAC is arguably one of the most advanced regional economic communities in Africa - and one of the most ambitious. Established (or rather, reestablished, as there was a previous manifestation of the EAC) in 2000, the EAC has already achieved a Customs Union and Common Market, and is now moving toward monetary and political federation.⁴ Implicitly if not at times explicitly, the EU has been an important role model for the EAC – for instance, in 2010 a technical team from the European Central Bank visited the region to advise on the achievement of monetary union.⁵

Because of this, the EAC represents an interesting case-study of how Brexit might impact on other regional blocks in Africa. Both the United Kingdom and the EU continue to have long-standing historical and economic ties with East Africa, and the UK is a major donor, in a region which in the past has been highly aid dependent. What will happen if over the course of the next two years the UK does definitely leave the EU?

The traditional way economists measure such shocks is through evaluating both *direct* impacts (e.g. through trade, investment and remittances) and *indirect* ones (e.g. through Brexit's impact on the global economy). This paper looks at both, but does not presume to put forward a comprehensive evaluation of Brexit and its trading impact globally. That would need to be done through a more exhaustive analysis, at a much more disaggregated level.⁶ Rather, the focus of the

² Some of the initial evaluations were quite alarmist. Thus Tan (2016) declares that 'African economies may be severely affected by Britain's exit'. Some of the orders of magnitude that the author quotes do not actually support the argument, however. Thus it is alleged that South Africa, the UK's biggest trading partner in Africa, will 'bear the brunt of Brexit', yet in the next sentence it is noted that the UK is only its eighth largest trading partner and that South African GDP "could shrink -0.1 percent of GDP", a figure which, from a macroeconomic perspective, could hardly be considered a major impact. See Amelia Tan (2016), "Africa after Brexit – African economies may be severely affected by Britain's exit", *African Renewal*, August-November 2016, pp. 18-19.

³ Three of the five countries (Uganda, Tanzania and Kenya) were former colonies of the United Kingdom. If the newest member of the EAC is counted (South Sudan), four of the six countries are ex-colonies of the UK. Burundi and Rwanda were Belgium colonies.

⁴ Article 5 (2) of the EAC Treaty states that "*The Partner undertake to establish among themselves a Customs Union, a Common Market, subsequently a Monetary Union and ultimately a Political Federation*"

⁵ The irony of this is of course it was the same year that the Greek crisis detonated.

⁶ Analysis carried out by the HM Treasury, IMF and OECD prior to the referendum came to a wide range of possible outcomes for the UK, dependant upon the agreed degree of market access under the new arrangements. Long-run impacts were estimated at between -1 and 8 per cent of GDP. See HM Treasury (2016), "The Long-Term Economic Impact of EU Membership and Alternatives", London, UK: HM Treasury; OECD (2016), *The Economics of Brexit: A Taxing Decision*", Economic Policy Paper 16, Organisation for Economic Cooperation and

paper is on the potential impact on another regional block in Africa. In this short article, I will argue that the short-to mid-term consequences through the direct impacts are likely to be relatively minor. But the longer-term indirect impact may be more consequential.

The paper begins in Section 2 by presenting the stylized facts of both the UK's role in the global economy, and quantifies its trading and investment links with Africa in general. In Section 3, we then look at the depth of those links with the East African Community. In Section 4, we carry out a simulation exercise, using the Global Trade Analysis Project (GTAP) model, which allows us to simulate what would happen to trade patterns, should the Brexit negotiations end up with the UK and the EU reverting to the tariff levels imposed on imports from the rest of the world (in WTO parlance, 'Most Favoured Nation' tariffs). We focus on how a 'hard' Brexit would end up affecting trade with the East African Community. In Section 5, we discuss some of the indirect links of what has happened in Europe, and how it might affect the EAC region, particularly with regard to its future process of regional integration. Section 6 concludes.

2. The UK Economy and Its Current Links with Africa

The first thing to stress is the enormous amount of uncertainty that surrounds the whole Brexit process. We currently know nothing about the terms of the agreement. It is not even clear if legally it will be possible to enact Brexit – there have already been legal challenges to the issue of whether parliament will have to vote on the final agreement reached with the EU. For the British themselves, the decline in sterling has been the most tangible impact so far (16 percent against the US dollar since June), resulting in a significant decline in real incomes. This will also of course have an impact on exporters to the UK market, making their products less competitive compared to comparable domestic goods. A lower exchange rate could also impact on remittances.

When measuring the impact of an event on the global economy, it is first important to get a sense of both magnitude of the economies in question, and the depth of their financial, trading and investment linkages with the rest of the world. In the case of Africa, everyone is aware of the *Africa rising* narrative⁷. This narrative is reflected in African GDP as a percentage of global GDP, which has been increasing over the last decade and a half, from 4.4 percent 2000 to 5.1 percent in 2015. By contrast, the UK economy has been declining in relative terms as a share of global GDP from 3.0 percent to 2.3 percent over the same period⁸. However, the influence of the British economy on global developments – and on Africa in particular - arguably goes beyond its economic size, partly as a function of its deep-seated historical ties with the continent, and also because of the influence of the City of London as one of the largest financial hubs in the world.

Development, Paris; IMF (2016), "United Kingdom: Selected Issues", Country Report 16/169, International Monetary Fund, Washington, D.C.

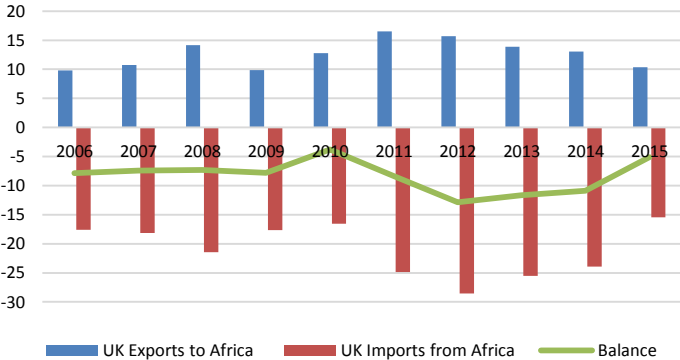
⁷ That narrative has of course taken a dent over the last 12 months, as commodity prices have tumbled and the growth of Nigeria and South Africa (the two largest economies) has stagnated. But it is notable that beyond the oil and mineral exporters, economic growth has still been quite resilient. See IMF Regional Economic Outlook: Sub-Saharan Africa- Multispeed Growth, October 2016, Washington.

⁸ Office for National Statistics (2016), "The UK's trade and investment relationship with Africa 2016, 23rd May.

Another important magnitude to bear in mind is the contribution of the UK economy to the GDP of the whole of the European Union. Based on 2015 figures, the UK represents approximately 17 percent of the EU economy, making it the second largest economy in the EU after Germany. The trading links between the UK and the rest of the EU are strong – approximately 50 percent of UK trade is with its EU partners, but the UK actually sustains a quite large deficit with its EU partners. Indeed, in 2015, the UK's intra-EU trade deficit was the largest among the EU-28, with a total deficit of -118.2 billion Euros⁹. The UK is also quite highly integrated into European-wide value chains, through foreign direct investors and national firms in sectors such as chemicals and the auto-industry.¹⁰ As a consequence, Brexit has the potential, if not well negotiated and managed, to destabilize Europe as a block, and substantially alter global trading patterns.

What of the United Kingdom’s existing trading relations with Africa? From the UK’s perspective, Africa represents a strategic, but in absolute terms not a major, trading partner (Figure 1). In 2015 Africa represented precisely the same share of UK imports and exports - just 2.6 percent of the total. Figures from the Direction of Trade Statistics of the IMF (2016)¹¹ show a trade deficit in favour of Africa, in the region of -5.1 billion USD in 2015. Total imports peaked at 28.6 billion USD in 2012, but have subsequently fallen to 15.5 billion USD in 2015, essentially on the back of much weaker commodity prices (raw materials, particularly oil, are the major imports).

