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Deep and Not Comprehensive?
What the WTO rules permit for a UK-EU Trade Agreement

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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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Introduction

Following Brexit, the UK will need to agree a new set of trading arrangements with the remainder of the European Union (EU27 hereafter). The UK and the EU have strongly re-oriented their trade towards each other and created deep interconnections between their economies. Many commentators and sectoral bodies argue that preserving as much as possible of this favourable access should be an important goal in any Brexit settlement. Concluding a very ambitious trade agreement is also a stated goal of both the UK government and the EU – HM Government (2017b): Part IV, and European Council (2017): Part IV para. 20.

In its White Paper of February 2017, the UK government stated its intention to leave the EU Single Market (SM) or Customs Union (CU), and that remains the position of the leadership of both main political parties. Staying in the CU would necessitate maintaining common external tariffs, going against its 'red line' on controlling its own trade policy. And the UK red line on restricting the immigration of EU nationals cannot be reconciled with continued membership of the SM, of which free mobility is an integral component - see Gasiorek, Holmes and Rollo (2016). But while giving up on the CU and the SM, UK political parties still say they wish to retain the same access to European markets as they have now! The EU will not permit this, but it is worth exploring whether in return for moderation in restricting migration, the UK could preserve most of the benefits of the CU and SM in key sectors?

The CU and SM play a role in 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 goods would require agreeing a zero-tariff Free Trade Area (FTA), and then agreeing to apply identical tariffs on imports from third countries in certain sectors that could support relaxed rules of origin and a very light customs procedure between the UK and EU. Also, the UK and EU would need to conclude mutual recognition agreements (MRAs) in certain sectors. For services, the UK and EU would need to secure an agreement only for certain services sectors, and then accredit/authorise bodies to certify equivalence of services, ie qualifications or banking procedures.

Clearly, a necessary condition for creating this relatively deep level of integration is political: the UK and the EU27 must agree that it would be beneficial. In addition, however, 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, WTO rules and practice require that agreements be both wide (covering many sectors – but not necessarily all) and deep (offering meaningful liberalisation of trade). This rules 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 EU27 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 agreement, they should not dress political failure up as legal impossibility.

There are caveats, however. First, selective tariff harmonisation will not eliminate all border 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 relevant goods *and all their significant inputs*. Moreover, this applies not just to MFN tariffs but to all (existing and new) third-country FTAs 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, from tomatoes to microchips, have dual or multiple end-uses, pursuing a CU for sector A would potentially spill over to sectors B, C, etc. Finally, 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 the more limited approach of agreeing that UK companies would be authorised to certify that products met EU standards, and vice versa.

Before we examine these issues, we first demonstrate that the elimination of trade barriers induced by membership of the CU and SM created a significant volume of trade between the UK and the EU, including to the formation of European value chains.

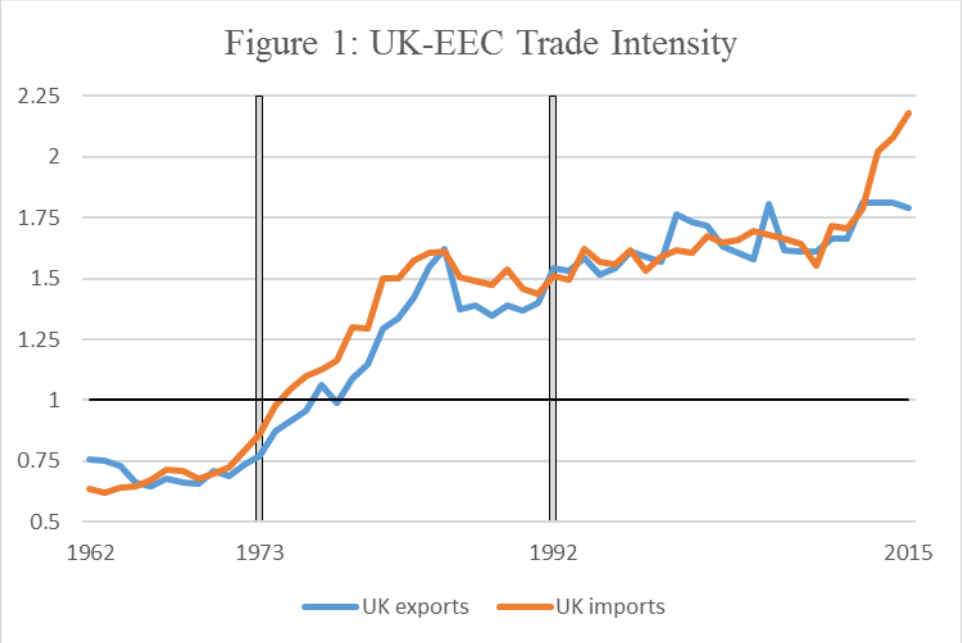
Do Trade Arrangements Matter?

