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# Customs and Exiting the European Union

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## SUMMARY

Through the UK's membership of the EU, British firms currently benefit from frictionless borders with other EU member states. The consequence is that there is substantial trade across borders. UK firms are part of integrated just-in-time supply chains, with parts criss-crossing countries as part of the production process.

If the UK exits the EU Customs Union, border controls will have to be reintroduced for goods on both sides of the UK-EU border. Delays on either side will have an impact on costs for UK firms and on the time taken for key inputs to travel to their destinations.

Border controls do not relate solely to tariffs. They may derive from a need to charge VAT on imports to the UK or the EU. Compliance checks with either EU or UK standards may also need to be undertaken. The need to control VAT, or product regulation, as part of a border process will depend on whether the UK exits the European Single Market as well as the customs union.

Even if the UK agrees zero tariffs with the EU, UK firms will still have to pay tariffs if UK products crossing into the EU are not considered to have had enough value added in the UK to be considered British. British firms will also have to bear the costs of obtaining and completing certificates of origin, which set out how much value in a product has been created in the UK.

A further effect of leaving the customs union is that continental producers may have to remove UK suppliers from their value chains to meet their own added-value thresholds set out in free-trade agreements for EU exports to third countries.

Currently it takes a lorry two minutes on average to clear Dover port on arrival. The volume of trucks using Dover means that if eight minutes were added to that clearance time, there would be queues of trucks all the way to Dartford, over 60 miles away. The average clearance times for lorries on EU borders with Norway, Switzerland and Turkey are about this long or longer.

The UK government is currently discussing two rival technological solutions for speeding up the customs process. The collection of tariffs and the payment of VAT may or may not be

amenable to technological solutions with which the EU will agree. And at best, either could only be introduced over a considerable period of time and with very substantial government spending. This would certainly take longer than the current agreed transition period.

However, automating tariff and VAT collection will not on its own be sufficient to ensure frictionless trade across borders if the UK intends to permit divergence in product standards or allow third countries, such as the US, to export goods to the UK that do not meet EU product standards. In such situations, the EU is likely to want to verify that any UK exports have been produced to EU standards and to want to treat UK goods with the same verification processes as goods from any other third country. The EU will legally have to treat UK goods like those from any other third country in a no-deal situation.

The UK has suggested that mutual recognition of product standards would mean that product checks would not be necessary. However, the EU has rejected this approach, and it is difficult to see how any sovereign body could accept the UK proposal.

The UK has also suggested that technology may reduce or avoid the need for customs infrastructure at the border. However, all existing technological solutions involving online declarations still require infrastructure at the border. This is true of the Norwegian, Swiss and Turkish borders, which are sometimes suggested as examples that the UK could follow.

It is difficult to envisage any border control that would not require border infrastructure. Any declaration system will be open to abuse, and governments will want to supervise this by applying physical controls to at least a sample of traffic before allowing goods into their countries. Infrastructure at the border for carrying out controls will inevitably mean delays.

A number of specific solutions have been suggested for the EU-UK border, notably by the Institute of Directors, the Confederation of British Industry and the Labour Party, and the Centre for European Reform (CER). The UK government has put forward two additional and rival solutions. At the time of writing, the government is yet to resolve which it will pursue. Of all these

solutions, only that put forward by the CER—that the UK stay in the customs union and the single market for all goods, including all agricultural goods—would result in a frictionless border. However, the authors themselves acknowledge that this suggestion was making the best of a bad job.

The adoption of infrastructure at the Irish border—which appears inevitable unless the UK remains part of both a customs union with the EU and the single market—would also breach the Good Friday Agreement and the joint UK-EU commitment to avoid any hard infrastructure on the Irish border that has already been given as part of the negotiating process.

The declared purpose that Brexiteers have set out for leaving the customs union is to give the UK the opportunity to strike its own trade deals with countries outside the EU. However, the government's own figures show that the losses of going down this route significantly outweigh any gains.

This paper makes clear that the options available to the UK for its future trading relationship with the EU all come with compromises. On the one hand, remaining in the single market and customs union would minimise friction, minimise the impact to the UK economy and avoid a hard border in Ireland. On the other hand, it would mean the UK could not strike its own trade deals. All the other options come with varying levels of friction and implications for the UK's ability to make trade agreements with other countries.

## INTRODUCTION

The United Kingdom (UK) is in the European Union (EU) Customs Union, an area in which internal tariffs and quotas on imports are prohibited. The customs union has tariffs for goods entering from countries outside it and a Common Commercial Policy for negotiating trade deals with third countries to maintain or lower tariffs between the EU and third countries.

The external boundaries of the customs union are the external borders of the EU member states. Goods from outside the EU have to cross these borders to enter the European Single Market. At these borders, goods being imported from outside the EU have to pay any tariffs that are required.

However, this is not the only activity that occurs when a good from outside the single market enters the EU. Value-added tax (VAT) is collected from importers, and goods are checked for compliance with EU standards. It is worth noting that the mission statements of customs authorities around the world are nowadays at least as much about protecting citizens from imported risks as about their historic mission of collecting tariff revenue. For example, the stated responsibilities of Her Majesty's Revenue & Customs (HMRC) include "[protecting] the UK's fiscal, economic, social and physical security before and at the border"<sup>1</sup> For companies operating within the EU, tariffs do not exist. Taxes and compliance checks do not normally happen at the border.

If the UK leaves the EU, companies will potentially face tariffs, taxes and compliance checks at UK borders. Even if the UK and the EU agree zero tariffs with each other, there may still be tariffs to pay on goods exported from the UK to the EU. This could occur if goods produced in the UK are assessed as being third-country goods. British-manufactured goods are typically part of global supply chains. There may not be enough value added in the UK for them to qualify as British, and therefore they will not benefit from the zero tariff that applies to goods assessed as British and exported to the EU.

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<sup>1</sup> <https://www.gov.uk/government/organisations/hm-revenue-customs/about>. Similarly, the New Zealand Customs Service states, "Our main purpose is to stop any dangers, hazards and threats entering New Zealand." <https://www.customs.govt.nz/about-us/about-customs/what-we-do/>

UK businesses will have to pay VAT upfront at customs when they import from the EU. Currently, they pay when they do their accounts and typically after receiving payment from their customers. This will apply to all UK importers, including those that are currently below the £85,000 threshold and at this point tax exempt. This is expected to affect 130,000 importing businesses.<sup>2</sup> The same VAT costs will potentially apply to British firms exporting into the rest of the EU.<sup>3</sup> The EU has only one cross-border VAT agreement, with Norway, which is in the single market. It remains to be seen whether the UK could negotiate something similar, and it may be difficult if the UK does not accept falling under the jurisdiction of the Court of Justice of the European Union.

Border controls do not all necessarily have to take place at the border. However, it would require a sophisticated set of infrastructure and information technology (IT) to efficiently deploy a new set of tariff, tax and inspection regimes. Such a regime would have to be duplicated on either side of the border, and it would have to be coordinated on either side of the border. Such a system does not currently exist at the required scale in the UK, nor does it exist in all of the EU countries to which UK exports would travel. In the absence of such infrastructure and IT systems, controls would have to take place at the border.

It is also the case that if there is divergence between the UK and the EU in tariff regimes or in regulated product standards (or if the UK allows imports from third countries with differing standards), then it is highly likely that the EU will wish to maintain border controls.

The imposition of border controls on trade with the EU would potentially create capacity constraints at ports. The volume of traffic is such that even a small increase in the time taken for lorries to clear the ports on either side of the Channel (or both) could lead to immense tailbacks on UK roads leading out of Dover and Folkestone.

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<sup>2</sup> <https://www.financialdirector.co.uk/2018/01/18/brexit-vat-changes-spell-nightmare-uk-businesses/>.

<sup>3</sup> For a detailed discussion of the EU VAT regime, see [https://publications.parliament.uk/pa/cm201719/cmselect/cmeuleg/301-xxii/30103.htm#\\_idTextAnchor003](https://publications.parliament.uk/pa/cm201719/cmselect/cmeuleg/301-xxii/30103.htm#_idTextAnchor003).

The reappearance of infrastructure at the Irish border would also breach the Good Friday Agreement and the existing joint declaration of the EU and the UK regarding negotiations on the UK's withdrawal agreement.

A consequence of the confluence of issues is that a border solution cannot deal with just one of tariffs, VAT and regulatory compliance; it must deal with all three forms of control. Brexiteers argue that the advantages of signing new trade deals with third countries outweigh the costs of exiting the single market and the customs union. This is not what the UK government's own figures or independent research finds.

Trade in services is not affected by whether or not the UK is in the customs union. Tariffs do not apply to services, and control of a physical property is not relevant. The impact of exiting the single market on services will be considered in a future paper by the Institute.



## THE SITUATION TODAY

### MEMBERSHIP OF THE CUSTOMS UNION

In the EU Customs Union, member states have agreed to abolish all tariffs between them and to have a common external tariff on goods coming in from third countries. Member states also have EU regulation of the single market in common. This allows the member states to dispense with the need for customs posts at borders and lets trade go through more quickly and smoothly. This means British firms either exporting goods to other EU countries or importing goods into the UK from other countries do not generally face customs checks<sup>4</sup> and do not have to make customs declarations.<sup>5</sup>

The paperwork is also light. No customs declaration is required. Businesses must, however, record exports in their VAT declarations. Supplementary declarations must be made monthly if imports are above £1.5 million a year or exports are above £250,000 a year, and the terms on which they are supplied must be declared to HMRC if the value exceeds £24 million.<sup>6</sup>

In practice, this means a British lorry simply drives onto a ferry at Dover and off again when it arrives at Calais or drives across the Irish border at Newry. (Spot checks can of course be made if customs authorities suspect fraudulent activity.) The time taken at Dover between entering and exiting the port is typically under two minutes.<sup>7</sup>

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4 [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/504604/Alternatives\\_to\\_membership\\_-\\_possible\\_models\\_for\\_the\\_UK\\_outside\\_the\\_EU.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/504604/Alternatives_to_membership_-_possible_models_for_the_UK_outside_the_EU.pdf), p. 14.

5 <https://www.gov.uk/guidance/dispatching-your-goods-within-the-eu>. The exception with respect to customs declarations occurs for controlled goods like weapons or dangerous chemicals. Licences are also required for the export or import of live animals and plants: greater checks are required to ensure that animal and plant diseases are not transported across borders. However, these checks do not normally take place at the border for intra-EU trade.

6 Exports and imports within the EU are called dispatches and arrivals, respectively.

7 Evidence of Rupert Everitt, chairman of the Port of Dover, to the House of Commons Exiting the European Union Committee, "Oral evidence: The progress of the UK's negotiations on EU withdrawal, HC 372", 29 November 2017, <http://data.parliament.uk/writtenevidence/committeeevidence.svc/>

The consequence is that as intended from participation in the single market, the EU genuinely operates as a single market for trade in goods. This not only permits consumers to buy products easily from other member states but also means that supply is put together on a cross-border basis. Production is organised on a just-in-time basis, with parts potentially crossing between countries multiple times in the course of the production process. In a single market, this is no more surprising than having factories located in different parts of the same country specialising in the element of production at which they are most efficient.

