Deep and not comprehensive? What the WTO rules permit for a UK-EU FTA

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What the WTO rules permit for a UK-EU FTA

by

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Abstract

WTO rules prohibit Free Trade Areas (FTAs) that provide tariff-free access or services liberalisation in only one or a few sectors. In this sense, a narrow, sectoral approach to concluding an FTA between the EU and the UK would contravene WTO law. However, assuming the EU and the UK were able to agree a substantially broad tariff-free FTA, WTO rules would not prevent them from moving further to maintain the bulk of the benefits of the Customs Union and the Single Market in a few key sectors. They could establish customs union-like conditions by coordinating external tariffs in some sectors and agreeing on relaxed Rules of Origin (RoOs) administered lightly and Single Market-like access could be approximated through sectoral Mutual Recognition Agreements. Such an approach would enable continued deep integration, whose desirability has been signalled on both sides. It would fall short of current market access levels even in the selected sectors and, in the case of tariff coordination, re-create some of the limits to an independent trade policy that Brexit aimed to remove. If the trade-off were deemed desirable, however, the approach could be reconciled with WTO rules including the 'Most Favoured Nation' requirement that equal treatment be awarded to all WTO Member States.

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1. Introduction

At the time of writing, eleven months after the UK triggered the two-year process of withdrawing from the European Union (EU), it has still not settled on its preferred EU trade arrangement. Different political factions and commentators have picked over options ranging from remaining part of the European Customs Union (CU) and Single Market (SM) to trading with the EU with no preferences at all, and all points in between – see, for example, Gasiorek et al (2016) and Holmes et al (2016).

One solution advocated by the Prime Minister (HM Government, 2017b) and the main opposition party was that the UK should leave the CU and SM but conclude a very ambitious trade agreement with the EU. As of February 2018, this was termed 'Canada plus, plus, plus', a reference to the EU-Canada Comprehensive Economic and Trade Agreement (CETA), which provides tariff free for most goods, mutual recognition agreements (MRAs) in some goods sectors and a little services liberalisation. The EU has indicated it could accept a 'balanced, ambitious and wide-ranging' trade agreement - European Council (2017) para. 20. Yet 'Canada plus, plus, plus' would be asymmetric: preserving, as far as possible, existing frictionless trade in sectors that rely on it most heavily. Both parties are members of the World Trade Organisation (WTO) and so any trade agreement between them must also be compatible with WTO rules and practices. For both goods and services, these require that agreements be both wide (covering many – but not necessarily all - sectors) and deep (offering meaningful liberalisation of trade). WTO rules also require that MRAs be made conditionally available to all WTO Members. Thus 'Canada plus, plus, plus' raises a question that is also more broadly applicable: to what extent do WTO obligations constrain countries from entering into sectorally-deep trade agreements?

This paper addresses this issue directly, arguing that a deep but not comprehensive trade agreement would not necessarily violate WTO obligations. These obligations do rule out apparently politically convenient solutions such as selective tariff reductions or granting special market access solely for some companies. However, the rules are drafted and applied in such a way that the depth of the mutual liberalisation can vary significantly across sectors: that is, the UK and the EU could design a *de facto* WTO-consistent trade agreement that went some way towards preserving current trading conditions in a subset of sectors. While the parties may not be able to reach such an agreement, they should not dress political failure up as legal impossibility.

We also consider approaches by which the UK and EU might pursue deep sectoral integration, and how such approaches would preserve, and fall short of, the benefits of the CU and SM. The CU and SM combine to enable the current free circulation of goods within the EU, a degree of integration far exceeding that attainable through any simple tariff-free Free Trade Area (FTA). The CU ensures zero tariffs between members and a common external tariff, which means that intra-EU borders posts are not required either to levy tariffs or to enforce rules of origin. The SM, which underpins the 'four freedoms' of movement for goods, capital, services, and labour contributes further through regulatory harmonisation, which ensures that goods may be exported without requiring additional certification, that customs procedures are harmonised, and that many services can be traded without hindrance

through approaches such as 'passporting' for financial services and mutual recognition of professional qualifications.

Approximating this level of market access for selected goods would require agreeing a zero-tariff FTA, and then agreeing to apply identical tariffs on imports from third countries in those sectors so that rules of origin could be very relaxed and customs procedures between the UK and EU very light. The UK and EU would also need to conclude mutual recognition agreements (MRAs) in these sectors to avoid the need for extra testing of the goods they export to each other. Extending the arrangement to selected services (a clear economic priority for the service-intensive UK economy), would require the UK and EU to get their appropriate regulatory bodies to agree equivalent regulations and certification regimes, design a procedure to keep them equivalent as the regulations developed, and agree a credible and reliable dispute settlement process.

There are caveats, however. First, selective tariff harmonisation will not eliminate all border posts and associated delays; absent a full CU and SM some checks will be needed to verify that goods are covered by the deep agreements and that they comply with tariff and regulatory requirements. Second, to relax or abolish RoOs (i.e. create CU-like conditions in a sector), the UK and EU would need to coordinate their tariffs on the relevant goods *and all their significant inputs*. Moreover, this applies not just to MFN tariffs but to all (existing and new) third-country FTAs and to trade defence instruments as well. Even absent a formal CU, such an arrangement would still constrain the UK's discretion in determining its own trade policy. Third, given that many products have multiple end-uses, pursuing a CU for sector A would potentially spill over to sectors B, C, etc. Finally, for both goods and (most) services the conformity of UK production with EU regulations is implicit at present. (It is achieved by proving that the products comply with UK standards, which, in turn, are identical, or deemed equivalent to EU standards.) This will now have to be done explicitly on a sectoral basis in order that the MRA can be signed in the first place, either by agreeing that regulation is equivalent, or, for goods, the more limited approach of agreeing that UK companies would be authorised to certify that products met EU standards, and vice versa.

In the remainder of this paper, we examine these possible approaches to preserving deep sectoral integration for goods and services trade in turn. In both cases, we identify the relevant WTO disciplines on FTAs and mutual recognition, and how they operate in practice.

2. WTO Rules and Practice on FTAs for Goods Trade

With the UK having ruled out participation in the CU, the options for a UK-EU trade relationship have narrowed. If the parties wish to continue preferential trade treatment, this will be classified for WTO purposes as a Free Trade Area (FTA). Any such FTA will have to comply with WTO disciplines on Regional Trade Agreements (RTAs).[4] RTAs enable

[4] The WTO utilises RTA as an umbrella term; agreements that fall under the WTO mandate include 'all bilateral, regional and plurilateral trade agreements of preferential nature' including the Customs Unions and other Free Trade Agreements that Articles XXIV GATT considers – WTO (1996).

countries to grant each other preferential market access. This contravenes the Most Favoured Nation (MFN) principle, a core WTO commitment whereby Members agree to treat all other Members equally. For trade in goods, Article XXIV of the General Agreement on Tariffs and Trade (GATT) provides an exception to the MFN principle.[5] It enables RTA Members, organised into a 'customs union', which has common external tariffs, or a 'free-trade area', which does not, to grant each other more favourable treatment as long as they meet established criteria. Primarily, RTA Members must not raise duties and other restrictive regulations to non-RTA Members (paragraph 5b), and must eliminate duties and other restrictive regulations on substantially all the trade between them (paragraph 8b).

The GATT never fully enforced the provisions of Article XXIV. In recent decades, the proliferation of RTAs and their growing political and economic importance has continued to erode the appetite of the WTO to do so - see Winters (2015).[6] The Committee on Regional Trade Agreements, the WTO body which now oversees RTAs, is no longer charged with reviewing the consistency of RTAs with the GATT, but is restricted to requiring members to provide information to allow one member to tell whether it will be adversely affected by another's agreements. Further, WTO Members have almost never formally complained about each others' RTAs through the dispute settlement system. In the handful of disputes that evaluate the WTO-legality of RTA provisions, the WTO Appellate Body has, with the exception of *Turkey – Textiles,* – WTO (1999) – never concluded that an RTA does not meet requirements of Article XXIV. The WTO/GATT has never declared an RTA to be overall GATT non-compliant.

Yet even a rule that is only weakly enforced may reduce the extent of bad behaviour (think of speeding laws). Moreover, the UK has set itself up as the champion of multilateralism and the WTO – Fox (2016) – and the EU has also sought to remain within the confines of Article XXIV in its FTA negotiations (European Commission, 2013: 4). There is no reason to expect the EU to depart from this past practice in its negotiations with the UK and so we ask what is possible within the confines of WTO law and practice.