The history of UK-EU trade suggests strongly that the CU and SM have had a profound influence on trade patterns and have directed UK trade toward the EU. To see the long-run trends, consider trade between the UK and the original European Economic Community 'six' – Belgium, France, Germany, Italy, Luxemburg and Netherlands. In 1968-70 – well before UK accession could be predicted – the UK sold 16% of its goods exports to EEC members; this rose to 36% by 1990-92 before declining to 33% by 2013-15, the latter reflecting the growing importance of Emerging Markets. To eliminate this relative market-size effect, consider the UK share of different markets' imports: for the world as a whole, the UK share has fallen from 6.2% in 1968-70, through 4.9% in 1990-92 to 2.4% in 2013-15, whereas for the same periods the UK's share of the EEC market evolved from 4.4%, through 6.9% and back to 4.4%. That is, from having a considerably smaller UK share than the world, the EEC countries have moved to having a share approaching twice as large.

Figure 1 plots the ratio of UK's share of all exports to the EEC to its share of world exports (in blue) and the EEC share of UK imports relative to the EEC's share of world imports (broken, in red). At first the UK had a smaller share in the EEC than elsewhere (30 percent lower), and vice versa, but following accession, trade in both directions surged. By the mid-seventies the UK and EEC had the same shares with each other as with elsewhere and by the

mid–eighties roughly 40 percent larger. Following a dip in the mid-eighties, the introduction of the Single Market over about 1988-1992, induced another surge, so that now mutual market shares are 75 to 100 percent above the norm.

Trade agreements – of which the CU and the SM are extreme examples - usually increase the trade between members. Sometimes this can be at the expense of trade with non-members, but most evidence suggests that the creation of new trade is stronger than the diversion of trade from non-members to members. 'Trade creation' is particularly likely to dominate 'trade diversion' when a Single Market is created. First, many Single Market regulations reduce the costs of doing trade and hence more trade becomes possible and profitable. Second, in many sectors, trade between the member and non-member countries barely existed initially because differences in standards and regulations prevented it. Thus the extra trade stimulated by the European SM arose as UK suppliers newly challenged domestic sellers in Europe, and vice versa. This increased competition benefited consumers and, in particular, users of intermediate imports – that is, as intra-EU value chains developed[3].



Note: the trade intensity index for UK imports from the EU is the share of UK imports from the EU relative to the share of all countries' imports from the EU, and similarly for exports.

WTO Rules and Practice on FTAs for Goods Trade

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

[3] One possible concern over these figures is whether, post-1990, they have been influenced unduly by the reunification of Germany. The answer is 'no': exactly the same patterns are evident if we exclude Germany.
[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 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 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 employed a limited and narrow use of the Article XXIV exception. It has never declared an RTA to be overall-GATT non-compliant.