Figure 1: UK Trade with Africa, 2006-2015 (billions USD)



Source: IMF DOT database

From the African perspective, however, the UK is a relatively minor market – it represents just 3.2 percent of total exports from Sub-Saharan Africa in 2015. Moreover, clearly this trade will

⁹ Eurostat (2016) data

¹⁰ See, for instance, Alicia Garcia Herrero and Jianwei Xu (2016), "Is the UK’s role in the European supply chain at risk?", Bruegel, Blog post 20th December, <http://bruegel.org/2016/12/is-the-uks-role-in-the-european-supply-chain-at-risk/>

¹¹ In one of those statistical discrepancies that often impact on statistics related to trade and investment in Africa, trade figures from the UK’s National Office of Statistics actually are at variance with the figures produced by the IMF’s DoT statistics.

not suddenly grind to a halt because of Brexit¹² – it will simply lead to a shift in the terms of trade between the UK and the EU on the one hand, and with countries outside the EU on the other, if and when tariffs are reinstated.¹³ This will lead to shifts in both the magnitudes and geographic patterns of trade flows, due to both the changed relationship between the UK with the EU, and also how Brexit impacts more generally on the state of the UK and global economy. However, from the perspective of countries outside the EU, the re-imposition of tariffs on trade between the UK and the EU could paradoxically benefit countries outside Europe. In other words, there is scope for 'trade diversion' - that is, with less trade between the EU and the UK, other trading partners potentially stand to benefit. That scenario is borne out to some extent in the simulations in Section 6.

What about the investment links? The UK constitutes an important FDI investor in Africa, with an investment stock that more than doubled over the decade since 2006, from 15.1 billion UKP (27.8 billion USD) to 38.9 billion UKP (59 billion USD) in 2015 (Figure 2). The total investment stock of Africa is estimated to stand at 740.4 billion USD in 2015,¹⁴ implying that the UK is responsible for approximately 8 percent of total FDI stock in Africa. The sectoral composition of UK investment in Africa shows a predominance in the mining and financial services sectors, with limited investment outside those two sectors (Figure 3). In 2015, mining alone represented more than half (53.7 percent) of the investment stock, and financial services approximately a third (32.7 percent). With such a large share being motivated by natural resource endowments, it would seem to be a reasonable *a priori* assumption that such investments in Africa are unlikely to be affected much by Brexit. There are a couple of caveats to this observation, however - were Brexit to lead to a serious deterioration of the British economy, it could constrain the ability of UK-listed companies to raise finance for foreign investments abroad. Similarly, a weak value of sterling is, *ceteris paribus*, likely to discourage UK direct investments abroad.¹⁵ There is no reason, however, to suppose that these factors would specifically impact on Africa.

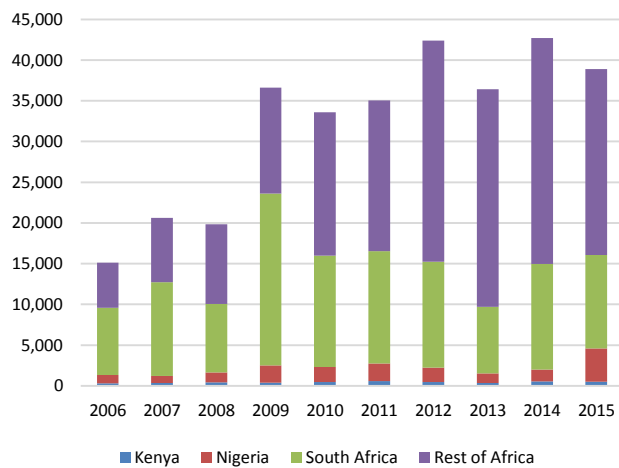
¹² This is however, the implication of some authors, who point out that once the United Kingdom is out of the EU, it would have to renegotiate hundreds of trade deals, and that Africa would probably be at the bottom of the queue in terms of its overall priority. These arguments however assume that no provisional arrangements will be put in place – arguably, an unlikely state of affairs.

¹³ WTO, ITC and UNCTAD (2016), "World Tariff Profiles 2016", https://www.wto.org/english/res_e/publications_e/world_tariff_profiles16_e.htm, page 81. Here it is worth stressing that the tariffs currently applied on the EU's external trade are generally low - average trade-weighted tariff by the EU of just 2.3 per cent on industrial goods, though the figures are significantly higher on agricultural goods, with an average trade-weight tariff calculated at 8.5 percent in 2015.

¹⁴ UNCTAD (2016), "World Investment Report- Investor Nationality: Policy Challenges" Geneva, Annex Table 1, pp.196-199.

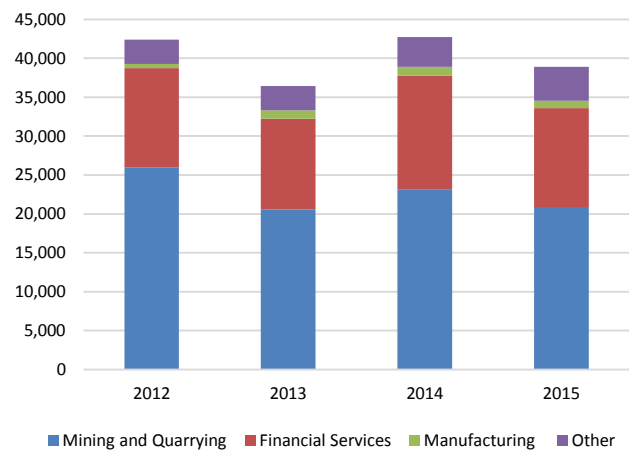
¹⁵ There is some academic debate over this proposition. In principle, a weaker sterling exchange rate makes assets denominated in foreign currencies more expensive, and so would discourage further foreign direct investments. But a lower exchange rate also makes repatriated profits more valuable in pounds sterling. For a summary of research on this matter, see John Dunning and Sarianna M. Lunda (2008), *Multinational Enterprises and the Global Economy* (Second Edition), Edward Elgar, Cheltenham, pp. 90-91.

Figure 2: UK FDI Investment Positions to Africa, 2006-2015 (billions GBP)



Source: Office for National Statistics (2016)

Figure 3: Sectoral Shares of the UK FDI Position, 2012-2015 (billions GBP)



Source: Office for National Statistics (2016)

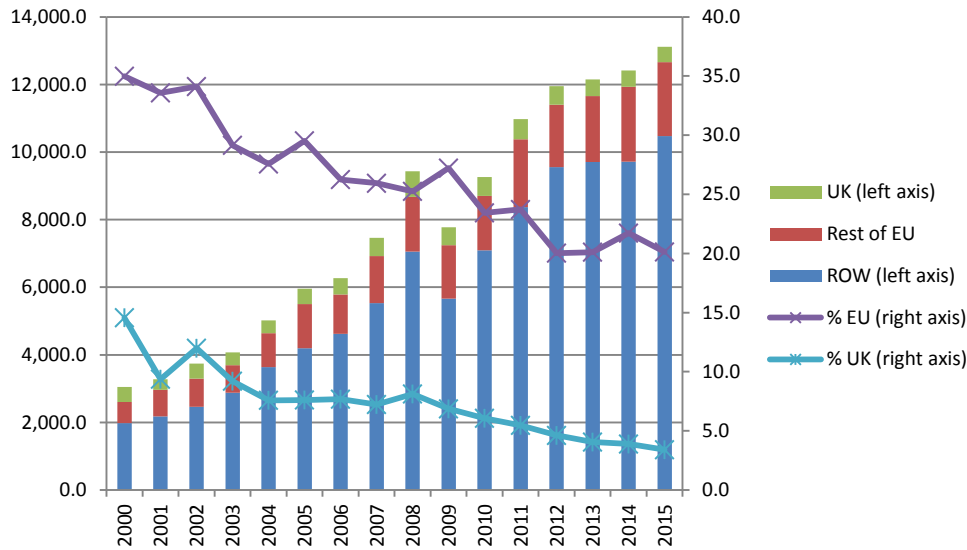
3. Existing UK Trading and Investment Links with the EAC

