

No deal Brexit – trading on the basis of WTO rules

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Introduction

The protracted negotiations over the terms of the UK's withdrawal from the EU have brought into stark focus the prospects of a 'hard' Brexit. One of the well-publicised consequences of this would be that the UK would have to rely on general World Trade Organisation (**WTO**) rules to trade with the EU (and vice versa). This would represent a dramatic change for companies that trade or provide services cross-border, and some believe it would have a damaging impact on many sectors of the UK economy.¹

EU-UK Trade in figures

In 2017, the EU accounted for 44% of UK exports and 53% of imports. This amounted to £274 billion of exports and £342 billion of imports. The EU's share of UK goods exports has fallen since 1999 and now stands at 48% (down from 61%). The EU has accounted for a consistent share of UK service exports (around 40% since 1999).

Source Statistics on UK-EU Trade House of Commons Briefing Paper, 30 November 2018

This briefing note explains the UK's process for becoming a fully independent member of the WTO, provides a short introduction to key WTO concepts and describes some of the main consequences for businesses operating in such a trading regime post-Brexit.

UK becoming a fully independent member of the WTO

As a co-founder of the General Agreement on Tariffs and Trade (**GATT** - the WTO's predecessor), the UK is a member of the WTO in its own right. However, under the EU Treaty, the EU institutions have exclusive competence over international trade matters, including WTO issues. The UK has, therefore, largely been trading on the basis of the EU's WTO goods and services schedules² of concessions and commitments, in particular the common external tariff that sets the maximum duties that apply to imports of goods from third countries.

In order to become a fully independent member of the WTO and to reduce disruption following the UK's withdrawal from the EU, the UK submitted its draft goods and services schedules to the WTO last year.³ To all intents and purposes, these replicate the existing applicable EU schedules. The UK had hoped that the process for "certifying" its WTO schedules

¹ A recent UK Government study found that a no deal scenario could result in an average estimated loss of GDP for the UK of 7.6% over the long term compared to the current trading arrangements. The losses are estimated to fall to on average 4.9% in the event of UK being party to a free trade agreement with the EU with zero tariffs and average non-tariff costs. In the event that the UK is in an EEA-type arrangement, the loss of GDP for the UK is estimated at on average 1.4%. HM Government report: 'EU Exit Long-term economic analysis', November 2018 (Cm9742).

² Goods schedules set out the maximum tariffs ("bound duties") that apply to the import of a particular product as well as other non-tariff concessions such as tariff rate quotas (TRQs) and limits on agricultural subsidies. Service schedules list the sectors being opened to cross-border trade and the extent that market access is being granted in those sectors.

³ The UK Government submitted, for certification, its draft schedule of commitments under GATT (goods) in July 2018 and its draft schedule of commitments under GATS (services) in December 2018. The texts of the draft schedules are available at: [Draft Schedules](#).

would be straightforward, but it has faced some opposition from a number of members, especially with regard to splitting tariff-rate quotas (**TRQs**⁴) between the UK and the EU.⁵ Even if the UK fails to have its schedules certified by 29 March 2019, it will still be able to use them as the basis to commence trading post-Brexit.

The UK has also applied to join the WTO Agreement on Government Procurement (**GPA**)⁶ in its own right to maintain UK companies' access to foreign procurement markets and to ensure that there continues to be competition in the UK among suppliers bidding for procurement contracts. In addition, the UK is introducing its own independent trade remedies regime.⁷

Trading under WTO rules – the basics

The WTO trading regime is based on certain key principles, the most important of which are two principles of non-discrimination: the “Most Favoured Nation” (**MFN**) concept, and the principle of National Treatment:

- Article I of GATT provides that members cannot discriminate between WTO trading partners and must apply the same (non-preferential) MFN tariffs to imports of like products irrespective of the country of origin. This broad principle is subject to certain exceptions that allow, amongst other things, members to grant preferential trading terms to countries with whom they are party to a customs union or a Free Trade Agreement (**FTA**) as well as interim agreements leading up to their formation.⁸ MFN principles also apply in respect of the General Agreement on Trade in Services (**GATS**) and the Agreement on Trade-Related Aspects of Intellectual Property Rights (**TRIPS**).
- Under the National Treatment principle, a member cannot apply its domestic tax and regulatory rules (taxes, internal charges, laws and regulations, etc) in a manner that discriminates against “like” imported goods. Thus imported and domestically-produced goods should be treated equally.