2.1 Applicability

There is no dedicated WTO provision pertaining to the situation in which a customs territory, which the EU comprises, is replaced by an FTA. Indeed, replacing a customs territory with a less liberal arrangement goes against Article XXIV's statement of purpose for RTAs, set out in the 4th paragraph: 'increasing freedom of trade' by 'closer integration of the economies of the countries parties to such agreement'.

A UK-EU FTA would uphold the stated purpose of Article XXIV if, rather than comparing the FTA with the current customs territory, MFN status is taken as the baseline, as the EU and UK would revert to this in the absence of a new trade agreement.[7] The justification for

[5] Interestingly it does so, however, not as an explicit exception to MFN but as a qualification to the definition of a customs territory, thereby reducing its political toxicity – see Winters (2015).

[6] According to the WTO website, as of 2016 all WTO Members are also members of at least one RTA: https://www.wto.org/english/tratop_e/region_e/scope_rta_e.htm

[7] The adoption of such a baseline could be purely notional (imagining that one second elapsed between the dissolution of EU Membership and the conclusion of the FTA) or could be established by a very brief period of operating such a policy.

this approach is that an FTA would enable a closer level of integration than would be possible without such an agreement.The Appellate Body has referred explicitly to the Vienna Convention on the Law of Treaties ('VCLT') as a source of customary rules of treaty interpretation. VCLT Article 31(1), frequently cited in WTO dispute settlement, states that: 'a treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty *in their context* and in the light of its *object and purpose*.' [Emphasis added] – VCLT (1969). The employment of MFN status as a comparative baseline conforms with the object and purpose of Article XXIV. Article XXIV sets out a minimum level of liberalisation that RTA Members must attain to qualify for an exemption from the MFN obligations established in the GATT Agreement, and thus attain closer integration than countries would attain without an FTA. As long as the EU and UK meet these requirements they are in compliance with its purpose of 'increasing freedom of trade'

In the recent *Peru – Agricultural Products* dispute, the Appellate Body stated:

> ….In our view, the references in paragraph 4 to facilitating trade and closer integration are not consistent with an interpretation of Article XXIV as a broad defence for measures in FTAs that roll back on Members' rights and obligations under the WTO covered agreements - WTO (2015), para. 5.116.

This statement underscores that WTO rights and obligations provide a minimum standard of liberalisation that FTAs should preserve.

On this basis we believe that WTO Members can be persuaded to accept this approach. Practically speaking, the WTO has no formal authority to constrain the UK's choice to leave the EU and it is highly unlikely that WTO Members would protest on the basis that the UK and EU have not achieved closer integration, as meeting this requirement would be impossible.

2.2 Requirements

As stated above, Article XXIV contains two key restrictions on FTAs. Countries can constitute such areas if:

> the duties and other regulations of commerce maintained in each of the constituent territories and applicable … to the trade of contracting parties not included in such area … shall not be higher [than] prior to the formation of the free-trade area. (Paragraph 5(b)).
>
> duties and other restrictive regulations of commerce … are eliminated on substantially all the trade between the constituent territories in products originating in such territories. (Paragraph 8(b))

Paragraph 5(b) requires that a UK-EU FTA should not result in increased tariffs or other regulatory barriers to third countries. This precludes either party increasing its bound tariff rates. There are very few cases where an FTA has increased the restrictions on imports from non-members, possibly because the latter could so easily complain. Turkey's raising of external tariffs prompted complaint in the only dispute in which the Appellate Body found a Member not in compliance with Article XXIV, *Turkey – Textiles* - WTO (1999). The UK has

indicated that it will 'replicate as far as possible our current position as an EU Member State' - HM Government (2017a): para. 9.18. On past precedent, the EU27 would not seek to change its concessions on signing an FTA – at least not upwards. Thus this condition is unlikely to cause problems.

Paragraph 8(b) has two components – the elimination of duties and other regulations between partners and the coverage of substantially all trade. Again, duties should cause little problem for a UK-EU FTA. The parties currently trade with no duties (tariffs). If cooperation was great enough to negotiate an FTA in the first place, we might assume that there would not be any serious pressure to introduce them in any post-Brexit FTA.

The meaning of the requirement to eliminate 'regulations of commerce' has never been clearly established.[8] In practice, many FTAs make few efforts to reduce restrictive regulations at all – Epps (2014) – and no FTA has the depth of regulatory integration that the SM provides.[9] If the UK asserts its regulatory independence by leaving the jurisdiction of the Court of Justice of the European Union (CJEU) and restricting the free movement of labour from the EU, the EU will want to pull back from the current high degree of integration. Even with a fair degree of retreat, a UK-EU FTA would more than satisfy current WTO practice to date. Further, as we have argued above, WTO MFN status, rather than the *status quo,* should act as comparative baseline. (We return to the SM in detail below when we deal with technical standards and their attendant regulations.)

The second element of Paragraph 8(b) is its coverage of 'substantially all the trade'. Years of discussion through GATT and WTO working parties, the Uruguay Round of trade negotiations and the WTO Committee on Regional Trade Agreements (CRTA) have failed to resolve the definition of 'substantially all'. Key debates centre on whether the definition should be quantitative (and if so what percentage[10]), qualitative, or on a case-by-case basis, and whether an FTA excluding agriculture can constitute 'substantially all trade'.[11] The Appellate Body in *Turkey—Textiles* decided, albeit in a case about a customs union, that the ordinary meaning of the term 'substantially' contains qualitative and quantitative elements, with the latter emphasised in relation to duties. It characterized 'substantially all' as not the same as all but considerably more than some - WTO (1999): paras. 48-49. Despite formulating these concepts, the Appellate Body refrained from applying them to an assessment of whether Turkey's customs union covered 'substantially all' trade with the EU as defined by Article 8(b), as the Parties had not appealed the Panel's 'assumption' that the EU and Turkey were in compliance – WTO (1999): para. 60.

Thus examining the practices of WTO Members is instructive. In its FTAs with developed countries, the EU defines 'substantially all' as 90 per cent of its trade being tariff-free and at

[8] Mathis (2006) argues that the phrase prohibits RTA Members from introducing additional trade restrictions not permitted under the WTO. This appears a reasonable interpretation to us.

[9] One might also infer that WTO members take a more severe line on duties than on 'other restrictive regulations' from the fact that the WTO Secretariat's factual reports on RTAs present detailed data on the elimination of duties (almost always showing that 'substantially all' is satisfied) and then list many cases where 'other restrictive regulations' persist, without the latter leading to any serious complaint. We rely on these factual reports in assessing what members expect on services liberalisation below.

[10] Proposals generally range from 80 to 90 per cent – see Sauve and Ward (2009), 22.

[11] See, eg, debate in Committee on Regional Trade Agreements regarding the FTA between Canada and EFTA – WTO (2010 b).

least some coverage of all sectors, even if minimal (Woolcock, 2007: 5). Given a starting point of zero tariffs on mutual trade and the EU's (and hence the UK's) low MFN tariffs, a UK-EU FTA seems likely to be able to achieve this threshold quite easily.

What paragraph 8(b) does clearly rule out, however, is sectoral deals whereby UK-EU trade in a few specific sectors received better terms than MFN. This principle is made clear in the 2000 dispute *Canada – Autos*. Canada granted import duty exemption to vehicle manufacturers affiliated with manufacturers in Canada; upon joining an FTA with the US in 1989 it closed the list of eligible manufacturers. The Appellate Body found that Canada was not in compliance with the Most Favoured Nation principle of GATT Article I:1 as it granted an advantage only to some products from some Members – WTO (2000): paras. 73-84.

Paragraph 8(b) also implies that a UK-EU FTA cannot be constructed piece-meal, starting with narrow coverage and adding sectors as they are negotiated. 'Substantially all' must be satisfied from the start, although once it has been achieved, the initially excluded sectors can be added subsequently.