Because of the longstanding historical links, product of their colonial histories, trade and investment links with Europe - and the UK in particular - have traditionally been extremely important to the East African region. However, in recent years the intensity of those links have declined because of the growing importance of South-South trade links - both intra-African trade and trade with emerging markets (particularly China).¹⁶ For instance, imports from China have increased since 2000 from an insignificant share of total imports (around 1 percent) to 20 percent of total imports for the EAC.¹⁷ The EU as a destination for EAC exports has been declining rapidly over the last decade and a half, from around 35 percent of exports to just 20 percent. The UK market has progressively been losing protagonism for EAC exporters – going from 14.6 percent of all exports in 2000 (around 40 percent of EAC exports to the EU at that time) to just 3.4 percent in 2015 (equivalent to just 17 percent of all exports to the EU) (Figure 4). This pattern of declining dependence on European markets is replicated – but even more accentuated, with respect to the origin of imports to the EAC. More will be said on this later.

¹⁶ ECA (2012) notes that the EU has gradually lost ground in all Eastern Africa countries to emerging market trading partner, to such an extent that actually the gains in trade shares by India and China in Eastern Africa are almost exactly mirrored by a decline in the corresponding share for the EU. This, more than any other stylised fact, perhaps explains the insistence of the EU on East African countries to sign up to their Economic Partnership Agreements.

¹⁷ Andrew Mold (2017), "Running Up that Hill?: The Challenges of Industrialisation in the East African Community", Development, Volume 58, issue 4.

**Figure 4: EAC Exports to the World, EU and UK, 2000-15
(millions USD and as a Percentage of Total)**



Source: IMF DOTs

Of course, none of this means automatically that in absolute amounts trade with the EU or the UK is declining. The EU received in 2015 approximately 2.6 billion USD of EAC exports, considerably up from the 1.1 billion USD in 2000. But that trade has not kept up with the dynamism apparent in the relations with other trading partners, and hence the share has declined over time. In addition, absolute amounts of EAC trade towards the UK have indeed actually declined – they peaked at 766 million in 2008, and had declined to just 447 million in 2015.

In terms of individual members of the EAC, it is actually quite surprising how low the UK comes, in terms of the ranking of its exports and imports as an export destination, for *all* East African countries - even Kenya (Figures 5 & 6). Tan (op. cit) argues that Kenya is ‘Britain’s third largest market in Africa, could witness capital flight after Brexit, leading to falling exports’ yet in 2015 the UK accounted for just 6 percent of Kenyan exports and 3 percent of imports. Indeed, collectively, the regional EAC market is a more important export destination for Kenyan exporters than the whole of the EU (accounting for 22 percent vis-a-vis 21 percent of exports). The story is similar for other EAC countries – the regional market is more important than the EU one. The only partial exception is Uganda, where the EU market is marginally more important (26 percent) than the EAC market (25 percent).¹⁸ More striking, perhaps is the fact that Kenya

¹⁸ Some care is required in interpreting the directional trade data because of the “Rotterdam effect”, whereby goods initially exported to one country are subsequently re-exported to another country. This might overstate the share of exports going to a particular country, in this case the Netherlands, and so overstate the share of exports going to the EU. This is a particular possibility with some of the horticultural exports from the EAC which are destined for the Dutch markets, but are ultimately reexported, particularly to the UK. Quantifying precisely this effect is however extremely difficult. It is interesting to note that intra-EAC trade statistics suffer a similar defect, with much tea in the region being exported to the Mombasa tea market, and then reexported, whereas the evidence suggests the final destination is often misreported as Kenya.

(<https://www.ons.gov.uk/economy/nationalaccounts/balanceofpayments/bulletins/uktrade/oct2016#summary-of-latest-uk-trade-statistics>)

alone makes up around half (1.3 billion USD in 2015) the total of EAC trade towards the EU. However, even Kenya has seen declining absolute values of its exports to the UK market, peaking similarly in 2008 at 580 million USD, falling by 30 percent to 373 million USD by 2015. In short, neither the UK nor the EU more generally are among the most dynamic of the EAC’s trading partners.