This is not to say, however, that Article XXIV has had no effect: even a rule that is commonly violated may reduce the extent of bad behaviour (think of speeding laws). The UK has set itself up as the champion of multilateralism and the WTO – Fox (2016) – and so would doubtless wish to be among the most rule-abiding members of the WTO. Furthermore, the EU is also rule-abiding and takes into account Article XXIV requirements in its FTA negotiations (see below).

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. Instead, Article XXIV's 4th paragraph establishes the purpose of RTAs as 'increasing freedom of trade' by 'closer integration of the economies of the countries parties to such agreement'. Replacing a customs territory with a less liberal arrangement goes against this requirement.

However this does not mean that a UK-EU FTA would contravene Article XXIV. We argue that, rather than comparing the FTA with the current customs territory, MFN status should be

[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 RTA Members: https://www.wto.org/english/tratop_e/region_e/scope_rta_e.htm

taken as the baseline, as the EU and UK would revert to this in the absence of a new trade agreement.[7] 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.

The WTO Dispute Settlement Understanding points to the Vienna Convention on the Law of Treaties ('VCLT') as a source of customary rules of treaty interpretation. VCLT Article 31(1), which has frequently been 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, which provide for 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'. As set out in Paragraph 7, Article XXIV also brings about transparency and enables WTO oversight of RTAs; supporting the EU and UK notification of their FTA will facilitate this oversight. On this basis we believe that WTO Members can be persuaded to accept this unconventional 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 is impossible.

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))

[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.

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, the former ought to cause little problem for a UK-EU FTA. The parties currently trade with no 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. And by virtue of the Single Market (SM), UK-EU trade currently faces very low levels of other restrictive regulations. The issue is that asserting UK regulatory independence by leaving the Court of Justice of the European Union (CJEU), and trading off migration controls for SM access will lead both parties to want to pull back from the current degree of integration in at least some sectors. No FTA has the depth of regulatory integration that the SM provides, and many make few efforts to reduce other restrictive regulations – Epps (2014). Thus it seems that even with a fair degree of retreat from the SM, a UK-EU FTA would more than satisfy WTO practice to date as long as the retreat is not spread too unequally across the sectors, a point to which we now turn. Again we argue that WTO MFN status, rather than the SM, should act as a comparative baseline.

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 not resolved the definition of 'substantially all'. Key debates centre around whether the definition should be quantitative (and if so what percentage[8]), qualitative, or on a case-by-case basis, and whether an FTA excluding agriculture can constitute 'substantially all trade'.[9] The Appellate Body in *Turkey—Textiles* decided 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.

In the absence of judicial guidance, examining the practices of WTO Members is helpful. In its FTAs with developed countries, the EU defines 'substantially all' as 90 per cent of its

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

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

trade being tariff-free (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 is sectoral deals whereby UK-EU trade in a few specific sectors received better terms than MFN. This restriction has two implications. First, the arrangement which the UK government reached with the car producer Nissan in order to persuade them to continue investing in the UK would not be WTO-consistent if it included any tariff concessions.[10] 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 a free trade agreement 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 (2000b): paras. 73-84.

The second implication is that a UK-EU FTA cannot be constructed piece-meal, starting with narrow coverage and adding sectors as they are negotiated. The criterion must be satisfied from the start, although further sectors can then be added subsequently.

Transitional arrangements

Article XXIV contains separate classifications for free-trade areas and interim agreements leading to, or necessary for, the formation of a free-trade area. Free-trade areas 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 free-trade areas under negotiation to be interim agreements, but rather full agreements with transitional periods.[11]

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.[12]

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.[13] That is, the UK and EU will not know precisely what trading conditions B actually are and hence will not be

[10] Holmes (2016) discusses possible arrangements for the vehicle sector.

[11] Note that WTO-notified interim agreements are also 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.'

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

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

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 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. Hence – as has just been revealed (Miles, 2017) - UK and EU diplomats ought to be cooperating to make the case for a waiver.

Of course, even a simple goods-only FTA will not be possible unless both sides are willing.[14] 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.

