What does no deal mean? By Global Counsel.

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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. Accordingly, 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.**

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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 judgment, 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 that 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.

Annex: Examples of potential enhancers to the WTO baseline in a no-deal scenario

1. Civil aviation	
Impact of no contingency	Commercial flights between the EU and UK are stopped (as are flights between the UK and the US, due to the UK falling out of the EU-US Open Skies agreement).
Legal considerations	There are no WTO constraints on aviation agreements. International aviation liberalisation generally remains outside the remit of WTO agreements.
Political considerations	A sudden end to air traffic would create major disruption to movement of people and goods between the EU, the UK and the US. This would likely provide compelling reasons for both Brussels and London to extend UK coverage under current aviation arrangements or negotiate new ones.

Practical considerations	Negotiating new EU-UK or UK-US aviation agreements could be lengthy and difficult, given competing interests of airlines (EU airlines may seek to restrict access for UK airlines at EU airports). Adding the UK as a third-party country to current arrangements (within the EU and between the EU and US) might prove simpler and quicker. This has been done for Norway and Iceland, although they are EEA members and it still took 18 months to add them to the EU-US Open Skies agreement after it was signed. These agreements need to be approved by the European Parliament, which can take up to a year, but can be provisionally implemented by the European Commission once signed.
2. Customs facilitation	
Impact of no contingency	Fully-fledged customs formalities would be re-imposed on EU-UK trade. The number of customs declarations processed by the UK could potentially increase fivefold. Personnel and facilities are lacking on both sides of the frontier, making major logjams at crossing points and disruption to movement of goods inevitable. This also creates problems behind the border, as it becomes difficult for EU and UK companies to source in each other's market in a smooth and timely manner.
Legal considerations and small ad hoc deals	A customs cooperation agreement could be reached between the EU and UK outside the framework of a free-trade agreement, without violating WTO rules on preferential treatment. The EU already has customs cooperation agreements with China and the US. Short of a full customs facilitation agreement, the EU and UK could also agree on small ad hoc deals such as mutual recognition of authorised economic operators.

Political considerations	The disruption at the border would be massive and sudden, creating problems for both sides and immediate incentives to relieve the burden placed on their customs authorities. The scope of disruption would likely be greater for the UK, given that almost half its trade is with the EU and many of its ports in the South and the East trade almost exclusively with EU countries. In the EU, the impact would be significant too, but concentrated on the Irish border and at ports and airports where a lot of goods transit to the UK.
Practical considerations	The UK and EU are already aligned on regulatory standards and customs practices, making the negotiation of an agreement easier. A customs cooperation agreement only needs to be signed by the European Commission before it can enter into force, meaning the implementation of an agreement would be quick.
3. Nuclear	
Impact of no contingency	The UK would no longer have an internationally-approved safeguarding system after leaving Euratom, which would put it in contravention of its obligations under international nuclear law. The UK is taking steps through domestic law to address this. In addition, the UK would no longer be party to Nuclear Cooperation Agreements between Euratom and third countries, including suppliers of nuclear fuel. Ultimately, this could disrupt imports of nuclear fuel, and in a worst-case scenario, lead to the shutting down of nuclear power plants. The UK would also no longer be able to participate in a range of nuclear research programmes on which it currently cooperates with the EU.

Legal considerations	The UK would have to choose between seeking an association agreement under Article 206 of Euratom, or a more narrow participation in research programmes under Article 101. Alternatively, the UK could become a third country and negotiate a Nuclear Cooperation Agreement. The new arrangement would have to be approved by the International Atomic Energy Agency. The WTO does not play a role in nuclear matters. The UK would also need to strike Nuclear Cooperation Agreements with third countries, without which trade in nuclear fuel and equipment may become illegal (e.g. US), or be refused as a matter of policy (e.g. Australia and Canada).
Political considerations	Both the EU and UK will want to maintain trade in nuclear goods and equipment and continue cooperating in nuclear research facilities – although these may be subject to 'poaching' by EU member states. The nuclear fuel company Urenco is jointly owned by the UK and Dutch governments and German utilities E.ON and RWE. The failure to find an alternative set of arrangements would be far more damaging to the UK. The strong anti-nuclear sentiment in some member states, notably Austria, could complicate negotiations.
Practical considerations	The UK currently operates to Euratom standards and practices, but continuing to do so as a non-member would require a significant upgrading of the resources and competences of the Office of Nuclear Regulation. This may not be complete in time for the UK leaving the EU and Euratom. With no deal and no transition period, the UK would need to move fast on its own to obtain IAEA approval for its new nuclear safeguarding system and subsequently to negotiate nuclear cooperation agreements with third countries around the world, before resuming fuel imports. This is likely to take some time.

