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Exit from the EU without a Free Trade Agreement on 31 December 2020

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On 31 January 2020 the United Kingdom left the European Union and is no longer represented in EU Institutions such as the European Commission, the European Parliament or the Court of Justice of the European Union. However current and future EU law will continue to apply in the United Kingdom until 31 December 2020.

This briefing discusses the main changes that would apply to businesses should the United Kingdom exit the transition period on 31 December 2020 without a free trade agreement in place. A detailed guide to WTO law that would apply in this case is available from your usual contact at Slaughter and May.

International trade is subject to a series of multilateral agreements that came into force in 1995 under the aegis of the World Trade Organization (WTO). These provide for a quasi-judicial rules-based system for the regulation of international trade that has been accepted by 164 countries across the Globe. In the absence of a free trade agreement, trade between the United Kingdom and the EU would revert to WTO rules, possibly supplemented by side-agreements in certain other areas. It has been assumed in this briefing that the EU will apply its existing rules for third countries to exports and imports of goods and services from the UK without any special concessions. Certain areas, such as civil aviation, are excluded from WTO rules.

As a result of the Lisbon Treaty areas subject to WTO rules (trade in goods and services) fall almost exclusively within the jurisdiction of the EU which negotiates through the European Commission on behalf of all EU Member States. This is referred to in EU law as the common commercial policy. However, at the time that the WTO Agreements were finalized the competence of the EU in the field of services was more circumscribed, meaning that the WTO Agreements were concluded jointly by the EU and its Member States. The main practical consequence is that the services commitments of EU Member States vary from Member State to Member State according to national decisions made at the time.

The World Trade Organization

The World Trade Organization is based in Geneva and exists, inter alia, to administer the multilateral agreements agreed in 1994 at Marrakech governing global trade, as well as to provide the semi-judicial dispute settlement system for trade disputes between states. The rules-based framework on which the WTO is based consists of two main agreements: the General Agreement on Tariffs and Trade (GATT) and the General Agreement on Trade in Services (GATS). These are supplemented by a number of other agreements, although it is for the WTO member state concerned to decide what commitments to make in terms of tariffs and provision of services under the GATT and GATS. Such commitments must, however, be applied uniformly (subject to certain exceptions). In addition, there are a few “plurilateral” agreements that only apply to those members that sign up to them, of which the most significant is that on Government procurement.

The EU is a party to this agreement and the United Kingdom Government has stated that it will accede to it.

WTO law should be set against the political background:

- The rules-based international trading system has come under increasing strain in recent years since the collapse of the Doha round of trade negotiations, with the result that national commitments remain basically frozen where they were in 1994. This may be contrasted with the several successful trade rounds that preceded the creation of the WTO.
- The trade policies of the Obama and, more materially, the Trump Administrations have arguably placed the system under significant pressure, through unilateral trade measures. This is supplemented by the refusal of the US Government to appoint judges to the Appellate Body which is the appeals court for trade disputes. This is now inquorate, and although the EU, and certain other WTO members, have proposed a workaround measure, this is voluntary and may not gain universal or even widespread adherence.
- It has been observed that there is an increasingly politicisation of international trade policy through sanctions and trade bans. Neither are new but they have become more prevalent in recent years.

A separate point relevant to the future United Kingdom-EU trading relationship is that although most international trade is conducted on WTO rules (even if all WTO members have now entered into one or more free trade agreements) trade is very rarely conducted solely on WTO rules. Thus compliance with WTO-compatible tariffs and rules of origin is often accompanied by separate agreements on conformity assessment (i.e. compliance of the exporting WTO member state with the product standards of the importing WTO member state may be carried out by traders or bodies in the exporting nation), mutual recognition of standards, etc. A failure to agree any such arrangements between the United Kingdom and the EU from 1 January 2021 could result in greater disruption to trade than the imposition of tariffs in many sectors. Further, in some cases EU legislation requires certification of third country goods by EU operators (e.g. for chemicals under the REACH regulation), and mandates agricultural checks at the border. These are not WTO requirements, but would require changes to existing EU legislation, and would need to be relaxed on a world-wide basis, absent relevant provisions in a free trade agreement between the United Kingdom and the EU.

Goods

Goods are subject to the GATT which is basically unchanged in form (but not enforcement) since 1947. The main ideas may be summarised in a few basic propositions, although, as in most areas, there is much technical detail.

The GATT is based on a few key principles:

- The only general restriction on trade in goods permitted is tariffs;
- Quantitative restrictions on trade are generally banned;
- WTO states are free (within some limitations) to maintain domestic regulations and measures to protect human, animal and plant health;

- WTO states may impose sanctions (in the form of additional tariffs) where other states engage in unfair trading practices such as dumping and subsidisation of exports; and
- The WTO process is inter-governmental and confers no rights on private parties, and is therefore subject to diplomatic considerations.

