

LEAVE ALLIANCE

Brexit Monograph 2

The WTO Option and its application to Brexit

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(corrected2 and revised)

Introduction

It is generally held that there are three main options available to Brexit negotiators to settle our trading relationship with the EU: the Efta/EEA Option (often known as the Norway Option); the bilateral free trade (or bespoke) option; and the so-called WTO Option. In this note, we look specifically at the WTO option, and its potential consequences for the UK.

Firstly, though, it is necessary to define what is meant by the WTO Option. This is taken to be a scenario where, for whatever reason, the UK eschews any form of directly negotiated trading agreement with the EU and trades solely and exclusively within the framework set by the diverse WTO Agreements. This might occur by design (even though this is unlikely) with the UK deciding not to conduct negotiations with the EU, or by accident.

The accidental scenario is conceivable, arising in the event that the UK fails to secure a negotiated Article 50 settlement within the two years initially allowed by the Article, and then fails to get an extension of time. Following this, the EU Treaties cease to have effect and the UK is forced to trade with the EU on the basis of WTO rules.

It must be said, and strongly emphasised in this context, that the WTO Option is an absolute. Some commentators advocate relying on the WTO rules to

provide a basic framework, while additionally brokering side-agreements with the EU to cover areas of specific interest to the UK.

There may or may not be merit in such arrangements but the point has to be made that any such arrangements are not the WTO Option. They take us outside the scope of the option. Confusingly, some have used the description "WTO plus" to cover these modified arrangements, but this should not be done. The term is already used to describe the regime applied new WTO entrants who are required to undertake Protocol commitments that are more stringent than those of original WTO Members. These are known as WTO-plus commitments.¹

Others have suggested the term "beyond WTO" but, whether this or "WTO-plus" is used, the essence – as Pascal Lammy has pointed out – is that in each bilateral trade agreement we have a "WTO-plus" provision".² The WTO rules are the baseline for any agreement (even the trade elements of EU Treaties). It is best, therefore, to stick rigidly to a definition of WTO Option that excludes any other form of agreement.

General application

The acceptability of the WTO Option is often justified by reference to other nations which supposedly trade with the EU without the benefit of bilateral trade agreements. Often cited are the United States, Australia and China, which are assumed to be operating under WTO rules.³

Such assumptions, however, are flawed – resting on an unduly narrow interpretation of a free trade agreement (or, technically, a regional trade agreement) as one which concerns tariff reduction and which are notified to the WTO and held on their databases.⁴ Trade agreements which do not deal specifically with tariffs are not notified to the WTO but are instead held on the United Nations treaty database.⁵

Although regulatory cooperation forms a major part of any comprehensive free trade agreement, and the OECD identifies eleven categories of agreement involving what is known as "International Regulatory Cooperation" (IRC), only one encompasses the traditional trade agreement and is thus notified to the WTO.⁶ The countries cited as having no trade agreements with the EU do in fact have multiple agreements with the EU – although none of them are notified to the WTO. They cannot in any respects be regarded as operating exclusively under WTO rules and cannot be held as examples of the WTO option in action.

¹ https://www.wto.org/english/thewto_e/acc_e/cbt_course_e/c5s1p1_e.htm

² <http://www2.weed-online.org/uploads/Watch%20out%20beyond%20the%20WTO.pdf>

³ For instance, on 24 April 2016, columnist Charles Moore wrote in *The Daily Telegraph*: "The EU has never yet, in its history, had a trade deal with America". No link available.

⁴ https://www.wto.org/english/tratop_e/region_e/region_e.htm

⁵ https://treaties.un.org/pages/Overview.aspx?path=overview/overview/page1_en.xml

⁶ <http://www.oecd.org/gov/regulatory-policy/irc-toolkit.htm>

This is especially the case with the United States which has its own State Department declare: "The United States and the 28 Member States of the EU share the largest and most complex economic relationship in the world". Transatlantic trade flows (goods and services trade plus earnings and payments on investment) averaged \$4.3 billion each day of 2013.⁷

On the European Commission's *Europa* website, there is the Treaties Office Database which boasts an advanced search facility. Search by "country" (United States of America) and "nature of agreement" (trade agreement), the database will list 23 agreements. Under the category of "Agreement for trade and cooperation", there are a further eight agreements, in particular the 1976 Framework Agreement for commercial and economic cooperation between the European Communities and Canada.