Over half of the UK's imports from the EU are of such intermediate goods and services, as are nearly 70 per cent of British exports to the EU.<sup>8</sup> Cars and car parts are the single largest UK goods export.<sup>9</sup> In the UK, 37 per cent of the total value of spend in the supply chain (£33 billion in 2012) is sourced locally, whereas, depending on the manufacturer, between 20 and 50 per cent is imported from the EU, and the rest from outside the EU.<sup>10</sup>

The story of the Mini's crankshaft illustrates how intermediate parts can move between member states before being sold as a final product:

*If there is just one anecdote that succinctly sums up the problems that Brexit and the threat of tariffs pose to the UK car industry, it is this: the story behind the crankshaft used in the BMW Mini, which crosses the Channel three times in a 2,000-mile journey before the finished car rolls off the production line.*

*A cast of the raw crankshaft – the part of the car that translates the movement of the pistons into the rotational motion required to move the vehicle – is made by a supplier based in France.*

*From there it is shipped to BMW's Hams Hall plant in Warwickshire, where it is drilled and milled into shape. When that*

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evidencedocument/exiting-the-european-union-committee/the-progress-of-the-uks-negotiations-on-eu-withdrawal/oral/75023.html.

8 <http://ukandeu.ac.uk/firms-supply-chains-form-an-important-part-of-uk-eu-trade-what-does-this-mean-for-future-trade-policy/>.

9 <https://atlas.media.mit.edu/en/profile/country/gbr/>.

10 <https://assets.kpmg.com/content/dam/kpmg/pdf/2014/04/uk-automotive-industry-and-the-eu.pdf>.

*job is complete, each crankshaft is then sent back across the Channel to Munich, where it is inserted into the engine.*

*From Munich, it is back to the Mini plant in Oxford, where the engine is then “married” with the car.*

*If the car is to be sold on the continent then the crankshaft, inside the finished motor, will cross the Channel for a fourth time.<sup>11</sup>*

Pan-European supply chains are also increasing in intensity. In 1995, 27.3 per cent of jobs in producing for EU markets were for intermediate elements in a supply chain, whereas by 2011, this represented 38.7 per cent.<sup>12</sup>

Just-in-time considerations are particularly critical for food supply chains. The British Retail Consortium told a House of Lords committee,

*Currently due to frictionless borders, even the most perishable products such as soft fruit can be transported from Spain but still have 5 days shelf life in store or fresh beef can be transported from Ireland, minced and still have up to 10 days shelf life. Delays due to border controls will reduce the life of products in the home, driving up food waste or, in the worst cases meaning it is unproductive to put it into store. We know where SPS [Sanitary and Phytosanitary] checks are applied to products from outside the EU such as processed meat coming into the UK that additional checks can take up to 2 days which is not feasible for a fresh supply chain.<sup>13</sup>*

According to the House of Lords committee, modelling by the UK Trade Policy Observatory found that even if the UK government negotiated a free-trade deal with the EU to keep tariffs at zero and minimise non-tariff barriers, the cost of border inspections and some low-level non-tariff barriers would cause food prices to rise by 3.8 per cent.<sup>14</sup>

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<sup>11</sup> <https://www.theguardian.com/business/2017/mar/03/brexit-uk-car-industry-mini-britain-eu>.

<sup>12</sup> Gasoriek, M. and Mendez-Para, M. (2014) “Ties that bind: the British jobs data that really shows the value of the EU”, <http://theconversation.com/ties-that-bind-the-british-jobs-data-that-really-shows-the-value-of-the-eu-34032>.

<sup>13</sup> House of Lords European Union Committee, “14th Report of Session 2017–19 HL Paper 129 Brexit: food prices and availability”, p. 13.

<sup>14</sup> *Ibid*, p. 14.

## IMPORTS INTO THE EU FROM THE REST OF THE WORLD

An exporter from a third country must submit an export declaration, for instance electronically via a freight forwarder—a third party that handles documentation and transportation. The export declaration includes the commodity code, VAT registrations in the country of origin and the country of destination, and certificates of origin of the goods. A customs declaration costs £20–45 per declaration. The estimation is that there will be 200 million more customs declarations (from the current 55 million) after Brexit in the UK, and the direct costs to business could be £4–9 billion.<sup>15</sup>

The paperwork includes a single administrative document and an entry summary declaration, with additional documents required for highly regulated goods, transport permits and insurance certificates. The single administrative document consists of 54 boxes with eight (mostly duplicative) parts, which must be completed and submitted for every declaration.<sup>16</sup>

The goods must be cleared by the domestic customs authority before they can be exported. This can simply be on the basis of the paperwork unless a risk assessment suggests that they need inspection. If they need to be inspected, the goods may have to go into storage until the inspection can be conducted. This can be a lengthy period of up to 90 days. Inspections can be forensic and involve the testing of samples. The likelihood of a consignment being inspected will depend on the country of origin, the trading history of the importing company and the type of good. This tends to mean that the brunt of inspection falls on small and medium-sized enterprises (SMEs), which trade less often. The costs of inspection are charged to the importer.

Once the goods arrive in the country of destination, the entry summary declaration must be provided. The rules of origin of the goods are checked, as this helps determine the duties to be paid. Duties must all be paid. The certificate-of-origin document

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<sup>15</sup> Institute for Government, p. 39.

<sup>16</sup> [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/374246/c88\\_1-8\\_-cont.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/374246/c88_1-8_-cont.pdf).

determines the rate if there is a free-trade agreement (FTA) between the country of origin of the exporter and country to which the good is being exported and there is a preferential tariff that is lower than the general tariff applied under the World Trade Organisation (WTO) regime. VAT must be paid.

## **TRADING UNDER WTO RULES**

In the absence of an FTA or a customs-union agreement between a country and the EU, a country's exports into the EU are covered by WTO terms. In the EU agreements referred to above, zero tariffs apply. Under WTO terms, there are 135 different EU tariff rates for different goods imported from third countries, ranging from 0 to 10 per cent on manufacturing, 20 per cent on many types of food and drink, and over 70 per cent on some tobacco products. There are 150,000 goods classifications that can attract a rate.<sup>17</sup>

The Organisation for Economic Cooperation and Development (OECD) estimates that inefficiencies arising from border clearance—not including the effects of tariffs—add costs of up to 10 per cent of the value of goods traded in OECD countries.<sup>18</sup> Open Europe estimated in 2015 that if UK companies had to meet border costs, compliance would on its own reduce UK gross domestic product (GDP) by a very substantial 1.19 per cent a year.<sup>19</sup>

Once an applicable tariff has been paid on a third-country good, the good is free to circulate within the EU.

## **KEY POINTS**

Delays in getting a good from the producer in the exporting country to the consumer in the country of destination can result

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<sup>17</sup> <https://home.kpmg.com/content/dam/kpmg/uk/pdf/2017/01/brexit-trade-theresa-may-can-navigate-customs-conundrum.pdf>.

<sup>18</sup> [http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=TAD/TC/WP\(2013\)3/FINAL&docLanguage=En](http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=TAD/TC/WP(2013)3/FINAL&docLanguage=En).

<sup>19</sup> Open Europe, "What if... the consequences and challenges and opportunities facing Britain outside the EU" (2015).

from the application of controls by the border authorities at either end or both.

Inspections are more likely if the country of origin's manufacturers generally produce to standards other than EU ones. For example, the EU rules on agriculturally produced food (agri-food) mean that 20–50 per cent of the shipments of beef and lamb from outside the EU must be checked by a food-health agency at the border, unless there is an agreement between the EU and the exporting country that exempts most checks.<sup>20</sup>

This point about divergence of regulation driving inspections can quite often be missed in discussions that focus purely on the role of customs as a mechanism for collecting trade duties. If a country has or introduces an ability to diverge from EU product standards, importers will have to include certification with their declaration showing that they have produced to EU standards. This will likely lead to greater checks at the border to verify that they have done so.

Importers must produce rules-of-origin certification to benefit from any preferential tariff rate in an FTA between the EU and the other country. The UK and EU have expressed a preference for zero-rate tariffs. An FTA between the UK and the EU would set the terms under which a good is considered to be either from the UK or a European import, product type by product type.<sup>21</sup> Typically, to qualify under agreement, this requires that a threshold percentage of value be added in the country of export. This prevents exporters in a country that does not have a preferential tariff agreement with the EU from routing their exports via the UK to avoid the tariffs they should be paying if exporting directly to the EU.

There is a large compliance cost for businesses in completing rules-of-origin certification. A 2013 report by the Centre for Economic Policy Research, commissioned by the UK government for its balance-of-competences review, estimated that the indirect

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20 Institute for Government, "Implementing Brexit: Customs" (2017), p. 19.

21 As CBI Director General Carolyn Fairburn put it in a speech at Warwick University on 31 January 2018: "Every consignment would also need . . . certificates of origin . . . declaring how much of each product has been made where. The Canada-deal rules of origin are as long as *The Lion, the Witch and the Wardrobe*. And a lot less fun to read." [www.cbi.org.uk/insight-and-analysis/a-business-plan-for-a-good-brexite/](http://www.cbi.org.uk/insight-and-analysis/a-business-plan-for-a-good-brexite/)

compliance costs to UK business of implementing rules-of-origin requirements on UK-EU trade would be approximately £3 billion per year.<sup>22</sup>

However, the problem of the rules of origin goes beyond a simple compliance cost. It poses real difficulties for UK participation in pan-European supply chains. Trade expert Sam Lowe gave the following evidence to the House of Lords Brexit Committee:

*Average UK added value is 42%, but to qualify for any free trade agreement the threshold is usually 55%. When I talk to them, they say that the locally sourced value-added is actually lower, because they are just counting the number of suppliers they buy off locally, but those suppliers might have got those inputs from elsewhere. It becomes a big problem for supply chains, especially when you take into account that we are currently part of a Europe-wide supply chain in most of these products, and we are largely a producer of intermediary goods. We import to export, so what happens to these supply chains once you leave a customs union?*<sup>23</sup>

In this context, it is important to note that under WTO rules, UK car exports to the EU would be subject to a tariff of 10 per cent and car parts to a tariff of 5 per cent. Profit margins for car producers are low: in 2015, they ranged from 2.9 to 9.7 per cent for a range of the largest manufacturers.<sup>24</sup>

In addition, UK content would now cause problems for EU exporters that use UK inputs that would no longer be counted as EU added value. This may lead EU exporters to switch to intermediate suppliers in the rest of the EU.<sup>25</sup> This is a particular problem for the

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22 Available at [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/271784/bis-14-512-trade-and-investment-balance-of-competence-review-project-report.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/271784/bis-14-512-trade-and-investment-balance-of-competence-review-project-report.pdf).