Figure 5: Top Five Trading Partners for Exports¹⁹ (% of Total), 2015

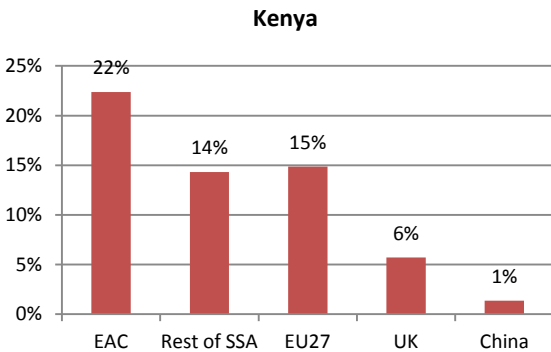
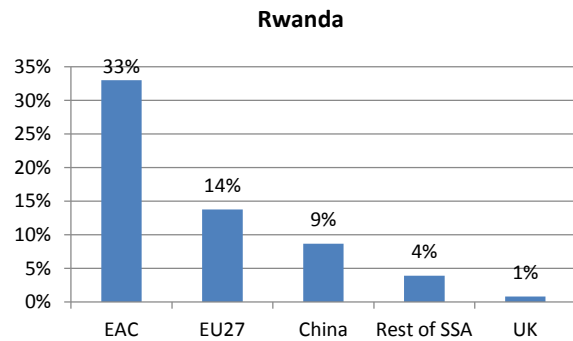
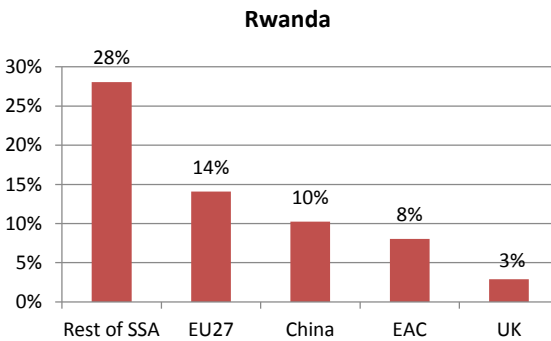
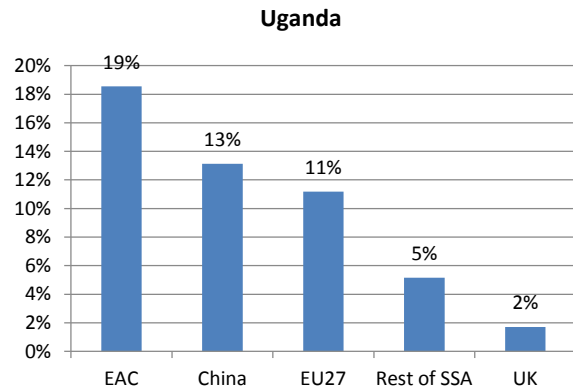
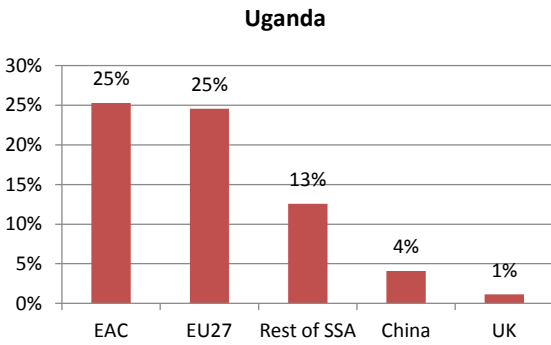
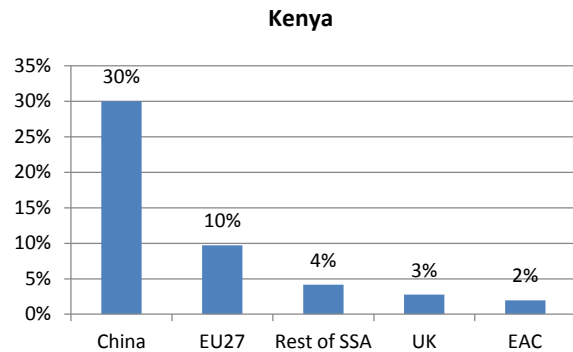
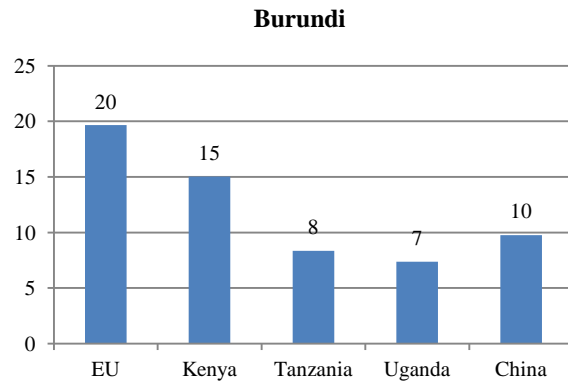
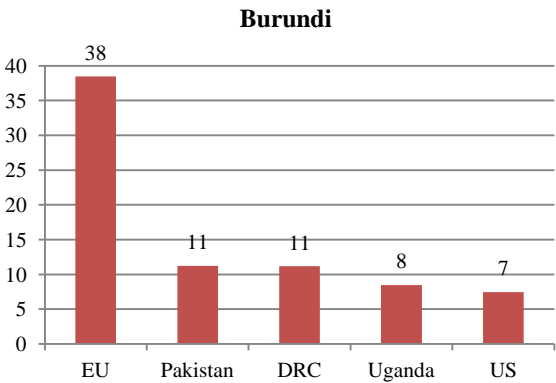
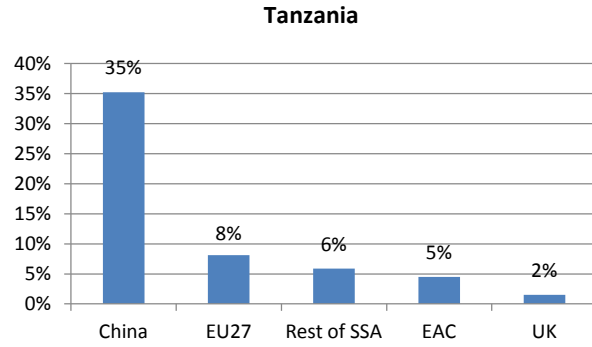
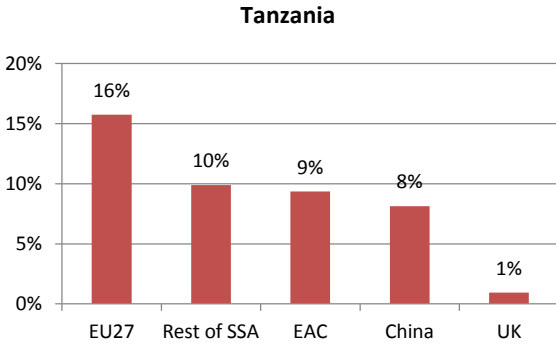


Figure 6: Top Five Trading Partners for Imports²⁰ (% of Total), 2015



¹⁹ Figures are calculated on a ‘Free-on-board’ (FOB) basis, i.e. excluding shipping and transport costs.

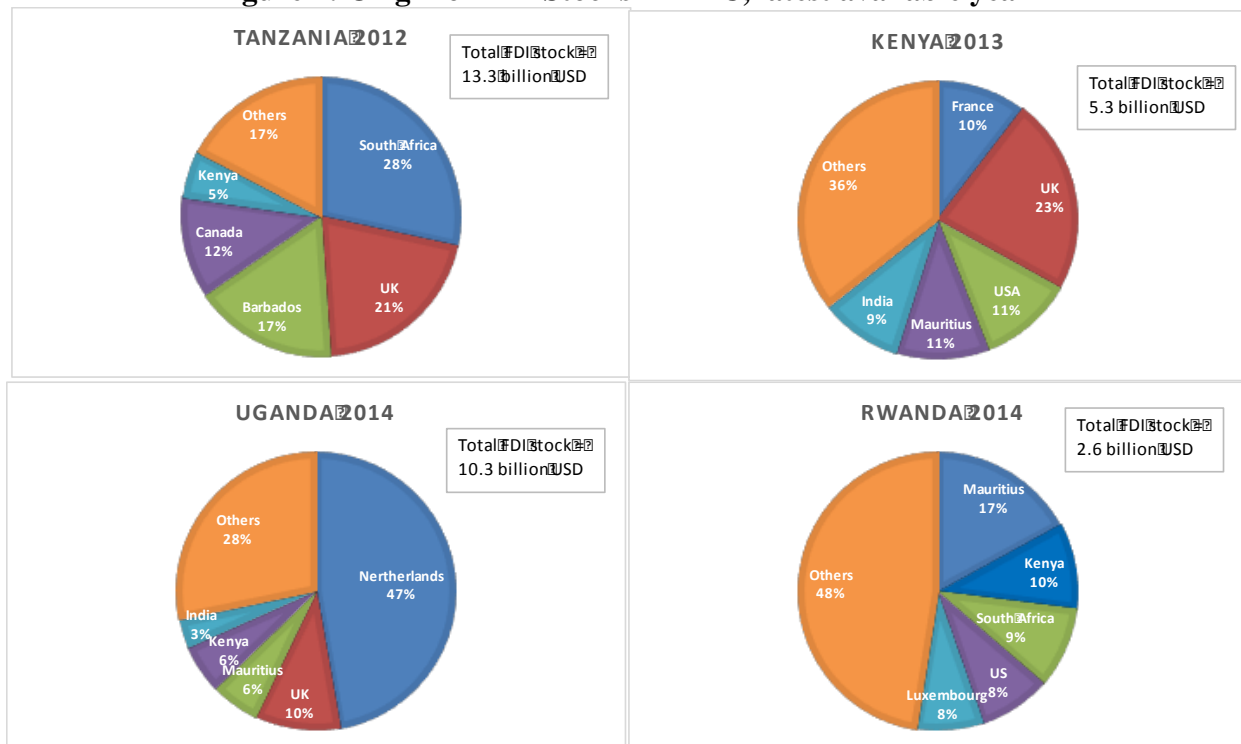
²⁰ Figures are calculated on a “Cost, insurance, and freight” (CIF) basis.



Source: Own calculations, on the basis of IMF Direction of Trade Statistics (2016)

What about the investment links? In terms of Foreign Direct Investment (FDI), Kenya, Tanzania and Uganda are countries where the UK is a significant stakeholder (Figure 7). The UK is the single leading investor in Kenya, representing approximately 23 percent of the investment stock, and the second largest investor in Tanzania, with 21 percent of the investment stock. In Uganda, British firms account for 10 percent of the FDI stock, but in the other two landlocked EAC countries (Rwanda and Burundi) UK investment is negligible. Again, the same arguments hold with regard to FDI flows in general to Africa - there is no reason to suppose that significant divestments would take place by British multinationals as a consequence of Brexit. The EAC is growing relatively rapidly, and some of the investments are associated with natural resources (e.g. in Tanzania, Uganda), and thus the motivations are location-specific, and less strongly dependent on conditions in either the source or host-country market.