Tariffs. Tariffs are a border tax on imports. GATT neither requires WTO members to limit their tariffs nor places a maximum level. However, if a WTO member limits its tariffs on classes of goods then it cannot (generally) raise them later. In practice, almost all nations have capped tariffs for almost all products. The EU has a common external tariff applicable to imports from all WTO members with which the EU does not have a free trade agreement or customs union (which would preclude the UK agreeing bilateral deals on tariffs with individual EU Member States). The United Kingdom Government is committed to capping its tariffs and in 2019 published a provisional new set of tariffs.

If there is no deal then it would be open to the United Kingdom to reduce tariffs on imports from the existing EU common external tariff for some or even all goods (save where there is no tariff). This may prove attractive for goods not produced in the United Kingdom as it should result in lower shop prices. The United Kingdom could do so on a provisional basis by reducing the "applied" (i.e. actual) tariff whilst maintaining the ("bound") (i.e. maximum tariff) at the EU level. However, whilst able to reduce prices (especially for agricultural goods) the United Kingdom would be required under the GATT to apply such lower tariffs to all goods of the same class on a world-wide basis. This is because of the "most favoured nation" clause of the GATT that requires (subject to certain exceptions not relevant here) the United Kingdom to treat all WTO members the in the same way.

Where supply chains require multiple import and export of goods between countries – whether the same or different – tariffs will be applied at each crossing of the border.

Other Charges: In principle, tariffs are the only permissible restriction on trade under the WTO system. The GATT requires that internal taxes and other internal charges and laws affecting the internal sale, etc. of products should not be applied to imported and domestic products on a protectionist basis.

General Exceptions: The GATT sets out a number of general exceptions to protect state interests. There is also an exception for measures taken in time of war or other emergency in international relations.

Technical Barriers to Trade

The principal barrier to trade between developed nations is generally thought not to be tariffs (which, save for agriculture and other sensitive sectors like vehicles) are either low or very low. It is expected that the principal barrier to trade between the United Kingdom and the EU would arise either from ensuring conformity with national technical standards, or from differences in regulatory standards. The EU has a very extensive regulatory framework in terms of the directives and regulations governing the Single Market. United Kingdom firms selling into the EU market will need to comply with (and prove that they comply with) applicable Single Market standards unless arrangements can be agreed for this process to be undertaken in the United Kingdom or for there to be mutual recognition of standards. If the standards are the same, or one is higher than the other, manufacturers may choose to adopt the highest standard (known in the US as the California effect).

However, if the standards are simply incompatible then this will not be a possibility, and firms will either need to manufacture to both standards, or exit one market, depending on their economic decisions. The degree to which the United Kingdom will diverge from EU product standards after 2020 is currently unclear, although the Government has stated its wish to be able to do so.

The Agreement on Technical Barriers to Trade (TBT Agreement) seeks to place some limits on WTO member states' domestic regulation acting as an impediment to international trade. In practice however, the TBT Agreement gives a wide discretion to states and the remedial system is thought to be slow.

Sanitary and Phyto-Sanitary (SPS) Agreement

The SPS Agreement is concerned with human, animal and plant health. The agreement is based on science – for a measure to be justified there must be a scientific basis, even if it is a minority one.

Moreover, discrimination is prohibited. There have been a number of successful challenges to national measures under the SPS agreement, such as the condemnation of the EU ban on the import of beef produced using growth-encouraging hormones brought by the US – although the EU has not renounced its ban.

Other Restrictions on the Trade in Goods

The GATT and its cognate agreements are concerned with setting a level playing field based on available science and internationally agreed technical standards, while according WTO members a more or less broad measure of discretion in setting regulatory standards. What the GATT agreements on goods do not do is require all WTO members to make the same judgments or reach the same conclusions on agreed facts.

Perhaps more significant, the GATT agreements will not obviate the need for customs declarations, customs checks and the collection (where payable) of tariffs. The EU will presumably continue to apply its existing customs and VAT procedures for imports from the United Kingdom as a third country. The UK will have to decide on what customs checks to apply, which need not replicate the existing (EU) rules the United Kingdom applies on imports from outside the EU. It is arguable that for a limited period the UK could impose no customs checks at all on imports from the EU (save for the current checks on people-smuggling and contraband) under the national security exemption in the GATT.

Employment and work permits may also prove an issue in a "no deal" scenario. Whilst both the United Kingdom and the EU have indicated that they will not impose visas on tourists, the same is not the case for work visas, or, indeed, as to what categories of work may be covered by a work visa, all of which is a national prerogative. The single Schengen visa does not apply to work, although some countries allow certain categories of work on a Schengen visa. As this is an aspect of immigration policy, and not WTO law, there are no international standards to fall back upon other than the generally respected principle of reciprocity.

Trade Remedies

The WTO Agreements recognise three trade remedies for abusive practices concerned with goods (there are none for services), although these may be of limited importance in a "no deal" scenario,

and would, in any event, apply if a free trade agreement were agreed. These are: anti-dumping duties, countervailing duties for subsidies and safeguard measures.

Trade in Services

The GATT only covers trade in goods. Services were not brought within the international trading regime until 1995 with the GATS. This is despite the overlap between trade in goods and trade in services. The commitments under the GATS are considerably less extensive than those in respect of goods, essentially because of perceived state interests in protecting trade in services. Individual states' commitments are generally far less significant than under the GATT and, as already mentioned, the EU does not have a single GATS schedule so that commitments vary from EU Member State to EU Member State. Tariffs are not relevant to services. The major barrier to trade in services is regulation.

