

## "The WTO Option"

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1. The UK may leave the EU without concluding any replacement preferential trade agreement with the EU. This outcome has now acquired the label "Hard Brexit". This note considers two issues which will be particularly important in a "Hard Brexit" situation:<sup>1</sup>

- (a) Can the UK rely on WTO rules post-Brexit? In particular, can the UK do so even if other WTO Members object to its proposals for revised "schedules"?
- (b) Will arrangements that seek to ease the transition from full EU Membership to "Hard Brexit" have to be approved by the WTO Membership?

### **The UK's ability to exercise WTO rights post-Brexit**

#### *The "worst case"*

2. The assumption in all of the UK Government's economic analysis prior to the referendum was that a reversion to WTO rules post-Brexit would be the most unfavourable outcome for UK trade.<sup>2</sup> However, an even more unfavourable scenario is theoretically possible: one where WTO rules do not apply and, as a consequence, the UK's trading partners, including the EU, are left free to selectively discriminate against UK exports.<sup>3</sup> In such a situation, for example, the EU-27 could impose prohibitive tariffs on UK exports of machine tools to protect its local industry and could choose to favour US law firms over UK law firms in its legal services market.

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<sup>1</sup> The second issue will not arise if there is a "Soft Brexit". The first issue will arise even in a "Soft Brexit" situation but would carry much less economic significance.

<sup>2</sup> HM Government, *Alternatives to membership: possible models for the United Kingdom outside the European Union* (March 2016), p. 35 (describing the WTO option as "*the minimum threshold*" and "*the most definitive break with the EU*"); HM Government, *HM Treasury Analysis: the long-term economic impact of EU membership and the alternatives* (April 2016), p. 126 (modeling an EEA option, a bilateral agreement option and a WTO option).

<sup>3</sup> This scenario was mentioned by the WTO's Director General, Roberto Azevedo, in press interviews prior to the referendum. See e.g., <http://www.bbc.co.uk/news/business-36470809>.

3. Needless to say such an outcome can create serious difficulties for UK exporters. Achieving continuity of WTO protection is, therefore, likely to be a priority for the UK Government.

#### *The UK's irregular position in the WTO*

4. The starting point is that Brexit does not result in the UK losing its status as a WTO Member. The UK is already a WTO Member and it does not need to accede (again) to the WTO.

5. Although it is a WTO Member, the UK is in an irregular position because it does not have its own "schedules". "Schedules" are additional pieces of treaty text which set out specific commitments. So if I want to know the maximum tariff that South Korea can charge on imports of cars I will have to look at South Korea's "goods" schedule and look up "cars". Likewise, if I want to know whether foreign accountancy firms can set up shop in South Korea I will have to look at South Korea's "services" schedule and look up the entry for "accountancy services" and then "local presence".

6. The WTO Agreements assume that every WTO Member has its own "goods schedule" and its own "services schedule".<sup>4</sup> However, the UK's item-by-item commitments are part of the consolidated EU-28 goods and services schedules. The UK does not have individual schedules. As a result, there is a lack of clarity about the UK's specific obligations in certain areas and that may be troubling for other WTO Members who currently export to the UK. It is apparent that, post-Brexit, the UK will eventually need to end up in a situation where it has schedules of its own in the WTO. The Government has recognised this and has recently announced that it will take the approach of seeking to "*replicate as far as possible ... current [EU] obligations*" in draft individual UK schedules.<sup>5</sup>

7. As far as the mechanics of this replication exercise are concerned, the vast majority of the commitments in the EU-28 schedules are transposable to draft UK schedules without difficulty. Specifically, the UK can simply cut and paste EU commitments which are not expressed using EU-wide volumes, for instance, the 8% tariff on ball bearings. (I will refer to these commitments as "**Standard Commitments**"). Standard Commitments account for the

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<sup>4</sup> This assumption is reflected in Article II of the GATT and Articles XVI of the GATS.

<sup>5</sup> Statement of the Secretary of State for International Trade and President of the Board of Trade Dr Liam Fox, 5 December 2016.

overwhelming majority of EU-28 scheduled commitments. There is, however, one category of EU commitments which cannot be transposed easily. This is the category of commitments expressed using EU-wide volume figures. For instance, figures in metric tonnes for the annual volumes of frozen chicken that can be imported into the EU-28 (under an EU-wide "tariff rate quota") or monetary figures for the maximum amount of agricultural subsidies that the EU-28 will grant in a given year. (I refer to this category of commitments as "**Volume Commitments**": it is worth highlighting that Volume Commitments are largely to be found in the field of agriculture.) Volume Commitments will need to be allocated between the EU-27 and the UK. Obviously, there is room for significant disagreement about how to do that allocation.<sup>6</sup>

#### *The blocking power of other WTO Members*

8. The key question that arises is whether some or all of the other 163 WTO Members will have the ability to veto the UK's resumption of its position as a full WTO Member if they disagree with how Volume Commitments have been allocated. If the other WTO Members enjoy effective veto power then the UK will face a difficult diplomatic challenge and UK businesses will face heightened commercial uncertainty. As a matter of commercial diplomacy, it certainly cannot be excluded that a subset of WTO Members will object to the draft schedules prepared by the UK and demand further market access from the UK and the EU-27.