23 Evidence of Sam Lowe to the House of Commons Exiting the European Union Committee, “Oral evidence: The progress of the UK’s negotiations on EU withdrawal, HC 372”, 21 February 2018, <http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/exiting-the-european-union-committee/the-progress-of-the-uks-negotiations-on-eu-withdrawal/oral/78927.pdf>.

24 <https://www.cer.eu/publications/archive/bulletin-article/2018/holding-out-hope-half-way-brexite-house>.

25 <http://www.statista.com/statistics/280346/ebit-margin-of-the-leading-carmanufacturers/>.

UK because 70 per cent of its good exports are intermediate inputs for other EU manufacturers' final exports to the rest of the world.<sup>26</sup> Under the EU trade deal with South Korea, a product exported from the EU qualifies only if less than 45 per cent of the value of the good is imported.<sup>27</sup>

The UK government hopes that it can negotiate mutual-recognition agreements with the EU so that UK goods are assumed to meet EU standards and therefore do not need to be checked for product compliance at all. This would be a superior version of mutual recognition to that available among EU member states and has never been granted by the EU before to a third country on a generalised basis.<sup>28</sup> The UK proposal would mean that once a product has been made to UK standards, it would have to be accepted in any other EU member state and no other member state could put in place barriers, even if it had legitimate public-interest concerns. Such member-state controls are feasible within the EU subject to the control of the Court of Justice and the democratic legislative institutions.

While the UK government proposes that tensions concerning regulatory divergence could be managed through joint institutions, this would give the UK an unparalleled weighting compared with any other EU member state. In trade agreements, the EU is instead prepared to grant mutual recognition of conformity testing only. This means that the EU and the third country agree to accept each other's conformity-assessment certificates for specific sectors. For example, under the trade deal between the EU and Canada, a designated conformity-assessment body in the EU can test EU products for export to Canada according to Canadian rules, and vice versa.<sup>29</sup> This does not remove the need for border controls but means it is much more likely that this can be restricted to a check of paperwork rather than product testing.

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26 <https://www.reuters.com/article/us-britain-eu-aviation/brexit-seen-threatening-uk-links-in-eu-supply-chain-idUSKCN1IE09G>.

27 <http://ukandeu.ac.uk/firms-supply-chains-form-an-important-part-of-uk-eu-trade-what-does-this-mean-for-future-trade-policy/>.

28 <http://eulawanalysis.blogspot.co.uk/2018/03/what-mutual-recognition-really-entails.html>.

29 <http://ec.europa.eu/growth/tools-databases/nando/index.cfm?fuseaction=ceta.main>.



## **BORDER FRICTIONS IN THE BESPOKE DEALS WITH NORWAY, SWITZERLAND AND TURKEY**

Comparative review of the time taken to clear EU border controls indicates that having different tariffs with the rest of the world, needing to pay VAT on imports and having different product regulation from the EU all have a slowing effect.

Even where there are zero tariffs between the EU and the UK, if there is no common external tariff because the UK and the EU are striking their own trade agreements for goods with third countries, there will be a need for controls. This can also arise if certain goods are excluded and there is a partial customs union. An incomplete customs union means controls, as Dr Peter Holmes put it in evidence to the House of Commons Brexit Committee:

*A very basic point, in my mind, is that an incomplete customs union is a quantum leap away from a complete one . . . The moment that anything is excluded—in this case, agriculture is excluded—you have to have a provision for stopping every truck just in case. Normally, they will be waved through, but unless your agreement is complete, it does not deliver you the frictionless border that you might hope for . . . Incompleteness is not a gradual thing. It is either complete or it is not, and if it is not, you potentially have lots of problems.<sup>30</sup>*

The requirement to pay VAT on imports will also potentially drive a need for border controls to ensure that the tax is paid.

Verification of compliance with product standards can be controlled at the border as well. For example, checks are applied at Felixstowe to verify that kitchenware from China and Hong Kong does not contain toxic materials.<sup>31</sup> Such checks are unnecessary for goods produced in the EU because they are only permitted to be

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<sup>30</sup> Evidence of Dr Peter Holmes to the House of Commons Exiting the European Union Committee, “Oral evidence: The progress of the UK’s negotiations on EU withdrawal, HC 372”, 21 February 2018, <http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/exiting-the-european-union-committee/the-progress-of-the-uks-negotiations-on-eu-withdrawal/oral/78927.pdf>

<sup>31</sup> A description of these checks can be found at [http://www.porthhealth.eu/plastic\\_kitchenware.htm](http://www.porthhealth.eu/plastic_kitchenware.htm).

sold in the EU in compliance with EU product standards in the first place.

In table 1, EU borders are colour coded green, amber or red depending on the extent to which they are frictionless. Only being in the customs union and the single market is completely frictionless.<sup>32</sup> Being in the European Economic Area (EEA), like Norway, has the next-lowest degree of friction. Norway has access to the single market but is not in the customs union.

*Table 1: Degrees of Friction in Trade Arrangements at Existing EU Borders*<sup>33</sup>  
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|   | <b>UK<br/>(current)</b> | <b>Norway<br/>(the EEA<br/>option)</b> | <b>Switzerland</b>              | <b>Turkey</b>                         | <b>No deal</b> |
|---|-------------------------|--|---------------------------------|---------------------------------------|----------------|
| Trade relationship with the EU                      | Single market           | Single market                          | Single market (in some sectors) | Customs union (excluding agriculture) | WTO rules      |
| Tariffs on EU goods?                                | No                      | No                                     | Some                            | Some                                  | Yes            |
| Non-EU tariffs on goods from the rest of the world? | No                      | Yes                                    | Yes                             | No                                    | Yes            |
| Different   | No                      | Few                                    | Some                            | Some                                  | Yes            |

32 This table is an amended version of a table that first appeared in the Times:<https://www.thetimes.co.uk/article/brexit-and-the-irish-border-jcm02pmz0>. The amendment comprises of the addition of the final row, the replacement of a Northern Ireland column with a UK column and the addition of a WTO column.

33 Typical Delays: The BBC comes to similar estimates to the Times: [http://www.bbc.co.uk/news/uk-44054594?ns\\_mchannel=social&ocid=socialflow\\_twitter&ns\\_source=twitter&ns\\_campaign=bbcnews](http://www.bbc.co.uk/news/uk-44054594?ns_mchannel=social&ocid=socialflow_twitter&ns_source=twitter&ns_campaign=bbcnews).

34 Additional checks at the border: This row is a modified version of a slide tweeted by the border expert, Dr Katy Hayward of Queen's University, Belfast: [https://pure.qub.ac.uk/portal/en/persons/katy-hayward\(a22013b2-7ab5-47ff-bbe9-6683e46c35b8\).html](https://pure.qub.ac.uk/portal/en/persons/katy-hayward(a22013b2-7ab5-47ff-bbe9-6683e46c35b8).html).

|  | UK<br>(current)  | Norway<br>(the EEA<br>option)   | Switzerland   | Turkey  | No deal   |
|--|--|---|---|---|---|
| regulations?   |  |   |   |   |   |
| VAT paid on import?                                    | No   | No  | Yes   | Yes   | Yes   |
| Sharing of customs facilities?                         | No   | Yes   | No  | No  | No  |
| Manual checks at the border?                           | No   | Yes   | Yes   | Yes   | Yes   |
| Cameras at the border?                                 | Some   | Yes   | Yes   | Yes   | Possible  |
| Typical delays   | Two minutes  | Five to ten minutes   | 30-45 minutes   | Hours   | Rapid - 20 minutes to days  |
| Compatible with UK-EU commitments on the Irish border? | Yes  | No  | No  | No  | No  |
| Additional checks at the border                        | <ul style="list-style-type: none"> <li>- Restricted goods (eg hazardous waste)</li> <li>- Prohibited goods (eg class A drugs)</li> <li>- Excise goods (eg alcohol)</li> <li>- Goods identified as a result of risk assessment</li> </ul> | <ul style="list-style-type: none"> <li>As in UK column, plus:</li> <li>- Agricultural produce</li> <li>- All third-country goods</li> <li>- Rules of origin</li> <li>- Expanded list of restricted goods</li> </ul> | <ul style="list-style-type: none"> <li>As in UK column, plus:</li> <li>- Regulatory compliance</li> <li>- VAT paid on import</li> <li>- All third-country goods</li> <li>- Transport permits</li> <li>- Rules of origin</li> <li>- Some agricultural produce</li> </ul> | <ul style="list-style-type: none"> <li>As in UK column, plus:</li> <li>- All goods not covered by the customs union</li> <li>- Agricultural produce</li> <li>- Regulatory compliance</li> <li>- Transport permits</li> <li>- VAT on import</li> </ul> | <ul style="list-style-type: none"> <li>As in UK column, plus:</li> <li>- Conformity assessment procedure on all products prior to access to EU market</li> <li>- Regulatory compliance checks</li> <li>- Potential for customs controls (tariffs and quotas) for all goods</li> </ul> |

|   | UK<br>(current) | Norway<br>(the EEA<br>option) | Switzerland | Turkey | No deal   |
|---|-----------------|-------------------------------|-------------|--------|---|
|   |                 |                               |             |        | crossing<br>the border<br>- Permits<br>required<br>for<br>transport<br>-<br>Agricultural<br>produce<br>- VAT on<br>import |
| Extent to<br>which trade is<br>frictionless | 5/5             | 4/5                           | 2/5         | 1/5    | <1/5  |

## EXPERIENCE AT THE BORDER

### THE UK: DOVER AND FOLKESTONE

Lorries travelling to destinations in the single market and customs union or from northern Europe to the UK board ferries in under two minutes. Currently, there is no general customs processing at the northern European ports or at Dover or Folkestone. These ports are the principal artery for trade between the UK and continental Europe, and this means that a small increase in customs paperwork risks clogging them up. Well over half of the 4.5 million heavy-goods vehicles that travel through British ports every year pass through Dover.

James Hookham, deputy chief executive of Britain's Freight Transport Association, said in an interview with the *Financial Times*, "If you add an average of two minutes to customs processing [at either end], you get a 17-mile queue [from Dover] almost back to Ashford. Another four minutes takes the queue back to Maidstone, six minutes back to the M25, eight minutes and you are up to the Dartford crossing and Essex."<sup>35</sup> Currently, when a lorry is checked as a result of a risk assessment, the average delay is 20 minutes.<sup>36</sup>

An in-depth report by the Institute for Government details the potential capacity problems at these ports and the long period that would be required for them to cope with the jump in scale of the controls that may be necessary if the UK exits the customs union and the single market.<sup>37</sup> Experts have underlined that delays will be caused not only by processing customs declarations but also by undertaking checks to verify compliance with either EU or UK regulatory standards. Hookham stated in testimony to the House of Commons Brexit Committee,

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<sup>35</sup> <https://www.ft.com/content/7ff7c97c-b33c-11e7-a398-73d59db9e399>.