Generally, cross-border trade in services under WTO rules is less liberalised than for goods, and there is more scope for members to invoke exceptions and reservations. The GATS covers all internationally traded services, with few exceptions.⁹ Under GATS, market access is a negotiated commitment specified at the sector level, which can be made subject to limitations. Similarly, a commitment to national treatment for a particular sector can also be subject to limitations. The details are contained in each member's schedules. Generally, WTO members grant greater market access in practice than what they have committed to in their services schedules since they wish to retain the maximum room for manoeuvre with respect to public policy measures without being unduly constrained by WTO rules.

Trade in goods

If the UK leaves the EU without a deal, it will be treated as a third country under EU law. UK goods imported into the EU will be subject to tariffs and will have to comply with EU regulatory requirements and complete customs procedures. Similarly, EU-27 goods imported into the UK will also be subject to tariffs.

EU tariffs on imported goods are generally low (on average around 5%), especially for intermediate goods and raw materials. There is, however, considerable variation across product areas as the chart below shows.

⁴ TRQs provide for goods up to a certain volume to be imported at a lower or zero tariff than the normally applied tariff.

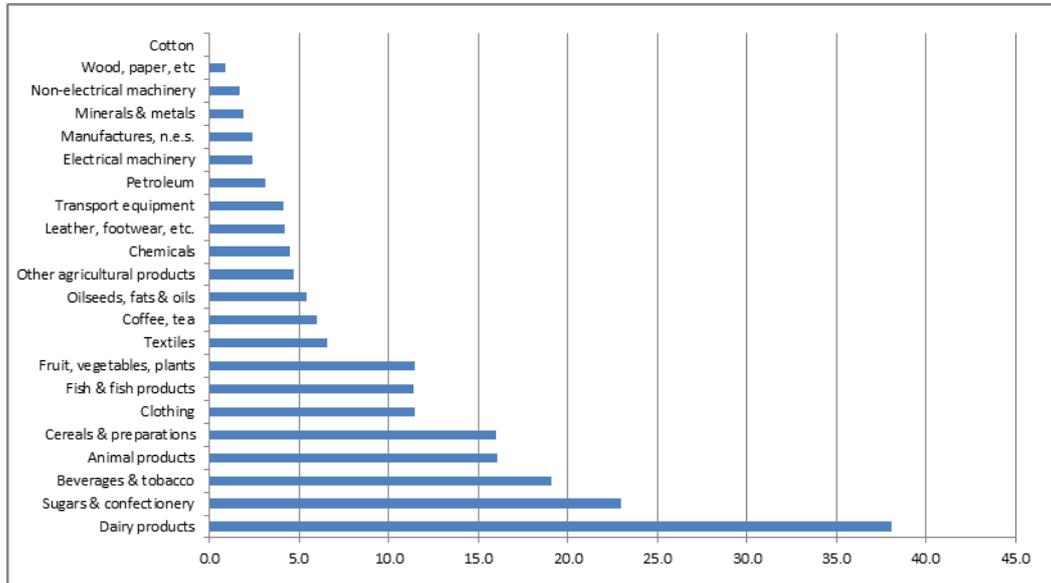
⁵ Representatives of Argentina, Brazil, Canada, New Zealand, Thailand, USA and Uruguay wrote a joint letter to the EU and the UK on 26 September 2017 expressing their reservations about the proposed approach for apportioning TRQs based on historical averages. A copy of the letter is available at: [Joint Letter](#).

⁶ The GPA opens up procurement for larger public sector procurement opportunities that exceed certain thresholds.

⁷ A newly set up authority will be responsible for investigating unfair trading practices (anti-dumping, anti-subsidy and safeguard measures) in accordance with the WTO rules. See A&O's publication of September 2018 on [The UK's New trade Remedies Regime](#).

⁸ Other exceptions apply to the granting of preferential treatment to imports from developing countries and least developed countries as well as the imposition of trade defence measures since such rules are applied in a non-discriminatory manner.

⁹ The GATS covers services falling within 12 broad categories which are subdivided into a further 160 types of services. The broad categories are: business services and professional services, communications, construction and related services, distribution, education services, energy, environmental services, financial services, health and social services, tourism, transport and movement of natural persons.



Some industries are likely to be particularly impacted by import tariffs as well as the application of rules of origin.¹⁰ UK goods and inputs will no longer be considered as originating in the EU and some goods will no longer satisfy the conditions to be imported into the EU on the basis of preferential tariffs under EU FTAs with third countries (see below). Moreover, MFN principles would effectively prevent the EU (or the UK) unilaterally reducing tariffs on imports between each other’s territories since the lower tariffs would also apply to all other WTO members’ imports unless the specific exceptions foreseen in the GATT applied (e.g. EU-27 and the UK were party to a customs union or an FTA). Industries that have highly integrated supply chains and are subject to relatively high tariffs, such as the automotive industry, are particularly affected.

