

# What does no deal mean? By Global Counsel.

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Global Counsel is an advisory firm, working with clients to navigate the critical area between business, politics and policymaking. Global Counsel helps companies and investors across a wide range of sectors anticipate the ways in which politics, regulation and public policymaking create both risk and opportunity – and to develop and implement strategies to meet these challenges.

## Summary

The baseline for the trade relationship after a no-deal Brexit would be WTO rules. In practice – and depending on the political atmosphere – there would at least be some enhancements to this baseline in the form of bilateral agreements between the EU and the UK on specific issues that are designed to avoid the worst consequences of a no-deal Brexit.

Any business or investor that wants to understand their exposure to a no-deal Brexit needs to take a systematic approach to assessing both what operating on WTO terms means and the prospects for enhancements in different areas. This must draw on an understanding of the existing templates that the negotiators could potentially draw on and a realistic assessment of how the legal, political and practical constraints will shape the likely outcomes. This is a complex task, but it can be kept manageable by focusing on the issues that are most critical for the business model or investment thesis.

The grinding progress of the negotiations – and the deep divisions in the British government – means the possibility of a no-deal Brexit is no longer remote. But what exactly would no deal mean? And how should businesses and investors assess the risks?

It is important to be clear on terminology. By **no deal**, we mean the two sides fail to negotiate even a modest form of preferential trade agreement, let alone the deep and special partnership which the UK wants. It also means there is **no transition agreement to maintain the status quo**, while a long-term deal is sealed. It may or may not involve the EU and the UK reaching a withdrawal agreement covering the divorce terms, including citizens' rights and the financial settlement. If it does not, the outcome would not only be highly disruptive, but toxic for EU-UK relations.

In such circumstances, the baseline for the trade relationship after Brexit would be **WTO** rules. In practice – and depending on the political atmosphere – **it is likely that there would at least be some enhancements to this baseline** in the form of bilateral agreements between the EU and the UK on specific issues that are designed to avoid the worst consequences of a no-deal Brexit.

This note explains what WTO terms mean in practice and the factors that would determine what sort of enhancements are most likely. It introduces a framework for assessing the prospects for specific enhancements, which allows businesses and

investors to evaluate their exposure to a no-deal Brexit in a systematic manner.

## **WTO terms** what WTO terms mean in practice

If the formula for a no-deal Brexit is WTO terms plus enhancements, then the first part of the equation is relatively clear.

**For Goods, WTO terms mean the non-preferential tariffs and tariff-free quotas that each WTO member offers to all others.**

The UK has already said it will adopt the same schedule of preferences, including the tariff profile, as the EU after Brexit, meaning that under WTO rules the tariffs imposed by the EU and the UK on each other would be symmetrical. Not all products would face tariffs – the EU schedule imposes 0% tariffs on thousands of tariff lines – but many would. Where these tariffs are material, this would be costly for consumers and for those businesses with supply chains crossing the EU-UK frontier, especially where they operate on low margins.

**For Services, WTO rules mean trading with the EU based on a combination of the commitments the EU has made to other WTO members or, where no EU-level commitments exist, the national licensing and market access regimes of each EU member state for the sector concerned.**

Wholesale and retail **banking** provides an example. In this sector, there is no EU-level framework for trading with non-EEA countries. This means UK-based firms would have to fall back on the regimes of individual EU states. While these vary, they are generally restrictive.

This is not a viable option for any UK-based bank wishing to maintain its passports to serve the full single market. Instead, such a bank would need to become **established and authorized** inside the EU. The general EU framework for establishing foreign services businesses is relatively liberal and this would apply to UK firms after Brexit, as this is a WTO commitment. But the adjustment would be costly, due to the need to move staff, the duplication of functions, and additional capital requirements.

A particular challenge for **services firms**, when preparing for a no-deal scenario, is that the rules vary from one sector to the next and across all 27 remaining EU member states. The UK also has its own rules for national licensing, market access and foreign establishment, although these are often more liberal than is typical in the EU27.

There are two additional complications to consider regarding **the UK and EU schedules of preferences** at the WTO.

**First**, the UK may in the end choose to adapt the EU's schedule, rather than simply transposing it. There is some support among British Conservative MPs for a unilateral reduction in at least some tariffs, particularly where this might benefit consumers, without significantly damaging domestic producer interests. If this happens, the changes are likely to be modest and would be biased towards

liberalization.

**Second**, the new UK schedule (and the modified EU schedule) must be agreed by the WTO membership by consensus. There are already challenges as to how the EU27 and the UK are proposing to divide the **tariff-free quotas** that are currently allowed by the EU. The UK and the EU would continue to import goods on their proposed terms unless either loses a WTO challenge and is forced to change. This is mostly an issue for agricultural products. If the UK and the EU end up adjusting their schedules, this will also be biased towards liberalization .

## Enhancements

Many countries, such as the United States, already trade with the UK without a preferential trade agreement. This observation has led some to conclude that it would not be such a big deal if the UK resorts to trading with the EU on WTO terms.

