

LEAVE ALLIANCE

Brexit Monograph 16

Leaving the Customs Union

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Introduction

The World Trade Organisation (WTO) defines a customs union as the substitution of a single customs territory for two or more customs territories, so that duties and other restrictive regulations of commerce (with certain exceptions) are eliminated with respect to substantially all the trade between the constituent territories of the union.¹

Additionally, the definition goes on, substantially the same duties and other regulations of commerce are applied by each of the members of the union to the trade of territories not included in the union. The common duties are known technically as a "common external tariff" (CET).

The customs union is a limited form of free trade agreement, 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.² But the modern version of the FTA goes much further, specifically identifying and abolishing qualitative and quantitative (non-tariff) barriers to trade between members, with particular emphasis on eliminating regulatory barriers.

Potentially, 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.

Since the referendum, however, the issue has emerged as a central part of the debate, specifically in terms of whether the UK should leave the customs union of which we are part, by virtue of our membership of the EU.

¹ See pg 792, para 8: https://www.wto.org/english/res_e/booksp_e/gatt_ai_e/art24_e.pdf

² *Ibid.*

The debate, as it has emerged, has highlighted an extraordinary degree of ignorance as to the nature of customs unions in general and the application of the EU's customs union, with considerable confusion over the respective roles of customs unions and free trade areas.

The purpose of this Monograph, therefore, is to clarify the role of the customs union, to clear up some of the more egregious misunderstandings, and to evaluate the relevance of this option to the UK's post-Brexit settlement with the EU.

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".³ 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".

According to the *FT* article, the customs union is an area that allows the free movement of goods with no tariffs, but imposes the same administrative and tariff barriers at its external borders. Under the customs union, the article says, the EU sets the same external tariff for all members but it then wrongly asserts that the EU also negotiates trade deals under the aegis of the customs union.

The article then goes on to say that quitting the customs union would not preclude Britain remaining in the European single market. But the UK's hands would be tied in trade deals because Britain would need to keep the same external tariffs as the customs union, leaving no room to negotiate on tariffs and other administrative issues. One government insider is said to have confirmed that Dr Fox wanted to leave the customs union, saying: "It's widely accepted that, to be able to negotiate free trade deals, we would have to be outside the customs union".⁴

In addition to this article though, the *FT* went on to publish another, of the same date, this one headed: "Whitehall split on a UK exit of EU customs union".⁵ This had it that there was a "live debate" in government (between the Treasury and Dr Fox's department) about whether Britain should quit the customs union, even though staying inside it could restrict Dr Fox's ability to strike new free trade deals or prevent them altogether.

Here, another element of confusion is introduced, as this article wrongly asserts (within the context of Norway and the EEA) that exporters in the single Market

³ <https://www.ft.com/content/e87614da-533a-11e6-befd-2fc0c26b3c60>

⁴ *Ibid.*

⁵ <https://www.ft.com/content/35063b50-532b-11e6-befd-2fc0c26b3c60+&cd=1&hl=en&ct=clnk&gl=uk>

but outside the customs union, "face customs controls, mandatory paperwork and - depending on the goods and their origin - duties to pay".

Thus, the article introduces two principal 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.

Thereby, we have the elements of an internal conflict in government – so beloved of the media. This has generated a widely disseminated but flawed narrative whereby Dr Fox's department wants to leave the customs union in order to regain the freedom to negotiate trade deals with third countries, while the Treasury wants to stay in the customs union in order to prevent the re-imposition of customs controls on UK goods exported to the EU.

Helpfully, in setting the parameters of this flawed debate, the *FT's* second article identifies a source of information, on which it appears to rely – "The HM Treasury analysis on the long-term economic impact of EU membership and the alternatives".⁶

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 Treasury paper

The specific assertions, wrongly made by the Treasury, are found in paragraphs 1.3-1.4. In terms of the first listed error, this comes in paragraph 1.4, where 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".

Actually, there is an amount of ambiguity here. As an EU Member State, it is true that UK does not have separate trade deals with third countries. The error comes with the reference to the customs union, repeated in Figure 1A (page 27), which asserts that the "customs union... establish[es] free trade deals beyond the EU".