Tariffs represent only the tip of the iceberg since cross-border trade is also heavily impacted by non-tariff barriers (in WTO-speak, **NTBs**) such as customs controls, health and safety regulations, technical standards, rules of origin, etc.

The UK’s revenue and customs authority (**HMRC**) estimated in 2018 that, if customs declarations were introduced between the UK and the EU, there would be between £17 billion and £20 billion of administrative costs per year of which only approximately £5 billion was accounted for by tariffs.¹¹ The validity of the estimate has been strongly challenged, but it is highly indicative of the possible costs arising from the increased red tape. HMRC also estimated that between 145,000 and 250,000 traders in the UK would need to make customs declarations for the first time. This includes both detailed import and export declarations and the accompanying customs processes.

The UK is introducing new and upgraded customs systems to manage the vastly increased workload, but the Government has admitted that the border will “be less than optimal” in the event of a ‘no deal’ Brexit. In a report issued last autumn, the UK National Audit Office indicated that many of the changes which will need to be made by Government under a ‘no deal’ scenario may not be ready on time.¹² EU Member States whose ports trade significantly with the UK are also expanding their customs facilities and hiring additional personnel in preparation for a ‘no deal’ Brexit.

The WTO regime includes rules addressing technical barriers to trade (**TBT**) in the TBT Agreement, but these set out only basic principles that governments should adhere to when introducing regulatory measures (e.g. transparency, non-discrimination and proportionality). In addition, the WTO’s Trade Facilitation Agreement (**TFA**) entered into force last year. It contains provisions for expediting the movement, release and clearance of goods, including goods in transit and rules to improve cooperation between customs authorities.

¹⁰ Under often highly complex rules of origin, FTAs may require that a minimum level of content or processing occurs within a member country of the FTA in order for the preferential tariff rates to apply. For example, under the EU-Korea FTA, non-EU parts/materials should not represent more than 45% of the ex-works price of the car.
¹¹ See House of Lords report ‘Brexit: the customs challenge’ (HL Paper 187), 20 September 2018, para. 65. Available at: [Brexit: the customs challenge](#).
¹² The UK border: preparedness for EU exit, National Audit Office, press release 24 October 2018. Available at: NAO press release and report.

These measures are, however, a far cry from the detailed rules and principles that apply to cross-border trade within the Single Market. Within the EU, goods can be traded across borders without restriction since the vast majority of regulatory measures have been harmonised at the EU level and goods are not normally subject to customs controls. Also, in the absence of EU harmonisation measures, goods lawfully marketed in one EU Member State can be sold in another EU Member State without needing to conform to different technical norms unless there is an overriding public interest justification (the principle of “mutual recognition”). In addition, national measures that can impede trade across the EU can be challenged directly before the national courts. There is no such enforcement mechanism at the WTO level since it is the responsibility of member states’ governments to pursue cases before the WTO dispute settlement bodies. As a result, we only see a selection of cases brought by governments.

Following a hard Brexit, UK goods entering the EU will be treated as originating in a third country, which will result in UK exporters (and in a similar vein the importer bringing the goods into the EU-27) facing a higher regulatory and administrative burden. For example, certain products must demonstrate that they meet set performance, safety and environmental criteria and need to be certified as compliant by “Notified bodies” prior to being put on the market in the EU. UK conformity assessment bodies will lose their “notified body” status with the result that the goods must be re-certified by an EU-27 conformity assessment body.¹³ Over time, the regulatory burden could well increase if the UK were to start diverging from EU product standards.

Trade in services

The EU’s Single Market has largely liberalised trade in services across the EU by granting individuals or companies the right to deliver services cross-border and to establish themselves or set up companies in another EU Member State. The EU institutions have also put in place detailed rules to ensure the recognition of professional qualifications across EU Member States. It is thus the most integrated market for cross-border trade in services that exists and the EU institutions continue to actively pursue further liberalisation.

Liberalisation under the GATS is far less developed and varies significantly by member, sector and mode of delivery/supply (the GATS distinguishes between four different modes¹⁴). The GATS largely codifies WTO members’ commitment to open up their markets to cross-border trade in services across 12 broad sectors that cover almost all services.¹⁵ This is achieved by the members giving market access and national treatment commitments, although they can limit the extent of the market liberalisation by inserting reservations. For example, market access can be limited in respect of the number of service suppliers or employees in a sector, the total value of transactions, the legal form of the service supplier and the participation of foreign capital. Moreover, services supplied in the exercise of governmental authority¹⁶ (i.e., public services) automatically fall outside the GATS and there are also other carve-outs (e.g. measures necessary for prudential reasons).

The details are contained in a member’s Schedule of commitments and limitations, which are complex and typically lengthy documents. There are also often coverage questions, including determining the appropriate classification of new services to identify the applicable commitments. Commitments can only be modified after negotiations with the affected countries. Members are also under a transparency obligation and must notify certain new measures to the WTO Secretariat.