2.3 Transitional arrangements

Article XXIV contains separate classifications for FTAs and interim agreements leading to, or necessary for, the formation of a FTA. FTAs are defined in paragraph 8 as agreements in which 'duties and other restrictive regulations of commerce are eliminated', suggesting that negotiations should be concluded. In practice, however, countries do not declare FTAs under negotiation to be interim agreements, but rather full agreements with transitional periods.[12]

Such transitional periods normally facilitate a move from trading conditions A to trading conditions B over a period of time, where B is known; this is partially managed by clauses in the Uruguay Round 'Understanding on the Interpretation of Article XXIV …'.There is an important difference, however, between this type of transitional period and the increasingly recognised need for a transitional arrangement for UK-EU trade.[13]

In the UK-EU case, a transitional deal is necessary because it is most likely that within the two-year period effectively allowed for negotiating UK exit from the EU, there will not be time to agree, let alone sign and ratify, a comprehensive trade agreement.[14] That is, the UK and EU will not know precisely what trading conditions B actually are and hence will not be able to submit an FTA text to the WTO. If, however, there is broad political agreement that a trade agreement will eventually be reached, there are two alternatives. Either UK-EU trade reverts to MFN status until it is agreed so that tariffs are increased for a period, only then to be reduced to zero again when agreement is reached. Or the UK and the EU seek a waiver

[12] This may be because WTO-notified interim agreements are subject to more oversight with respect to plan and schedule than full agreements. As stated in paragraph 7b, if WTO Members find that an interim agreement is not likely to result in the formation of a free trade area, they can make recommendations; parties to the agreement are obliged 'not [to] maintain or put into force, as the case may be, such agreement if they are not prepared to modify it in accordance with these recommendations.'

[13] An early argument that transitional arrangements would be necessary is in UKTPO (2016) published in July 2016.

[14] This timetable has been discussed in Szyszczak and Lydgate (2016).

from the WTO membership to continue UK-EU tariff-free trade *for a finite period*. Waivers are granted on the basis of consensus of WTO Members. While some might see the opportunity for short run mercantilist gains from insisting that UK-EU trade impose tariffs and then remove them, none can claim that permitting a waiver to avoid this negates their reasonable expectations from a previous agreement. Moreover, many would potentially lose if the UK and EU economies were seriously disrupted. UK and EU diplomats have expressed the intention to work together in the WTO to smooth the path of Brexit (Miles, 2017) and this could potentially include seeking a waiver for a forthcoming FTA.[15]

Of course, even a simple goods-only FTA will not be possible unless both sides are willing.[16] The UK and the EU would need to work together to persuade the rest of the WTO membership to take a sympathetic view of the need for a transitional arrangement while they worked out the details of the FTA and of the fact that a UK-EU FTA will be unwinding trade liberalisation rather than extending it. In the subsequent analysis we assume that a substantial tariff-free FTA can be achieved, and consider how much further the EU and UK can go in maintaining benefits of the Customs Union and Single Market.

3. Can individual sectors approach Customs-Union-like access?

The critical difference between a customs union (CU) and an FTA is that the former allows goods, once inside the area, to circulate without facing any additional tariffs, as they will have faced the same tariff wherever they entered the CU. The latter cannot do this. If one member of an FTA has a zero tariff on, say, apples, while others have positive tariffs, exporters would seek to send their apples to the first country and serve the others from there. To avoid this 'trade deflection', FTAs have rules of origin (RoOs) to determine whether a good has been produced within a member country, in which case it is exempt from tariffs under the FTA agreement, or whether it has been produced outside, in which case it has to pay the tariff of the country of destination.

Applying a RoO is straight-forward for simple goods like apples, but most manufactured goods are produced by combining many inputs, some of which may come from third countries. In these cases, the RoOs can be complex, but typically a product needs to contain 60% local value added to be eligible for duty free import into the EU under the European Economic Area agreement and we might anticipate the same rule for the UK. Enforcing such RoOs means customs checks between the EU and the UK even in an FTA. These could be minimal if exporters are well-known to the customs authorities and their production methods have been inspected in advance. But even then there is the cost of periodic inspections and random border checks. Moreover, while such a solution is feasible for large flows - the cost of establishing origin is mainly a fixed cost which can be spread over a large volume of sales - for small, and even more so, one-off transactions, such an approach is not realistic and the

[15] On the other hand, their first joint effort - 11th October 2017, to clarify the division of EU-wide tariff-rate quotas - met fierce opposition from several members.

[16] From shortly after the referendum, UKTPO Fellows have stressed the premium on diplomacy in achieving an effective Brexit – see, for example, Lydgate, Rollo and Wilkinson (2016).

bureaucratic costs and resulting uncertainty can be proportionately very high – even prohibitive.

This raises the question as to whether, if the UK and the EU agreed to maintain the same external tariff on a specific final good *and all the significant inputs into it*, that final good could be spared intrusive RoO procedures; that is, whether, for a specific sector, customs-union-like conditions could pertain within an FTA?[17] Note, however, that this would not address trade frictions associated with regulatory barriers, which we consider in section 4 below.

There is no WTO regulation that precludes two countries from having the same external tariff on a specific good, nor from co-ordinating to achieve that end. Indeed, providing that, as the UK government intends, the UK adopts the EU's existing external tariffs, the trade partners will have *de facto* tariff coordination. Moreover, since preferential rules of origin within an FTA are essentially a matter between the partners (despite the fact that they may impose costs on other WTO members – see, for example, Krueger, 1999), there seems to be no barrier to their agreeing to express and operate those rules in a way that imposes rather little cost on market transactors. Thus, it is, in principle, possible to create customs union-like conditions for specific sectors within an FTA.[18]

On the other hand, this approach implies a good deal of coordination. First, many goods have a large number of inputs; tariffs on all of these would need to be harmonised, including any preferential rates that are offered to developing countries or in FTAs with other countries and any duties arising from trade defence measures. Second, there may be issues about inputs into those inputs: thus one might exempt tomato ketchup from RoOs if tomato paste faced the same tariff in both partners, but if one member produced tomato paste locally from imported tomatoes the other partner might wish to know that those tomatoes were facing the same tariffs as it imposed on its imports. Third, inputs such as tomatoes, may have uses in other end products, and the tariff chosen for the sake of the sectoral coordination may not be at all appropriate for those other users. That is, because tariffs cannot be varied according to the end-user, the tariff on any good needs to balance the interests of the sector seeking customs-union-like access with those of other sectors. Fourth, the more open two markets are to each other, the more businesses agitate to ensure that they face reasonably equivalent market conditions for non-traded inputs such as electricity and for labour .This sort of problem besets any agreement to reduce barriers to mutual trade and was, indeed, one of the pressures towards deeper integration within Europe[19]. Many such differences are tolerated *de facto*, but

[17] The high level of co-ordination and harmonisation among EU customs authorities was actually introduced under the Single Market programme – Leave Alliance (2016) - but it is designed to give effect to the benefits of the customs union and could, if desired, be continued without the SM architecture.

[18] Also since no tariffs would be changed if the UK and EU adopted this strategy, there would be no violation of Article XXIV.5(b) that an FTA should not increase protection levels against third countries.

[19] A telling illustration is the Commission's insistence that before it would remove possibility anti-dumping policies on the countries of Central Europe, the latter would need to adopt almost all of the acquis communitaire – the body of EU (then EC) law: 'once satisfactory implementation of competition and state aids policies (by the associated countries) has been achieved*, together with the wider application of other parts of Community law linked to the wider market*, the Union could decide to reduce progressively the application of commercial defence instruments for industrial products from the countries concerned'. European Commission (1995), emphasis added

when potential partners are large like the UK, maintaining very open borders may be made conditional on some maintaining sort of equivalence. That is, deep trade integration may be sustainable only with constraints on other areas of policy.[20]

A more fundamental shortcoming is that the requirement that even preferential tariff rates need to be coordinated if customs-union-like conditions are to prevail, effectively requires the UK and the EU to have FTAs with precisely the same set of third countries and to have pretty much identical conditions for the relevant goods.[21] This strikes at the notion of an independent UK trade policy. For example, the EU allows Korean exports of goods tariff-free access, and if the UK did not, it would presumably want to impose RoOs to ensure that EU production using high proportions of Korean inputs could not freely enter the UK given the competitive advantage they would reap from cheaper inputs. This, of course, would undermine the customs-union-like conditions in that sector.

Finally, while it would certainly benefit firms to avoid RoO certification, the extent to which this arrangement would actually manage to circumvent border delays is uncertain. Border checks will still be needed for other products transiting between the UK and the EU, and even if a given product doesn't require RoO certification, border officials still need to verify that it qualifies for customs-union-like treatment and it may still be subject to queues while other products are checked.

4. Regulations

Tariffs are not the only friction in international trade – meeting regulatory conditions and proving that you have done so are in many cases far greater barriers to commerce -World Economic Forum (2013). Addressing these was the purpose of the European Single Market (SM). In this section we ask whether, as part of an FTA, the UK and the EU could agree to maintain SM-like conditions on specific sectors or whether doing so would violate any WTO non-discrimination rules. Our question is not whether the UK could remain part of the SM on exiting the EU. It is, rather, whether it could have SM-like access in selective sectors.