This is described as a "non-preferential agreement" and was the very first formal agreement of its kind between the EEC and an industrialised third country, under which the parties committed "to develop and diversify their reciprocal commercial exchanges and to foster economic co-operation".⁸

With this and the categories, "agreement on Customs Matters" - an issue which is intimately trade-related – and "Agreement on internal market matters", there are recorded 38 EU-US "trade deals", of which at least 20 are bilateral.⁹

A similar exploration of China's status with the EU identifies multiple agreements - 65 over term, including 13 bilateral agreements, ranging from trade and economic co-operation to customs co-operation. None of these are of the simple, tariff reduction variety, but collectively they have enabled China to become the EU's second largest trading partner, with trade valued at over €1 billion a day.¹⁰

So many other countries have their own trade deals with the EU that it is difficult to identify countries which do trade solely under WTO rules – there are so few of them. One cannot even cite North Korea, ranking 182 as an EU trading partner, as this country is not a WTO member.¹¹ Altogether, the EU has 880 bilateral agreements with its trading partners, and there is no example of a developed nation trading with the EU solely by reference to WTO rules.¹²

For the UK to trade with the EU relying on the WTO Option would be unique for a developed nation, creating an unprecedented situation. There is nothing with which a comparison could be made.

⁷ <https://ustr.gov/sites/default/files/2015%20NTE%20Combined.pdf>

⁸ <http://ec.europa.eu/world/agreements/downloadFile.do?fullText=yes&treatyTransId=709>

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<http://ec.europa.eu/world/agreements/AdvancedSearch.do?freshSearch=true¤tUser=null>

¹⁰ http://ec.europa.eu/trade/policy/countries-and-regions/countries/china/index_en.htm

¹¹ http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113428.pdf

¹² <http://ec.europa.eu/world/agreements/searchByType.do?id=1>

General consequences of relying on the WTO Option

Because it is a unique event, it is not possible accurately or completely to define the entire range of consequences arising from the UK dropping out of the EU Treaties, with no replacement agreements, relying solely on WTO rules. That is an issue in itself, as the prospect raises considerable uncertainties.

Of the known knowns, however, one significant issue is that Article 33 of the Treaty of the Functioning of the European Union (TFEU) provides the legal base for the Union's Customs Code (UCC), which defines the procedures adopted by officials to regulate the flow of goods (and some services) in and out of this country.

This law drives an EU-wide system that handles 17 percent of world trade – over two billion tonnes of goods a year with a value of €3.3 trillion. Between 2004 and 2010, despite the impact of the financial crisis, the value of EU external trade has grown by almost 50 percent.

The EU is at the centre of global trade and supply chain logistics, and is the number one trading partner for the United States, China and Russia. More than 90 percent (8.4 billion tons of merchandise) of global trade is carried by sea, of which more than 20 percent is unloaded in Europe.

The EU has over 250 international airports. The eastern land border runs to almost 10,000km with 133 commercial road and rail entry points. Taking into account the entire EU external border (land, air, sea) there are in total more than 1,000 customs offices of entry.

In 2011, EU customs processed 36 million pre-arrival cargo declarations, 140 million import declarations, 96 million export declarations and 9 million transit declarations. These figures represent an average of 8.9 declarations per second handled by the Member States' customs administrations. They collected customs duties that contributed an estimated €16.6 billion to the EU budget, i.e. approximately 13 percent of the total.

In settling for the WTO option, the UK will be, whether by accident or design, embarking on a course of action that will cause significant damage to this system.

The problem is that, as it stands, there is no applicable UK law of significance. The entire body of law has been replaced by the Union Customs Code (UCC) as part of a broader legal package. The package itself is composed of the Union Customs Code itself, adopted on 9 October 2013 as Regulation (EU) No 952/2013 of the European Parliament and of the Council. This entered into force on 30 October 2013 although most of its substantive provisions apply from 1 May 2016.

It also includes the UCC Delegated Act, which was adopted on 28 July 2015 as Commission Delegated Regulation No 2015/2446. It contains certain non-

essential elements of the UCC. Then there is the UCC Implementing Act, adopted on 24 November 2015 as Commission Implementing Regulation No 2015/2447. This is required to ensure the existence of uniform conditions for the implementation of the UCC and a harmonised application of procedures by all Member States.

Two other measures then complete the package. One is the UCC Transitional Delegated Act, adopted on 17 December 2015 as Commission Delegated Regulation No 2016/341. It establishes transitional rules for operators and customs authorities pending the upgrading or the development of the relevant IT systems to create a fully electronic customs environment.