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

[14] 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?[15] Note that this would not address trade frictions associated with regulatory barriers, addressed in the subsequent section.

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.[16]

One area where these considerations are particularly significant is food and agriculture. In sectorally-incomplete customs unions, agriculture is often the excluded sector (eg, the Turkey-EU customs union), due to the political sensitivities of opening agriculture to tariff-free trade. In the current case, however, there is already tariff-free trade between the UK and EU, and some incentive to maintain harmonised external tariffs. UK accession to the EEC (EU) was associated with a significant increase in protection for agricultural markets and was followed by a fair degree of trade diversion of UK imports from third countries to EU sources. These sales are presumably attractive to EU farmers and hence, because of the latter's substantial political clout, EU policy makers. Even if an FTA agreement ensured that the UK imposed no tariffs on imports from the EU, EU producers would lose if the UK liberalised its agricultural imports from other suppliers. Thus the UK may be able to offer a significant concession to the EU by agreeing to maintain its agricultural protection at pre-Brexit (i.e. EU) levels, while exempting imports from the EU from tariffs – that is, by maintaining the status quo. Such a policy would suit the UK's farm community, and UK consumers might hardly notice it because it would merely fail to engineer a decline in food prices rather than raise them directly. Thus one can see its political attractions. We certainly do not advocate any particular policy in this area, but if it were concluded that such an outcome were desirable as part of the overall outcome of Brexit, it would not fall foul of WTO rules.

On the other hand, this approach implies a good deal of coordination. First, many goods have a large number of inputs and tariffs on all of these would need to be harmonised, including any preferential rates that are offered as part of FTAs with other countries or unilaterally to developing countries. Second, there may be issues about inputs into those inputs: thus one

[15] 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.

[16] 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.

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, say, electricity, or even for labour (migration?). 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[17]. Many such differences are tolerated *de facto*, but 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.[18]

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.[19] 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 likely need to be introduced for many products transiting between the UK and the EU. Even if a given product doesn't require RoO certification, it may still be subject to queues while other products are checked and verification that they actually qualify for customs-union-like treatment.

[17] 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 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 Commisssion (1995), emphasis added

[18] 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'.

[19] 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.

Regulations

Tariffs are far from being 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 SM, and as we have argued above, its progress seems to have had a material effect on the volume of trade and degree of competition within the EU. 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. The 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.

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 *not* meet its standards on public safety, health or the environment, it is assumed that standards are equivalent.[20]

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 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.[21]

The extension of the principle of mutual recognition to Turkey confirms that it can be extended to non-SM countries. 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.) This seems to suggest that the UK may be able to benefit from the mutual recognition principle, exempt some sectors from coverage, and not establish a CU with the EU. (On the latter, note that participating EEA countries do not have a CU with the EU.) However Turkey has agreed to align its legislation with the EU *acquis* in the areas covered by the CU.[22] It is difficult to imagine that the UK would be exempted from the

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

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

[22] 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).

requirement 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 – 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 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. If the UK were so willing, it is unlikely that it would object to conformity assessments conducted by EU laboratories. Having accepted EU standards for sales in the EU, its offensive interest will be to ensure simple and quick conformity assessments in the EU or, better, that UK laboratories could certify UK goods for the EU.

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

As previously established, 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 on 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 complete the analysis we consider the GATT as well.

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.[23] A third party could complain that it was excluded despite having an equivalent ability to achieve a particular standard. GATT Article I:1 requires that Member States should provide equality of competitive opportunities for imported products from all WTO Member States. This is a 'market based' test, which does not take into account the policy justification of a discriminatory measure (see *EC – Seal Products*, Appellate Body Report, para. 5.82). For this reason, in many cases the exclusion of a petitioning third country from an MRA would contravene Article I:1.