This ignores the fact that trade with the US is enhanced by a set of bilateral agreements, covering issues such as customs facilitation, data transfer, and certain regulatory barriers to trade in goods and services. These bilateral agreements are not as comprehensive as the rules governing trade within the single market – but without them, trade with the US would be severely disrupted.

If the UK simply leaves the EU, it would not be able to fall back on a ready-made, US-style set of bilateral agreements, established over several decades. However, given the disruption to trade from an abrupt adjustment to basic WTO rules, it is likely that the UK and the EU would attempt to agree at least some enhancements before the UK formally left the EU.

This second part of the no-deal Brexit equation – the enhancements that might be expected to be agreed – is even harder to assess, as there are no precedents and many uncertainties. There would very likely be little time to reach an agreement, which would also have to be done in difficult circumstances. However, we can evaluate which enhancements are the most plausible. The key is to understand three sets of constraints: the legal; the political; and the practical.

## The constraints

The most important legal constraint is a consequence of WTO membership, which requires that in the absence of a preferential agreement, any terms offered to one country must also be available to other WTO members on a non-preferential basis, unless the issue falls outside the scope of WTO rules.

This prevents the arbitrary waiving of many specific trade rules between the UK and the EU. In practice, it means that some concessions can only be offered where these are embedded in an existing framework and where the concessions are conditional on meeting set criteria.

The EU's data protection framework provides an example. Under the current framework (and a revised framework that enters into force next year) the EU can recognize another jurisdiction as having adequate levels of data protection and allow free flow of data with the EU. The framework is non-preferential, and therefore compatible with WTO rules, as any WTO member can seek an adequacy judgement,

including the UK after Brexit.

The political constraints are more ambiguous, but are also likely to be significant. The context for the negotiation of enhancements would be the failure to reach agreement on a comprehensive new preferential trading relationship and perhaps even a withdrawal agreement. This would almost certainly be acrimonious and may even be politically destabilizing, as it is questionable whether the UK government of the day would survive such an outcome.

At a minimum, it means the two sides would only have the appetite, and the political space, to attempt to negotiate enhancements where there is an exceptionally strong, mutual interest in addressing the issue.

In assessing the strength of the interest, it is necessary to consider both the materiality of the issue and its urgency. Aviation provides an example of an issue that would be both material and urgent, as a failure to reach a new aviation agreement before Brexit would mean that flights could no longer legally operate between the UK and the EU, causing severe disruption for the sector, for passengers and for commercial relations.

In assessing whether the interest is mutual, it is necessary not only to consider whether the interests of both sides are aligned, but also the extent to which they are balanced. If the interests are not balanced – and one side has a substantially stronger interest than the other – then there is a risk that the issue will be held hostage to gain leverage elsewhere in the relationship. It is possible, for example, that the EU may feel less urgency than the UK to address disruption to data transfer and judge that a short delay in reaching an adequacy decision might allow it to force the UK to make concessions on, for example, citizens' rights.

In an acrimonious political context, the threshold for passing these two tests is likely to be high.

There are several practical constraints to consider, particularly given that there may be very little time to negotiate, agree and implement enhancements.

The need to conduct negotiations and secure agreement quickly, means the issues may need to be conceptually simple. It may also require that a ready-made template exists for such an agreement, even if it is not a perfect one.

These templates might ideally be found in the EU's existing frameworks for its relationships with third countries, but where these do not already exist, some creativity may be required in finding and adapting WTO-compatible templates used by other countries in their bilateral relationships.

The EU and the UK would have two practical advantages. The first, is that they start from a position of close policy alignment, which would be largely preserved by the UK's EU (Withdrawal) Bill, assuming it is passed into law. This makes it more likely that, for example, the EU would conclude relatively quickly that the UK has adequate data protection.

The second, is that some of the issues may already have been explored to the satisfaction of both sides in negotiations over a comprehensive agreement, even if

those negotiations ultimately failed. This could provide the basis for agreeing specific enhancements, even where these are legally constrained to be non-preferential.

The need to implement enhancements quickly means the formal processes for doing so on each side become important. This is especially so for the EU, where the European Commission, the European Parliament, and the Council of Ministers will typically play a role. These processes are often prolonged, but in many cases the Commission is able to provisionally implement an agreement, once it has been signed.

## What should businesses and investors do?

The set of enhancements that is agreed in a no-deal scenario would be limited, but how limited will depend on both the time available and the political context.

Any business or investor that wants to understand their exposure to a no-deal Brexit needs to take a systematic approach to assessing both what operating on WTO terms means and the prospects for enhancements in different areas.

This must draw on an understanding of the existing templates that the negotiators could potentially draw on and a realistic assessment of how the legal, political and practical constraints will shape the likely outcomes. The annex illustrates this for some issues. The assessment should also be dynamic, as the prospects for enhancements will depend on the progress of negotiations, even if they ultimately break down, and the timing and circumstances of that break down.

This is a complex task, but it can be kept manageable by focusing on the issues that are most critical for the business model or investment thesis.

**[Please read the Potential Enhancers on the site for the WTO route that require practical consideration.]**