The other is the UCC Work Programme, adopted on 11 April 2016 as Commission Implementing Decision No 2016/578. It relates to the development and deployment of the electronic systems provided for in the UCC and is closely linked to the UCC Transitional Delegated Act.¹³

The point to be made here is that this body of law has emerged in its present form over many decades since its inception in 1968 and currently comprises over 1,300 pages.¹⁴ As regulations and decisions, they have direct effect.¹⁵ With UK independence, they would cease to have any legal effect in the UK. If the law was then to apply to the UK as an independent state, elements which were applicable to the UK (and within its jurisdiction) would have to be replaced.

Outside the EU, though, it is unlikely that this law could just be copied out. Substantial adaptation would almost certainly be needed. This would be a complex and time-consuming process and, assuming that the UK had lost Union law as a result of the expiry of the Article 50 process, it might be an unplanned event.

No doubt a series of emergency orders could be rushed into place but, during the period when new legislation was being produced, there would be no legal code applying to UK Customs operations. Temporary measures aside, it is difficult to see how a comprehensive code could be quickly or easily replicated, even if there were the personnel available with the necessary skills and experience. This might be further complicated by certain aspects requiring Union and international recognition.

Nor is it necessarily the case that the resultant system could be fully functional at an operational level as, without ongoing agreements to ensure continuity of

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http://ec.europa.eu/taxation_customs/customs/customs_code/union_customs_code/ucc/legislation_en.htm#ucc

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[http://ec.europa.eu/taxation_customs/resources/documents/common/publications/com_reports/customs/com\(2012\)791_en.pdf](http://ec.europa.eu/taxation_customs/resources/documents/common/publications/com_reports/customs/com(2012)791_en.pdf)

¹⁵ <http://www.eurofound.europa.eu/observatories/eurwork/industrial-relations-dictionary/direct-effect> and <http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=URISERV:114547&from=EN>

cooperation, UK Customs authorities would be cut off from EU risk management and other databases, and preciously shared systems for communication and information exchange.

Tariff and non-tariff barriers

Having acquired the status of a third country, in respect of exports to the EU, the UK's "non-Union goods" would be subject to the EU's Common External Tariff (CET). This would be applied automatically, in accordance with the WTO's non-discrimination rules which require all third countries to be treated equally for tariff purposes.¹⁶

According to UK government sources, UK exporters to the EU would face tariffs to the equivalent weighted average 6.7 percent, plus incurring administrative burdens estimated as two percent of the transaction values.¹⁷ The range of tariffs could be wide. Switzerland, for instance, faces a 15.4 percent tariff when exporting prepared meats to the EU, a 3.2 percent tariff on instant print cameras (high-tech manufacturing) and a 12.2 percent tariff on anoraks (low cost manufacturing).¹⁸

For most industries, however, the tariffs are minimal and amount to less than the normal currency variations as between sterling and the euro.¹⁹ Costs could be absorbed without significantly impacting on profitability or trade volumes.

The greater problem is the prevalence of non-tariff barriers which, in many instances of third countries dealing with the EU, are represented by regulatory barriers – the need to conform to EU product rules. However, as the UK is currently fully compliant with Single Market requirements, regulatory convergence is high. Meeting EU regulatory standards (in the short- to medium-term) is unlikely to impose any additional costs.

However, conformity with relevant standards cannot be taken for granted. Before imported goods can be placed on the market, importers must satisfy themselves that goods conform to relevant standards and, where specified in legislation, must provide independent evidence of conformity.²⁰ This latter requirement is an entirely separate function and can add varying degrees of complexity (and expense) to those seeking to bring goods into the Union market.

With goods, where there are no specific, harmonised standards, the requirement may often be satisfied by demonstrating conformity with good manufacturing

¹⁶ https://www.wto.org/english/thewto_e/whatis_e/tif_e/fact2_e.htm

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https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/220968/foi_eumembership_trade.pdf

¹⁸ *Ibid.*

¹⁹ <http://www.telegraph.co.uk/money/ask-a-money-expert/pound-is-up-475pc-ahead-of-brexipoll-should-i-buy-dollars-or-e/>

²⁰ http://ec.europa.eu/growth/single-market/ce-marking/importers-distributors_en

practice, in accordance with a self-certification procedure known as the suppliers' "declaration of conformity".²¹ Conformity assessment ranges in severity in a series of modules ranging from A-H. Where product must be independently tested, samples have to be submitted to independent testing houses known as Notified Bodies. These must be located on Member State territory and must be approved by the EU.²²

In the case of third countries, tests may be carried out in originating countries where domestic testing regimes are recognised by the EU, usually in conjunction with the international standards body ISO.²³ Recognition is either built into free trade agreements or is channelled through Mutual Recognition Agreements (MRAs) on conformity assessment.²⁴ These have treaty status and are properly regarded as trade agreements.