A Member State has never defended an MRA under Article XXIV, but the Article makes clear that regional liberalisation is the aim of RTAs (paragraph 4) and requires that RTA members should remove regulatory barriers between them (paragraph 8b). The case law establishes a high threshold for applying the Article XXIV 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 assessing the applicability of the Article XXIV exception in justifying Turkey's introduction of additional trade barriers to third countries. It is not entirely clear whether the same high threshold would apply to removing trade barriers between trade partners through MRAs in an FTA. If such a test were applied, the UK and EU would be required to establish

[23] 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.'

that the MRAs were necessary for the FTA to be concluded. This is complicated by the fact that there are certainly FTAs that achieve tariff reduction but no mutual recognition whatsoever.

Even if the UK and EU were able to argue that MRAs were necessary for the FTA, the Appellate Body would be hesitant to apply the Article XXIV exception as it is not available under the TBT Agreement. The TBT Agreement 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. Thus it is unlikely that a country could defend excluding a third country from an MRA under the Article XXIV exception.

Instead it would need to take recourse to GATT Article XX General Exception, which permits trade-restrictive measures that fall under listed public policy objectives, eg human health and conservation of natural resources, if they fulfil additional non-discrimination criteria established in its chapeau.[24] 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 General Exception.

Since the WTO was established there have been no Article I:1 disputes on MRAs. However *EC – Tariff Preferences* (2004) is instructive in some respects: it dealt with market access conditioned on achieving 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 as a category. The Appellate Body analysed whether the EU could provide preferential tariff treatment to some 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 main element 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 – WTO (2004a) paras. 187-189.

An MRA dispute would differ in factual and legal respects, including that 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 ceding regulatory oversight. The Appellate Body would probably appreciate that the countries would wish to undertake a high level of scrutiny before allowing third parties into an MRA. Nonetheless it is likely that the Appellate Body would similarly require objective and transparent criteria in order to avoid 'closed list' MRAs.

[24] 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….'

This interpretation is supported by 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).

Also, in a pre-WTO GATT dispute, *EEC – Beef from Canada*, Canada complained successfully that the EEC had violated the GATT MFN Principle – GATT (1981): para. 4.2(a). The EEC specified a US 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'.[25] Thus the burden of proof fell on Canada to establish that it could fulfil the requirements to be automatically certified as meeting EEC product standards.

Despite the lack of disputes on MRAs we can extrapolate an obligation on MRA parties to be objective and transparent, and parties seeking MRA membership to establish that they can fulfil the requirements of the regulator. These requirements would likely also be central in a dispute under the TBT or SPS Agreements, further considered below.

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.[26] 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 regulation restricts trade in order to meet legitimate regulatory goals. TBT Article 2.7, a dedicated provision on technical equivalence, also 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'. In this context, 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

[25] Ibid at para. 4.1.

[26] 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.'

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 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, though 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 proven elusive in practice due to attachment to 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. 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 would be undermined by the fact that products from Turkey and the EEA also receive automatic mutual recognition. Bartels (2009) 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 (2009) 719-720. Indeed, a move to negotiated, sectoral MRAs between the UK and EU – rather than comprehensive, automatic mutual recognition – would actually be more likely to comply with MFN obligations, 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 (2009) 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.

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)[27]. 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 remove some of the services liberalisation currently available, 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.

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 nor 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

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

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. Despite this relative carefulness in the treaty text, 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 not 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, even if a sector is listed, this would still allow the possibility that commitments extend only to one sub-sector of the committed sector – 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' by providing national treatment as described in GATS 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: avoiding 'GATS-minus' outcomes.[28] Article V prohibits discrimination 'in the sense of GATS Article XVII', which only applies to specific commitments identified by WTO Members in their GATS schedules. These commitments can be further limited to specific circumstances or exempt some measures.

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 (2000a), 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.

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

Another unsettled area concerns market access commitments. WTO Members determine which of their service sectors will be subject to GATS Article XVI commitments to removing 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 eg *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 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 to the sector in question; the Panel did not conclude that NAFTA as a whole contravened GATS Article V.