4.1 Mutual recognition

The EU has harmonised a great deal - but not all - of its Members' standards for product safety and public protection. Goods regulated by standards that are not harmonised still circulate freely due to the principle of mutual recognition – European Parliament and Council (2008). Products from EU and EEA countries, as well as Turkey, are automatically exempted from national technical regulation. Unless a country can prove that an imported product does

[20] Thus, for example, paragraph 20 of the EU's Negotiating Brief of Article 50 states that outcomes should 'encompass safeguards against unfair competitive advantages through, inter alia, tax, social, environmental and regulatory measures and practices'.

[21] The alternative that the final and all the intermediate goods covered by a sectoral agreement were excluded from EU and UK FTAs with others is not workable: it would rapidly create more exemptions than were compatible with Article XXIV, it would complicate those FTAs, and for all the FTAs that currently exist, the EU has already committed to include those sectors in the FTA.

not meet its standards on public safety, health or the environment, it is assumed that standards are equivalent.[22]

Although the principle of mutual recognition applies to non-harmonised Member State legislation, it comprises an essential component of the 'four freedoms' of the SM: the right to free movement of goods. It was established in order to 'complete' the internal market such that goods would travel as freely within the EU as they would in a national market; all EEA and EU countries are bound by the Mutual Recognition Regulation which gives effect to the principle.[23] The extension of this principle to EEA countries, who do not have a CU with the EU, makes clear that the EU does not view CU-membership as an essential requirement. Nor does the EU view SM membership as essential, as the example of Turkey establishes. Turkish mutual recognition applies to the goods covered by the CU, but with certain exceptions such as pharmaceuticals – EC-Turkey Association Council (1996), para. 66; European Commission (2014) 106. (And, of course, the CU does not cover all goods.) However Turkey has agreed to align its legislation with the EU *acquis* in the areas covered by the CU.[24]

These examples suggest the UK could benefit from the mutual recognition principle in the absence of full sectoral coverage and a CU with the EU. Even if the EU were willing to agree to such an arrangement, however, mutual recognition for non-harmonized regulation does not equate with broad acceptance of regulatory divergence. On the contrary, divergence is only accepted for products not subject to EU harmonization. The UK would be expected to conform with the *acquis* in covered sectors, thus compromising its regulatory self-determination.

Less comprehensively, the EU and UK could agree to mutual recognition of goods on a sectoral basis. In general, the EU views the extension of MRAs for regulation to third countries as part of a larger process of harmonisation and market integration with the EU. While there is no promise that partner countries will eventually become EU Members, it will only undertake such MRAs in sectors where the regulations and conformity assessment procedures are aligned with the EU's – Correia de Brito et al., (2016) 19.

As members of the Single Market, the EU and UK currently have standards that are identical or deemed to be perfectly equivalent; indeed, their common history could offer cover for the EU and the UK favouring each other with quick agreements of a sort that other parties have been negotiating for years. More complex will be devising a dispute settlement system that precludes the CJEU having jurisdiction in the UK and creating arrangements that assure consumers and producers that standards and assessments will be mutually acceptable into the indefinite future, so that longer-term investments become possible. Most of that accommodation will have to come from the UK, as a much smaller market, but it might be eased by agreeing a forum or consultation procedure which obliged the EU to discuss future

[22] 'Mutual Recognition', European Commission website at: http://ec.europa.eu/growth/single-market/goods/free-movement-sectors/mutual-recognition_en

[23] 'Free Movement of Goods', European Parliament website at: http://www.europarl.europa.eu/atyourservice/en/displayFtu.html?ftuId=FTU_3.1.2.html

[24] The acquis is the entire body of rights and obligations binding on EU Members. European Commission website at: https://ec.europa.eu/neighbourhood-enlargement/policy/glossary/terms/acquis_en
The most recent WTO Trade Policy Review for Turkey documents its ongoing efforts to adopt the EU *acquis* - WTO (2016).

regulation changes with the UK. Clearly, however, a technical regulation MRA that either side could rescind on short notice offers a lot less long-term assurance than a legal requirement enforced by the CJEU, and so even if regulations do not change and there are consultation procedures, co-operative outcomes that were achieved under the Single Market may no longer be sustainable even under a very cooperative Brexit. That is, after Brexit one has to expect that some of the existing harmonisation of standards and mutual recognition will unwind.

A third option that better accommodates this unwinding is to negotiate Mutual Recognition Agreements (MRAs) on conformity assessment procedures. CAPs determine that the requirements imposed by technical regulation or standards have been fulfilled. They establish that EU product inspection, testing and certification can be done in the third country and vice versa. Such MRAs are more modest in ambition; they do not require that equivalence be established but simply avoid duplication in testing.

However they do necessitate the Conformity Assessment Body in country A to be knowledgeable of the regulatory requirements of country B, and capable of fulfilling them, and vice versa. This requires a high level of mutual trust. While CAP mutual recognition promises to maintain EU regulatory requirements in foreign products and vice versa, even achieving this more limited goal has proven difficult. For example, negotiations between the US and the EU to grant mutual recognition of pharmaceutical inspections, such that a EU facility could produce a US-approved drug and vice-versa have taken years to conclude. Differences in drug approval procedures were difficult to overcome and the US was reluctant to concede that EU producers could meet its safety standards. In practice negotiations have included working toward areas of mutual standardisation - US Food and Drug Administration (2017), Van Norman (2016). The EU has succeeded in concluding MRAs in a few sectors with some countries: Australia, Canada, Japan, New Zealand, the US and Switzerland, though many of these have been problematic or only partially functional in practice - Correia de Brito et al., (2016) 80.

The UK and EU have established trust in one another's CAPs already, which gives them a major advantage. The UK is unlikely to object, *per se*, to assessments of conformity to UK standards being conducted by EU laboratories. Its key its offensive interest will be to ensure simple and quick conformity assessments of its exports to the EU, ideally conducted by UK laboratories. This is not something that the EU will offer lightly. In its relations with countries in its eastern and southern neighbourhood, the EU has insisted that "Agreements on Conformity Assessment and Acceptance" of goods into free circulation within the EU

> requires the prior full alignment of the partner country's legal framework with EU legislation and standards and the upgrading of the implementing infrastructure in line with the model of the EU system, in relation to standardisation, accreditation, conformity assessment, metrology and market surveillance. (European Commission, 2016)

4.2 *Would UK-EU MRAs on goods be compatible with WTO obligations?*

As previously confirmed, mutual recognition can establish that rules are equivalent (technical regulation MRAs) or that firms in both countries are capable of undertaking each others'

conformity assessment procedures (CAP MRAs). Both types of agreements must comply with MFN provisions set out in the GATT, the Agreement on Technical Barriers to Trade (TBT Agreement) and the Agreement on the Application of Sanitary and Phytosanitary Measures (SPS Agreement). If the regulations or CAPs covered under the MRA meet established criteria to be classified as 'technical', the TBT Agreement will apply; unlike the GATT, it contains articles that deal explicitly with conformity assessment procedures. MRAs concerning food safety, animal and plant health regulations fall under the SPS Agreement. Disputes on MRAs would almost always fall under the more specialised provisions of the TBT or SPS Agreements. However to make the analysis comprehensive, we first consider the issue of GATT compliance.

GATT compliance

With respect to the GATT, UK-EU sectoral MRAs, either on technical regulations or CAPs, are subject to compliance with its MFN principle, Article I:1.[25] GATT Article I:1 requires that Member States should provide equality of competitive opportunities for imported products from all WTO Member States. A third party could complain that it was excluded despite having an equivalent ability to achieve a particular standard. Article I:1 does not take into account the policy rationale underlying a measure in dispute, but only its impact on competitive opportunities (see *EC – Seal Products*, Appellate Body Report, para. 5.82). Thus, the exclusion of a petitioning third country from an MRA, regardless of its policy justification, would likely contravene Article I:1 in many cases – see also Zell (2016).

