‘No deal’ and WTO rules
A briefing for non-specialists

Richard Barfield
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‘No deal’ and WTO rules: a briefing for non-specialists

Introduction
The aim of this briefing is to describe what happens under WTO rules if there is ‘no deal’.

Leading Brexiter assert confidently that World Trade Organisation (WTO) rules would allow the UK to trade with the EU on current terms for up to ten years. They say that the UK could leave the EU on 29th March with no deal and, from a trade perspective, nothing much would change. Unfortunately, it is a false claim that seems designed to encourage people to think that a no-deal ‘WTO Brexit’ would be manageable.

This paper looks at what going to WTO would mean in practice, drawing on inputs from trade specialists. The first section of the paper:

- summarises the Brexiter position; and
- explains why Article 24 does not apply.

To provide context, the following three sections:

- define at high level what ‘no deal’ means for trade;
- provide an overview of the WTO; and
- describe what moving to WTO terms involves.

A preferential trade deal with the EU, the UK’s largest trading partner, will be essential in a post-Brexit world. The UK would gain nothing by going to WTO rules, and then trying to negotiate a deal. ‘Going to WTO’ would not only severely damage the UK economy but it would surrender the UK’s negotiating leverage to the EU.

Brexiter assertions and Article 24
Some Brexiter MPs, MEPs and pro-Leave campaigners assert that Article 24 of General Agreement on Tariffs and Trade (GATT) or, as they term it, “WTO Article 24” means that UK and EU do not need a Brexit deal. They argue that:

- London and Brussels would tell the WTO that they are negotiating a future free trade agreement (FTA), to be concluded in ten years.
- WTO’s GATT allows trade to continue on existing UK-EU terms by way of an interim agreement for up to ten years.

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1 This paper draws on a more extensive briefing for non-specialists ‘UK trade and the WTO’, September 2018
2 For example, Jacob Rees-Mogg, Daily Politics, May 2018
3 John Redwood, January 2019
4 Richard Tice, January 2019
5 GATT Article XXIV: Territorial Application — Frontier Traffic — Customs Unions and Free-trade Areas
6 Why Claims about a ‘WTO Article 24’ Interim Agreement Are A Red Herring, Peter Ungphakorn, January 2019
Article 24 allows the UK to bypass the WTO’s non-discrimination rule. As a result, UK-EU trade could be duty-free without having to scrap tariffs on imports from other countries, such as the US or China.

They go on to assert that an interim agreement allows “a smooth transition into a ‘no deal’ scenario after 29th March, if found necessary, and then allows the UK to negotiate its desired comprehensive Free Trade Agreement with the EU without having to impose tariffs or quotas in the interim.”

Article 24 of GATT is intended to apply when specific WTO members want to eliminate substantially all the duties on trade between themselves. Primarily, Article 24 is concerned with ensuring that goods trade is liberalised. It permits trade agreements that eliminate tariffs. To qualify under Article 24, a free trade agreement must cover “substantially all the trade” and reduce tariffs to zero on that portion. ‘Substantially all’ is usually taken to mean 90% or more.

For services trade, Article 5 of the WTO’s General Agreement on Trade in Services (GATS) permits economic integration agreements that improve access to service sectors by eliminating substantially all discrimination.

Article 24 also allows an interim deal, but only if the negotiating parties have agreed on a detailed implementation plan to achieve a final agreement, which will complete “within a reasonable length of time”. Under a WTO Understanding, ‘reasonable length of time’ means no more than ten years. Interestingly, no WTO interim agreements have been used since 1995.

So, for the UK to present an interim agreement to the WTO, the agreement would need to meet these criteria:

- The UK and the EU agree on an interim agreement and undertake to create a more comprehensive one. That is, the UK could not propose an agreement unilaterally.
- It includes a plan and timetable for achieving the final agreement.
- It provides sufficient detail, including what the final agreement would look like.

It is therefore clear that a Brexit ‘no deal’ scenario does not meet the criteria for an interim agreement. In fact, the Brexiter position misinterprets Article 24.

