

FINANCIAL MARKETS

A CLOSER LOOK
AT WTO RULES



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APPROACHING THE CLIFF EDGE?

FOREWORD

The World Trade Organization (WTO) and its trading rules have been a recent focus in media commentary.

It's understandable. The UK is set to leave the European Union (EU) on Friday 29th March 2019 - and at the time of writing, a Withdrawal Agreement hasn't been signed. Should it leave the EU without a deal, the UK would then trade on WTO rules.

The purpose of this eBook is simple. We'll explain how WTO rules would affect UK trade and business in the event of a "No Deal" Brexit.

Patrick Latchford
CEO, Blackwell Global Investments (UK) Limited

WHY THE WTO MATTERS

WHAT IS THE WTO?

First, let's clarify what the WTO is.

Put simply, the WTO is an organisation that governs global trade rules between countries. In total, there are 164 members of the WTO.

Now, what you need to understand is that WTO trade rules are "default rules". In other words, if two or more countries aren't in a free trade deal with one another, they must adhere to WTO rules.

This an important point - because it will apply to the UK should it leave the EU without a Withdrawal Agreement on Friday 29th March 2019.

But before we explore that scenario in more detail, it's vital to understand the history of the WTO and what the organisation aims to achieve.

WTO ORIGINS

The WTO was established in 1995 and replaced something called the General Agreement on Tariffs and Trade.

Essentially, the organisation was created to provide a globally accepted framework for international trade. In addition, the WTO was formed to resolve trade disputes between its members.

WTO SCHEDULES

Each member of the WTO has its own “schedule”. This is simply a list of tariffs and quotas that it applies to imported products from foreign countries.

As a member of the EU, the UK enjoys tariff-free trade with other EU members. Plus, the UK relies on the free trade deals negotiated by the EU as a whole. Remember - member states within the EU are not allowed to negotiate their own free trade deals.

This is why many politicians, economists and businesses worry about a “No Deal” Brexit, as it would see the UK revert to WTO “default rules”. Let’s explore the scenarios in further detail.

WTO RULES IN A NO DEAL SCENARIO

So, what happens if the UK leaves the EU without a deal on Friday 29th March 2019?

The answer is actually quite simple. Legally, the UK would no longer conduct free trade with the EU, or be party to any of the

trade agreements the bloc has negotiated.

The UK would then revert to WTO trade rules. Practically speaking, this would see the introduction of tariffs on certain products crossing the UK border.

Two industries that are likely to feel the impact of these tariffs are agriculture and the automotive sector. For instance, dairy products would see an approximate tariff of 35% applied when crossing the UK/EU border, while cars would see a 10% tariff.

Clearly, the introduction of tariffs is likely to have real consequences for business.

Specifically, the impact is two-fold. Firstly, UK business that import products from the EU could see the cost of those imports increase. Secondly, UK businesses that export products to the EU could see their products become more expensive for EU customers.

However, it's important to remember that in the event of a "No Deal" Brexit that GBP will likely depreciate. This could offset the additional costs faced by UK businesses that export products - but would further punish British businesses that import products from the EU.

And that's the real problem. UK businesses are anxious about disruption to international supply chains.

Not only would these businesses have to deal with increased costs in the event of a "No Deal" Brexit, but they would potentially have

to contend with time-intensive border checks on goods coming into the UK.

MOST FAVOURED NATION RULE

But couldn't the UK lower its WTO tariffs in order to promote free trade with other countries? The answer is yes, it can, but not for an individual country or bloc (unless a free trade agreement was secured with that country or bloc).

Any change to the UK's WTO tariffs has to apply to all countries. It's part of the WTO's Most Favoured Nation Rule. It's enforced so that every member of the WTO can conduct trade on a level playing field.

THE IMPORTANCE OF THE WITHDRAWAL AGREEMENT

A key provision within Prime Minister Theresa May's draft Withdrawal Agreement is a transition period with the EU. This would see the UK and EU maintain the status quo for 21 months while a future trading relationship is negotiated

WILL A "NO DEAL" BREXIT HAPPEN?

At the time of writing, a "No Deal" Brexit is still the default legal position come Friday 29th March 2019.

However, one factor which makes a "No Deal" Brexit unlikely is the parliamentary arithmetic in the House of Commons. Specifically, a clear majority of MPs want to avoid a "No Deal" Brexit from happening. It's why securing an amended Withdrawal Agreement

or an extension to Article 50 is viewed as more likely at this moment in time.

However, it's important to emphasise that a "No Deal" scenario is very much a possibility. The situation remains fluid - and traders should closely monitor developments in Brussels and UK parliament..

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Or contact Customer Support:

Tel: +44 (0)20 7397 3781

Email: cs@blackwellglobal.com

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