However, the error is repeated and the ambiguity removed 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

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https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/517415/treasury_analysis_economic_impact_of_eu_membership_web.pdf

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 requires a common external tariff for goods arriving from outside it, "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". Such compliance checks, it says, add to an exporter's costs and so create trade barriers. This is true even when tariffs are eliminated, as the administrative costs associated with customs are an important barrier to trade.

The reader is left in no doubt as to the importance of these barriers. The impact of these administrative costs would be particularly pronounced for time-sensitive industries like fresh food or those participating in complex pan-EU supply chains such as the aerospace and automotive industries. For example, separate evidence from time-sensitive industries in countries acceding to the EU suggests that every one hour of customs delay adds 0.8 percentage points to the *ad valorem* trade-cost rate and leads to five percent less trade.

The position on separate trade deals

Addressing first, for the sake of convenience, the claim that "a common external trade policy is an inherent and inseparable part of a customs union", one notes that reference is made to the generic, rather than 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. Turning to that definition, one finds that it does not exclude the possibility of individual members of a customs union making their own deals with third countries, by virtue of its reference to members of a union importing into their own territories from third countries products at preferential rates of duty.⁷

Rather than prohibit or in any way exclude this as a possibility, 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 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

⁷ WTO pg. 792, *Op cit*

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 1963.⁸ This union applies to goods (other than agricultural products) produced in the EU or Turkey, including those from third countries which are in free circulation in EU Member States or Turkey, as long as any customs duties have been paid.

In accordance with the WTO proviso, however, any member of the union can export to other members, goods from third countries on which the full CET has not been paid. Those goods are not considered to be in free circulation. The importing State then applies additional charges, subject to what are known as "rules of origin" criteria.⁹ For Turkey, detailed rules of origin and related matters are set out in Decision No 1/2006 of the EC-Turkey Customs Cooperation Committee of 26 September 2006.¹⁰ These are elaborated in the Turkish government's consolidated decision on determination of origin of goods.¹¹

The point that emerges from this is that, in practical terms, membership of a customs union is in itself not a barrier to the negotiation of trade deals with third countries. 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.^{12,13}

This notwithstanding, within the broader EU-Turkey agreement, there are provisions relating to the harmonisation of Turkey' commercial policy with that of the Community (Union) which require Turkey progressively to align preferential agreements with third countries with the preferential customs regime of the Community.¹⁴ As of 2006, full alignment was achieved.¹⁵ Decisions published in the Official Gazette of the Republic of Turkey on 9 October 2003/25254 and 20 March 2004/25408 bring the rules of origin for third countries into line with those of the Community.¹⁶

These harmonisation provisions, however, extend the scope of the customs union, but they are not a *necessary* part of it. They are not required for the customs union agreement to be recognised as such under WTO rules.

⁸ http://www.avrupa.info.tr/fileadmin/Content/Downloads/PDF/Custom_Union_des_ENG.pdf

⁹ *Ibid.*

¹⁰ <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:22006D0646&from=EN>

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[http://www3.nd.edu/~jbergstr/DataEIAs2006/FTA5yrData_files/PDF%20Files/Europe/GSP%20-%20Turkey%20\(Origin%20rules%202001\).pdf](http://www3.nd.edu/~jbergstr/DataEIAs2006/FTA5yrData_files/PDF%20Files/Europe/GSP%20-%20Turkey%20(Origin%20rules%202001).pdf)

¹² <http://yoikk.gov.tr/upload/idb/ftascompatibilitymode.pdf>

¹³ https://www.wto.org/english/tratop_e/tpr_e/s331_e.pdf

¹⁴ Agreement, *op cit*, Article 16.

¹⁵ http://unctad.org/en/Docs/itcdtsbmisc74_en.pdf

¹⁶ *Ibid.* p.7.

The proof of this assertion lies in the text of the Treaty of Rome, the foundation document of the EEC – which was to become the EU.¹⁷ In the Treaty, the customs union is set out in Part Two, Title 1, Chapter 1. The Common Commercial Policy, on the other hand, is set out in Part Three, Title 2, Chapter 3. The customs union and the commercial policy share the same treaty, but the latter is no more dependent on the customs union than is the common agricultural policy found in the same Part Two as the customs union.