<sup>36</sup> Evidence of Rupert Everitt, chairman of the Port of Dover, to the House of Commons Exiting the European Union Committee, "Oral evidence: The progress of the UK's negotiations on EU withdrawal, HC 372", 29 November 2017, <http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/exiting-the-european-union-committee/the-progress-of-the-uks-negotiations-on-eu-withdrawal/oral/75023.html>.

<sup>37</sup> Institute for Government, "Implementing Brexit: Customs" (2017).

*In some respects, though, the more serious proposition was the decision to leave the single market, because it is the single market that gives us the true benefit of the frictionless trade at the moment. It is that way that the conformity checks, the checks by which European standards and norms are enforced, will most significantly change. It changes from a background check, where enforcement is done largely at the point of production or at other points in the supply chain. By coming out of the single market and losing the mutual recognition of those conformity checking systems, the checks move from the point of production to the border. That is why you are hearing so much about the congestion around the border: because there will be a lot of different agencies—possibly up to a dozen or 15 or so—seeking to conduct the work they previously did in the background in the very congested areas of our roll-on, roll-off ferry ports. We are concerned about the physical performance of those checks, and the delays and the queues that will pose to the infrastructure.<sup>38</sup>*

Outside the EU, the UK could minimise the number of checks on imports from the EU, but only as part of a comprehensive trade deal. If it did so unilaterally in the absence of an FTA, it would legally have to extend such treatment to all imports from all WTO countries.<sup>39</sup> Despite some claims to the contrary, the argument

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<sup>38</sup> Evidence of James Hookham, deputy chief executive of the Freight Transport Association, to the House of Commons Exiting the European Union Committee, “Oral evidence: The progress of the UK’s negotiations on EU withdrawal, HC 372”, 29 November 2017.

<sup>39</sup> Dr Sylvia de Mars, lecturer in law at the University of Newcastle, has said, “It would not be for the United Kingdom to unilaterally not apply a customs border, if it is treated as a separate customs territory. The WTO would not permit that. It is not as simple as saying, ‘We will not put up a border’. If you don’t put up a border to the EU, you would then have to not put up a border to the entirety of the WTO membership. That would be most-favoured nation. That is genuinely not an option, unless we go for maximum deregulation and literally no borders, no tariffs, no controls, on anything ever coming into the United Kingdom again.” Evidence to the House of Commons International Trade Committee, “Oral evidence: Implications of arrangements for Ireland - Northern Ireland border for wider UK Trade Policy, HC 665i”, 13 December 2017, <http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/international-trade-committee/implications-of-arrangements-for-ireland-northern-ireland-border-for-wider-uk-trade-policy/oral/75929.html>. The House of Lords Select Committee on Exiting the EU has come to the same conclusion; see paragraph 22 of

that the UK has a unilateral ability to not put in place border controls is a fantasy.<sup>40</sup>

In any event, unless the minimisation of checks were mirrored in northern Europe, the capacity problem would remain. The queues of lorries along the M20 in Kent in 2015 was due to a temporary strike in Calais and nothing to do with any issue in Dover or Folkestone.<sup>41</sup>

Unsurprisingly, all of the UK's main business trade associations are very unhappy at the idea of the UK being outside the customs union. The Federation of Small Businesses submitted evidence to the UK government's balance-of-competences review of trade that it is an advantage to small businesses that there are no physical or customs barriers when trading within the single market.<sup>42</sup> The Confederation of British Industry (CBI) also recently called for the UK to stay in a customs union with the EU.<sup>43</sup> The Institute of Directors has called for a customs union similar to that between the EU and Turkey.

## THE NORWEGIAN-SWEDISH BORDER

The EEA Agreement ensures that Norway can take part in the European Single Market and thus benefit from the free movement of people, goods, services and capital. This means that Norway's technical standards and verification testing, and certification procedures for these, are harmonised with the EU and there is no need for such checks.

Norway is not, however, in the customs union. All lorries travelling between Norway and Sweden are subject to border

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[https://publications.parliament.uk/pa/ld201719/ldselect/ldcom/129/12905.htm#\\_idTextAnchor021](https://publications.parliament.uk/pa/ld201719/ldselect/ldcom/129/12905.htm#_idTextAnchor021).

40 <https://www.thesun.co.uk/news/5832827/no-deal-brexit-could-see-us-abandon-all-border-checks-on-goods-say-mandarins/>.

41 <https://www.independent.co.uk/news/uk/home-news/calais-strike-suspended-but-thousands-of-lorry-drivers-still-stuck-on-m20-in-kent-10359807.html?origin=internalSearch>.

42 Federation of Small Businesses, submission of evidence to the Review of the Balance of Competences between the United Kingdom and the European Union Single Market: Free Movement of Goods February 2014, p. 27.

43 [www.cbi.org.uk/insight-and-analysis/a-business-plan-for-a-good-brexit/](http://www.cbi.org.uk/insight-and-analysis/a-business-plan-for-a-good-brexit/).

checks. Pål Hellesylt, director for customs and trade facilitation at the Directorate of Norwegian Customs, told the House of Lords Select Committee on the European Union, “At the border stations all the trucks have to report, present for formalities and be cleared. So they have to stop.”<sup>44</sup> The lorries are checked for whether the load satisfies rules-of-origin requirements or is carrying undeclared agricultural produce, third-country goods or restricted goods.<sup>45</sup>

Norway and Sweden share what is usually identified as the most advanced automated border system in the world.<sup>46</sup> Paul MacFlynn, senior economist at the Nevin Economic Research Institute, highlighted the limitations of digital technology in practical terms for the House of Commons Northern Ireland Affairs Committee:

*The point that was made on the Sweden-Norway border, where they have a fully electronic system and people are sharing information, was: “Why are you still stopping people and x-raying trucks? They have told you what they have in their customs declaration”. They say, “How do we know they are telling the truth?”<sup>47</sup>*

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44 <http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/european-union-committee/brexit-ukirish-relations-followup/oral/78776.html>.

45 William Davidson writes for CapX to suggest ROO checks do not take place at this border: [https://capx.co/beware-nonsense-claims-about-the-customs-union-and-ireland/?omhide=true&utm\\_source=CapX+briefing&utm\\_campaign=ab7e332c31-EMAIL\\_CAMPAIGN\\_2017\\_07\\_17&](https://capx.co/beware-nonsense-claims-about-the-customs-union-and-ireland/?omhide=true&utm_source=CapX+briefing&utm_campaign=ab7e332c31-EMAIL_CAMPAIGN_2017_07_17&)

Contradictory reports are provided at <https://fullfact.org/europe/borders-and-customs-union>, <http://www.epicenternetwork.eu/wp-content/uploads/2017/04/The-EU-and-Norway-a-complex-relationship.pdf>, <https://www.economist.com/news/britain/21737265-even-latest-technology-being-outside-customs-union-entails-hard-border-norways> and <https://www.instituteforgovernment.org.uk/sites/default/files/publications/5704%20IFG%20-%20Frictionless%20Trade%20Web.pdf>, p. 35.

46 Policy Department for Citizens’ Rights and Constitutional Affairs, European Parliament, “Smart Border 2.0. Avoiding a hard border on the island of Ireland for Customs control and the free movement of persons” (2017), p. 29.

47 House of Commons Northern Ireland Affairs Committee, “The land border between Northern Ireland and Ireland”, [https://publications.parliament.uk/pa/cm201719/cmselect/cmniaf/329/32906.htm#\\_idTextAnchor050](https://publications.parliament.uk/pa/cm201719/cmselect/cmniaf/329/32906.htm#_idTextAnchor050).



In its review of borders with the EU, the *Times* provided the following description of Norwegian customs officials at work at the border:

*After a minute checking the X-ray the officers decide that there is a case for a manual search and shepherd the lorry into a hangar. The driver waits in isolation with a cup of coffee while a small team of officers get to work, climbing into the container to rifle through boxes, searching the cabin at the front for any hidden compartments and peering into the bowels of the truck from underneath.*<sup>48</sup>

## **THE EU-SWISS BORDER**

Like the Norwegian-Swedish border, the EU-Swiss border has been heralded by some as frictionless or not involving any customs infrastructure of which to speak.<sup>49</sup> Such analysis tends to confuse the experience of individuals benefiting from freedom of movement (Switzerland is part of the Schengen Area of passport-free travel) and the experience of commercial operators.<sup>50</sup> The *Times* described the process for a French manufacturer of stairs exporting into Switzerland. The experience would be similar for a Swiss exporter heading in the opposite direction:

*Mr Lepoutre says that the border crossing costs time, money and peace of mind. "When we take a staircase to a customer in Switzerland we have to prepare documents for customs describing it precisely, giving its weight and saying exactly what are the parts in it and where they are from. You have to do that four or five days beforehand and it takes an hour to an hour and a half every time."*

*There is more paperwork when French staff cross the border to install a staircase in Switzerland; the Swiss authorities demand to be notified of everyone working in their country. With two sets of VAT registration documents to be completed every time as well, Mr*

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48 <https://www.thetimes.co.uk/article/brexit-and-the-irish-border-jcm02pmz0>.

49 <https://www.thesun.co.uk/news/6126568/swiss-border-irish-ireland-brexit-customs-union/>.

50 <https://www.independent.ie/business/brexit/a-glimpse-of-what-our-postbrexit-border-could-look-like-swiss-cheese-35835833.html>.

*Lepoutre has taken on an employee just to fill in the forms. Road hauliers arriving from France park their vehicles, go into a small French customs office to get a stamp on a VAT clearance form and then into a second office where a forwarding agent charges up to €150 to make sure that the documents for the Swiss authorities are in order. After that, they drive 100 metres or so for Swiss customs to stamp their papers in turn. If there is no traffic and the forwarding agent has received all the documents in advance – which is usually the case where big haulage companies are concerned but not always for small firms – the whole process takes between 30 and 45 minutes. If not, it can take much longer.<sup>51</sup>*

Checks are potentially more extensive than on the Swedish-Norwegian border because the nature of the bilateral trade agreements between the EU and Switzerland means that officials at the border may in addition want to check documentation certifying that Swiss goods have been produced to EU standards, collect any VAT and additional tariffs required under rules of origin, and verify that a Swiss transporter has the right haulage permits.<sup>52</sup> Unlike the situation for a current UK haulage operator, haulage rights are limited for lorry firms from outside the EU.

Legal expert Dr Sylvia de Mars described the Swiss border to the House of Commons International Trade Committee as one that “by Northern Irish and Irish standards, would be considered quite hard in that there are controls, there are posts in place. It is all the stuff that the joint report that the EU and the UK have just now agreed to rules out as an option for Northern Ireland.”<sup>53</sup>

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<sup>51</sup> [http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=TAD/TC/WP\(2013\)3/FINAL&docLanguage=En](http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=TAD/TC/WP(2013)3/FINAL&docLanguage=En).

<sup>52</sup> Swiss agricultural goods (mostly) avoid product controls since Switzerland agreed in 2009 to effectively adopt and stay aligned with EU legislation on agricultural safety health.