Australia, Canada, Japan, New Zealand, the USA, Israel and Switzerland all have MRAs on conformity assessment with the EU. China also formalised an MRA on recognition of Approved Economic Operators on 16 May 2014.²⁵ This, and other agreements on Customs co-operation, considerably eases the flow of trade between China and the EU.²⁶

Should the UK leave the EU, goods exported by the UK and presented for circulation in the Union market will be defined as "non-Union goods".²⁷ If we have left without securing an exit settlement, UK testing and certification bodies previously approved by the EU would lose their approvals. Documentation generated by them may no longer be recognised by EU authorities.

Member State customs authorities - who have sole responsibility for admitting goods – may then decide to increase inspection frequency and that additional testing is required before goods are allowed into circulation.²⁸ This is the major distinction from the current situation. Products moved across internal borders (say from the UK to France) cannot be inspected or detained, except under exceptional circumstances.

For batches of goods for which testing is required, samples have to be obtained under official supervision and sent to Notified Bodies.²⁹ Costs can be

²¹ http://trade.ec.europa.eu/doclib/docs/2006/december/tradoc_117312.pdf

²² https://ec.europa.eu/growth/single-market/goods/building-blocks/notified-bodies_en

²³ http://www.iso.org/sites/cascoregulators/03_considerations.html, accessed 22 April 2015.

²⁴ http://ec.europa.eu/growth/single-market/goods/international-aspects/mutual-recognition-agreements/index_en.htm, accessed 18 April 2015.

²⁵ http://europa.eu/rapid/press-release_IP-14-555_en.htm, accessed 18 April 2015.

²⁶ http://europa.eu/rapid/press-release_MEMO-14-353_en.htm, accessed 18 April 2015.

²⁷ See Article 5: <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013R0952&from=en>

²⁸ Blue Guide (EN). See pp 96-97.

<http://ec.europa.eu/DocsRoom/documents/18027/attachments/1/translations/>

²⁹ http://ec.europa.eu/growth/single-market/goods/building-blocks/accreditation_ga

considerable.³⁰ Container inspection may reach £700 (more if it has to be wholly or partly emptied) and detention fees are about £80 a day.³¹ Ten days or more may be required to obtain results and secure customs release, the cumulative costs adding up to £2,000 to shipping a container into the EU.³²

As regards products of animal origin, a more rigorous regime applies. The exporting country must be on a list of countries authorised to export the category of products concerned to the EU. Products may be imported into the EU only if they come from approved processing establishments in the exporting country. All imports must be accompanied by a health certificate signed by an official veterinarian of the competent authority in the exporting country. And then every consignment is subject to health checks at the border inspection post (BIP) in the EU country of arrival. Products may only enter the EU via designated BIPs.^{33,34}

A particular problem is that, in the French ports which take most of the UK traffic, there are no designated BIPs, other than Dunkirk, which has limited capacity. To equip port (or ports) capable of handling the volume of traffic would require major investment in infrastructure, personnel and systems.

The facilities at the Port of Calais are already inadequate for the current intra-community traffic. A major extension and upgrade is already proposed, at the cost of €725 million.³⁵ To further adapt it and expand the facilities would take millions more, and many years to plan and execute. The same would have to be done to many of the other Continental ports, especially those which handle ro-ro traffic. Until the facilities are in place, it is difficult to see how any significant volume of food exports could be handled.

Authorised Economic Operators

In the event that a working customs system has been patched together, there will still be numerous obstacles to the efficient function of the system, not least because – as indicated above – some elements will require Union and international recognition.

Another such element is the Authorised Economic Operator (AEO) system, which awards AEO status to qualifying enterprises. The status itself is an internationally recognised quality mark indicating that the enterprise has a

³⁰ <http://www.dpworldsouthampton.com/about-us/tariff-and-charges/>

³¹ Price for a 40ft container: https://www.cma-cgm.com/static/DemDet/Attachments/DD_Tarifs_GB%2001042016.pdf

³² For typical UK charges, see here: <http://www.pdports.co.uk/Documents/Navigational%20Information/Dues-and-Charges/PD%20Teesport%20%20Schedule%20of%20Charges%201st%20January%202015.pdf>, accessed 26 June 2015.