If this were to occur, MRA members would have recourse to GATT exceptions. This includes Article XXIV, which establishes that regional liberalisation is the aim of RTAs (paragraph 4) and requires RTA members to remove restrictive regulations of commerce between them (paragraph 8b). However, the case law establishes a high threshold for applying this exception. The Appellate Body in *Turkey – Textiles* concluded that members of a customs union could act inconsistently with GATT provisions only if 'the formation of that customs union would be prevented if it were not allowed to introduce the measure at issue' - WTO (1999b): para. 58. It applied this criterion in reference to Turkey's introduction of additional trade barriers to third countries. If this same threshold were applied, the UK and EU would be required to establish that the MRAs were necessary for the FTA to be concluded. There are certainly FTAs that achieve tariff reduction with no mutual recognition.

Even if the UK and EU were able to argue that MRAs were necessary, there is another problem: it is unlikely that the Article XXIV exception would be available under the TBT Agreement,[26] which will act as *lex specialis* in many MRA disputes. The Appellate Body would want to avoid the asymmetry of providing an exception for regional integration that applied only when a disputed MRA happened *not* to be adjudicated under the TBT Agreement.

[25] Article I:1 requires that '…. any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties.'

[26] While this has never been clarified explicitly, the Appellate Body in *Turkey – Textiles* examined whether Article XXIV provided an exemption from *GATT provisions*, adopting a narrow approach to the scope of covered agreements – para. 58.

Instead a party to a closed MRA would need to establish that recognising third country regulation or conformity assessment would undermine its ability to uphold its desired level of protection in a regulatory area falling under the GATT General Exception, Article XX. This permits trade-restrictive measures that fall under listed public policy objectives, e.g. human health and conservation of natural resources, if they fulfil additional non-discrimination criteria established in its chapeau.[27]

Since the WTO was established there have been no Article I:1 disputes on MRAs. However *EC – Tariff Preferences* (2004) is instructive in that it dealt with market access conditioned on exporting countries' achievement of particular public policy goals. As part of its Generalised System of Preferences (GSP) for developing countries, the EU awarded preferential tariffs for developing countries if they met standards on protection of labour rights and the environment, as well as efforts to combat drug production and trafficking. India claimed that the EU was discriminating by providing tariff preferences to Pakistan and not to India. This dispute fell under the 1979 Enabling Clause which authorises extending more favourable treatment to developing countries. The Appellate Body analysed whether the EU could provide preferential tariff treatment only to some developing countries and comply with the Enabling Clause's non-discrimination requirement. It considered whether the countries were similarly situated and had similar needs – WTO (2004a) paras. 154-165. The basis of the Appellate Body's finding of discrimination was that the EC had a closed list of beneficiaries and there were no objective criteria or standards for inclusion on the list –paras. 187-189.

An MRA dispute would differ in factual and legal respects. It would focus on comparability of regulatory bodies and approaches rather than domestic situations more broadly. The market access 'reward' would consist not just of lowering tariffs but some ceding of regulatory oversight. The Appellate Body would certainly appreciate that countries require detailed scrutiny before allowing third parties into an MRA. Nonetheless it is likely that it would require objective and transparent criteria in order to avoid 'closed list' MRAs, a requirement applicable as well in the context of the TBT and SPS Agreement provisions examined below

This interpretation is supported by GATT disputes that have focused on equivalence more narrowly. In *US – Shrimp* the US required that its trade partners install a device on fishing nets to exclude, and thereby protect, sea turtles. In the context of the GATT Article XX chapeau, the Appellate Body found that the way that the certification was administered was unfair, as trade partners were not notified of whether they had been certified nor provided with the rationale or given the opportunity to respond – WTO (2001): paras. 163, 166, 172.

Yet there is also a burden on complaining countries to establish that they can fulfil the requirements of the regulator. This is made explicit in the TBT and SPS Agreement provisions examined below. A pre-WTO GATT dispute, *EEC – Beef from Canada*, suggests this would be required under GATT as well. Canada complained successfully that the EEC had violated the GATT MFN Principle – GATT (1981): para. 4.2(a). The EEC specified a US

[27] Article XX exempts measures that fulfil a closed list of objectives including those '(a) necessary for public morals; (b) necessary to protect human, animal or plant life or health; and (g) relating to the conservation of exhaustible natural resources…'.as long as they do not constitute 'arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade….'

product standard that met its definition of 'high quality' cut in its regulation, and noted only one certifying agency for the meat entering the EEC, which was located in the US. While finding this discriminatory, the GATT Panel also made clear that an important component of its decision was the fact that Canada could certify that the meat it proposed to export 'met the exact product specifications required for access'.[28] Canada was required to establish that it could fulfil the requirements to be automatically certified as meeting EEC product standards.

TBT Agreement compliance

The TBT Agreement contains dedicated provisions on technical regulation (Articles 2-4) and conformity assessment (Articles 5-9). The TBT Agreement's MFN provision on regulation, Article 2.1, differs slightly in wording from GATT Article I:1.[29] The implied obligation is substantively the same: to avoid providing more favourable treatment to some trade partners through closed MRAs not available to third parties with equivalent standards. TBT Agreement Articles 2.1 and 2.2 provide grounds to argue that a trade-restrictive measure is justified on the basis that it flows from a legitimate regulatory 'distinction' (TBT Article 2.1) or 'objective' (TBT Article 2.2). While the TBT Agreement does not contain a General Exception (such as GATT Article XX), it aims to strike a similar balance between avoiding obstacles to trade and allowing Members the right to regulate – WTO (2012b): para. 96.

TBT Article 2.7, a dedicated provision on technical equivalence, provides a qualified obligation to 'give positive consideration to accepting as equivalent technical regulations of other Members' but only if they are satisfied that they 'adequately fulfil the objectives of their own regulations'. Absent any disputes clarifying this requirement, Schroder proposes that regulators should compare the equivalence of: the regulatory goals, the results of the regulation and the means to achieve the goals – Schroder (2011) 124.

Article 6 on Recognition of Conformity Assessment Procedures parallels TBT Article 2.7 though applying directly to CAPs. Article 6.1 states that Members shall accept different conformity assessment procedures '…provided they are satisfied that those procedures offer an assurance of conformity with applicable technical regulations or standards equivalent to their own procedures.' Article 6 recognises further conditions for acceptance that include negotiation ('prior consultations') to ensure confidence and reliability. The obligation is on third parties to 'offer an assurance of conformity'. Article 6.3 also states that Members 'are encouraged' to 'enter into' negotiations for CAP MRAs, but such Agreements must provide 'mutual satisfaction regarding their potential to facilitate trade'.

SPS Agreement compliance

The SPS Agreement places a more precise obligation for cooperation on importing countries. Article 4.1 requires that Members shall accept other Members' regulations as equivalent if an exporting Member 'objectively demonstrates' equivalence. As under the TBT Agreement, the exporter must establish that its measures meet the objective, defined here as 'appropriate

[28] Ibid at para. 4.1.

[29] Article 2.1 requires that 'Members shall ensure that in respect of technical regulations, products imported from the territory of any Member shall be accorded treatment no less favourable than that accorded to like products of national origin and to like products originating in any other country.'

level of protection' as determined by the importing country, a requirement which is difficult to fulfil. Equivalence differs from mutual recognition in that it does not require bilateral assessment - Schroder (2011) 142. Article 4.2 also stipulates that 'Members shall, upon request, enter into consultations…' to recognise multilateral or bilateral equivalence. Article 4 was further clarified by a 2001 'Decision on Equivalence', which requires countries to describe their objectives, desired level of protection and risk assessment procedures, and provide exporters reasonable access to relevant procedures – WTO (2004). Members must do this quickly without disrupting existing imports.

There have been no complaints dealing directly with Article 4 violations. The legal status of the Decision on Equivalence is uncertain, although the Panel in *US – Poultry* has concluded that it does not bind Member States – WTO (2010a), paras. 2.5-2.16. Also, despite the exhortations of Article 4.2, establishing equivalence on a bilateral or multilateral basis has proved elusive in practice due to authorities' attachments to their own national regulatory approaches. For this reason equivalence agreements are few in number and often narrow in scope – Echols (2013) pp 97-99. As in the case of technical regulations, however, the integration of UK and EU SPS measures puts them well ahead of other trade partners with respect to these kinds of obstacles.

