

Brexit Monograph 16: Leaving the Customs Union

30 November 2016

Introduction:

The World Trade Organisation (WTO) defines a customs union as the substitution of *a single customs territory* for two or more customs territories. All duties and other restrictive regulations of commerce (with certain exceptions) are eliminated. The common duties are known technically as a "common external tariff" (CET).

The customs union is a limited form of free trade agreement. It is distinguished from the classic form by the application of the CET and by its focus on tariff reduction. A fully-fledged free trade agreement (FTA) also abolishes internal duties (tariffs), although members are free to impose their own external tariffs.

The modern version of the FTA however, specifically identifies and abolishes non-tariff barriers to trade between members, with particular emphasis on eliminating regulatory barriers.

A customs union is one of the options for a post-Brexit trade relationship with the European Union. It is of such limited scope though that, *prior to the referendum on 23 June, it was largely regarded as a non-starter and rarely discussed.*

The seeds of confusion:

The recent (post-referendum) seeds of confusion seem to have been sown by *Dr Fox*, the current international trade secretary. The primary source can be traced to a 26 July article in the *Financial Times*, headed: "Fox presses May to pull out of EU customs union". In this, Dr Fox is said to have wanted "maximum freedom to negotiate new trade deals around the world" and was "determined that Britain should break out of the EU framework, which he believes has stifled such agreements".

The article introduces *two principle errors*.

The first is that the EU's *external trade policy* is an integral part of the customs union – and, therefore, to negotiate trade deals with third countries, we have to leave the customs union.

The second is that the removal of controls on *the cross-border movement of goods is a function of the customs union*, and that withdrawal from the customs union would necessary result in the re-imposition of these onerous and expensive controls, with the attendant paperwork.

The Treasury Paper:

This 201-page command paper was published in April 2016, before the referendum, and would appear to be the source of much of the error which has pervaded the current debate, making precisely the wrong assertions that the FT has made, assertions which are wrong in fact and historically unsustainable.

The specific assertions, wrongly made by the Treasury, are found in paragraphs 1.3-1.4. In paragraph 1.4 we are told that, "as a member state and part of the customs union, the UK does not have separate trade deals with [third] countries, but participates in EU negotiated deals". The error is repeated in Figure 1A (page 27), which asserts that the "customs union... establish[es] free trade deals beyond the EU". in paragraph 1.45 where it is asserted that membership of the Single Market gives the EU an important role in facilitating access to non-EU markets through its responsibility for negotiating external trade deals on behalf of all its members with non-EU countries. Indeed, it says, *"a common external trade policy is an inherent and inseparable part of a customs union"*.

The second error comes in paragraph 1.3 where perversely, the Treasury claims (para 1.3) that the Single Market creates a customs union within the EU. This "and allows for the removal of costly, complex and time-consuming customs controls *within the EU*". In paragraph 1.25, under the heading: "creating a customs union", the Treasury goes on to say that the "second element of the Single Market", the customs union, "means that *there are no customs checks on trade within the EU*".

The position on separate trade deals:

The claim that "a common external trade policy is an inherent and inseparable part of a customs union" is generic, rather than directed to the EU's specific form of customs union.

In this respect, one can rely on the official *WTO definition of a customs union*, accepting the WTO as an authoritative arbiter in such matters. *It does not exclude the possibility of individual members of a customs union making their*

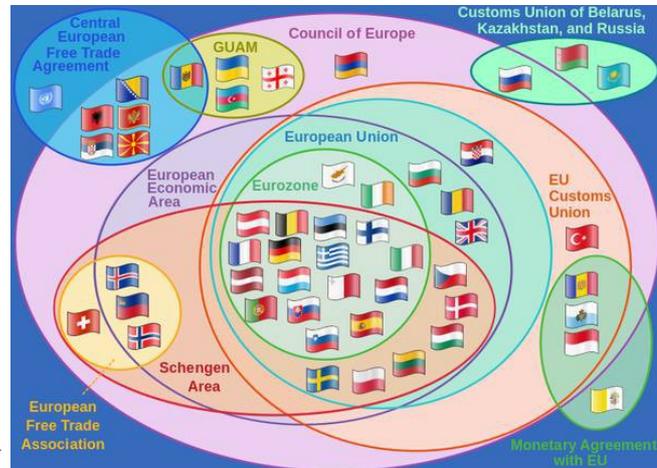


own deals with third countries.

The WTO simply makes the proviso that, if goods are then re-exported to the territory of another member, the latter member should collect a duty. (And that this duty should be equal to the difference between the duty already paid and any higher duty that would be payable if the product were being imported directly into its territory). This is the basis of what are known as the "rules of origin" (ROO), which apply as much to free trade areas as they do customs unions. With these rules applying, there is no bar to a member of a customs union negotiating trade deals with countries outside the union.

This is exactly the case with *the EU-Turkey customs union*, established in 1995 via Ankara Agreement of 1963. Between 1992 and 2013, Turkey has negotiated 19 free trade deals (including one yet to come into force), 14 are under negotiation and another 13 are planned.