4. Fisheries	
Impact of no contingency	The EU and UK lose fishing rights in each other's exclusive economic zones, and impose prohibitively high import tariffs on each other's fish exports.
Legal considerations	The EU and UK can negotiate a fisheries cooperation agreement to manage shared fish stocks and grant each other fishing rights in their respective exclusive economic zones. This would not violate WTO rules. But any reduction or elimination of the tariffs on fish imports outside of an FTA would violate WTO rules.
Political considerations	The EU would be keen to reach an agreement on management of shared stocks and fishing rights, given that ensuring sustainable fishing practices in and around its maritime territory is a priority for the common fisheries policies. The post-Brexit UK policy is unclear. But it is unlikely to sign any such agreement without the guarantee in return that it can export its fish to the EU tariff-free. Their interests are misaligned and imbalanced, making agreement unlikely.
Practical considerations	Any fisheries cooperation agreement would be negotiated by the European Commission and referred to the European Parliament for approval. Past precedents suggest it could take up to a year for the agreement to reach the parliament after signature. But it could be provisionally implemented by the European Commission before then.
5. Data flows	

Impact of no contingency	Leaving the EU without any contingencies for data transfers would mean companies need to establish alternative legal mechanisms for transferring personal data between the EU and the UK. While some larger companies would have the legal resources to implement binding corporate rules (for intra-group transfers) and standard contractual clauses (for transfers between companies) these mechanisms cannot fully replicate free flow of data and would be costly to implement. They are also currently subject to legal challenge at the ECJ. Many smaller companies would not have the legal resources to do this. In effect, this would mean an end to transfers of personal data between the EU and the UK for all but the largest companies.
Legal considerations	Under the General Data Protection Regulation (GDPR), which enters into force in May 2018, the EU can pass an adequacy decision, recognising another jurisdiction as having suitable levels of protection and, therefore, as eligible for free flow of data with the EU. The UK's Data Protection Bill is implementing similar powers for the UK.
Political considerations	Nearly every economic sector would be negatively affected by a cessation in the free flow of data between the EU and the UK. The disproportionate impact on SMEs and tech start-ups would give the issue political salience. Concerns about disruption would be balanced in the EU to an extent by misgivings over the UK's surveillance and security frameworks, and a need to ensure EU citizens' privacy rights are respected under an adequacy framework. As in some other policy areas, it is possible that the EU may feel less urgency to address this issue than the UK.

Practical considerations	Adequacy decisions under the current Data Protection Directive have taken at least 18 months to implement. More uncertainty is created by the fact that the GDPR enters into force in May 2018, ushering in a revised process and new regulatory thresholds for decisions. The fact that the UK is implementing the GDPR via the Data Protection Bill should expedite this process. Even then, some form of transitional adequacy decision would be needed while the formal process takes place. A precedent exists – the EU's data protection authorities granted a transitional period to transfers to the US in 2015 after the Safe Harbour Agreement was struck down by the ECJ.
6. Product standards (cars, chemicals, food safety, medicines, etc)	
Impact of no contingency	**The EU and the UK stop recognising each other's product standards and conformity assessment procedures**. For many sectors, this means that goods must undergo additional conformity assessments in the export market before being sold there, creating delays and increasing regulatory costs for companies.
Legal considerations	Signing equivalence or mutual recognition agreements outside an FTA framework does not violate WTO rules, providing other WTO members are not denied the opportunity to enter into similar agreements with the EU and the UK. It has typically been straightforward to clear this bar and the EU already has a few such agreements with Australia, the US, and New Zealand, among others, despite not having an FTA with any of them.

Political considerations	Although businesses in most sectors would support this, the EU might regard it as allowing the UK to pursue an a-la-carte regulatory approach to the single market. The EU might therefore seek to tie agreement in certain sectors of strong interest to the UK (cars, chemicals) to agreement in others that are more contentious (food safety). For the UK, there would be strong incentives to negotiate these agreements to mitigate disruption, but they might also conflict with attempts to re-orientate UK trade towards other markets (notably North America), which could be the priority for DIT in a no-deal scenario.
Practical considerations	Agreement could be reached quickly, in theory, with regulatory equivalence already established in practice at the point when the UK leaves the EU. From a procedural point of view, these agreements need to be approved by the European Parliament, which past precedents suggest could take up to a year. However, agreements can be provisionally applied pending parliamentary approval as soon as an agreement is signed by the European Commission.

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