Figure 7: Origin of FDI Stocks in EAC, latest available year



Source: Latest Foreign Investment Surveys of EAC States

Finally, an arguably more minor channel of 'contagion' is through remittances. The best estimates that we have for remittances from the United Kingdom suggests that Kenya is the most exposed, with 523 million USD of remittances from the United Kingdom in 2015 (approximately a third of total remittances), followed by Uganda (283 million USD or approximately a quarter of all remittance inflows). This channel is directly impacted by the devaluation of sterling, resulting in potential decline in the value of remittances from the second half of 2016. It is also reasonable to assume that remittance flows would be negatively impacted by any negative economic consequences of Brexit, particularly if it results in higher rates of unemployment or lower rates of economic activity among migrants. So far, however, this has not been the case. In addition, it should be remembered that similar forecasts of declining remittances were issued at the time of the global-financial crash - forecasts which did not actually materialize. Indeed, remittances proved to be one of the most resilient cross-border flows.²¹ That may be true also this time.

Table 1: Remittance Flows to the EAC from the UK, the EU and the World

	Burundi	Kenya	Rwanda	Tanzania	Uganda
From United Kingdom	0	523	0	69	283
From rest of EU	5	97	16	19	50
From World	49	1,561	161	389	1,049

Source: World Bank Migration and Remittance Data

<http://www.worldbank.org/en/topic/migrationremittancesdiasporaissues/brief/migration-remittances-data>

²¹ See, for example, Sanket Mohapatra and Dilip Ratha (2010), "The Impact of the Global Financial Crisis on Migration and Remittances" in Octaviano Canuto and Marcelo Guigale (Eds), "The Day After Tomorrow - A Handbook on the Future of Economic Policy in the Developing World", World Bank, Washington, pp. 297-320.

4. Simulations of the Impact of a ‘Hard’ Brexit on the EAC

It is clear from this summary of existing economic links with the EU that the impact of Brexit is likely to be complex. One approach to making an assessment of those impacts is to use a Computable General Equilibrium (CGE). Using the model Global Trade Analysis Project (GTAP), we report simulations in this paper which involve a scenario whereby there would be a ‘hard Brexit’ – that is to say, that the UK would not be able to retain access to the Single Market, and instead would be returned to standard MFN tariffs. In passing, from a strictly trade perspective, this should not be excessively alarming – the EU is a fairly open trading block, with an average Most-Favoured-Nation (MFN) tariff of only 3 percent, though average tariffs are higher in agriculture.²² The underlying data in the GTAP 9.1 database refers to a 2011 baseline. The model is run using a regional aggregation which includes the standard regions included within the GTAP model, plus a distinct EU-27 and UK region, the East Africa Community,²³ and a ‘Rest of Africa Region’. The sectoral aggregation includes the 10 standard sectors.²⁴ The standard GTAP model assumes perfect competition and constant returns to scale in production.²⁵ Our study uses a closure that reflects the high levels of un- and under-employment that characterise African labour markets, by fixing wages for both the EAC and the Rest of Africa regions. We also use the standard GTAP savings-driven model where changes in savings rates drive investment.

The first result we report is the terms of trade (TOT) impact of the implementation of MFN tariffs on EU-UK trade, as this is perhaps the broadest measure of the trade impacts. It is immediately apparent that the UK is the economy most adversely affected by Brexit, with a TOT loss of -9.2 billion USD, representing -1.31 percent of GDP. The EU is also a significant loser, but to a much smaller extent, with a loss of -2.5 billion USD (representing a collective loss of only -0.04 percent of GDP). Which regions would be the main beneficiaries? In absolute terms, it would be East Asia and North America, with TOT gains equivalent to more than 2.0 billion USD. But in relative terms (i.e. as a percentage of GDP), it is interesting to note that the largest beneficiary would be the East African Community.

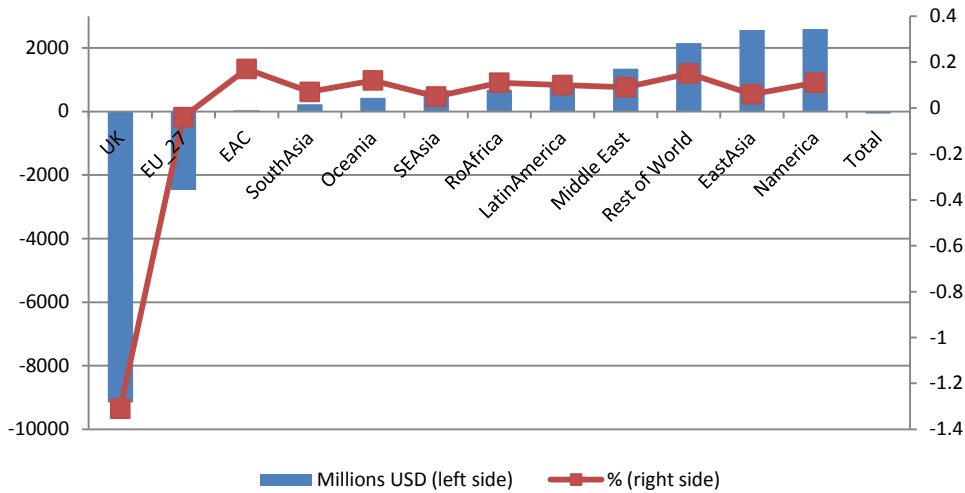
²² Given the fact that pound sterling had already depreciated by -16 percent in the period between June and December 2016, British exports would remain competitive within the EU – although European exports to the UK might be quite seriously impacted by the ‘double whammy’ of a depreciated exchange rate plus the addition of tariffs. However, from a macroeconomic perspective, such a shift might be deemed desirable. As noted early, the UK sustains the largest intra-EU trade deficit amongst member states.

²³ The EAC region in GTAP comprises of Kenya, Rwanda, Tanzania and Uganda. Burundi could not be included as there is no underlying data in the GTAP database at present. However, because Burundi represents just XX percent of the regional economy, it is unlikely that its exclusion would impact significantly on the results.

²⁴ The sectors are: Grains and Crops, Meat and Livestock, Extraction, Processed food, Textiles and Apparel, Light Manufacturing, Heavy Manufacturing, Utilities and construction, Transport and Communications, and Other Services.

²⁵ A general description of the GTAP model can be found in Mary E. Burfisher (2011), "*Introduction to Computable General Equilibrium Models*", Cambridge University Press.

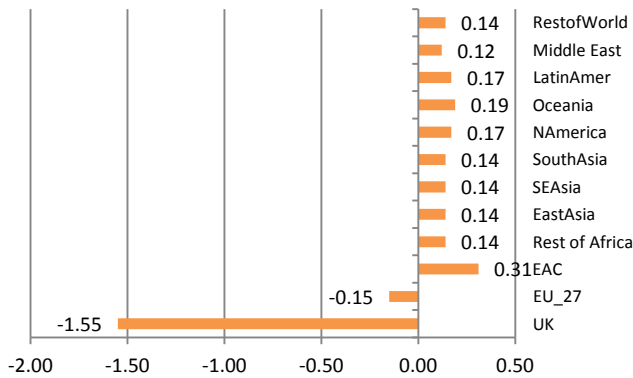
Figure 8: Terms of Trade Impact, Millions of USD and % of GDP



Source: Own simulation

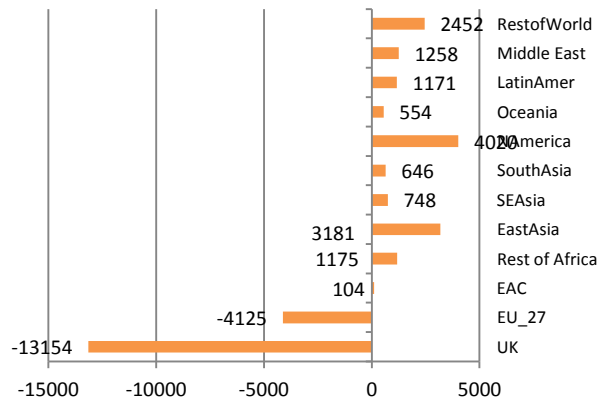
A similar story is revealed in the GDP and welfare impacts (*‘Equivalent variation’*), the latter of which measures approximately the net benefit/losses to consumers. While the UK losses -1.55 percent of GDP in static losses from the re-imposition of tariffs, and the EU a smaller 0.15 percent, the EAC again benefits, with a net gain of 0.31 percent of GDP – that largest gains of all the regions identified in the model. Regarding the welfare changes, Brexit translates into -13.15 billion USD of losses for the United Kingdom, but 104 million USD of benefits for the EAC, and 1.175 billion USD of benefits for the rest of Africa. Not large gains in macroeconomic terms, but not insignificant ones either.