<sup>53</sup> House of Commons International Trade Committee, “Oral evidence: Implications of arrangements for Ireland - Northern Ireland border for wider UK Trade Policy, HC 665i”, 13 December 2017, <http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/international-trade-committee/implications-of-arrangements-for-ireland-northern-ireland-border-for-wider-uk-trade-policy/oral/75929.html>.

## THE EU-TURKISH BORDER

The partial nature of the EU-Turkey Customs Union means that border infrastructure cannot be avoided. Turkish exporters may not need to produce rules-of-origin certification because Turkey has the same tariffs with the rest of the world as the EU does,<sup>54</sup> but Turkish hauliers do need to produce permits.<sup>55</sup> The production of permits is a potentially serious problem for UK freight haulage companies after Brexit.<sup>56</sup> Turkey adopts single-market rules and standards in manufacturing to try to smooth the export process.

When the EU signs an FTA with a third country, that country may or may not sign a similar trade deal with Turkey. The consequence would be that the third country's goods can enter Turkey subject to the tariff level agreed with the EU but Turkey's goods cannot be exported to the third country without the third country agreeing a separate trade deal with Turkey. Turkish priorities in terms of tariffs would not necessarily be of interest to EU negotiators of the deal with the third country, and the third country may have no interest in negotiating an agreement with the UK once it had already secured lower tariffs to Turkey as a result of the trade agreement with the EU. The EU is, however, prepared to negotiate a Turkey clause in its agreements with third countries. This is a non-binding clause encouraging the third country to negotiate a similar deal with Turkey.

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54 This may be necessary on some Turkish exports to the EU because the EU and Turkey do not have a 100 per cent overlap in the third countries with which they have FTAs or to which they apply anti-dumping duties.

55 Road-haulage rules for third-country providers are not harmonised in the EU, and countries may impose restrictions such as a limited number of licences for third-country road-haulage service providers. Turkish providers are, for example, hit by licence quotas in successive countries. Kabak, O. "Effects of quotas on Turkish foreign trade: a gravity model" (2014), <https://www.unece.org/fileadmin/DAM/trans/doc/2014/sc1/Presentation-SC1-2014-1e.pdf>, Economic Commission for Europe Inland Transport Committee Working Party on Road Transport 109th session Geneva, 28–29 October 2014. For a comprehensive report on the EU market for road haulage and the potential barriers, see <https://ec.europa.eu/transport/sites/transport/files/modes/road/studies/doc/2014-02-05-state-of-the-eu-road-haulage-market-task-b-report.pdf>.

56 <https://www.theguardian.com/politics/2018/feb/08/no-deal-brex-it-would-trigger-wave-of-red-tape-for-uk-drivers-and-hauliers>.

The widely reported delays for Turkish lorries to cross the border may be driven by border-security concerns, because this is a significant route for human and drug trafficking.<sup>57</sup>

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<sup>57</sup> <http://www.hurriyetdailynews.com/turkeys-trade-to-europe-see-delays-amid-long-truck-queues-at-kapikule-border-gate-104566>.

## PROPOSED POST-BREXIT CUSTOMS SOLUTIONS

From March 2019, when the UK is set to formally leave the EU, until the end of the transition period (assuming there is a withdrawal agreement), the UK will be in the customs union with the EU on a temporary basis. After the end of the transition period, the UK would, absent any other arrangement, be in the same position as any other third country vis-à-vis the EU.<sup>58</sup> It would be subject to the EU's common external tariffs, tax requirements and controls of compliance with product regulation.

At various times, the EU's bespoke arrangements with Norway, Switzerland and Turkey have been suggested as ones that could be copied by the UK. It has also been suggested that a permanent partial customs union would provide a viable compromise between Remainers and Brexiteers and would solve the Irish-border problem. Others have suggested that the UK remain in a customs union rather than the customs union. This works as an efficient solution only if the UK also remains in the single market for goods.

One of the alternative options proposed by the UK government in the UK's August 2017 paper "Future Customs Arrangements" was a streamlined customs arrangement. The other option set out in the paper was a customs partnership, and it appears that this may be UK Prime Minister Theresa May's current preferred option. In the absence of any deal, the UK would default into a WTO relationship at the end of the two-year notice period set out in article 50 of the Treaty on European Union.

### TEMPORARY MEMBERSHIP OF THE CUSTOMS UNION

This would be a function of the UK's withdrawal agreement. It would last as long as the transition period. Nothing would change vis-à-vis the UK's customs relationship with the EU except that the UK would have no say in the formation of the EU's Common

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<sup>58</sup> From the beginning of the transition period, the FTAs the EU has signed with third countries will no longer apply to the UK. The UK is hoping to roll over these deals. However, some countries have already signalled that they may require renegotiation and concessions by the UK: <https://www.ft.com/content/92bb5636-a95b-11e7-ab55-27219df83c97>. More generally, see <https://blogs.sussex.ac.uk/uktpo/2017/09/27/grandfathering-ftas-and-roos/>.

Commercial Policy, including tariff levels, which would continue to apply to imports coming into the UK from third countries. The UK would be permitted to negotiate FTAs with third countries but not to apply them until after leaving the EU.<sup>59</sup>

## **A PARTIAL CUSTOMS UNION**

The Institute of Directors has proposed that the UK pursue a partial customs union for industrial goods and processed foods with the EU<sup>60</sup>. This is the same arrangement that Turkey has with the EU. The basis for this proposal would appear to be twofold: firstly, it would be the minimum amount of goods coverage to be commercially useful; and secondly, by excluding agriculture and raw materials, it would give the UK an area in which to conduct trade deals in exchange for services, for which tariffs do not apply and are not subject to the customs union.

This proposal would avoid tariffs on those goods and mostly avoid costly rules-of-origin requirements. It would reduce the need for border checks in Northern Ireland but not eliminate them because the proposal would not apply to agricultural goods. The need for checks to verify compliance with standards would also mean that border infrastructure would not be avoided.

It has been argued that it would be hard to do trade deals with third countries when the UK has no control over tariffs for manufactured goods and processed foods.<sup>61</sup> However, the UK could still try to strike deals on services and agricultural goods. In any event, as the CBI points out, there is no economic case for alternative trade deals to recuperate the losses caused by exiting the customs union and the single market.<sup>62</sup>

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59 Article 124(4) of [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/691366/20180319\\_DRAFT\\_WITHDRAWAL\\_AGREEMENT.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/691366/20180319_DRAFT_WITHDRAWAL_AGREEMENT.pdf).

60 <https://www.iod.com/Portals/0/PDFs/Campaigns%20and%20Reports/Europe%20and%20trade/IOD-Customising-Brexit.pdf?ver=2018-02-15-083137-800>.

61 <https://www.conservativehome.com/thetorydiary/2018/02/partial-customs-union-means-paying-a-high-price-to-be-stuck-in-eu-limbo.html>.

62 This has led Jonathan Springford of the CER to state that if the UK government needs to sign deals for political reasons only, then it ought

A problem with a partial customs union is that the UK would be committed to lowering tariffs on imports with countries with which the EU signs a trade agreement, but there would be no requirement on the third country to lower its tariffs on UK exports. The UK would need to negotiate and sign a separate deal with the third country to receive access on the same terms as EU exporters. The incentives on the third country to sign a deal with the UK would be much lower.

## **A CONTINUED CUSTOMS UNION WITH THE EU**

The CBI and the Labour Party argue that the UK should stay in a customs union with the EU. This is similar to the proposition that the UK should operate a partial customs union except that it would also cover agriculture. This would reduce the level of checking required at the border. However, because membership of a customs union does not on its own imply alignment with single-market rules, this would be insufficient to remove the need for customs infrastructure to carry out checks for compliance with product regulation.

Labour Party Leader Jeremy Corbyn has said that “Labour will not countenance a deal that left Britain as a passive recipient of rules decided elsewhere by others. That would mean ending up as mere rule takers.”<sup>63</sup> While the EU might agree to consult the UK on a proposed trade deal, the UK would not obtain any formal vote or veto over any deal conducted by the EU.<sup>64</sup> The UK, of course, would have the ability not to do a similar deal with the third country. The same problem with respect to third countries’ incentives to extend similar terms in agreements with the EU to the UK would apply as in the partial customs union case.

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logically to stay in the customs unions and sign some nominal service deals, because that would allow it to maximise its economic and political objectives: <https://www.cer.eu/media/cer-podcast-customs-union-debate>.

63 <https://www.reuters.com/article/uk-britain-eu-corbyn/putting-pressure-on-may-labour-backs-new-customs-union-with-eu-idUSKCN1GA005>.

64 The marginal ability at best to influence the EU as member of a customs union is well described by David Henig in this article on the EU-Turkey relationship: <http://ukandeu.ac.uk/what-turkeys-customs-union-experience-can-teach-the-uk>.

## **CONTINUED MEMBERSHIP OF THE CUSTOMS UNION AND SINGLE MARKET FOR ALL GOODS**

The Centre for European Reform argues that the UK should stay in the customs union and the single market for all goods, including agricultural goods.<sup>65</sup> The advantage of this proposal is that it does eliminate the need for any border infrastructure, because all goods in the UK would be produced to EU standards and there would be no tariffs to pay. There would, however, be some formidable political and EU institutional hurdles to overcome to permit a large country to be partly in the EU. If the UK is inside the customs union, it would also benefit from all tariff reductions negotiated by the EU.

### **A STREAMLINED CUSTOMS ARRANGEMENT ('MAXIMUM FACILITATION')**

This is one of the two rival suggestions put forward by the UK government. It would rely on data sharing, continued UK access to certain EU-wide customs systems, infrastructure away from the border and trusted-trader schemes to speed up customs clearances.

In particular, the UK has said it hopes to negotiate:

- mutual recognition of authorised economic operators (AEOs),<sup>66</sup> enabling faster clearance of AEOs' goods at the border—according to HMRC estimates, UK companies with AEO status account for around 60 per cent of the UK's imports and 74 per cent of the UK's exports;<sup>67</sup> and
- bilateral implementation of a technology-based solution for roll-on, roll-off ports and for Northern Ireland, which could consist of pre-arrival notification of consignments on a port IT system

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<sup>65</sup> <https://www.cer.eu/publications/archive/bulletin-article/2018/holding-out-hope-half-way-brex-it-house>

<sup>66</sup> AEOs are trusted traders and as such can benefit from reduced documentary requirements, fewer physical inspections and faster clearance times.

<sup>67</sup> These were based on April–December 2016 figures, of a total 548 AEOs in the UK. House of Lords European Union Committee, 16th Report of Session 2016–17, “Brexit: trade in goods”, p. 9.



linked to customs declarations and vehicle registration numbers so that vehicles are not required to stop at the border, enabling traffic to flow smoothly.