In practice, even if the UK and EU concluded an interim deal that qualified, it would be much simpler to notify it to the WTO as a fully-fledged agreement to remain in force until a replacement is

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7 A ‘Managed No Deal’ WTO option using Article 24 of GATT can avoid raising tariffs or quotas, David Campbell Bannerman MEP, January 2019
8 WTO, Understanding on the interpretation of Article XXIV, 2002
9 Potential fully-fledged examples include:

- The present proposed Withdrawal Agreement with backstop
- A simple one-pager basic FTA (for an example see here)
- An agreement that UK and EU are continuing with present arrangements
- Any other form of FTA or customs union

However, unless Article 50 of the Lisbon Treaty is extended, there would not be enough time to reach agreement.
agreed. This would avoid the need to submit an implementation plan and a schedule for the replacement. The practice of WTO members has been to notify a final agreement with a transition period, thereby avoiding the need for an interim agreement\textsuperscript{10}.

Please also note that:

- The Political Declaration accompanying the Withdrawal Agreement does not qualify as an interim agreement since it does not contain enough detail.
- It is highly unlikely the EU would consider an interim agreement without a Withdrawal Agreement including binding backstop arrangements. Otherwise it would amount to negotiating a trade agreement before the UK had left the EU.
- Other WTO members have the right to comment and have their comments respected if they think the agreement will not result in an FTA inside ten years. The UK and EU would have to accept those changes or scrap the agreement. (For example, if there was no adjustment for, say, nine years, it is unlikely that anyone would accept this as leading to an FTA within ten years).

With Brexit, there seems to be only one situation that might justify an interim agreement. This would be if the UK and EU decided to exclude a sector, such as agriculture, temporarily while negotiating how to include it. This could mean that the agreement would not cover “substantially all trade” and, therefore, that it did not comply with Article 24 on day one.

\textbf{‘No deal’ defined}

‘No deal’ means the failure by the EU and the UK to conclude a Withdrawal Agreement before the EU Treaties cease to apply at 11pm GMT on 29 March 2019. There would be no transition period and no political agreement on the UK’s future relationship with the EU. An enormous range of legal agreements involving UK parties and governed by EU law would lapse.

Although government preparations for ‘no deal’ might mitigate some of the operational effects, they cannot do much to mitigate the macroeconomic impacts. ‘No deal’ would cause severe disruption and, in the Bank of England’s view\textsuperscript{11}, trigger a recession that would be worse than the one caused by the financial crisis in 2007/8. It would also create a long-term, permanent drag on UK international trade.

The UK would leave the Single Market and the Customs Union and be treated by the EU as a ‘third country’ - one that is not an EU member - and one that does not have a preferential trade agreement with the EU. This means that new tariffs and other trade barriers would apply to UK trade with the EU. These barriers and the loss of the extensive benefits of frictionless trade within the Single Market and the Customs Union would reduce UK trade with the EU\textsuperscript{12}. This will hit the economy and jobs.

\textsuperscript{10} ‘Interim agreements’ under Article XXIV GATT, Lorand Bartels, 2009

\textsuperscript{11} Bank of England, EU withdrawal scenarios and monetary and financial stability, A response to the House of Commons Treasury Committee, November 2018 The detailed report finds that the main immediate impacts of ‘no deal’ would include: economy contracting due to instant trade barriers and uncertainty; financial markets lose confidence in British institutions; unemployment rises and sterling falls; inflation spikes due to weak £; new tariffs and higher cost of trade; interest rates rise sharply and house prices fall.

\textsuperscript{12} See Appendix A for an overview of the EU’s trade framework
At 11pm on 29 March, the UK would begin to trade with the EU on WTO terms without the benefit of any UK-EU trade agreement. As a result, the EU’s Common External Tariff will apply immediately to UK’s duty-free exports and imports with the EU27. UK goods exports to the 70+ countries with which the EU has 40+ trade deals that are not rolled over would also face new tariffs.

The EU is the UK’s largest trading partner so substantial figures are involved. 44% of UK exports of goods and services worth £274 billion go to the EU\textsuperscript{13}. A further 21% (£125 billion) go to countries with EU trade agreements.

