Brexit Factsheet:

The UK in a Changing Europe

No Deal: The WTO Option

What is the current situation?

The World Trade Organisation (WTO) is the global body governing international trade. Member countries that do not have a free trade agreement with each other trade under "WTO rules". If the UK does not reach an agreement with the EU on a future trading relationship after Brexit, then the default position is that WTO rules would apply on trade between the UK and the EU, and between the UK and third countries (including countries with which the EU has trade deals).

What has the British government indicated it wants?

The UK government has indicated that it wishes to negotiate a time-limited transition period after Brexit, during which the UK remains, effectively, part of the single market and the EU customs union. After that, it wishes to see a "deep and comprehensive free trade agreement" between the EU and the UK. The EU has not ruled out a time-limited transitional period, and is prepared to negotiate on the future trading relationship, but has stated that such negotiations cannot begin until the terms of withdrawal are settled under Article 50. Moreover, there are a number of substantive obstacles to a future trade agreement.

What are the possible outcomes?

If no agreement is reached by March 2019 – or there is agreement on a transition period, but none on a future relationship – then, by default, the UK will need to move to trading under the WTO regime, either in March 2019 or on the expiry of the transition period. Both the UK government and EU representatives have made statements implying that this outcome is a significant possibility.

The UK is a member of the WTO in its own right. But various procedures are needed to re-establish our autonomy from the rest of the EU. In particular, we have to agree on "schedules" for tariffs on goods. The government has stated that in the short term it would simply replicate the schedules of the EU to smooth our transition. There are some more problematic areas, such as agreeing on the division of quotas for goods where the EU currently has agreed quotas at EU level. Yet with enough goodwill and time, it should be relatively easy for the UK government to get agreement from WTO members to operate under WTO rules. It would also be necessary for the UK to negotiate with other countries with which the EU has free trade agreements; this might be more problematic.

Under WTO rules, each member must grant the same 'most favoured nation' (MFN) market access, to all other WTO members.[1] This means that exports to the EU would be subject to the same customs checks, tariffs and regulatory barriers that the UK and EU currently charge on trade with countries such as the US. The UK's exports to the EU and other WTO members would also be subject to the importing countries' most favoured nation tariffs.

What are the potential consequences of these outcomes?

The imposition of tariffs on trade with the EU would increase costs for both UK importers (and hence consumers) and exporters. The average EU tariff rate is low - around 1.5%. However, at a sectoral level, the impacts would be much larger: for example, for cars and car parts the tariff rate is 10%. Since most UK-based car production is exported, and uses imported parts, the impacts would be magnified. The impacts would also be large on agriculture, where EU tariffs and quotas remain high; this would result in significant food price inflation for British consumers.

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[1] The only exceptions to this principle are that countries can choose to enter into free trade agreements and they can give preferential market access to developing countries.

The UK could alleviate the impact on consumers by reducing or eliminating tariffs unilaterally – as long as this is done in a non-discriminatory way, this would be permitted under WTO rules. However, this would have significant impacts on domestic producers, especially in agriculture. In any case, increased tariff barriers would not be the most important impact. The bulk of the cost of doing business across borders comes from non-tariff barriers such as border checks, custom controls and compliance with different product standards and regulations across countries. These barriers cannot be removed unilaterally because they require trade partners to agree on a set of rules and regulations which they can both accept. While the UK is in the EU, its businesses do not have to go through border checks because they already qualify as being compliant with EU rules and regulations.

Under a hard Brexit/"WTO rules" scenario, without mutual recognition agreements for product standards, it is unlikely that UK products could enter the EU without further checks at the border. Over time, if there is divergence between UK and EU standards, UK businesses would need to produce two different product lines - one for the UK and one for the EU - which would increase costs and reduce competitiveness.

The impacts of non-tariff barriers would be larger for the service sector, which makes up 80% of the UK economy. Access to the single EU aviation market requires headquarters and majority shareholdings to be located within the EU so that it can have regulatory oversight on safety. UK service exporters would also suffer from the loss of 'passporting' rights for financial services, as well as reduced access for other service providers like legal and accountancy services.

The Centre for Economic Performance estimates that a "No Deal WTO rules only" scenario would reduce the UK's trade with the EU by 40% over ten years. This reduced trade would mean a fall in income per head of 2.6% per year (net of the savings from no membership fees). There would also be longer-term negative effects from lower investment and slower productivity growth, which are estimated to be another 3.5% of GDP. Adopting a policy of unilateral free trade would mitigate part of these costs. But the savings from unilateral tariff cuts are estimated to be just 0.35% of GDP. The short-term disruption resulting from the sudden imposition of these WTO rules could exacerbate these negative effects.

Further Reading

- Swati Dhingra and Nikhil Datta (2017), London Review of Books

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