Figure 9: GDP Change (% of GDP)



Source: Own simulation

Figure 10: Welfare Changes (Millions USD)



Source: Own simulation

What is driving these changes? Essentially it is a story of trade diversion (Viner, 1950), away from the European market, and towards other trading partners outside Europe. The matrix presented in Table 2 shows the changes in trade volumes, with large losses in net exports for both the UK and the EU_27. Being the directly implicated parties, the trade losses for both the UK and the EU-27 are large – a 51 billion USD decline of UK exports to the EU-27, and an even larger 71 billion USD decline for the EU_27 to the UK. On the other hand, for the EAC, a hard

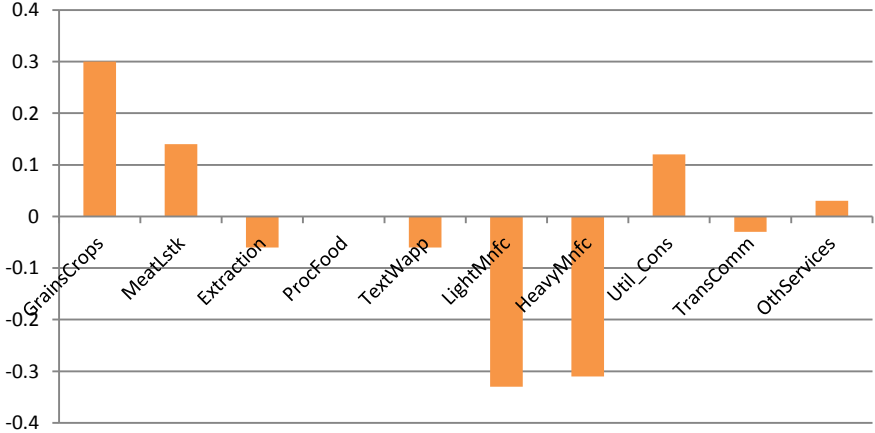
Brexit would entail an estimated increase in exports to the UK of 105 million USD, but a decline of -38 million USD towards the EU, leaving a net gain of 67 million (though this would also be accompanied by some marginal declines in intra-Africa trade). The rest of Africa would see increases of exports to both the UK and the EU-27 post-Brexit, of a value of 625 million USD.

Table 2: Changes in Trade Volumes, Post-Brexit (Millions USD)

EXPORTING COUNTRY	UK	EU_27	EAC	REST OF AFRICA
UK	0	-51166.9	90.4	1695.3
EU_27	-71322.8	30045.6	42.8	1670
EAC	104.9	-37.6	-6	-14.9
REST OF AFRICA	575.2	50.2	-1.6	-132.7

What explains this pattern of shifts in trade for African countries, post-Brexit? It is essentially a tale of trade creation in the sectors more heavily protected by the reimposition of MFN tariffs on EU-UK trade. For Africa, that essentially means that the greatest opportunities will be in agricultural products, where existing tariffs are highest.²⁶ These changes in trading patterns are also reflected in the output changes estimated by the simulation – for the EAC, grain crops, meat and livestock would experience the largest increases in output, while there would actually be small declines in light and heavy manufacturing. Not exactly desirable consequences from the perspective of diversifying the economies of the EAC, but again the magnitudes are rather small).

Figure 11: Changes in Output in EAC, Post-Brexit



This raises an interesting proposition, because at the moment, we do not know how Brexit will impact on support to farmers in the United Kingdom (or indeed on the EU-27). Under the Common Agricultural Policy, British farmers – as is true of their European partners - have been receiving very large subsidies from the EU. In the UK, this amounts to approximately half the income that British farmers currently receive. This has been a constant bone of contention for

²⁶ Conversely, for the UK and EU, the biggest losses are in manufacturing trade. The simulation predicts quite large falls in intra-EU trade, doubtless reflecting the intense intra-regional value chains in products such as automobiles and chemical goods.

African countries, as the CAP has effectively made entry into the EU market extremely difficult for African agricultural produce. Ironically, Brexit might represent the first crack in the dam in a set of policies which have impeded African agricultural exports from entering European markets.

5. The Indirect Consequences of Brexit on the EAC

The objective of these simulations was not to prove the case of substantial benefits for the EAC from Brexit – the benefits are potentially there, but are of rather small magnitude. Rather, the objective was to dispel the idea of a catastrophic outcome from Brexit for Africa in general, and for the EAC in particular. Arguably, the real risks to the region reside elsewhere, in the form of indirect impacts. Three major risks – and one potential opportunity, could be envisaged on the horizon.

a) Commitment to Overseas Assistance in Question?

Under Prime Minister David Cameron, the British conservative government continued a commitment started under the previous Labour governments to raise overseas development assistance. In 2013 the UK's aid programme reached, for the first time, the 0.7 percent of GNI target set out by the United Nations back in the 1970s. And around half of that assistance is destined to Africa.²⁷ The UK is a leading provider of development assistance to the EAC – it is the second largest bilateral donor to the region, providing around 900 million USD a year. This is in addition to the support it provides through multilateral institutions like the World Bank and the EU itself. The UK is one of the biggest contributors to the European Development Fund, currently contributing £409 million—\$585 million— making up 14.8 percent of contributions to the fund²⁸. The UK is also the number-one funder of IDA17 (the concessional borrowing window at the World Bank) with about a 13.2 percent share.

However, judging by various public pronouncements,²⁹ the UK government is beginning to change its stance substantially since the Brexit referendum. Theresa May, the new Prime Minister, has included a number of prominent aid-sceptics in her cabinet – among them, the head of the British aid agency, DFID. As Sy and Sow (2016) put it,

“Perhaps the biggest impact of the Brexit on Africa would be the end of British “outwardness”—the country’s concern with and responsiveness to global development issues—which, from an African development perspective, reached its peak in 2005 with the U.K. presidency of the G-8.....Indeed, at the G-8 Summit in Gleneagles, Scotland that year, leaders agreed to double aid to Africa and eliminate outstanding debts of the poorest countries.”

²⁷ The figure is difficult to measure with precision, because there are both bilateral and multilateral components to the aid flows, and tracing the part of the latter destined for Africa is more complicated.

²⁸ It should be noted that this is more or less in line with the UK's share of EU GDP.