Tariffs outside agriculture are usually low with a few exceptions such as the automotive sector. So, for most trade, it is the other trade barriers that matter more. Tariffs are easy to measure and average less than 3% of UK goods imports\textsuperscript{14}. The cost of non-tariff barriers is harder to estimate, but trade economists agree that they are more expensive than tariffs. The Government assumes that, trading under basic WTO terms, non-tariff barriers would cost the UK the equivalent of a tariff of around 5% to over 20%, depending on sector\textsuperscript{15} and arguably higher for services.

Other trade barriers (principally customs checks and regulatory standards) would suddenly appear to impede UK-EU goods trade. Exporters would need to furnish import licences, certificates of origin, evidence of compliance with technical standards, evidence of meeting environmental standards and compliance with health and safety requirements, etc. These requirements would vary by product.

The need to follow EU regulatory standards e.g. on chemicals or pharmaceuticals includes the need to have that confirmed by an EU-recognised licensing agency inside a member state\textsuperscript{16} - not in the UK. This would be another source of significant cost and delay.

New trade barriers in relation to regulatory standards and market access would have a big effect on services trade which is critically important for the UK (accounting for 80% of the economy and 44% of exports). The UK has a healthy trade surplus of £28 billion with the EU on services trade, mainly from financial and business services. No deal would make UK exports of services to EU-based subsidiaries in the EU27 would need to transact the business. In aviation services, the UK would fall outside of EU agreements which support aviation services between the UK and the EU27 and the UK and other countries.

It is not just that services access becomes more difficult for exporters. In some sectors, for example, audio-visual and legal services, access to the EU will essentially stop for any business not working from within the EU27.

\textsuperscript{13} House of Commons, Statistics on UK-EU trade, January 2019 and see Appendix B for trade statistics 
\textsuperscript{14} Institute for Fiscal Studies, The Customs Union, tariff reductions and consumer prices, May 2018 
\textsuperscript{15} See for example HMG, EU Exit: Long-term economic analysis, November 2018 
\textsuperscript{16} These requirements also apply to trade with EEA states that are not EU members – Norway, Iceland and Liechtenstein – which also have EU-recognised regulatory agencies.
WTO in a nutshell
The WTO aims to help trade flow as freely as possible for the benefit of all, through negotiations that lower trade barriers and streamlining procedures to create and implement a trading system based on rules.

Successive rounds of international negotiations since 1947, initially under the WTO’s predecessor, the General Agreement on Tariffs and Trade (GATT), have sought to liberalise world trade and make the rules more relevant. The WTO rules do not address the de-liberalisation of trade through, for example, unwinding an FTA or a customs union.

The WTO was founded on 1st January 1995 to provide a global framework for trade policy. The Geneva-based WTO is an international body that provides the overarching legal and institutional framework for the world trading system. It currently has 164 members, who accounted for 98% of world trade in 2017.

The EU is a member in its own right and, in practice, often acts on behalf of the member states, but the UK and the other member states are all WTO members in their own right. The WTO provides a framework, governments negotiate trade agreements.

Although 98% of world trade is conducted under WTO rules, practically all of it is subject to additional agreements, governed by WTO rules, that countries have agreed between themselves. These are either multi-country customs unions and regional trade areas, such as the EU Customs Union or the United States-Mexico-Canada Agreement or bilateral agreements, such as those between the US and Australia, and the EU and Japan.

Less than 12% of UK trade in goods and services was conducted in 2017 with countries without some form of EU trade agreement (see Appendix B).

The WTO’s international trade treaties are legally-binding and provide stability to global trade. To be a WTO member, a country must sign up to all the treaties, which govern five main areas:

- Trade in goods
- Trade in services
- Intellectual property (e.g. trademarks, patents, copyright)
- Dispute settlement
- Trade policy reviews

The treaties are supported by subsidiary agreements and annexes. In all, there are about 60 WTO agreements and annexes that create the framework for global trade.

One of the key principles of the WTO is non-discrimination. WTO members should not discriminate between trading partners outside a preferential trade agreement. This principle is known as most-favoured-nation (MFN) treatment.

Some exceptions to the MFN principle are allowed. For example, countries can negotiate free trade agreements which might give preferential access to a country or group of countries (such as the EU). Article 24 of GATT allows pairs or groups of countries to break the non-discrimination principle by

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17 [What Is the Most-Favoured-Nation Clause?](https://www.UNCTAD.org) Dr. Holger Hestermeyer, September 2017
trading duty-free with each other but not the rest of the WTO. Article 5 of GATS is the corresponding article for trade in services.