9. To a certain extent the legal consequence of any such objection will depend on the procedural setting in which it is made. There appear to be at least three procedures which may be applied to give legal effect to new draft schedules:

- (a) "*certification*" under the decisions of 26 March 1980 (L/4962) (for goods) and 14 April 2000 (S/L/83) (for services);
- (b) "*renegotiation*" under Article XXVIII of the GATT (for goods) and Article XXI of the GATS (for services); and

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<sup>6</sup> There is also room for disagreement about whether aggregate tariff rate quota volumes (i.e., aggregate of post-Brexit UK and EU-27 volumes) need to increase to reflect the exclusion of trade between the EU-27 and the UK in the existing EU schedule.

(c) supplementary negotiations on the basis of bespoke modalities established under Article XXVIII *bis* of the GATT and/or Article IV of the WTO Agreement.

Every WTO Member has a right to block certification [option (a)]. Negotiations in the WTO [option (c)] are usually carried out on the basis of consensus which, again, implies that every WTO Member can block a result it does not like. Renegotiation [option (b)] is different and can proceed over the objections of relevant WTO Members (but there are some doubts about whether the UK can trigger renegotiations independent of the EU-27).

10. But critically, and in any event, there are good arguments to be made that the UK will be able to enforce its WTO rights even if objections by other WTO Members prevent it from establishing valid goods and services schedules following Brexit.

11. First, the UK will continue to be a WTO Member and that status (arguably) gives it the automatic ability to enforce its WTO rights. Put another way, the exercise of WTO rights is not explicitly conditioned on having fully valid individual schedules. And not having complete schedules is not a ground for expelling an existing WTO Member from the organisation. The only ground for expulsion is refusing to agree to particular amendments: see Article X:3 of the WTO Agreement. In this regard it is worth noting that the EU's schedules have been subject to objections from other WTO Members (following successive EU enlargements) but that has not prevented the EU from enforcing its WTO rights.

12. Second, even if the UK had an obligation to maintain individual schedules,<sup>7</sup> any breach of that obligation would not automatically allow other WTO Members to ignore their own WTO obligations towards the UK. This is because unilateral countermeasures, such as banning exports from a WTO Member because it does not have complete schedules, are not permitted under WTO law. Instead, dispute settlement procedures would have to be initiated against the UK prior to any such response.

13. In summary, there is a good argument to be made that UK exports are likely to be protected under WTO rules even if the UK is unable to regularise its position in the WTO by establishing valid goods and services schedules by the end of the Article 50 TFEU process.

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<sup>7</sup> For completeness, I note that an obligation to have a schedule is a very odd concept. As a practical matter a schedule containing new obligations can only come into being if all WTO Members agree to the commitments set out in that schedule. So an obligation to have a schedule is actually an obligation to reach agreement with all other WTO Members. Nevertheless, some textual support for such an obligation can be derived from GATS Article XX:1 (but there is no equivalent provision in the GATT).

14. I note that other WTO Members would have good grounds for political complaint in a situation where they are required to comply with their own schedules vis-à-vis UK exports while the UK itself does not even have defined schedules. The obvious way of neutralising this complaint is for the UK to make a unilateral declaration that it will respect its draft schedules pending their formal approval in the WTO. Again, this is not unprecedented: the EU has followed a similar practice during prior enlargements.

### **Transitional arrangements under WTO law**

15. The UK and EU-27 may wish to enter into a transitional arrangement which provides for a gradual introduction of tariffs and other barriers to trade between the EU-27 and the UK. In such an arrangement, there is likely to be a point at which UK-EU trade will no longer involve duty-free treatment for the vast majority of goods traded between the UK and the EU-27. Similarly, there is likely to be a point where the vast majority of services trade between the UK and the EU-27 will no longer be unrestricted. At that point in time the transitional arrangement can no longer be justified under the relevant exceptions for preferential trading arrangements (these exceptions are set out in Article XXIV of the GATT and Article V of the GATS and they require that "substantially all" trade is unrestricted).

16. It follows that any transitional arrangement with this structure (as opposed to one which merely postpones the date of "Hard Brexit") will need to be authorised by the WTO Membership through a waiver. Three-fourths of the WTO Membership would have to agree to such a waiver. This will give rise to substantial diplomatic challenges for both the UK and the EU-27.

### **Conclusion**

17. Going back to the questions raised:

(a) Can the UK rely on WTO rules post a "Hard Brexit"? In particular, can the UK do so even if other WTO Members object to its proposals for revised "schedules"?

(b) Will any arrangements which seek to ease the transition from full EU Membership to "Hard Brexit" have to be approved by the WTO Membership?

18. My tentative answers are "yes", the UK is likely to be able to enforce WTO rules post-Brexit despite the objections of other WTO Members to its schedules and, "yes", certain forms of transitional arrangements will need to be approved by the WTO Membership by means of a waiver. However, much will depend on how the WTO Membership as a whole responds to this unusual situation and that ultimately comes down to economic diplomacy rather than law.