A streamlined customs arrangement might ultimately be feasible. However, according to anonymous Treasury ministers cited in the *Evening Standard*, it would take “years” and heavy investment to achieve.<sup>68</sup>

Some commentators are less charitable about the practicability of this solution. Professor Anand Menon wrote in the *Independent*, “Brexiters referencing Norway-Sweden or Canada-US or Switzerland-EU as examples of ‘frictionless crossings’ are simply wrong. The simple fact is that much of the technology needed to make this kind of system work has simply not been developed yet.”<sup>69</sup> This assessment is shared by Lord Kerslake, former head of the UK Civil Service: “The [maximum facilitation] model that’s being proposed will not work. Even if you back a technological solution to customs, the systems wouldn’t be reliably ready. On that count alone, the transition period isn’t long enough.”<sup>70</sup>

Even when the technology has been developed elsewhere, it might prove difficult to add to the new IT system currently in the pipeline that was designed before the Brexit vote to deal with increased customs declarations in the EU. HMRC is simultaneously wrestling with a number of other major IT projects.<sup>71</sup> If the UK does not obtain a transition period, the new system and a revamped back-up system will be scheduled to come online just before their use is required. If they function as expected and on time, this will be an unusual feature for new government IT projects.

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68 <https://www.standard.co.uk/news/politics/brexit-news-latest-michel-barnier-presses-britain-to-decide-on-customs-partnership-by-june-a3826996.html>.

69 “Brexit: the Cabinet’s battle over EU customs is an insult to our intelligence”, *Independent*, 8 May 2018. Brexiteers also appear to accept that there would need to be an extended transition period in order to achieve a maximum-facilitation solution: <https://www.thesun.co.uk/news/6250153/brexit-extend-theresa-may-custom-partnership/>.

70 <http://uk.businessinsider.com/theresa-may-brexit-customs-plans-undeliverable-warns-former-head-of-uk-civil-service-bob-kerslake-2018-5>.

71 [https://www.theregister.co.uk/2018/01/12/pac\\_warns\\_hmrc\\_is\\_biting\\_off\\_more\\_than\\_it\\_can\\_chew/](https://www.theregister.co.uk/2018/01/12/pac_warns_hmrc_is_biting_off_more_than_it_can_chew/).

Investment to achieve a streamlined customs system would not just be a central government investment. Companies, private freight forwarders, ports and local authorities that interact with the new declaration system would also have to upgrade their systems. Achieving AEO status itself is a time-consuming and labour-intensive activity. There are currently roughly 600 trusted traders in the UK, whereas there may be around 200,000 UK companies that import from or export to the EU.<sup>72</sup>

It is important to note that an effective streamlined customs arrangement nonetheless begs the critical question of alignment with the single market. If the UK is going to adopt rules that allow UK producers to diverge from EU product regulation or exporters into the UK from third countries to produce to diverging regulations (for example, chlorinated chicken<sup>73</sup>), then the EU is likely to require border compliance checks regardless of whether the UK shares a good online customs-declaration system with the EU. This customs arrangement is the one preferred by the Conservative European Research Group and other pro-Brexit Conservatives.<sup>74</sup>

According to PoliticsHome, an assessment prepared by the Treasury warns that this option would leave the UK economy 1.8 per cent worse off in the long run. The report of the assessment does not explain why, but it is presumably because this mechanism does not minimise all border costs.<sup>75</sup>

UK Brexit Secretary David Davis admitted on 1 May 2018 to the House of Lords Brexit Committee that the EU had pushed back on the realism of such a project or an alternative being workable in

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<sup>72</sup> <https://fullfact.org/europe/how-many-businesses-export-eu/>.

<sup>73</sup> Other areas where US standards diverge from the EU (and UK) include a range of other agricultural goods, for which UK farmers are permitted to use hormones or genetic modification not permitted in Europe. With respect to chemicals and pharmaceuticals, the general philosophies of the EU (including the UK) and US approaches are very different. Unlike the US, the EU adopts a precautionary regulatory principle: products cannot be introduced unless it can be proved that they do not harm humans. US and EU car-safety rules, which are incorporated into car features, are also different.

<sup>74</sup> <https://www.thesun.co.uk/news/6250153/brexit-extend-theresa-may-custom-partnership/>.

<sup>75</sup> <https://www.politicshome.com/news/uk/political-parties/conservative-party/boris-johnson/news/95043/brexit-customs-plan-would>.

relevant timeframes—or at all. This admission reflects what had been widely reported in the press.<sup>76</sup> Tony Connelly of the Irish broadcaster RTÉ reported the Swedish Europe Minister Ann Linde as saying, “[EU Chief Brexit Negotiator] Michel Barnier said . . . the 2 British proposals the cabinet is disagreeing about – none of them are realistic. So he thinks it’s unnecessary to fight about it, as none of them are realistic no matter which one they choose.”<sup>77</sup>

*Table 2: Smart Border Technology*

| <b>What it can do</b>  | <b>What it requires</b>  |
|--|--|
| <ul style="list-style-type: none"> <li>• Reduce time and paperwork required for customs declarations.</li> <li>• Reduce time taken to receive clearance for entry into a different customs zone.</li> <li>• Make risk management more efficient and comprehensive.</li> <li>• Keep data on when a registered vehicle passes a border crossing point.</li> <li>• In some limited cases in specific conditions,</li> </ul> | <ul style="list-style-type: none"> <li>• Pre-registration of operators and commercial travellers.</li> <li>• Full customs declarations to be made; full data disclosed by all relevant parties.</li> <li>• Efficient operating software for submitting and receiving declarations.</li> <li>• Physical hardware at the border crossing to match the vehicle to the declaration or permit. Ideally more than one means of verification (e.g. ANPR, e-tag, mobile phone ID).</li> <li>• Built infrastructure at border crossing points OR inland clearance depots with capacity for inspecting freight (e.g. offices, HGV parking, refrigerated warehouses).</li> <li>• The capacity to follow-up on alerts about high-risk goods or false declarations and catch non-declarations.</li> <li>• Sufficient time for development and roll-out.</li> <li>• Full training of officers, support staff and operators.</li> </ul> |

<sup>76</sup> See for example <https://www.politico.eu/article/brexit-northern-ireland-eu-rejects-uk-customs-fixes/>.

<sup>77</sup> <https://twitter.com/tconnellyRTE/status/996127971009286144>.

| What it can do   | What it requires   |
|--|--|
| <p>reduce time taken to scan a consignment.</p> <ul style="list-style-type: none"> <li>• Enable link up with other systems and sources of data.</li> </ul> | <ul style="list-style-type: none"> <li>• Border surveillance at 'approved' and 'unapproved' crossings.</li> <li>• 'Single window' facilities for multiple agencies (e.g. police, veterinary) and border inspection posts for certain agricultural goods.</li> <li>• Technical agreement between customs forces.</li> </ul> |

Source: Queen's University Belfast

## A CUSTOMS PARTNERSHIP

Under a customs partnership, the UK would charge EU tariffs at its borders for goods from third countries that are intended to be exported to the EU and pass those tariffs to the EU. It would simultaneously put in place a mechanism so that the UK could apply its own tariffs and trade policy for goods intended for the UK market.

The UK government acknowledges that this would need a robust enforcement mechanism to ensure that goods that have not complied with the EU's trade policy stay in the UK. The government's policy paper says,

*This could involve, for instance, a tracking mechanism, where imports to the UK were tracked until they reached an end user, or a repayment mechanism, where imports to the UK paid whichever was the higher of the UK's or the EU's tariff rates and traders claimed a refund for the difference between the two rates when the goods were sold to an end user in the country charging lower tariffs. Businesses in supply chains would need to be able to track goods or pass the ability to claim a repayment along their supply chain in order to benefit.<sup>78</sup>*

<sup>78</sup> [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/637748/Future\\_customs\\_arrangements\\_-\\_a\\_future\\_partnership\\_paper.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/637748/Future_customs_arrangements_-_a_future_partnership_paper.pdf), paragraph 41.

It is unclear how tracking would work for components buried inside finished products. Take the example of imported meat: Tracking would have to ensure that a consignment of meat that entered the UK at a zero tariff under a new FTA between the UK and the third country was not doing so just to avoid the EU's tariff and was destined for re-export. This may be hard to achieve in practice. Tracking would also have to ensure that if the meat were turned into a dish (for example, a frozen meal), it was not re-exported to the EU as containing UK meat that attracts a zero tariff. This may be even harder to achieve.

All this would still require checks to ensure compliance with EU standards. As Joe Owen, senior researcher at the Institute of Government, has put it: "If the Government wants to avoid a border in Ireland and keep lorries moving freely through Kent, it needs to deal with regulatory checks as well. A nice new customs arrangement is necessary, but it's not sufficient."<sup>79</sup>

The technology does not currently exist. Brexiteers like Conservative member of parliament Jacob Rees-Mogg do not like this option because they see it as a trap to keep the UK in the customs union until future technology comes into existence.<sup>80</sup> The *Guardian* has reported that Brexiteer sources claim "the prime minister had been told eight times by civil servants that her preferred option, which is backed by her top Brexit civil servant Olly Robbins, was unworkable".<sup>81</sup> Peter MacSwiney, chairman of Agency Sector Management, who co-chairs the HMRC-sponsored committee for consultation with business on customs, has called the customs partnership a "ridiculous suggestion".<sup>82</sup>

The substantive difference between the streamlined customs arrangement and the customs partnership is that the latter would leave the UK both inside and outside the customs union: UK firms could be either inside or outside from a tariff perspective, depending on where their final customers reside (and whether any

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79 <https://twitter.com/instituteforgov/status/996284042319466496>.

80 <http://www.bbc.co.uk/news/uk-politics-43878356>.

81 <https://www.theguardian.com/politics/2018/may/01/pm-tries-to-hold-cabinet-together-by-delaying-customs-partnership-decision>.

82 <https://www.thetimes.co.uk/article/brexit-and-the-irish-border-jcm02pmz0>.

trade deals negotiated by the UK had differentiated tariffs from the EU).

In other words, as the *Financial Times* has put it: “The plan represents the best efforts of Britain’s top civil servants to craft a solution that bridges the ideological gulf in the Conservative party. It would combine the frictionless trade of a customs union with the promise of an independent trade policy.”<sup>83</sup>

Arguably, it would solve the Irish-border problem as long as this were only a tariff problem—in which physical checks were restricted to mobile behind-the-border checks. It would be restricted to a tariff problem only if the UK stayed in the single market. It would solve the problem because the UK would not implement it until the technology that does not currently exist came into existence. And once it came into existence, the border would run inside firms rather than at the physical border.<sup>84</sup>

However, this solution would have the downside that it would run through all firms that used imported goods—with those not re-exporting having to apply for a rebate. This might lead to heavy lobbying from most sectors for the UK not to have a different tariff from the EU. The Irish Taoiseach, Leo Varadkar, has hinted that he favours this option,<sup>85</sup> although this may be only comparatively favourable, given comments he made on 16 May 2018:

*The customs partnership proposed by the United Kingdom last June would not be workable. That is very much the view of the task force and the [other 27 EU members] and it has been rejected. I believe the customs partnership is closer to being made workable than the maximum facilitation proposal or max-fac which, as Deputy Joan Burton pointed out, I had thought was some form of make-up or deodorant. I have certainly not seen to date any detail that indicates that such a solution would be as functional as make-up or a deodorant. We are not drawing up any plan for a border between Northern Ireland and Ireland, full stop. There is not going to be one.*

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<sup>83</sup> “May confident of pushing through hybrid customs plan”, *Financial Times*, 8 May 2018.