The separation is maintained in the current consolidated treaties, as amended by Lisbon. The customs union has shrunk to one article (Article 60 TEU), while 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.¹⁸

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

Returning to the Treaty of Rome, with the customs union set out in Part Two, there was only one reference to "customs matters".¹⁹ Member States were required "in so far as may be necessary" to approximate their laws, regulation or administrative action in respect of customs matters. To that end, the Commission had to make all "appropriate recommendations" to Member States.²⁰

One of first forays into this area was Council Regulation (EEC) No 222/77 of 13 December 1976, on Community transit. This was a procedure whereby goods brought into the customs territory of the Community could be carried from the place of entry to their destination or, in the case of passage through the Community, to the customs office at the point of exit, without renewed customs formalities when the goods crossed from one Member State to another.²¹

Although noting that the Community was "based on a customs union", the preamble to this Regulation pointed out that Article 27 did not empower the institutions of the Community to issue binding provisions on customs matters. In order to regulate at all, therefore, the Commission had to rely on the "catch-all" Article 235. There was no reliance at all on customs union provisions.

¹⁷ http://ec.europa.eu/archives/emu_history/documents/treaties/rometreaty2.pdf

¹⁸ https://europa.eu/european-union/sites/europa.eu/files/eu_citizenship/consolidated-treaties_en.pdf

¹⁹ Article 27

²⁰ Treaty of Rome, *op cit*.

²¹ <https://publications.europa.eu/en/publication-detail/-/publication/6f3c687a-305a-442e-bf15-8977c0927868/language-en>

During the period, customs cooperation had proceeded outside the remit of the Treaty of Rome, relying on an intergovernmental accord known as the Naples Convention of 1967. By the early 1980s, however, customs checks were still common at internal borders, despite the completion of the customs union in 1968. Very little progress had been made. Even the Community transit procedure had fallen into disuse.²² By the European Commission, the situation was described thus:

Last year a Belgian journalist rented a van and loaded it up with some old furniture that he wanted to take to a holiday house that he had just bought in the South of France. He drove to the frontier and was eventually allowed to cross an hour and a half, 15 signatures and half-a-dozen forms later. The import of second-hand furniture into France for a holiday home ('Do you have proof of ownership, sir?') is perfectly legal, and not subject to any tax or duty. But all the old French customs procedures still exist. The red tape involved in transporting an old wardrobe is the same as for a load of computers or fifty barrels of poisonous dioxin waste from Seveso.

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.²³

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.^{24,25,26}

At Community level, the response in June 1984 was for the Fontainebleau European Council to agree in principle to abolish customs and police formalities at the Community's internal borders.²⁷ On 13 July 1984, the French and German governments took the step towards attaining this objective, signing the Saarbrücken Agreement at the Saarbrücken-Forbach border crossing point in symbolic Goldene-Bremm area.²⁸ This bilateral treaty committed the two nations to reducing checks and establishing joint control points.²⁹

²² <http://aei.pitt.edu/52394/1/B0685.pdf>, see p. 8.

²³ *Ibid.*

²⁴ <http://archive.commercialmotor.com/article/25th-february-1984/7/french-chaos>

²⁵ <http://www.csmonitor.com/1984/0224/022433.html>

²⁶ <http://www.nytimes.com/1984/02/24/world/french-truckers-want-some-respect.html>

²⁷ http://www.cvce.eu/content/publication/2001/10/19/ba12c4fa-48d1-4e00-96cc-a19e4fa5c704/publishable_en.pdf

²⁸

https://translate.google.co.uk/translate?hl=en&sl=de&u=https://de.wikipedia.org/wiki/Goldene_Bremm&prev=search

²⁹

http://www.cvce.eu/en/obj/agreement_between_france_and_the_frg_on_the_gradual_abolition_of_checks_at_the_franco_german_border_saarbrucken_13_july_1984-en-46468e59-54ec-41c1-a15e-258d92568910.html

The following year, on 14 June 1985: Belgium Luxembourg and the Netherlands joined with France and Germany to build on this initiative, signing the Schengen Agreement.³⁰ The five countries committed themselves to the gradual abolition of checks at shared borders and to facilitate the transport and movement of goods at those borders.³¹

The theme was further developed in the White Paper on the completion of the internal market, also published on 14 June 1985, when complete abolition of frontiers was proposed.³² This was adopted in the Single European Act on 9 September 1985. Article 13 added measures to establish the internal market - "an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of this Treaty".³³

With the target of eliminating internal frontiers by 1992, in the interim, exit checks at Community internal frontiers were to be abolished when goods were transported between two Member States. Formalities were to be confined to the office at the point of entry, avoiding much of the duplication and delays that were still occurring.³⁴

Amongst other things, this report furnishes evidence that border controls were still an issue in the late 1980s, 30 years after the signing of the Treaty of Rome. It also demonstrates that the abolition of frontier controls came with the creation of the internal market, rather than with the customs union.

