

KEY POINTS

- It would be open to the EU and the UK to enter into an interim agreement, without contravening the Most Favoured Nation principle.
- The WTO Members have a right to make recommendations if they are of the view that the interim agreement is not likely to result in the formation of a Free Trade Agreement within the period contemplated.
- In respect of financial services, there is a specific exemption from the MFN principle in respect of “economic integration agreements”.

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Brexit, interim arrangements and the WTO rules: much ado about nothing?

In this article, Saima Hanif considers the possible outcomes in terms of a transitional position pending the conclusion of a Free Trade Agreement with the EU and explains why the best option for the UK is the interim agreement option.

INTRODUCTION

Having triggered Article 50, the government now has a two-year window within which it not only has to conclude an exit agreement, but also ideally, to negotiate a new Free Trade Agreement (FTA) with the EU. If, as seems to be the case, it is not possible to complete an exit agreement and an FTA simultaneously, a decision will have to be taken as to the most expedient means of bringing an FTA into existence.

The UK could, with the consent of the other 27 member states, agree to extend the time for it to exit, therefore acquiring more time to negotiate the withdrawal agreement and the subsequent FTA. In this scenario, the current status quo would continue. However, given that a powerful sentiment behind Brexit was the need to regain sovereignty, it is doubtful that this would be politically acceptable, and indeed the government has never expressed any desire to proceed down this path. Moreover, the need for consent from all the other Member States could prove problematic. Hence this appears to be a highly unlikely outcome.

In terms of a transitional position pending the conclusion of an FTA, the outcome is likely to be one of the following:

- At the end of the two-year period, the UK could leave the EU single market without any preferential trading agreement in place. It would therefore trade with the EU under the WTO Rules (the “Default Option”) and would be in the same position as any other country that does not have an FTA with the EU.

- Alternatively, the government could enter into an “interim arrangement” with the EU, in accordance with the material WTO rules (namely GATT article XXIV and GATS article V), pending the coming into force of a full FTA. (The “Interim Arrangement” Option.)

The government’s stance on the interim position has altered over time: initially it expressed a preference for the Default Option,¹ however its more recent pronouncements suggest that it is inclined towards the Interim Arrangement Option.² For reasons set out

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below, this is highly sensible.

DEFAULT OPTION: RELIANCE ON THE WTO RULES

The two key WTO agreements that seek to liberalise trade in goods and services are:

- The General Agreement on Tariffs and Trade (GATT);
- The General Agreement on Trade in Services (GATS).

Hence if the UK exited in two years without any form of an FTA with the EU, it would by default, fall back on the WTO rules as contained in these two Agreements.

The characterisation of this option by some as representing a tough – and therefore desirable – negotiating position, ignores the

inescapable reality, namely that falling back on the WTO rules would be problematic for the UK, both from an economic and political perspective.

The economic perspective: the most favoured nation principle

From an economic perspective, the UK would be in the same position as any other third country that did not have an FTA with the EU. The UK would not be able to offer more preferable trading terms to the EU (or vice versa). This is as a result of the “Most Favoured Nation” (MFN) principle, which is the fundamental principle of non-discrimination between WTO members. In short, when trading under GATT/GATS, all WTO members shall be treated the same – it is not permissible under the Agreements to offer an advantage to one country, without also

offering that to all the other members.³ The UK would therefore be subject to the external tariffs of the EU, such as the 10% tariff imposed on imported vehicles. Given that the UK is starting from a position of no tariffs, this will be a painful outcome.

The political perspective: the schedules of concessions

Each member state is required to have its own “schedules of concessions” (GATT Article II/Articles XVI of GATS). These are essentially lists, setting out the tariffs imposed on imports from the various WTO members, and any quotas in respect of the volume/quantity of goods that may be imported. There are separate schedules for services, which set out when a country

Feature

will allow a foreign service provider to enter its markets.

Although the UK is a WTO member in its own right, the practical problem is that it does not have its own schedules, because its specific commitments are contained in the EU goods and services consolidated schedules. The government's current position is that upon exit, it will essentially cut and paste its commitments from the EU consolidated schedules into its own individual schedules.⁴ Whilst this should be possible for straightforward tariffs,⁵ it is likely to be problematic for tariff quotas, where there will need to be agreement between the UK and the EU as to how the quotas will be allocated between them. There is a concern that this could give rise to lengthy and protracted political disagreement.

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Moreover, notwithstanding the fact that the UK schedules will, at least in the first instance, be extracted from the consolidated schedules, the UK's individual schedules will still need to be approved unanimously by all 163 WTO members. This is likely to involve intense and prolonged negotiation with WTO members. The drafting of schedules is therefore a complex political process.

INTERIM AGREEMENT OPTION

Both GATT and GATS permit a departure from the MFN principle in certain prescribed circumstances. In respect of goods, FTAs (whose very purpose is to give preferential treatment to the parties) are expressly permitted on the basis that they "facilitate trade" and encourage the "closer integration between the economies of contracting parties". (GATT Article XXIV (4).)