²⁹ For instance, the new Secretary of State of Department for International Development, Priti Patel – already renown for her aid skepticism, announced on her arrival at her new post that Britain would "leverage" its £11 billion foreign aid budget to build a series of new trade deals as it leaves the European Union. <http://www.telegraph.co.uk/news/2016/07/30/britain-to-leverage-11bn-of-foreign-aid-to-build-new-trade-deals/>

Despite the declared intentions of all EAC member states to reduce their level of aid dependence, it is also still the case that aid-dependency is very high within the region (Table 3). Tanzania is actually one of the UK's top bilateral ten recipients, receiving over 2.5 billion USD in 2015, followed closely by Kenya (2.47 billion USD). In relative terms, though, Rwanda and Burundi are the most highly aid-dependent countries, both with an ODA to GNI ratio in excess of 10 percent. In four out of five of the EAC countries, the United Kingdom is the second largest bilateral donor, behind only the United States. Notwithstanding of course the additional contributions that the UK makes to bilateral institutions such as the World Bank, the EDF, and the AfDB.

Table 3: Aid-Dependence within the EAC, 2015

	Burundi	Kenya	Rwanda	Tanzania	Uganda
Net ODA (million USD)	366.7	2,473.8	1081.7	2580.5	1628.2
Net ODA (% of GNI)	11.9	3.9	13.7	5.8	6.3
UK's Contribution (millions USD)*	-	526.6	117.0	279.6	195.5
Position of UK as Bilateral Donor	Not ranked	No. 2 behind US (762.3)	No. 2 behind US (179.2)	No. 2 behind US (481.6)	No. 2 behind US (442.8)

Source: OECD DAC (2016)³⁰

Note: * figures are averages for the years 2014-15

While short-term commitments to development assistance are still be in place, then, we may therefore expect over the mid-term to see a reduction in support to the region through this channel. Again, as in the case of trade, it is best to temper our judgments. We should not expect a catastrophic reduction - the UK is an important donor, but its bilateral contributions for the region are usually (with the exception of Kenya) between 10-15 percent of all aid inflows, and the UK is highly unlikely to complete renege on its aid commitments to the region.

b) The Negative Impact on the Global Economy of Brexit?

The second risk is more diffuse and difficult to quantify, but no the less important for that. Brexit has already been impacting on the global economy, adding an additional layer of economic uncertainty in an already turbulent landscape. It is certainly true that the more pessimistic forecasts emitted prior to Brexit have been shown to be false and excessively alarmist, to the extent that the Bank of England's Chief Economist has actually even recently apologized.³¹ But the counter-argument is that Brexit has not yet occurred, and that it is still potentially an enormous liability once the terms and conditions of Brexit have been agreed and implemented. More difficult to assess still is the impact of Brexit on global markets – certainly, on its own, Brexit would not be enough to destabilize global markets. But it is coming at a time when there are a host of other uncertainties negatively affecting global growth. As the World Bank has put it, “Stagnant global trade, subdued investment, and heightened policy uncertainty

³⁰ OECD (2016). Development Co-operation Report 2016: *The Sustainable Development Goals as Business Opportunities*, OECD Publishing, Paris.

³¹ <https://www.ft.com/content/e94c96a2-d3e3-11e6-b06b-680c49b4b4c0>

marked another difficult year for the world economy”³². If Brexit were to have a fundamental negative impact on the EU as a block by, for instance, reigniting the crisis of the Euro, or encouraging other member states to hold their own referendums leading to their own departure from the Union – leading, even, to the disintegration of the European project - then the implications for global markets may be much more serious.

How would this impact on Africa? Sensitive as it is to fluctuations in commodity prices, Africa generally does not perform well when the global environment is adverse. Brexit has only contributed to generating more uncertainty. That said, it is also true that East Africa has performed well, despite the adverse global climate since the financial crisis of 2008/9. In addition, unlike West and Central Africa, East Africa is in fact a net commodity importer, so it is not necessarily adversely affected by declines in commodity prices to the same extent as in other parts of Africa.³³

c) A Blow to Confidence in Regional Integration?

Perhaps most fundamentally for the EAC, Brexit has arguably dealt a serious blow to confidence in regional integration processes. The EU has been a long-standing model of integration- not so much for its successes (it has suffered its fair share of set-backs, such as the ERM crisis of the early 1990s, and the Euro-crisis of 2010), but rather for the scale of its ambition. Unlike free-trade deals like the North American Free Trade Area (NAFTA), the EU represents a bold project of political and economic union (what economists term “deep integration”). In this sense, it is not good for regional integration processes anywhere if the European project begins to falter.

The East African Community is, by common consent, one of the most ambitious programmes of regional integration in Africa. It contemplates both economic and political union. It also includes, as an integral part of the project, the achievement of monetary union. In terms of the scale and scope of its aspirations, then, the parallels with the European project are clear. Yet there are growing fears within the region with regard to the direction the EAC is taking. A particularly harsh criticism was recently voiced by Maina (2016):

*"It is not the thing one says in polite society but, barring a dramatic reset, the East African Community is in a terminal crisis, barely a decade and half since it was re-established...East Africa's problems are deep-seated: They include a lack of fit between the interests of Kenya and Tanzania; inability to agree on shared values; and a mistaken expansion strategy that favours geographical breadth over institutional depth."*³⁴

³² World Bank Global Economic Prospects, January 2017, p. 1

³³ The degree of diversification is however still low, and export earnings are still heavily dependent on the export of commodities. As a result, even if the net impact is positive when commodity prices are lower, the decline of export earnings compounds problems associated with the lack of foreign exchange.

³⁴ Maina, Wachira (2016), "Breadth versus depth: Why East African Community is doomed", The East African, 2nd December, <http://www.theeastafrican.co.ke/OpEd/comment/Why-East-African-Community-is-doomed/434750-3472382-gmx7tq/index.html>

One does not have to agree with this assessment to concede that at present the EAC could benefit from regaining some of the dynamism that characterized the block in its initial period. The danger is that the travails of Europe make policymakers lose enthusiasm for the process of deeper integration. We will elaborate a little more on this point in the conclusions.

d) The Beginning of the End for the Economic Partnership Agreements?

Finally, on a potentially more positive note, for more than a decade, the European Union has been pursuing regional trade deals (Economic Partnership Agreements, or EPAs) with African countries to replace its existing preferential agreements, under the (some say spurious) grounds that preferential access would no longer be tolerated within the WTO and could be legally challenged. The EPAs were premised on the grounds that they would be negotiated only regionally and would help consolidate regional integration processes in Africa. The EAC is proof, if any were needed, that this is not the case, and that they end up potentially pitting countries within regional blocks against themselves.

Negotiations between the EU and African regional groups formally started in 2003 and entered what was intended to be the final stage in 2007, with a view to agreements being implemented from 2008 (Morrissey et. al., 2007).³⁵ A decade later, and the EPAs have still not been implemented. EPAs have been highly divisive with the EAC. The key contentious point is that Kenya does not benefit from the same preferential access to the EU market as its other partner EAC countries because it is not classified as a "Least Developed Country". Kenya has been put under particular pressure by the European Commission to sign because of its dependence on horticultural and flower exports destined to the EU market (worth in excess of 1 billion USD in 2015). Rwanda and Uganda have backed the Kenyan position, but both Burundi and Tanzania have dissented. In the former case, it is tied up with the current political crisis in the country, but in the latter, it is based on an objection of a more fundamental nature. Former Tanzanian President Mkapa himself recently penned an op-ed on the subject, explaining that it was tantamount to risking the viability of the region's development plans:

*“Tanzania’s position as one over concern for the implications of the region’s drive to industrialization and the capacity of EAC firms to compete directly with European firms. The EPA is a free trade agreement. Under it, Tanzania would have to reduce to zero the tariffs on 90 per cent of all its industrial goods trade with the EU, according duty-free access for almost all the EU’s non-agricultural products into the country. Such a high level of liberalisation vis-à-vis a very competitive partner is likely to put our existing local industries in jeopardy and discourage the development of new industries.... Regional integration and trade is the most promising avenue for EAC’s industrial development. The EPA would derail us from that promise.”*³⁶

³⁵ Morrissey, Oliver, Chris Milner and Andy McKay (2007), "A Critical Assessment of Proposed EU-ACP Economic Partnership Agreements" Chapter 8 in Andrew Mold (ed), EU Development Policy in a Changing World: Challenges for the 21st Century, Amsterdam University Press.