Existing MFN obligations on the EU

These MFN obligations also pose a challenge to the EU's existing principle of mutual recognition, available only to a subset of WTO Members. One possible line of defence is that, as a contracting party and customs territory in its own right, the EU is exempt from extending the treatment provided within the EU to third countries on an MFN basis. However such an argument is undermined by the fact that products from Turkey and the EEA also receive automatic mutual recognition. Bartels (2005) concludes that the EU principle of mutual recognition contravenes GATT Article I:1. Further, he concludes, if the EU unjustifiably rejects a request from a third country to recognise the equivalence of its technical regulations or conformity assessment procedures this would violate the TBT Agreement. In order to bring the EU into conformity with these obligations, Bartels calls for it to make its principle of mutual recognition conditionally available to all WTO Members – Bartels (2005) 719-720. In this sense, a move to negotiated, sectoral MRAs between the UK and EU actually seems more compatible with MFN obligations than does comprehensive, automatic mutual recognition, as long as these MRAs were in principle open to other WTO Members.

In practice, the EU could maintain the exclusivity of its principle of mutual recognition simply by upholding the existing requirement that countries who wish to benefit must implement the EU *acquis*. However the deeper problem that this analysis reveals is the inadequate recognition in the TBT and SPS Agreements that regional integration necessitates a greater level of regulatory harmonisation than that available to all WTO Members – see Howse (2015). Instead, countries must resort to defending closed MRAs on the basis that other countries cannot meet their regulatory standards. Yet in practice the WTO has not presented any obstacle to regional regulatory integration, simply because there have been no WTO complaints on the principle of mutual recognition as applied by the EU, nor on negotiated sectoral MRAs in the EU or more broadly. It is unclear whether there is tacit acceptance of the exclusivity of the EU SM, or whether requests for equivalence from third

countries will arise imminently, as Bartels (2005) predicted. From a legal realist perspective it is difficult to imagine that the WTO dispute settlement bodies would want to undermine the functioning of the SM.

5. Services and GATS Article V

Services trade agreements are governed by GATS Article V, which differs from Article XXIV in that it does not refer to Regional Trade Agreements but rather to 'Economic Integration Agreements' (EIAs)[30]. Also, GATS does not distinguish between customs unions and free trade areas: most services are not subject to tariffs and border measures, rendering the distinction meaningless. The objective of Article V, as implied by paragraph 1, is 'an agreement liberalising trade in services.' As it is more or less inevitable that a UK-EU EIA would undo some of the services liberalisation achieved previously, it would not meet this minimum threshold, such that the UK and EU would need to establish a different baseline. The obvious way of doing this is to utilise WTO GATS schedules applied to all WTO Member States.

5.1 *The degree of liberalisation*

The legal constraints imposed by the WTO in negotiating a sectoral deal for trade in services are similar to those for goods. GATS Article V operates *mutatis mutandis* to GATT Article XXIV. Parallel to GATT Article XXIV(5)b, paragraph 4 prohibits Members from raising barriers to trade in services for non-Parties to the EIA. The Article also, in paragraph 1, requires broad sectoral coverage and non-discrimination; the extent of its reach in both instances hinges around the interpretation of the term 'substantial'. The basic requirements for compliance with Article V have not been precisely codified by Member States or subject to interpretation by the Appellate Body.

Substantial sectoral coverage

Rather than GATT Article XXIV's 'substantially all trade', Article V requires 'substantial sectoral coverage'. The footnote to paragraph 1a states that this is constituted by number of sectors (implying that not all sectors need to be covered), volume of trade affected and modes of supply, and that there should not be *a priori* exclusion of any of the four modes of supply. The modes are 1) cross-border supply; 2) consumption abroad; 3) commercial presence; and 4) presence of natural persons. Other than in Mode 1, the value of services trade cannot be straightforwardly quantified still less simply added up; this explains the emphasis on liberalisation across sectors rather than simpler 'substantially all the trade' that pertains to goods RTAs. Even so, it is still not clear which elements of trade in services (sectors, trade volumes, modes of supply) require quantitative and which qualitative assessment and, as with goods, precise thresholds have never been established. There is nothing to prevent a very uneven approach to liberalisation within the different modes, as long as no Mode is entirely excluded. In most EIAs there is greater ambition within modes 1 and 2 than in mode 3, and mode 4 commitments are often only marginal - Cottier and Molinuevo (2008) 133-4. Further,

[30] In the WTO's RTA database, agreements that cover both goods and services are flagged as both "FTA & EIA".

even if a sector is listed as liberalised, this still allows the possibility that commitments extend to only one of its sub-sectors – see Wang (2012), 427.

Substantially all discrimination

Within the sectors that are included in the 'substantial sectoral coverage', EIA members must eliminate 'substantially all discrimination, in the sense of Article XVII'; namely, treating 'like' services of EIA members no less favourably than domestic ones. This can be seen as a vertical requirement: within the covered sectors there must be depth of liberalisation.

The requirement to eliminate 'substantially all' discrimination indicates that some subsectors can be exempted. But it is unclear how deep EIA Members must go vis-à-vis existing GATS commitments to non-discrimination. Paragraph 1(b) contains two very different thresholds. It states that EIA members can eliminate substantially all discrimination by 'eliminating current discriminatory measures *and/or* prohibiting new or more discriminatory measures' [emphasis added]. Eliminating all discriminatory measures suggests near total merging of the domestic market with the foreign market(s): there would be no discriminatory barriers e.g. to cross-border sales, consumption abroad, establishing firms and movement of persons. Simply prohibiting new or more discriminatory measures, on the other hand, suggests that a standstill will suffice: that is, avoiding 'GATS-minus' outcomes.[31] Article V prohibits discrimination 'in the sense of GATS Article XVII', which applies only to specific commitments identified by WTO Members in their GATS schedules.

The use of the word 'or' cannot be ignored. However, it seems difficult to imagine that an EIA that contained only standstills would meet the drafters' intentions. Paragraph 1 makes clear that EIAs liberalise trade in services, a point echoed by the Panel in *Canada - Autos* – WTO (2000), para. 10.271. An interpretation suggested by Cottier and Molinuevo is that the first obligation should apply to sectors in which there are many discriminatory measures and the latter to sectors where there is little discrimination – Cottier and Molinuevo (2008) 136-137. But the message for countries negotiating EIAs is that Article V does not establish a *de jure* requirement to eliminate *all* discriminatory barriers.

Another unsettled area concerns market access commitments. WTO Members determine which of their service sectors will be subject to GATS Article XVI commitments to remove six categories of mainly quantitative restrictions on foreign services and capital. The text of Article V does not mention Article XVI, suggesting that it does not apply. However there is no clear line separating market access from non-discrimination commitments and in practice there are overlaps – see Muller (2016). Also, the WTO Secretariat has considered reduction of market access barriers as contributing to the liberalisation achieved by an EIA; see, for example, *Factual Presentation of the EU – Korea FTA* – WTO (2012).

The dispute settlement bodies have enforced the non-discrimination requirement only once, in a Panel finding that was not appealed. The Panel in *Canada – Autos* concluded that Canada's conditioning of access to an import duty exemption could not be justified under GATS Article V:1 – WTO (1999a): paras 10.269–10.272. The exemption was awarded within only one sector: vehicles. Within that sector it was awarded only to a small number of service

[31] See Adlung (2015) on GATS-minus clauses in RTAs. They are not as rare as one might expect.

providers associated with companies which met particular export criteria. Canada argued that the measure could be defended as part of an FTA (NAFTA), but the Panel decided it failed meet the requirement of eliminating substantially all discrimination, asserting that members of an EIA should not discriminate between service suppliers (Panel Report, para. 10.270). Clearly, singling out some service providers for duty exemption within a particular sector in an EIA contravenes GATT Article V. Note that this decision applied only to the sector in question; the Panel did not conclude that NAFTA as a whole contravened GATS Article V.

5.2 GATS and Mutual Recognition

GATS Article VII addresses MRAs in services; Article VII:2 includes the tentatively-worded obligation that a party to an MRA "shall afford adequate opportunity for other interested Members to negotiate their accession to such an agreement or arrangement or to negotiate comparable ones with it. "Article VII.3 also provides for non-discrimination 'in the application of … standards or criteria for the authorisation, licensing or certification of services suppliers." There have been no disputes to elaborate these provisions and it has been speculated that the lack of disputes is because the 'burden of persuasion' for third countries to establish that they should receive better than MFN recognition is perceived to be too high - Marchetti and Mavroidis (2010), 423.

5.3 Assessing the GATS compliance of a UK-EU EIA

Given the uncertainty about how to interpret the GATS' legal provisions on EIAs and the absence of any rulings from the Appellate Body, we turn to the actual practice of members and Secretariat for guidance. This is clearly not definitive about how a UK-EU EIA would be viewed, but precedent does carry some weight in WTO proceedings as does, in the case of assessing RTAs and EIAs, the old adage that 'people who live in glass houses should not throw stones'.