Another common exception to the MFN principle is discrimination in favour of developing countries. For example, as part of the EU’s Generalised System of Preferences (GSP) scheme for developing countries, the least developed countries are allowed to export tariff-free to the EU under its “everything-but-arms” agreement.

Article 24 underpins the old Common Market and the goods part of the present Customs Union. So, since 1973, the UK has been in a long-term GATT Article 24 relationship in the EU.

Moving to WTO terms
The EU has evolved to become the global leader in removing trade barriers, principally between its member states. The EU Single Market is unique - complemented by the EU Customs Union, EU customs cooperation and the EU VAT area. Together, these four frameworks allow EU businesses to trade freely in the EU with no tariffs and minimal non-tariff barriers from customs and regulation. Over 80% of UK goods imports are tariff-free (and mostly free of formalities) as a result of EU membership and EU trade deals.

By contrast, WTO rules are the basic minimum for international trade. WTO rules create the base from which other agreements attempt to reduce frictions.

Pascal Lamy, ex-head of the WTO, memorably described the UK leaving the EU and moving to WTO terms as like being relegated from the Premier League to the bottom league.

Members submit schedules to the WTO that describe the terms that will apply to trade without a preferential trade agreement. These schedules cover, for example, import tariffs and tariff-rate quotas for goods, and access terms for service sectors.

The UK has submitted its post-Brexit schedules which replicate the EU’s Common External Tariff rates for goods imports. The schedules set the maximum levels of tariffs by sector. For services, WTO terms provide bare-bones access to markets for exports and to UK markets for imports. In leaving the Single Market without an agreement, the UK will lose preferential access for services exports to the EU.

The WTO principle of non-discrimination means that if post-Brexit UK decides to lower a tariff for one WTO member it must do so for all. For example, if the UK wants to maintain tariff-free agricultural imports from the EU, it would have to make agricultural imports from other WTO members tariff-free, too.

Concluding remark
Returning to the big picture, a preferential trade deal with the EU, the UK’s largest trading partner, will be essential. The UK would gain nothing by going to WTO rules, and then trying to negotiate a preferential deal. The whole process of going to WTO rules would severely damage the UK economy and surrender the UK’s negotiating leverage to the EU.

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18 See Appendix A for an overview of the EU trade framework
19 Source: [Eurostat international trade database](https://ec.europa.eu/eurostat/data/database)
Appendix A - EU trade framework

Trade between EU members
Economic cooperation between member states is a core objective of the EU. Barrier-free trade is at the centre of EU economic cooperation, both within the EU and with its trading partners. Removing trade barriers increases trade, improves efficiency and reduces the cost of doing business, leading to improved quality and lower prices. The EU is the global leader in removing trade barriers from the trade between its members.

One of the major benefits of EU membership is near-frictionless trade of goods and services in the Single Market and the EU Customs Union, supported by the EU VAT area and strong customs cooperation between member states.

• The EU Customs Union is comprehensive and means that all trade within the EU is free from tariffs, which helps keep costs down for producers and prices down for consumers. The EU Customs Union, supported by regulatory alignment in the Single Market, eliminates customs controls for goods flows across borders within the EU. Removal of administrative checks and delays at customs reduces costs and helps manufacturers to get the most out of modern techniques such as “just-in-time” production.

• The Single Market is based on common regulatory and technical standards that apply across the EU plus mutual recognition in many sectors. This means that a product made in a member state can be sold anywhere in the EU without additional regulatory checks. The same applies to the manufacture of intermediate components, which can go into a manufacturing process anywhere else in the EU.

The EU reduces regulatory barriers by harmonising legislation and creating a common rulebook. Mutual recognition plays an important role. In sectors where there are still differences, it minimises the effects of the differences. Member states recognise the equivalence of the other 27 national authorities’ domestic regulations, thereby allowing products and services that can lawfully be sold in one country to be sold in other member states. The EU recognises that it still has work to do to remove some remaining barriers to trade in services. Member states may, for example, have different local laws that affect trade in some services sectors. However, in areas where the UK is strong – such as financial and legal services – the EU rules give EU service providers unparalleled access to customers across the EU with minimal regulatory barriers.