³³ http://www.exporthelp.europa.eu/thdapp/display.htm?page=rt/rt_SanitaryAndPhytosanitaryRequirements.html&docType=main&languageId=EN

³⁴ http://ec.europa.eu/food/animals/vet-border-control/index_en.htm

³⁵ <http://www.asce.org/magazine/20160112-port-of-calais-expansion-underway/>

record of conformity with customs controls and procedures, entitling the holder to rapid access to certain simplified customs procedures and in some cases the right to "fast-track" processing of shipments through some customs and safety and security procedures.³⁶

The concept was initiated in 2005 by the World Customs Organization (WCO) as a part of the WCO SAFE Framework of Standards to Secure and Facilitate Global Trade (SAFE Framework) and adopted by the EU in 2008 as an EU-wide system.³⁷ Participation is open to any legal entity trading within the EU, which is currently holder of an EORI number.³⁸ Applications are made to the relevant departments of Member State governments.³⁹

The EU also has mutual recognition agreements on AEOs with China, Japan, Norway, Switzerland and the United States, which the UK is party, their approved operators enjoying certain privileges when exporting to those countries.⁴⁰

Obviously, if the UK drops out of the Customs legislation as a result of Brexit, it will cease to have access to the AEO system in its entirety. UK-registered operators will no longer be recognised within the European Union or in the countries with which the EU has mutual recognition agreements. Equally, the UK will not longer be able to verify the status of AEOs approved by other EU Member States, or those accepted under mutual recognition agreements.

Conclusions

Reviewing the impact of adopting the WTO Option to define our trading relationship with the EU, it is entirely reasonable to assert that the result would inevitably be some perturbation to the Customs system and the management of traffic flow at the borders and UK ports.

At one extreme, if no preparation had been made to introduce a UK legal code to govern the import and export of goods from the UK – a scenario which could very well apply if Article 50 negotiations failed - it is arguable that all trade activity would cease, with a complete standstill in place until a replacement, UK-originated code was in place.

The complete replacement of a legal code – currently in excess of 1,300 pages – cannot be a simple task. Even treated as an emergency (which, undoubtedly it would be), it might take several weeks before even a temporary code was in

³⁶ <https://www.gov.uk/guidance/authorised-economic-operator-certification>

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http://ec.europa.eu/taxation_customs/customs/policy_issues/customs_security/aeo/aeo_en.htm#what_is

³⁸ <https://www.gov.uk/guidance/eori-supporting-guidance>

³⁹ <https://www.gov.uk/government/publications/notice-117-authorised-economic-operator/notice-117-authorised-economic-operator>

⁴⁰ *Op cit*,

http://ec.europa.eu/taxation_customs/customs/policy_issues/customs_security/aeo/aeo_en.htm#what_is

place. Given that the four-day period of disruption at the Channel ports in 2015 cost £1 billion, actual costs could easily run into tens of billions.⁴¹ From experience of this year's disruption (2016), it can be seen how even small incidents can have a major effect.⁴²

However, even with a legal code back in place, problems are very far from over. With no formal recognition of UK conformity assessment, for a great many products it could prove very difficult – at least in the short-term – to export them to Union Member States. And even when the situation has been stabilised, it will be more complex and expensive – especially when it comes to goods of animal origin.

This also applies to the AEO issue. The system is designed for trade facilitation purposes (and for added security) and anything which works to counter that effect is going to add time, complexity and cost to international trade.

All of this, though, does not militate against the possibility of returning to the EU to negotiate arrangements which overcome the problems arising from the adoption of the WTO Option. But if new arrangements are agreed, the outcome is a bilateral deal (or deals) with the EU, which no longer qualifies as the WTO Option. That option, it must be evident from this note, has to be considered entirely unworkable.

Despite this, there are those who have specifically advocated that the UK voluntarily adopts the WTO option, either as the option of choice or as a default option.⁴³ The more plausible scenario is that we end up trapped into adopting the WTO-Option as a result of a failure of Article 50 talks. This will not be because anyone wanted it or intended it. It will be in the nature of an accidental crisis, not so very different from the scenario which brought the First World War into being, where the troops were mobilised and there was no means of turning back.

The point which needs to be drawn from this note is that the WTO option is a very dangerous and potentially expensive option which could do significant damage to the EU and UK, the effects of which could be long-lasting.

This has considerable implications for how we address the Article 50 negotiations. The adverse effects of dropping out of the EU Treaties without an alternative agreement in place are so serious that this is not something any responsible person would want to consider.

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⁴¹ <http://www.cips.org/supply-management/news/2015/july/calais-disruption-cost-uk-1-billion-says-dover-port-chief/>

⁴² <http://www.bbc.co.uk/news/uk-36922772>

⁴³ See, for instance, here: <http://politeia.co.uk/blog/open-letter-sir-mike-rake-dr-ruth-lea>