As noted above, the WTO review procedure is now restricted to the Secretariat providing information to members, from which they can draw their own conclusions. The information that the members seek and the Secretariat provides through this process may be taken as a reasonable guide to what they consider important in making an assessment. Even ignoring the points above that a sector is covered even if only one sub-sector is included in the liberalisation and that 'eliminating substantially all discrimination' does not mandate precisely national treatment in all covered sectors, actual practice appears to offer considerable comfort to the notion that an EIA with the depth of integration varying over service sectors would be acceptable to the WTO membership. We base this view mainly on the Secretariat's *Factual Presentation of the EU-Korea FTA* (WTO, 2012a) but that on the *EU-Peru FTA* (WTO, 2013) suggests similar criteria.[32]

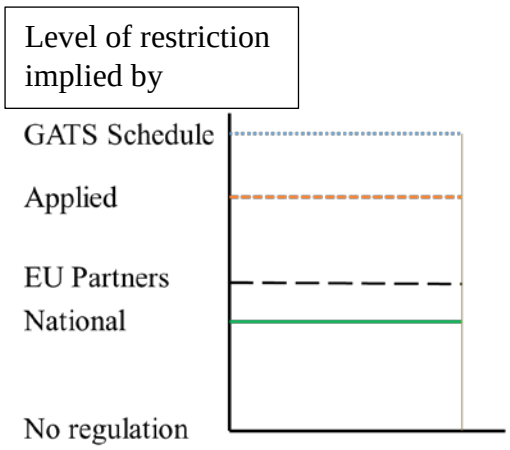
[32] We do not analyse the Comprehensive Economic and Trade Agreement between the EU and Canada or the EU-Switzerland agreements for this purpose because they have not been subject to Secretariat analysis, the former because it is too recent and the latter because only the simple trade agreement was subject to review (in 1973), rather than the totality of the over one hundred further partial agreements that followed it. Besides the EU is thought to be clear that it does not wish the UK to have a relationship like that with Switzerland – Owen et al (2017).

We start by considering schematically a single service sector, such as health provision, banking or telecoms, and imagining that the degree of restriction can be collapsed into a single scalar measure, which we represent on the vertical axis of Figure 2(A). No country fails to regulate these sectors internally – that is, national suppliers are required to obey some (generally perfectly justifiable) restrictions on their behaviour. We denote this level of restriction as 'national' in the figure. At the other end of the scale, a WTO member must record in its GATS schedule the maximal amount of restriction that it will impose on services and service providers from abroad, up to and including infinity (unbound). As Borchert (2016) has observed, however, there is very considerable binding overhang, such that applied policies towards services imports are typically less restrictive than scheduled commitments. Both of these levels apply on an *erga omnes* (MFN) basis to all foreign countries. In addition, within the EU, and often as part of the Single Market, EU member states afford each other less restrictive regulations than general, which we label 'EU partners'. This may be the same level as applied to nationals – as, for example, in financial services whereby establishment in one member state is sufficient to have a 'passport' to operate in another – or more restrictive – as, for example, with the provision of legal services in which several members states impose residence/nationality requirements – European Commission (2017). It will never exceed, however, the restriction applied at the MFN applied level[33].

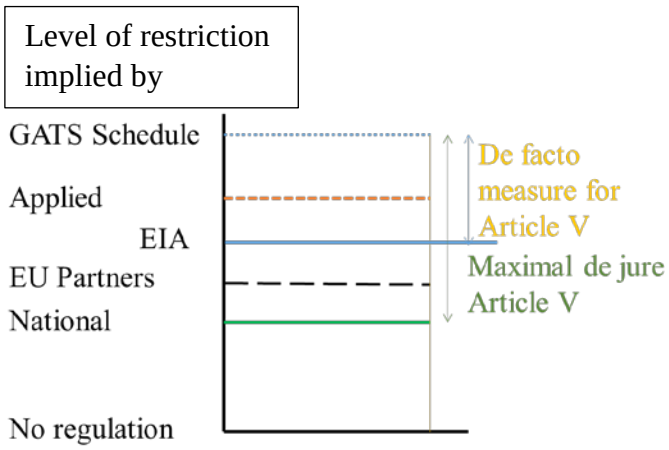
[33] One is tempted to argue that the rights given to EU partners will never be less restrictive than those accorded to nationals. However, in at least one case outside trade, this is not true: the UK's restrictions on residents bringing their non-citizen spouses into the UK are more restrictive than those it applies to nationals of other EU members! In the following analysis we ignore such perversities.

Figure 2: Levels of Restriction in a Single Services Sector

(A) At present



(B) Following a UK-EU EIA



Now suppose that the EU signs an EIA which defines the level of regulatory restriction that will pertain to imports of services from the UK. This might be anything from merely binding the GATS schedule to offering identical conditions to those facing nationals, but if the EIA is to mean anything it will require that this does not exceed, and in at least some sectors is lower than, the restrictions offered on an applied basis to all WTO members.[34] Further, because the Single Market is so deep – including, for example, the free movement of workers and supranational enforcement via the CJEU – the EU's offer to the EIA partner is almost bound to imply effectively less integration (more restriction) than the Single Market level in most sectors. Figure 2(B) sketches in a notional EIA agreement on the illustrative service trade.

In assessing the compatibility of the EIA with GATS provisions, Article V(1) might seem to imply that in every covered sector the EIA must deliver liberalisation to something like the national level. However, Article V (1) requires the absence of discrimination 'in the sense of Article XVII', which arguably covers only a subset of the issues that may be covered by the legal treatment of nationals or even of those covered in the Single Market. In other words, 'national treatment' may entail a level of restriction above what we have termed 'national' or even above our 'EU partners' level. We do not have to settle this question here, but for concreteness we show the degree of liberalisation required of an EIA under the most demanding interpretation, labelling it as 'maximal de jure Article V'. Clearly, on this basis, the EIA agreement for our illustrative sector would fail the test of eliminating existing discrimination.

In presenting the EU-Korea FTA, however, the Secretariat declares that 'the EU's commitments cover, at least partly, a large range of services sectors' (paragraph 99) and that 'The list of commitments made by Korea …. covers, at least partly, most sectors' (paragraph 102). It then notes that 'The specific commitments by the Parties in the Agreement are based on their GATS commitments, …. For certain sectors (and sub-sectors) coverage is enlarged,

[34] Even if the EIA is not more liberal than the applied MFN provision, binding it is still valuable.