The GATS (like most trade agreements that cover services) operates on a positive list basis. This means that trade in services is only liberalised to the extent that each WTO member chooses to do so based on its list. There are twelve service sectors, and more numerous sub-sectors, and WTO members are (at their discretion) required to undertake (or not) commitments in respect of each sector and sub-sector. According to the GATS, there are four modes of supply of a service, and commitments are (or are not) made in respect of each mode of supply for each sector or sub-sector. The modes of supply are as follows:

- from the territory of one WTO member into the territory of another WTO member;
- into the territory of one WTO member to the service consumer of another WTO member;
- by the service supplier of one WTO member, through commercial presence in the territory of any other member; and
- by a service supplier of one WTO member, through the presence of natural persons in the territory of any other WTO member. This is concerned with temporary presence of experienced individuals necessary to provide the service and does not impinge on the ability of WTO members to regulate immigration into their territory.

The basic principles of the GATS are less extensive than the GATT. They are:

- Most Favoured Nation: We encountered this principle under the GATT and the idea is the same: all WTO members should be treated equally and discrimination is prohibited. There are exceptions.
- Market Access: This is discretionary under the GATS and is confined to six specific types of restrictions and is not of general application.
- National Treatment: This is again a national discretion under the GATS in which the member specifies the conditions and qualifications which it applies to each service sector and mode of supply.

It should be noted that none of the above provisions prevent the regulation of services in a more strict manner than that applies in the case of goods. Article VI of the GATS preserves the right of domestic regulation of services. Whilst mutual or unilateral recognition of national standards of different WTO members is encouraged, it is not legally enforceable, and the EU has so far rebuffed the United Kingdom's request for mutually agreed recognition, insisting on a unilateral approach.

GATS contains (like the GATT) general exceptions which are broadly similar so far as the subject matter permits.

Dispute Settlement under the WTO Agreements

This is regulated in detail under the Dispute Settlement Understanding (DSU) which is an agreement among WTO states. Under EU law private persons (such as companies) may bring actions to enforce EU law in their own or other EU Member States. This is not possible under the WTO Agreements where all disputes are state-to-state and therefore inevitably involve political and diplomatic considerations as well as the legal merits. The DSU requires first consultations which, if unsuccessful in resolving the issue, will lead to the establishment of a WTO Panel composed of trade experts which will decide on the merits of the dispute. The DSU contemplates an appeal on point of law to the Appellate Body. As already noted, this is currently inquorate preventing new appeals being heard. If a Panel decision is not appealed it becomes binding upon adoption (which is quasi-automatic) by the WTO Dispute Settlement Body. Where there is an appeal, but no quorate Appellate Body, the position is unclear as this was not foreseen in the DSU.

Perhaps more importantly, there is no ability of private parties to obtain monetary compensation. Even if a private party's state takes up a case at the WTO and wins the private party will obtain nothing. Nor are WTO decisions retroactive. This does not mean that the dispute settlement system is toothless: a winner may require the loser to bring its laws into compliance with WTO rules within a reasonable period of time (determined by arbitration if not agreed). Moreover, if non-compliance continues the successful party may impose retaliatory tariffs on the losing party. These are generally calculated to impose maximum economic or political harm on the losing party, and for that reason must be authorised by the WTO Dispute Settlement Body.

Conclusion

The WTO offers a framework for the regulation and resolution of disputes concerning international trade. In many ways it has been considered successful since its inauguration in 1995. However, the rules-based trading order has come under increasing pressure since the collapse of the Doha Round of trade negotiations and there seems little likelihood of material improvement in the near future. Ultimately a system such as the WTO depends on a consensus that free trade is beneficial to all nations in the long-run, together with confidence in a system of impartial arbitration by trade experts and judges. It was established based on a conviction that greater liberalisation of trade, and especially of services and trade in agriculture, will bring benefits to all. In an era marked by the rise of national populism and COVID-19 this is no longer as obvious as it seemed in the 1990s and 2000s.

The transition to WTO rules on 1 January 2021 following a failure of negotiations on a free trade agreement between the United Kingdom and the EU will affect United Kingdom – EU trade. The effects are too early to assess as the customs policies and other non-tariff barriers are yet to be set. Tariffs are likely to be a minor irritant (save in certain key sectors). Customs declarations, and proving conformity with United Kingdom/EU rules, is a more likely impediment to trade. Almost all published economic analyses have suggested that a WTO outcome will be less advantageous to both economies than a free trade agreement, and the United Kingdom and the EU remain publicly committed to an agreed outcome. Whether this happens depends on the on-going negotiations and it is premature to reach a judgment on the future, particularly if the COVID-19 crisis continues. Nonetheless, the United Kingdom's single largest individual trading partner is the United States with which trade is conducted on WTO terms. The same applies to China, India and other major trading

nations. Undue pessimism, or predictions of severe economic damage if the United Kingdom ends up trading with the EU on WTO terms, may therefore seem premature.

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