³⁶ Benjamin Mkapa (2016), “The EPA with Europe is bad news for the entire region, even Kenya”, The East African, 30th July <https://www.theeastafrican.co.ke/OpEd/comment/434750-3323648-item-0-52vbde/index.html>

The divisions within the EAC caused by this difference in perspective are potentially serious. As the outgoing Director-General in charge of Trade and Customs at the East African Community, Peter Kiguta, commented recently:

"The failure to sign the EPAs with the EU... has posed a challenge. Countries appear to be more cautious about committing to anything during trade meetings, and are taking hardline positions. Suspicions are also resurfacing." (Kigatu, 2017, cited by Ligami 2017).³⁷

Cautious, if not openly critical, assessments have come from mainstream sources, too. Over a decade ago, World Bank economists Hinkle and Newfarmer warned, for example, that

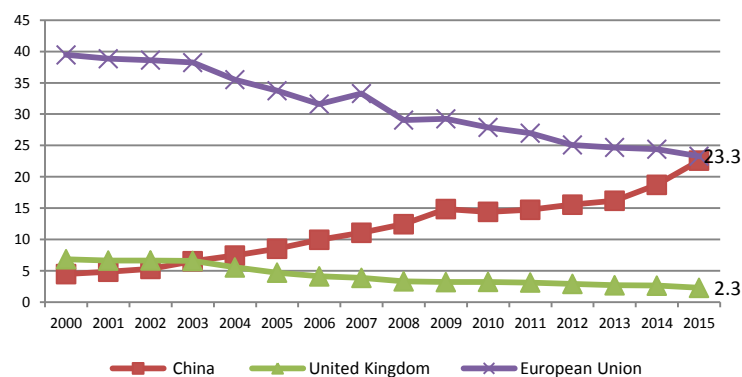
*"To realize their potential development benefits, the European Union must truly treat EPAs as instruments of development, subordinating its commercial interests to Africa's development needs and effectively coordinating trade and development assistance. The African countries need to use EPAs to accelerate the trade and investment climate reforms necessary to raise growth rates and integrate their economies regionally and globally. A number of important issues will need to be addressed to limit the development risks associated with EPAs. If these issues cannot be satisfactorily resolved, the EPA process could end up being replaced by improved preferences or even abandoned."*³⁸

Since their inception, then, the EPAs have generated considerable controversy. There has always been an important sense in which the EPAs were being pursued not due to development concerns, or possible legal challenges to preferential market access, but rather were intended to address Europe's rapid loss of market share across Africa, in the face of sustained competition from China and India. The stylized facts support that view –with regard to total imports to Sub-Saharan Africa, the EU has experienced a sharp decline in its market share, from around 40 percent in 2000 to just 23.3 percent – a decline that has been mirrored by the rise of China as a source of imports for SSA. The UK has similarly been progressively losing market share. All this puts into context the push for the Economic Partnership Agreements on the part of the European Commission (Figure 12).

³⁷ Ligami, Christabel (2017), "Zeal to work together as EAC has waned over the past two years", The East African, 3rd January, <http://www.theeastafrican.co.ke/news/Zeal-to-work-together-as-EAC-has-waned-over-the-past-two-years/2558-3505224-qko8ngz/index.html>

³⁸ Laurence Hinkle and Richard Newfarmer (2006), "Risks and Rewards of Regional Trading Arrangements in Africa: Economic Partnership Agreements between the European Union and Sub-Saharan Africa" in Richard Newfarmer (ed.), Trade and Development, Washington, World Bank, p. 163.

Figure 12: Sub-Saharan Imports, CIF, as a % of Total, 2000-2015



Source: Calculated from IMF DOTs data

However, a key question which is not being asked is whether it will be tenable to continue with the EPAs when the UK is no longer part of the block? In September 2016, this argument was used by Tanzania to delay signing of the EPA, despite intense pressure from some of its partner states. At the very least, Brexit may give grounds for the EAC to renegotiate the whole EPA agreements - though surely no one is particularly interested in a further prolonged period of negotiations. Like the Common Agricultural Policy, it opens the possibility that Brexit will lead to a rethink on the part of the European Union of some key elements in key policies which impact, directly or indirectly, on Africa.

6. Conclusions

The overall conclusion of this paper is that Brexit does indeed potentially present a challenge for East Africa – but not necessarily in the way that is commonly thought. It is not going to lead to a sudden collapse in trading or investment links- indeed, on this score, there is some reason for a more positive outcome. According to Boateng (2016)³⁹ Brexit presents Africa and the UK with an opportunity to “*put development at the heart of our trading relationship with Africa in a way frankly that it has not always been in relation to the EPAs, let’s be frank about it...The UK recognizes that and we will seek every opportunity to minimize the disruption in our trading relationship and take every opportunity to seize this chance to re-fashion the relationship between the UK and Africa in terms of trade so intra-African trade becomes an opportunity which we can seize together.*”

However, this paper argues that Brexit may still represent a serious challenge to the onward march of regional integration processes. For the EAC, the message is particularly poignant - the EAC is arguably one of the most advanced regional economic communities in Africa - and also one of the most ambitious. Implicitly, if not explicitly, the EU has been an important role model for the EAC. Yet that role model is now wobbling. Many observers are already remarking that the EAC is in danger of losing momentum In a recent article, Maina argues that there are a

³⁹<https://www.tralac.org/news/article/10909-britain-won-t-turn-its-back-on-africa-following-brexit-mp-lord-paul-boateng.html>

number of worrying parallels to recent developments within the EAC, and the path taken by the EU: *“The EAC should look to Brexit and see that a lack of common values; a growing democratic deficit; self-serving nationalism and political opportunism coupled with youth exclusion will eventually sap and ultimately destroy regional integration.”* He singles out as a risk to the EAC the decision in 2013 to create a ‘multi-speed’ EAC - a so-called coalition of the willing between Kenya, Uganda and Rwanda, on the one hand, and the perceived laggards - Burundi and Tanzania. He also warns against *“a headlong rush to political union without proper democratisation of regional institutions will be seen as elite-bargaining and, almost certainly, will unleash angry nationalism in member states. That would permanently damage the EAC”*⁴⁰

Africa is indeed different from Europe and, from an economic perspective, there is possibly more at stake from all this than in Europe - without regional integration, East African economies would remain balkanized. Most external assessments agree that over the last decade the region has clearly benefit from greater intra-regional trade, investment and migration.⁴¹ Collectively, the economies of the EAC are stronger. The correct response at a time like this is not to doubt, but rather to redouble efforts towards regional integration, while learning the pertinent lessons about where the European ‘experiment’ has gone wrong. A key element in those lessons is surely making sure that popular support for the regional integration project does not wane.

⁴⁰<https://www.theeastafrican.co.ke/OpEd/comment/Four-lessons-from-Brexit-and-EU-fallout-for--East-Africa/434750-3277224-item-2-10qn0ku/index.html>

⁴¹ For example, a recent assessment of the depth of integration in global value chains of Sub-Saharan economies argues that EAC countries are "among the best performers, progress within the EAC has been particularly strong, with Kenya, Tanzania, and Uganda exhibiting solid progress—also a reflection of the benefits of the more general economic integration at play among these countries and their stated intention to further deepen their economic and monetary ties." See C Allard, J.I.C. Kiriljenko, W. Chen, J. Gonzalez-Garcia, E. Kitsos and J. Trevino (2016), "Trade Integration and Global Value Chains in Sub-Saharan Africa - In Pursuit of the Missing Link", IMF African Department, International Monetary Fund, Washington D.C.