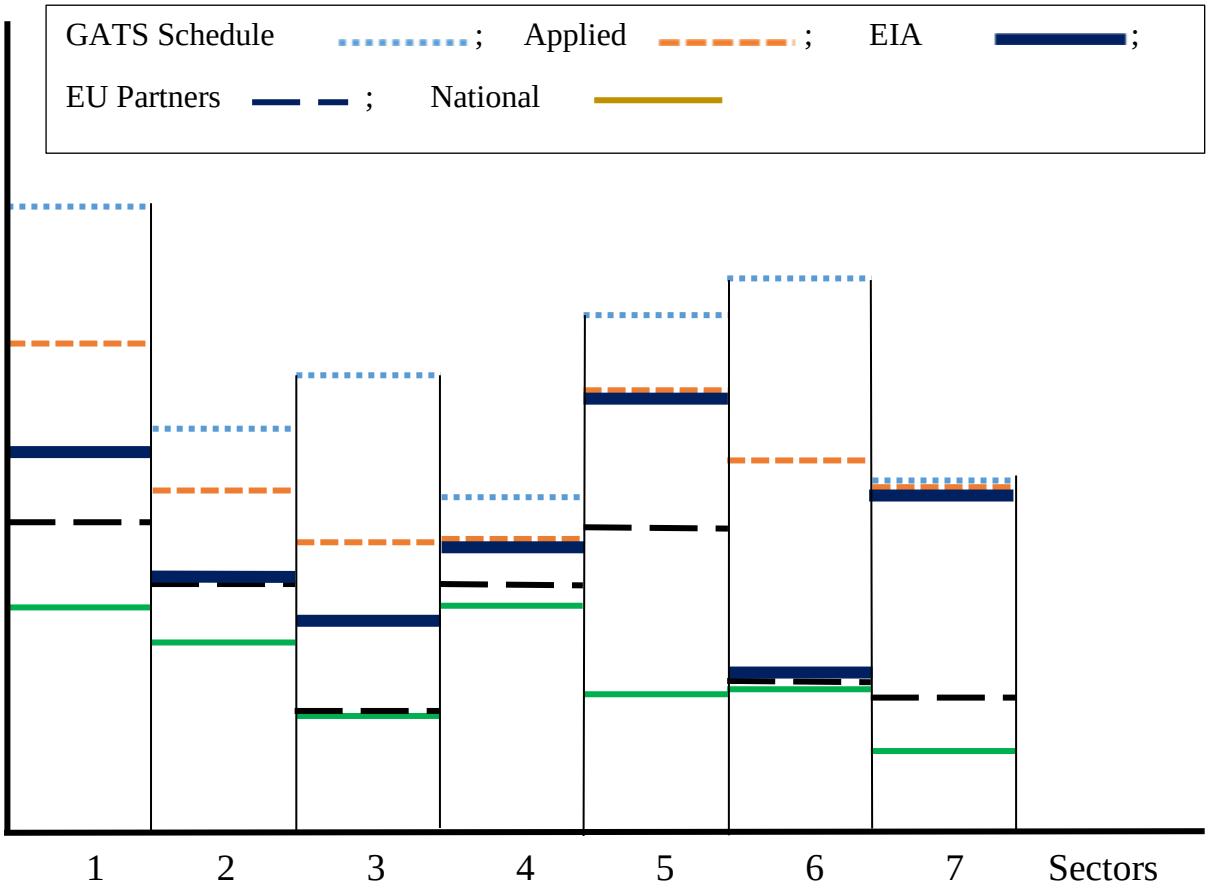
while, for a number of sectors (sub-sectors) already covered, new commitments are made or certain GATS-limitations are withdrawn' (paragraph 104) and it 'compares [the Parties' specific commitments] with their GATS schedules' (paragraph 105).[35] That is, the measure that the Secretariat uses for defining a sector as covered is that the EIA improves upon the GATS scheduled degree of restriction – i.e. that the distance we have labelled as the '*de facto* measure for Article V' in Figure 2(B) exceeds zero. Given that no challenge has been made to the EU-Korea FTA, we might take it that its standard is acceptable to WTO members. Moreover, given that in most sectors, EU and UK applied MFN policies are already more liberal than scheduled policies, even an EIA that merely committed to current applied levels would seem to satisfy the *de facto* standard.

Given that nearly all sectors should meet the standard, there is ample cover for a few – or perhaps more than a few – to offer mutual access at the EU Partner (Single Market), level without violating the 'substantially all sectors' criterion. Figure 3 generalises Figure 2 to sketch a notional UK-EU EIA in services with seven illustrative sectors, ignoring strictures about every mode of supply having to be included. Sector 1 is identical to that in figure 2, with differences between all five levels of regulation. Sector 2 is similar, but the UK and EU offer each other essentially the EU Partner level of access via harmonised regulations and mutual recognition. In Sector 3 the EU partners face exactly the same restrictions as nationals, but this is not extended to the EIA, while in sector 4, little integration has been achieved and UK-EU mutual access is bound at applied MFN levels.

Even sector 4, however, appears to meet the WTO's *de facto* standard because applied regulation is a little less restrictive than the GATS schedule requires. The latter is also true of sector 5 but here there has been considerable Single Market liberalisation that has not been extended to the UK. In sector 6 both the Single Market and the EIA offer the same treatment as nationals receive, whereas in sector 7 the key feature is that neither MFN nor the EIA goes any further than the GATS binding. Of all the sectors in figure 3, only sector 7 would *de facto* be considered 'not covered' in the EIA.

[35] It goes on to note that 'Improvements in existing GATS commitments are either a reduction of the limitations applicable to market access and/or national treatment, a relaxation of the form of establishment under mode 3, further sub-sectors in which commitments are made, and/or additional commitments'

Figure 3 A Notional UK-EU Sectoral Services Deal



5.4 *Connections between EIAs*

The EU-Korea FTA appears to offer a strong precedent for a UK-EU EIA that, while comprehensive in coverage, offers significantly different degrees of integration in different sectors. Some of the obligations of this agreement, however, pose a very serious political challenge for the EU. Articles 7.8.1 and 7.14.1 of the EU-Korea agreement state that for cross-border services trade and establishment respectively,

> unless otherwise provided for in this Article, each Party shall accord to services and service suppliers of the other Party treatment no less favourable than that it accords to like services and service suppliers of any third country in the context of an economic integration agreement signed after the entry into force of this Agreement.

Hence whatever preferential arrangements for services the EU includes in other EIAs must be extended to Korea with the exception (noted under 'unless… ') of those that 'either create an

internal market on services and establishment[36] or encompass both the right of establishment and the approximation of legislation.' (Annex 7-B)[37]

In sum, these clauses mean that either an agreement between the UK and the EU has to be extended to Korea in these two critical areas of services trade, or that the UK and the EU have to agree that the agreement between them approximates legislation or amounts to an internal market with, *inter alia*, free movement of persons. These are not impossible goals but they mean that, in the relevant sectors, the UK will have to commit to a high degree of market integration with the UK.

6. Conclusion

WTO law and practice is perfectly consistent with concluding a UK-EU FTA/EIA that includes very deep integration in a number of sectors. However, it does impose some constraints. With respect to the elimination of tariff barriers, the parties cannot cherry-pick sectors but must maintain comprehensive coverage. This does not prevent coordinating external tariffs, and relaxing RoOs, in key sectors to replicate something like a customs union in those sectors. With respect to regulatory cooperation, if the EU and UK maintain some mutual recognition of each other's technical regulation and/or CAPs, there is a risk of violating relevant WTO MFN provisions under certain scenarios. The MFN obligation here is a procedural one: to cooperate with interested parties toward concluding MRAs. Thus far there has been no appetite among WTO Members to complain about MRAs.

In services the GATS also requires EIAs to have substantial sectoral coverage, but the requirements for liberalisation within covered sectors are very undemanding. An agreement that maintained the current level of (deep) integration in a number of sectors and merely bound MFN applied policies in most others would, *de facto*, be GATS-compatible. Deep services liberalization is mostly achieved via MRAs of the parties' regulations for the covered sectors; there are MFN requirements for these, but they are weak. A more significant MFN problem in services is that some EU EIAs have MFN clauses that would extend any favourable terms offered to the UK to other partners with no reciprocity. This may constrain EU enthusiasm for deep integration with the UK.

What is possible does not necessarily equate with what is desirable – the latter is for the EU and UK authorities to decide. However, we note that EU integration has strongly increased UK-EU27 trade flows and the development of integrated supply chains, and that physical proximity furthers these advantages. Imposing additional tariff barriers and customs procedures on existing value chains will be costly and disruptive. The agreement we have outlined in this paper is intended to preserve as much as possible of the mutual access that the UK and the EU27 currently offer each other. It needs for the sake of formality to be presented in the WTO relative to the MFN alternative of 'no deal'. However, the obvious way to try to negotiate it is from the other direction – to take the status quo as the starting point and ask

[36] 'An internal market on services and establishment means an area without internal frontiers in which the free movement of services, capital and persons is ensured. For greater certainty, the European Economic Area (EEA) is the only internal market with third countries of the European Union at the time of signature of this Agreement.' - footnote in original.

[37] In addition, Annex 7-C also lists a further 43 specific reservations against MFN.

how much change is required to accommodate each side's red lines. This requires agreement in principle that a deep arrangement is sought, and working closely together to design the details to meet that objective.

The first step is to agree the simple tariff-free FTA. It would then be for the UK to decide to what extent it wished to coordinate its MFN and preferential tariffs with the EU. We have argued elsewhere that the UK should initially adopt the EU tariff schedule through a rectification at the WTO – UKTPO (2016) – but that is a short-term expedient. The decision here is a longer-run one, and in our view it is very finely balanced. If tariff coordination did seem desirable, work would then pass on to coordinating regulations and designing rules of origin and their administration in a way that minimised the customs burden. The latter can occur only once the UK has worked out its general customs regulations and procedures. Of course, these regulations should be as convenient as possible anyway, but we would expect that in the presence of coordinated policies, they could be made significantly easier to manage.

Regarding regulation for goods, conformity assessments and services, it is relatively straightforward to convert existing harmonisation into MRAs, as compared to the usual situation in which trade partners have to build trust in divergent regulatory systems. The issue is how to enforce the agreed rules in the UK independently of the CJEU, and how to modify MRAs to reflect changing regulation. The UK as the smaller party would have to accept EU leadership in most standards, a voluntary reduction in regulatory self-determination in exchange for market access.

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