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.

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 if even 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, 2012) but that on the *EU-Peru FTA* (WTO, 2013) suggests similar criteria.

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). (We avoid for now the vexed question of how to aggregate the degree of restriction across modes of supply.) 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 'national' in the figure. At the other end of the scale, a WTO member must record in its GATS schedule the maximal amount of regulation that it will impose on services and service providers from abroad, up to and including infinity – i.e. provisions that explicitly or effectively ban trade. As Borchert (2016) has observed, however, there is very considerable binding overhang, so that applied policies towards services imports are typically more liberal – impose less regulatory constraint – than scheduled commitments. Both of these levels apply on an *erga omnes* (MFN) basis. In addition, within the EU, and often as part of the Single Market there is a further level of regulation – that accorded by one EU member state to another, which we label 'EU partners'. This may be the same as required of 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 restrictions offered at the MFN applied level[29].

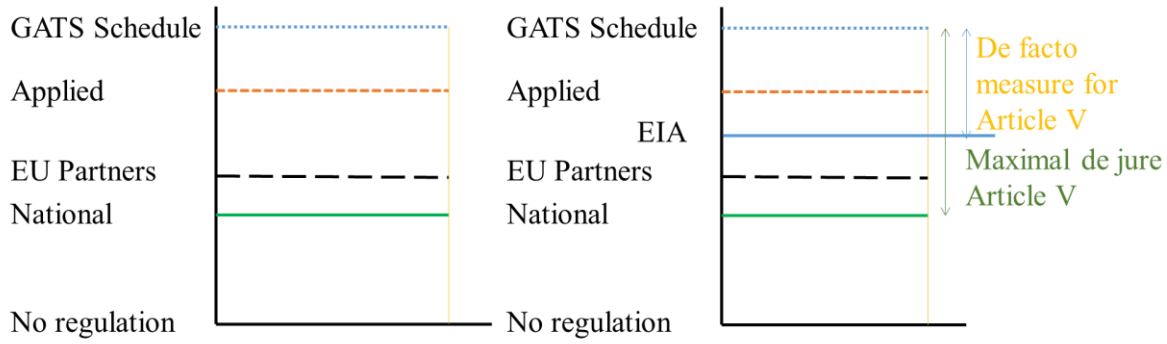
Now suppose that the EU signs an EIA which defines the level of regulation that will pertain to imports from the UK. This might be anything from merely confirming the GATS schedule to offering identical conditions to those facing nationals, but if the EIA is to mean anything it will require that in at least some sectors the level of regulation is below that offered on an applied basis to all WTO members. 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 than the Single Market level in at least some (probably, 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

[29] 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



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. As we argue below, we do not have to settle this question, but for concreteness 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.