As well as permitting the final FTA to derogate from the MFN principle, an interim agreement is similarly exempt. (GATT Article XXIV (5).) Hence, pending the completion of a full FTA, it would be open to the EU and the UK to enter into an

interim agreement, without contravening the MFN principle.

The exercise of this option is however subject to a number of conditions:

- It has to lead to the formation of a full FTA within a "reasonable" period of time. According to the Understanding on the Interpretation of Article XXIV of the General Agreement on Tariffs and Trade 1994, this period "... should exceed 10 years only in exceptional cases ...". Hence the EU and the UK should have sufficient time to conclude a full FTA. Moreover, it does not appear to be fatal to the conclusion of an FTA if in fact the interim arrangement continues in place beyond 10 years: there appears to have been little enforcement of the strict terms of the interim

arrangement.⁶ This should provide some comfort to the UK.

- A party which wishes to enter into such an interim agreement is required to notify the WTO Members (GATT Article XXIV(7)(a)). The WTO Members have a right to make recommendations to the parties if they are of the view that the interim agreement is not likely to result in the formation of an FTA within the period contemplated by the parties or that such a period is not reasonable. In this scenario, the parties cannot maintain or bring into force the interim agreement if they are not prepared to modify it in accordance with the recommendations (XXIV(7)(b)). Whether the WTO Members would object to any interim agreement is difficult to predict, as the process is essentially political in nature. However, if the UK and the EU were simply going to replicate the existing position (ie that the Common Customs Tariff would apply between the parties) it is difficult to see how WTO members could reasonably maintain that their

positions were now worse off by virtue of this arrangement.

- The interim arrangement must cover "all substantial trade"⁷ between the parties. It cannot therefore cover only certain sectors. The practicalities of crafting such an interim arrangement in a two year period should not be underestimated; however in principle at least, the condition does not appear so onerous as to make this option undesirable. In this respect, the extent of the economic and institutional integration between the UK and the EU is an advantage. Furthermore, if the basis of the interim arrangement is essentially to apply the Common Customs Tariff to trade between the EU and the UK, then it should not be difficult to satisfy this requirement.

In respect of services, GATS contains equivalent provisions: there is a specific exemption from the MFN principle in respect of "economic integration agreements" (Article V). Such an interim agreement has to have "substantial" sectoral coverage, either at the entry into force of the agreement or on the basis of a "reasonable time frame".⁸ As such the comments above would also apply to an interim agreement under GATS.

CONCLUSION

It is clear that extending the timeframe for exiting from the EU is unlikely to be politically acceptable, either to the UK or the EU. From an economic perspective, exiting the EU only to rely on the default WTO rules would be irrational. Accordingly, the most attractive option is to seek an interim arrangement, pending the completion of a full FTA.

Given the advantages and feasibility of an interim arrangement, it is surprising that there has been so much debate about how the UK should approach the transitional position. On any rational and objective view, this is the best option available to the UK. The fact that some commentators think otherwise, reflects the unfortunate reality

Biog box

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that ultimately this is a political – and emotional – issue. ■

- 1 “... no deal ... is better than a bad deal ...”
Speech by Theresa May, Lancaster House, 17 January 2017.
- 2 “... the interim arrangements we rely upon are likely to be a matter of negotiation ...”,
the government White Paper.
- 3 Article 1 of GATT/2 of GATS.
- 4 “... the Government will prepare the necessary draft schedules which replicate so far as possible our current obligations ...”,
Liam Fox, 5 December 2016.
- 5 It will also give rise to the rather odd situation whereby the EU would be subject to its own tariff regime.
- 6 See ‘Interim Agreements under Article XXIV GATT’ (2009) 8 World Trade Review 339-350, Dr Lorand Bartels.
- 7 In ‘Turkey – Restrictions On Imports Of Textile And Clothing Products’ 1999, the WTO Appellate Body accepted that the meaning of “substantially all” was not agreed upon by WTO members but that it “accords some flexibility” to the parties. Unhelpfully, the Appellate Body stated that the phrase did not mean “all the trade” but it definitely meant more than “some of the trade”.
- 8 The services market is far less liberalised than that for goods, and the EU has tended to allow third parties access to its services markets by virtue of the concept of “equivalence”. Moreover, in respect of financial services, WTO members can restrict access to their financial markets for prudential reasons. In short, for financial services, a trade agreement under GATS is unlikely to confer the same advantages in terms of market access as the single market.

Further Reading:

- Licensing issues post-Brexit: what future for cross-border business? [2017] 2 JIBFL 66.
- An orderly Brexit? The trouble with talking about transitionals [2017] 4 JIBFL 199.
- LexisNexis Loan Ranger blog: Crossing the river: the Brexit transition.