The European Commission, EU regulatory bodies and domestic regulatory agencies conduct checks to ensure the rules are followed (and check that the checks are carried out!). Unresolved disputes over the interpretation of rules or compliance with them can be escalated, if necessary, to the European Court of Justice for a decision. In principle, all EU citizens and businesses have access – they do not need to rely on their governments to act for them in disputes.

• The EU VAT area means that VAT does not need to be paid on imports from within the EU of, say, raw materials and intermediate components, until the end of the relevant accounting period (rather than immediately on importation). This provides an important cash-flow benefit to suppliers, many of whom are small and medium-sized enterprises (SMEs) – and also means that there is no need to set up checks at the border to ensure that VAT is paid on importation. It
also means that consumers can order goods from anywhere in the EU without having to worry about additional VAT being imposed on importation causing delays and inconvenience.

If an import is from a non-EU country, the importer must pay the VAT before the goods are released from customs – and in the case of postal deliveries to consumers the parcel will not be handed over until the consumer has settled the VAT paid. (This means that all EU countries have to inspect imported goods from non-EU countries, including parcels, in order to apply the correct rate of import VAT).

The system depends on extensive and unparalleled exchanges of information between the member states’ tax authorities, as well as very substantial, though not complete, harmonisation of VAT rules.

• The framework for strong **EU customs cooperation** between member states is found in the Union Customs Code, which is an essential instrument of the Single Market. It defines all the formalities that must take place in the movement of goods between the EU member states and third countries, including import–export procedures, data requirements, tariff classifications, and common risk criteria. Common interpretation of those rules is necessary to avoid, for example, differences in tariffs charged by different member states as a result of different tariff classifications of the same goods. The Union Customs Code also mandates greater use of information technology between member states’ customs authorities to allow for real-time information sharing. Many of these features are included in the recent WTO Trade Facilitation Agreement.
Appendix B – Trade statistics

UK trade 2017

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<th>Goods</th>
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<th>Total</th>
<th>Goods</th>
<th>Services</th>
<th>Total</th>
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<tr>
<td>UK Total</td>
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<tr>
<td>Exports</td>
<td>339</td>
<td>277</td>
<td>616</td>
<td>55%</td>
<td>45%</td>
<td>100%</td>
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<tr>
<td>Imports</td>
<td>476</td>
<td>166</td>
<td>642</td>
<td>74%</td>
<td>26%</td>
<td>100%</td>
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<tr>
<td>Surplus/(deficit)</td>
<td>(137)</td>
<td>111</td>
<td>(26)</td>
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<table>
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<th>EU</th>
<th>% of total</th>
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<tr>
<td>Exports</td>
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<td>110</td>
<td>274</td>
<td>48%</td>
<td>40%</td>
<td>44%</td>
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<tr>
<td>Imports</td>
<td>259</td>
<td>82</td>
<td>341</td>
<td>54%</td>
<td>49%</td>
<td>53%</td>
</tr>
<tr>
<td>Surplus/(deficit)</td>
<td>(95)</td>
<td>28</td>
<td>(67)</td>
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<table>
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<td>Exports</td>
<td>175</td>
<td>167</td>
<td>342</td>
<td>52%</td>
<td>60%</td>
<td>56%</td>
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<tr>
<td>Imports</td>
<td>217</td>
<td>84</td>
<td>301</td>
<td>46%</td>
<td>51%</td>
<td>47%</td>
</tr>
<tr>
<td>Surplus/(deficit)</td>
<td>(42)</td>
<td>83</td>
<td>41</td>
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</tbody>
</table>

Source: House of Commons, Statistics on UK-EU trade,

68% of 2017 UK trade in goods and services was with countries with EU agreements (not all are FTAs and goods are better covered than services). 32% of UK trade was conducted with countries without EU agreements. This includes 15% with the US and 5% with China which trade with the EU on basic WTO terms complemented by multiple smaller bilateral trade agreements. Some of the countries accounting for the remaining 12% also have smaller complementary agreements with the EU.
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