<sup>84</sup> This concept may be best captured by Northern Irish comedians—well worth viewing: [https://twitter.com/hayward\\_katy/status/982009149721579522](https://twitter.com/hayward_katy/status/982009149721579522).

<sup>85</sup> [http://www.heraldsotland.com/news/16215256.Surprise\\_support\\_from\\_Taoiseach\\_for\\_May\\_\\_\\_s\\_preferred\\_customs\\_plan/](http://www.heraldsotland.com/news/16215256.Surprise_support_from_Taoiseach_for_May___s_preferred_customs_plan/).

*I have made it very clear to my counterpart in the United Kingdom and the other EU Prime Ministers that under no circumstances will there be a border.*<sup>86</sup>

## **THE CURRENT STATE OF PLAY**

The UK government is intending to publish a white paper on its preferences. It is not yet clear whether this will set out a definitive preferred UK option. The government may seek simply to remain in the customs union until the technological options are clearer at an indeterminate point in the future. Irish officials have briefed journalists that “London would seek to call the future customs relationship something other than the, or a customs union.”<sup>87</sup>

Remaining in the customs union until technology can deliver a frictionless border appears to be what the UK prime minister suggested to a gathering of EU leaders in Bulgaria, and it has apparently been presented by the UK as a third option. It would not, however, appear to be a design for customs processes so much as an option to put off deciding a preferred option for as long as possible. European Council President Donald Tusk apparently told May that it was too early to give any assurances about the reception her proposal would receive because of the “disorientating” messages the EU was getting from London.<sup>88</sup>

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86 <https://twitter.com/SJAMcBride/status/996665118376321024>.

87 <https://www.rte.ie/news/brexit/2018/0516/963831-eu-customs-union/>.

88 <https://www.bloomberg.com/news/articles/2018-05-17/eu-is-said-to-brush-off-may-s-pitch-for-customs-plan-guarantees>.

## THE IMPLICATIONS OF NORTHERN IRELAND'S STATUS FOR CUSTOMS ARRANGEMENTS

The border between Northern Ireland and the Republic of Ireland poses particular problems for customs arrangements.

The UK government has stated that to be compliant with the Good Friday Agreement, a customs design must observe the following principles with respect to Northern Ireland:

- Recognise the crucial importance of avoiding a return to a hard border for the peace process in Northern Ireland. This must mean aiming to avoid any physical border infrastructure in either the UK or Ireland, for any purpose (including customs or agri-food checks).
- Recognise the unique nature of the land border, in particular its history and geography; the cross-border movements of smaller traders, farmers and individuals; the need to protect everyday movement of goods; and the integrated nature of the agri-food industry.
- Prevent the creation of new barriers to doing business within the UK, including between Northern Ireland and Great Britain.
- Address other regulatory and customs-related barriers necessary to deliver as frictionless a land border as possible, including waivers from security and safety declarations, and ensuring there is no requirement for product-standards checks or intellectual property rights checks at the border.<sup>89</sup>

The avoidance of a hard border means no infrastructure at the border. This can be achieved only if Northern Ireland, at a minimum, stays in a customs union and the single market.

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<sup>89</sup> “HM Government Position Paper by the United Kingdom”, Northern Ireland and Ireland, p. 15.





The Irish border is currently marked only by road signs. (Source: Getty)

A paper commissioned by a department of the European Parliament from the former director of the World Customs Organisation for a design avoiding a hard border envisaged an identification system at the border and automatic gates that a lorry could not pass until the gates were opened.<sup>90</sup> While as frictionless a process as the author could envisage, this is the description of an automated border rather than an absent one. The conclusion of the House of Commons Northern Ireland Affairs Committee after reviewing evidence from around the world was: “We have had no visibility of any technical solutions, anywhere in the world, beyond the aspirational, that would remove the need for physical infrastructure at the border.”<sup>91</sup>

As far as enforcement is concerned, this would also be weak, because automatic number plate recognition cameras cannot ascertain whether the contents of a vehicle match the electronic

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90 Directorate General for Internal Policies Policy, Department for Citizens’ Rights and Constitutional Affairs, “Smart Border 2.0: Avoiding a hard border on the island of Ireland for Customs control and the free movement of persons”, p. 11, [http://www.europarl.europa.eu/RegData/etudes/STUD/2017/596828/IPOL\\_STU\(2017\)596828\\_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/STUD/2017/596828/IPOL_STU(2017)596828_EN.pdf).

91 <https://publications.parliament.uk/pa/cm201719/cmselect/cmniaf/329/32903.htm>.

customs-declaration form. It is unlikely that the EU could contemplate accepting this if the UK is intending to apply different tariffs, adopt different product regulation or import goods from countries that apply different product regulations from the EU.<sup>92</sup>

To make the process manageable in practice, the UK government proposes that all cross-border traders in Northern Ireland either become AEOs or have their obligations waived.<sup>93</sup> The intention would be to waive border controls altogether for SMEs:

*Many of the movements of goods across it by smaller traders cannot be properly categorised and treated as economically significant international trade. Such an exemption would ensure that smaller traders could continue to operate as they do now, with no new requirements in relation to customs processes. It is important to note that in 2015, over 80 per cent of North to South trade was carried out by micro, small and medium sized businesses.*<sup>94</sup>

Again, exempting 80 per cent of commercial traffic creates a serious problem for enforcement if the UK is intending to apply different tariffs, adopt different product regulation or import goods from countries that apply different product regulations from the EU.<sup>95</sup> This approach carries particular risks where paramilitaries that

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92 Norwegian customs officials at the world's current most frictionless border outside the EU were not very impressed by the idea of mobile checks. The officers are also unimpressed by the idea of conducting checks away from the geographical boundary, as the British government has proposed for the Irish border. As soon as a vehicle is over the line, the driver can start offloading goods and funnelling them into the black market. "The border is the only point where you know you have the lorry driver, the lorry, the goods, the export and the import documents in one place at the same time," Hoiberget says. "With every minute that passes after the truck has left this point it gets more difficult to do a proper control."

93 There are currently 53 AEOs in Northern Ireland:  
[http://www.europarl.europa.eu/RegData/etudes/STUD/2017/596828/IPOL\\_STU\(2017\)596828\\_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/STUD/2017/596828/IPOL_STU(2017)596828_EN.pdf).

94 "HM Government Position Paper by the United Kingdom", Northern Ireland and Ireland", p. 17.

95 As Dr Christian Bock, director general of the Swiss Federal Customs Administration, said in evidence to the House of Lords Committee on Exiting the EU: "You talked about exempting some traffic from controls. I am sorry, but that is an invitation for everyone to use exactly that means."  
<http://data.parliament.uk/writtenevidence/committeeevidence.svc/>

participated in a bitter sectarian struggle are major participants in contraband activities.<sup>96</sup> Logically, it is also a problem having an exemption to avoid border controls, because an exemption approach requires a border control to verify whether a vehicle legitimately falls within the exemption.

To operate an affordable and protected system (automated or otherwise), it is likely that just as for Norway and Switzerland, the number of cross-border crossings for commercial vehicles would have to be restricted. Currently, more than 200 roads are used for commercial traffic<sup>97</sup> –more land border crossings than in the entire rest of the EU, which total 137.<sup>98</sup> This would recall a very troubled past: until the 1960s in Northern Ireland, cross-border car journeys required permits, and journeys could be made only at the 16 crossing points with customs points; motorists using unapproved cross-border roads were liable to have their vehicles seized. Many cross-border roads were spiked during the Irish Republican Army's (IRA's) 1956–1962 campaign, and roads were again blocked during the Northern Ireland Troubles.<sup>99</sup>

The various approaches to border control for the UK—remaining in the customs union and the single market, setting up a partial customs union, arranging a customs union, remaining in the customs union and single market for goods, maximum facilitation, and a customs partnership—can be compared in terms of whether

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evidencedocument/european-union-committee/brexit-ukirish-relations-followup/oral/78776.html.

96 Peter Sheridan, chief executive of Co-operation Ireland and a former police officer in the border area, says that some of the first shots in the Troubles were fired at customs posts. An economic border can quickly become a military one, he says. “When the customs posts were shot at, that required police to guard them. Then when the police were shot at, that required the army to guard the police. Then when the army were attacked they ended up building watchtowers, sealing off roads, bringing in helicopters and permanent checkpoints.” <https://www.thetimes.co.uk/article/brexit-and-the-irish-border-jcm02pmz0>.

97 [http://www.europarl.europa.eu/RegData/etudes/STUD/2017/596828/IPOLE\\_STU\(2017\)596828\\_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/STUD/2017/596828/IPOLE_STU(2017)596828_EN.pdf).

98 <https://www.belfasttelegraph.co.uk/news/northern-ireland/revealed-number-of-border-crossings-between-northern-ireland-and-republic-36850570.html>.

99 [https://www.britac.ac.uk/sites/default/files/BrexitandtheIrishBorderHistoricalContext\\_0.pdf](https://www.britac.ac.uk/sites/default/files/BrexitandtheIrishBorderHistoricalContext_0.pdf), p. 5.

they remove customs friction at the border (see table 3). In practice, only two options work: staying in the customs union and the single market in their totality, and staying in the customs union and the single market just for goods. The point of restricting membership to the latter would solely be to allow the UK government to claim it was pursuing its “global Britain” agenda through stand-alone trade deals. This would represent a form of mitigated self-harm that is better than the alternatives, but still irrational. A forthcoming Institute paper will explain how critical single-market membership is for the UK’s services industries.