In the current consolidated treaties, as amended by Lisbon, the customs union has shrunk to one article (Article 60). The common commercial policy (CCP) takes up Articles 206 and a lengthy 207 (TEU). Article 206 requires the Union to "contribute, in the common interest, to the harmonious development of world trade, the progressive abolition of restrictions on international trade and on foreign direct investment, and the lowering of customs and other barriers". Article 3 makes the CCP an exclusive Union competence and also *gives the Union exclusive competence for the conclusion of international trade agreements.*



Rather than the customs union, it is the common commercial policy and Article 3 which prevent individual Member States negotiating free trade deals.

The customs union and customs controls:

In 1984, customs formalities were taking an average of 80 minutes per lorry. Each hour's delay cost between £2.50 and £3.25. The overall cost of customs controls was therefore in the region of £1.7 billion (at 1980 prices) – between 5-10 percent of the value of the goods transported across frontiers. In the February that year, a go-slow by customs officials on the Franco-Italian border brought the system to crisis point, when French lorry drivers mounted a strike in protest, blockading roads and paralysing commerce. After two weeks, riot police and soldiers had to be mobilised to clear the roads.

Despite the customs union having been part of the original founding treaty, the specific issue of customs cooperation was not formally introduced into the treaty structure until the Maastricht Treaty. There, it is identified in Article K.1, as a "matter of common interest". Article K.3 permitted the Council to draw up conventions on customs cooperation. Taking this as the legal base, the original Naples Convention of 1967 was updated to become the Convention on Mutual Assistance and Cooperation between Customs Administrations of 1997 – called the Naples II Convention.

This remains in force and currently works alongside the current Union Customs Code (Regulation (EU) No 952/2013), which deals with trade between the Union and third countries. This is a harmonising instrument which brings together all the different customs rules of the Member States.¹

In EU treaty law and practice, the customs union involving the abolition of internal tariffs and the setting of a common external tariff, *and customs cooperation*, involving the abolition of customs controls at internal borders, *are entirely separate concepts.*

The idea that the removal of (physical) barriers at internal borders of the EU necessarily follows the abolition of internal tariffs within the customs union is entirely flawed. Anyone arguing differently needs to visit the Kapikule road border crossing between Bulgaria and Turkey. At the interface between Turkey and the EU – joined by their customs union - it is the busiest border crossing in Europe and the second busiest in the world. Commercial vehicles awaiting customs clearance are being delayed 12-24 hours. Border crossings between Greece and Turkey can be similarly problematical.

Conclusions:

In seeking an optimal Brexit settlement, it is both logical and sensible to avoid re-imposition of border controls between

1. Codification is relatively recent, stemming from Council Regulation (EEC) No 2913/92 of 12 October 1992. Tellingly, the current code relies for its legal base on Article 33 TFEU, entirely distinct from Articles 30-32 which cover the customs union, carried over from the original Treaty of Rome.

the UK and EU Member States. Equally, a newly independent UK would wish to negotiate its own trade deals. On the one hand, **the abolition of border controls** appears to depend on Britain's membership of the customs union while, on the other hand, Britain's membership of the customs union, seems **prevent our negotiating free trade deals globally**.

What emerges from this Monograph, though, is that the conflict is not real.

The restriction on negotiating trade deals stems not from the customs union but from the EU's common commercial policy and its exclusive competence over international trade agreements. On the other hand, while the removal of physical barriers to the free movement of goods within the Community is an **adjunct** to the customs union, **it is not dependent on it**. The abolition of frontiers came with the Single European Act in pursuit of developing the internal market, so the customs union is an irrelevance in this respect.

On the historical development of the EU, it is quite clear that the customs union pre-dates the Single (or internal) Market, and is a stand alone policy. **In most respects, the customs union has been replaced by the internal market**: the abolition of internal duties and quantitative restrictions are also brought about by this means. The only necessary **residual functions**, from the perspective of the EU, **are the maintenance of the common external tariff and the payment of the receipts into central Community funds as part of the traditional own resources**.²

The central question, though, is one which seems to have been completely ignored – whether the UK could leave the EU and remain in the customs union. To be part of that customs union would require the UK to be part of the structure of the EU, which it cannot be if it has left. In other words, it is highly questionable as to whether membership is even possible, post-Brexit.

That question though is academic. There are no advantages in the UK remaining in the customs union. In or out, the UK would be free to make its own trade deals (assuming it has withdrawn from the common commercial policy) and membership would have no impact on the free movement of goods.

To ensure the continued abolition of border checks, the UK will have to negotiate a separate deal. This would be much facilitated by maintaining its membership of the EEA.

To that extent, the customs union issue, and Britain's membership of it, is a red herring. The media conflict is spurious and has nothing to do with the substantive issues relating to Brexit. The question of our membership of the customs union should never have arisen. **It should be a given that we leave the customs union when we leave the EU**.

2. That was the primary purpose of the customs union, and why this form of trading agreement was chosen in the founding treaty. The revenue obtained was the principal resource to be assigned to the European Economic Community (EEC) to finance its expenditure. Continued membership of the customs union, therefore, would necessarily involve the UK continuing to make payments to the EU budget, as an inherent part of the policy.