The EU Services Schedule reflects individual Member State entries. It dates back to 1994 and only covers the 12 states that were members of the EU at the time the GATS was signed. The EU has a consolidated EU-25 GATS schedule that was ‘certified’ at the WTO in 2006, but it has not yet formally entered into force as the process has been held up by

¹³ This may be done on the basis of a transfer of the certificate (and corresponding paperwork) for certification by an EU-27 notified body. Otherwise, UK based manufacturers will have to apply for a new certificate from an EU-27 notified body.

¹⁴ The four modes of supplying services under GATS are (i) cross-border supply (Mode 1), (ii) consumption abroad (Mode 2), (iii) commercial presence (Mode 3), and (iv) presence or movement of natural persons (Mode 4). There is also increasingly discussion about how services which are incorporated into goods which are then traded across international borders (Mode 5) should be addressed under GATS or preferential trade in service regimes.

¹⁵ See note 9 above. The list of service sectors is available at: [WTO services list](#).

¹⁶ This is subject to the proviso that they are not supplied on a commercial basis or in competition with other suppliers.

disputes at the EU level.¹⁷ This further complicates the process for identifying the relevant commitments and limitations applicable to the provision of services to the EU-27 post-Brexit.

As with other WTO members, EU Member States grant greater market access and national treatment conditions than was typically foreseen under the GATS. The OECD Services Trade Restrictiveness Index¹⁸ indicates that EU Member States have generally lower barriers to cross-border services trade than many other developed countries (the database covers 44 countries). Nonetheless, such restrictions are far higher than those that apply within the Single Market.

Loss of access to preferential EU trade agreements

The EU has entered into about 40 FTAs with around 70 countries to liberalise trade, including with the EFTA states, South Korea, Canada, Singapore and most recently Japan. The agreements provide exporters with preferential access to the trading partners' markets, including typically tariff-free access as well as increasingly measures to reduce the impact of NTBs.

The UK will lose access to these preferential trading arrangements once the UK leaves the EU (similarly, exporters in the EU FTA partner countries will lose preferential access to the UK market). The UK Government has indicated that trading arrangements with EU FTA partner countries account for between 10-20% of the UK's exports. The level increases as some of the more recent and important FTAs enter into force.

The loss of preferential trade access could harm the UK's exporter's ability to compete in these overseas markets and, therefore, the UK government has expressed a desire to "roll-over" the current EU FTAs largely by hoping to replicate the terms of the current agreements with appropriate technical changes (e.g. to the rules of origin). In the event of a no deal Brexit, the UK Government has stated that it will enter into bilateral UK-third country agreements with the EU FTA partner countries.

In practice, it may be difficult for the UK to quickly replicate the current set of EU FTAs. Third countries may want to renegotiate all or part of the agreements that they entered into with the EU to reflect the differences between the UK and EU economies and divergences in trading relationships. They may also adopt a wait and see approach in order to understand the implications of a future FTA between the EU-27 and the UK for their own possible UK-centric FTA.

Without preferential access under rolled-over FTAs (or under a withdrawal agreement), all trade between the UK and the EU-27 FTA partner countries will revert to WTO terms post-Brexit.

Possible mitigation and contingency planning

Even if the UK exits the EU without an agreement, there is likely to be a common interest in avoiding the most damaging effects of a hard Brexit. There has been discussion about the UK and EU-27 entering into "bare bones" agreements covering fundamental issues such as counter-terrorism, justice, data exchange, nuclear safeguards and aviation. It is possible that some accommodation could also be reached in respect of other important areas, such as in the area of customs provided that an approach that is WTO compliant can be found.

The UK and other EU countries that are likely to be severely affected by Brexit are also increasingly implementing contingency plans. Both the EU and UK have issued technical notices advising businesses on how to prepare for a no deal Brexit.¹⁹ However, many businesses in both the UK and EU-27 could be severely affected by the sudden and far-reaching change caused by a no deal Brexit, especially given the challenge in preparing for such a scenario.

¹⁷ Following the Court of Justice clarifying in Opinion 2/15 of 16 May 2017 (EU:C:2017:376) the scope of the EU's exclusive competence in the area of international trade, the Commission issued a proposal in November 2018 to have the EU Council conclude the agreements covering the compensatory adjustments between the EU and the relevant WTO members (2018/0384 (NLE)). The EU-25 consolidated GATS schedule should then be able to enter into force.

¹⁸ Available at [OECD Index](#).

¹⁹ See UK government guidance 'How to prepare if the UK leaves the EU with no deal'. Available at: UK Government No Deal Guidance.

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