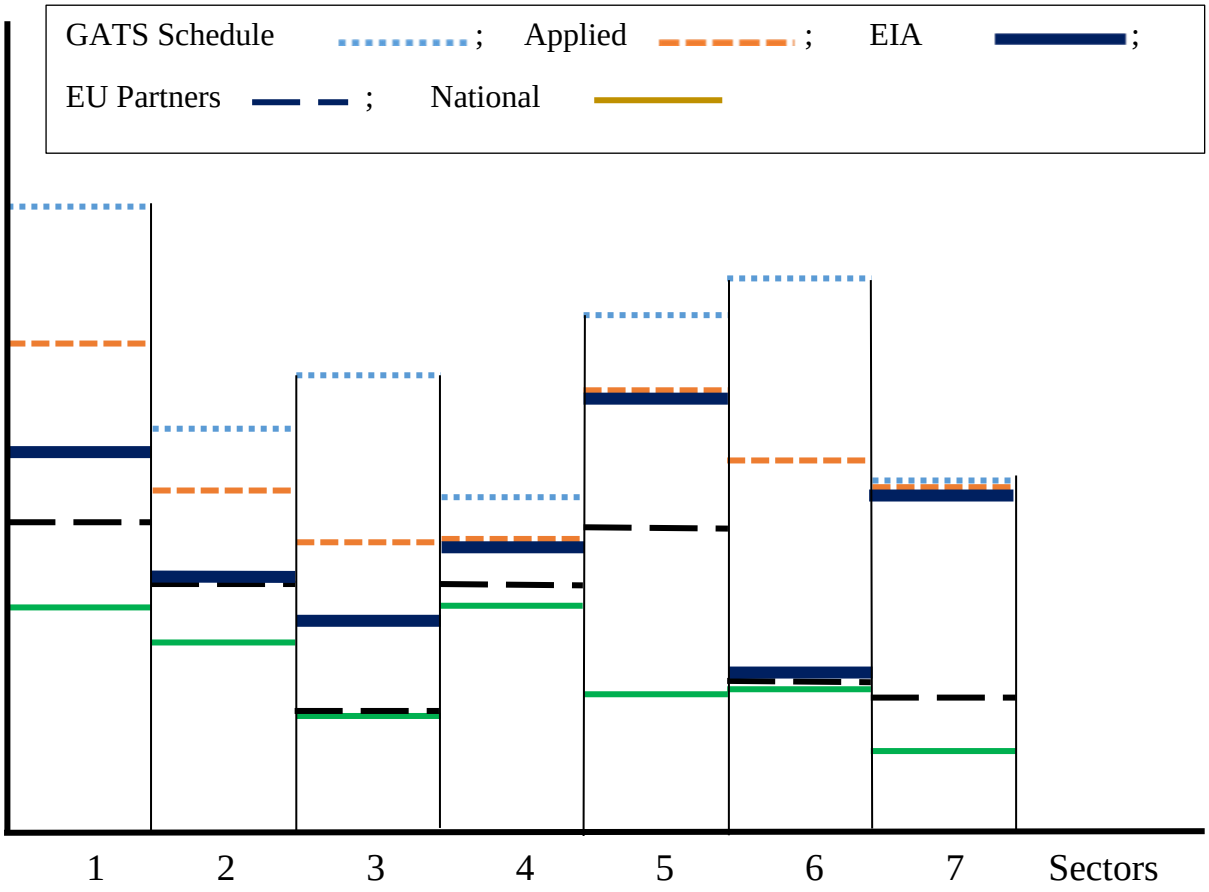
In presenting the EU-Korea FTA, however, the Secretariat declares that 'the EU's commitments cover, at least partly, a large range of services sectors' (paragraph 99) and that 'The list of commitments made by Korea …. covers, at least partly, most sectors' (paragraph 102). It then notes that 'The specific commitments by the Parties in the Agreement are based on their GATS commitments, …. For certain sectors (and sub-sectors) coverage is enlarged, 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).[30] 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

[30] 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'

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.

Figure 3 A Notional UK-EU Sectoral Services Deal



Even sector 4, however, appears to meet the WTO's *de facto* standard because applied regulation is a little more liberal 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 binding. Of all the sectors in figure 3, only sector 7 would *de facto* be considered 'not covered' in the EIA.

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.

In other words, whatever preferential treatment for services and service suppliers the EU grants to third parties must also be extended to Korea. The exception implied by the first phrase is that agreements with third parties may avoid such an MFN extension only if they achieve a significantly higher level of obligations than the EU-Korea FTA. More specifically such an agreement must constitute an 'internal market' on services and establishment, with the EEA listed as the sole exemplar, or 'encompass both the right of establishment and the approximation of legislation.' (Annex 7_B)

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.

Conclusion

WTO law and practice is not prohibitive of the successful conclusion of 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. Yet the MFN obligation here is a procedural one: to cooperate with interested parties toward concluding MRAs.

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 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 it is in our view 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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