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".³⁵ 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.³⁶

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. Codification is

³⁰ <http://www.cvce.eu/en/education/unit-content/-/unit/02bb76df-d066-4c08-a58a-d4686a3e68ff/50c23742-6a21-483e-aebd-3aaf21b44bf9>

³¹ [http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A42000A0922\(02\)](http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A42000A0922(02))

³² http://europa.eu/documents/comm/white_papers/pdf/com1985_0310_f_en.pdf

³³ http://www.consilium.europa.eu/uedocs/cmsUpload/SingleEuropeanAct_Crest.pdf

³⁴ http://www.cvce.eu/content/publication/2003/2/20/c3566514-11e3-4f31-ad38-f42bb6a5bf07/publishable_en.pdf

³⁵ https://europa.eu/european-union/sites/europa.eu/files/docs/body/treaty_on_european_union_en.pdf

³⁶ [http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:31998F0123\(01\)&rid=2](http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:31998F0123(01)&rid=2)

relatively recent, stemming from Council Regulation (EEC) No 2913/92 of 12 October 1992.³⁷ 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.³⁸

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 *inter alia* the abolition of customs controls at internal borders, are entirely separate concepts.

The idea that the removal of (physical) barriers at internal borders necessarily follows the abolition of internal tariffs is entirely flawed. Anyone arguing differently needs to visit the Kapıkule 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.^{39,40,41} Border crossings between Greece and Turkey can be similarly problematical.⁴²

Conclusions

In seeking an optimal Brexit settlement, it is both logical and sensible to avoid re-imposition of border controls between the UK and EU Member States. Equally, a newly independent UK would wish to negotiate its own trade deals. That the abolition of border controls appears to depend on Britain's membership of the customs union while freedom to negotiate trade deals seems to be prevented by it sets up an obvious conflict.

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.

The confusion over these issues was initially spread by the *Financial Times* in the post-referendum period, but actually stems from the April Treasury report, one of its major errors being to assert that the customs union is part of the Single Market and is created by it. The confusion is not helped by the

³⁷ [http://eur-](http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:1992R2913:20070101:EN:PDF)

[lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:1992R2913:20070101:EN:PDF](http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:1992R2913:20070101:EN:PDF)

³⁸ <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013R0952&rid=1>

³⁹ <http://thecontinentaldrifters.com/bulgaria-eu-turkey-border/>

⁴⁰ <http://www.hurriyetdailynews.com/turkeys-trade-to-europe-see-delays-amid-long-truck-queues-at-kapikule-border-gate.aspx?pageID=238&nID=104566&NewsCatID=345>

⁴¹ <http://www.bta.bg/en/c/DF/id/1448701>

⁴² <http://www.dailysabah.com/nation/2014/07/09/turkish-border-gates-closed-due-to-strike-in-greece>

Commission grouping the customs code as part of the customs union acquis in its accession chapters.⁴³

Yet, in 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, as 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, is the maintenance of the common external tariff and the payment of the receipts into central Community funds as part of the traditional own resources.

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.⁴⁴ 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.⁴⁵

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. After all, since its inception, the EU has been based on a customs union. To be part of that 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.⁴⁶

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 membership should never have arisen. It should be a given that we leave the customs union when we leave the EU.

ends.

⁴³ See Chapter 29. http://ec.europa.eu/enlargement/policy/conditions-membership/chapters-of-the-acquis/index_en.htm

⁴⁴ <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=URISERV%3A134011>

⁴⁵ Currently about £2 billion: https://ec.europa.eu/taxation_customs/facts-figures/customs-duties-mean-revenue_en

⁴⁶ Through Protocol 10 and Protocol 11 of EEA Agreement, the Efta states agree mutual border inspection programmes with the EU, and commit to "mutual assistance" on customs matters.