*Table 3: The Efficacy of the Options in Delivering Frictionless Borders*

|  | <b>Removes tariff-controls friction?</b> | <b>Removes VAT-collection friction?</b>   | <b>Removes product regulation compliance checks from the border?</b> | <b>Meets requirement for no border infrastructure in Northern Ireland?</b> |
|--|--|---|--|--|
| Temporary or permanent membership of the customs union and the single market | Yes                                      | Yes   | Yes  | Yes  |
| A partial customs union  | Reduced                                  | Participation in the EU VAT regime would normally require membership of the single market | Not without membership of the single market                          | No   |
| Membership of a customs union (Labour Party Policy)                          | Yes                                      | Participation in the EU VAT regime would normally require membership of the single market | Not without membership of the single market                          | Would require membership of the single market                              |

|  | <b>Removes tariff-controls friction?</b>  | <b>Removes VAT-collection friction?</b>   | <b>Removes product regulation compliance checks from the border?</b> | <b>Meets requirement for no border infrastructure in Northern Ireland?</b> |
|--|---|---|--|--|
| Membership of the customs union and single market for goods only | Yes   | Yes   | Yes  | Yes  |
| Maximum facilitation   | No  | Participation in the EU VAT regime would normally require membership of the single market | Not without membership of the single market                          | No   |
| A customs partnership  | Yes (except where UK firms that import from the rest of the world and do not export to the EU have to claim a rebate) | Participation in the EU VAT regime would normally require membership of the single market | Not without membership of the single market                          | No   |

## THE ECONOMIC COSTS AND BENEFITS OF EXITING THE CUSTOMS UNION

The benefit put forward by Brexiteers for exiting the customs union is that it would allow the UK to do trade deals with countries with which the EU has not yet signed trade deals. The problem with this argument is that the UK government's own leaked economic analysis shows that this is not the case. The predicted losses involved with exiting the EU far more than outweigh any gains from leaving. A deal with the US is estimated to benefit GDP by 0.2 per cent in the long term. Trade deals with other non-EU countries and blocs, such as China, India, Australia, the Gulf countries and the nations of Southeast Asia, would add in total a further 0.1–0.4 per cent to GDP over the long term. The UK government's estimate of the effect of exiting the customs union alone is a 1.8 per cent fall in GDP.<sup>100</sup>

Most independent academic studies do not paint a rosier picture. In “Assessing the impact of trade agreements on trade”, economist Monique Ebell applied econometric techniques to test export outcomes with 2014 data from 42 countries and territories: 34 from the OECD plus Brazil, China, Hong Kong, India, Indonesia, Malaysia, Russia and South Africa.<sup>101</sup> This constitutes most of world trade by volume. The findings were that trading with other single-market members gives rise to higher trade in goods than FTAs and that these in turn give rise to higher trade in goods than the absence of an FTA. Replacing membership of the single market with an FTA would give rise to a 35–44 per cent decline in trade in goods with countries with single-market membership. About 56 per cent of the UK's goods trade is with such countries, so this might imply a decline in total trade of 20–25 per cent.

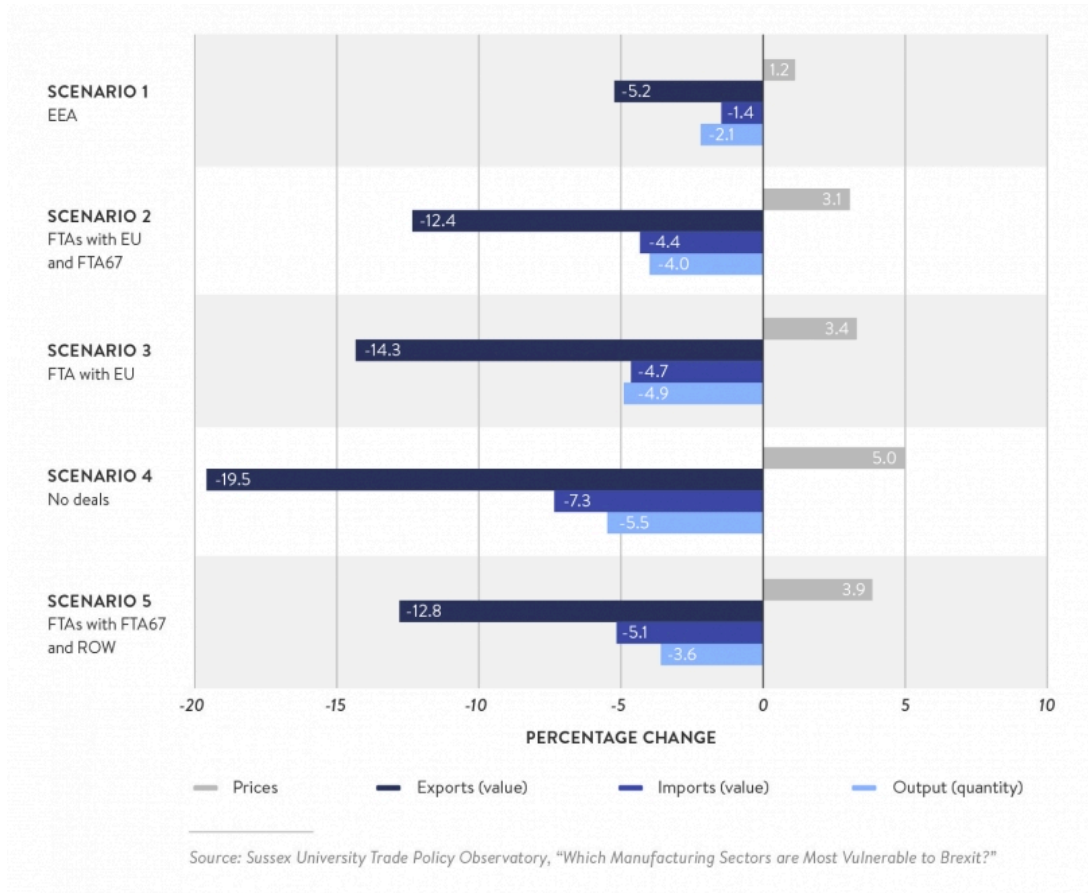
The Sussex University Trade Policy Observatory has estimated that if the UK left the EU without a deal but signed FTAs with all other countries in the world, this would lead to a substantial fall in UK manufacturing output (the fifth scenario in figure 4).<sup>102</sup>

100 <https://www.politicshome.com/news/uk/political-parties/conservative-party/boris-johnson/news/95043/brexit-plan-would>.

101 Monique Ebell, “Assessing the impact of trade agreements on trade”, National Institute Economic Review, no. 238, November 2016.

102 <http://blogs.sussex.ac.uk/uktpo/publications/which-manufacturing-sectors-are-most-vulnerable-to-brexit/>.

Figure 4: Predicted Trade Gains and Losses Under Different Brexit Scenarios



There should be nothing surprising about all these findings. The reasons to expect this to be the case are:

- There is a gravity effect to trade: countries trade far more heavily with countries that are close by.
- Trade with the EU is currently frictionless, making it far easier for UK businesses to sell to other businesses and consumers in the EU than with any other part of the world.
- The EU has strong enforcement practices, unparalleled anywhere else in international trade, for ensuring that no non-tariff barriers can be placed in the way of goods trade.
- The EU already has low-tariff deals with countries from which the UK benefits, and these plus the EU represent about 60 per cent of UK exports; the number of deals that the EU is signing continues to grow.<sup>103</sup>

103 <https://www.independent.co.uk/news/world/europe/brexit-trade-deal-eu->

There would also be some specific difficulties in trying to do deals with some of the countries with which the EU does not currently have agreements.

## THE UNITED STATES

The UK government's balance-of-competence review concluded, on the basis of Australian and Canadian experiences of negotiating with the US, that US special interests would have a strong effect on trade deal outcomes, and that the UK could not expect a favourable deal:

*The experience of Canadian and Australian counterparts in their negotiations with the United States should give UK officials pause. Many of the reasons why those negotiations fell short of Ottawa and Canberra's goals would apply to any future US-UK negotiation over a free trade agreement. That US administrations can launch trade negotiations must not be confused with the fact that, in the US constitution, it is Congress that ultimately decides whether, and upon what terms, a trade agreement is approved . . . There should be no illusions about expecting the latter [a strong non-trade related diplomatic and military relationship with the US] to "deliver" a high quality FTA that is of significant commercial interest. The parallels to the Australia-US FTA negotiation are evident. A strong security partnership is, as argued earlier, a double-edged sword: it makes not only the launch of an FTA negotiation with the USA more likely but also increases the odds that the UK will be offered a deal on US terms, indeed a deal that the UK will find it hard to reject for fear of harming its overall relationship with Washington. Moreover, given the greater importance of trade and investment to the UK economy than to the US, as their Canadian counterparts discovered, British officials will find themselves disadvantaged during the inevitable haggling by wanting a deal more than their negotiating partner.<sup>104</sup>*

The US commerce secretary has already signalled that he would expect the UK to realign its regulatory regime away from European

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[australia-new-zealand-european-parliament-vote-meps-a8020716.html](#).

<sup>104</sup> CEPR, Trade and Investment Balance of Competence review, study for the department of Business Innovation and Skills (2013), p. 85.



standards, which are based on the precautionary principle—a requirement on producers to prove that products do not harm consumers before they are put on the market—if it wants to deal with the US.<sup>105</sup> The most recent British former ambassador to the US has said,

*We are going to come under huge pressure to accept genetically modified food, chlorinated chicken and all that kind of stuff. There cannot be a free trade agreement with America that's not going to include that [agriculture].*<sup>106</sup>

The historic complaint of US pharmaceutical companies that European countries unfairly suppress the prices that such companies can charge European patients now has a presidential champion.<sup>107</sup> Within the EU, the UK's policies have not been singled out by US pharmaceutical companies: the UK has found itself in the protective company of Austria, Belgium, the Czech Republic, Finland, France, Germany, Hungary, Lithuania, the Netherlands, Poland, Portugal and Spain.<sup>108</sup>

In contrast, it is extremely unlikely that the UK would gain any traction in increasing access for UK financial services:

*Following the financial crisis, financial services regulation in the US has been the subject of intense political debate and legislative activity; since the US was reluctant to make any concessions on regulatory harmonisation during the [Transatlantic Trade and Investment Partnership] negotiations, when the UK was playing a leading role on the EU side, it is unclear why the US would be prepared to concede more in a purely US-UK deal with more limited upside.*<sup>109</sup>

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105 <http://uk.businessinsider.com/us-commerce-secretary-wilbur-ross-on-post-brexit-trade-with-uk-2017-11>.

106 <https://www.theguardian.com/politics/2018/mar/06/brexit-ex-ambassador-says-prospect-of-easy-uk-us-trade-deal-is-an-illusion>.

107 <https://www.mirror.co.uk/news/politics/nhs-could-forced-pay-billions-12542016>.

108 [https://ustr.gov/sites/default/files/European%20Union\\_0.pdf](https://ustr.gov/sites/default/files/European%20Union_0.pdf), p. 144.

109 Ed Balls, Mehek Sethi, Eleanor Hallam, Sebastian Leape and Nyasha Weinberg, "On the Rebound: Prospects for a US-UK Free Trade Agreement", M-RCBG Associate Working Paper Series no. 89 (2018), p. 11.

The ability to “take back control” of regulatory standards very much depends on the size of the economy. There are two dominant sets of standards in the world at this point: EU standards and US standards. In the EU, the UK gets to help set the standards. It is not in the least bit likely that the UK will enjoy parity when it comes to negotiating on its own with the US. The UK will have to choose whether it follows EU or US standards. It makes little sense to follow US ones when the EU takes 48 per cent of the UK’s goods exports and the US takes roughly a third of the EU total.<sup>110</sup>

Harvard academics analysing the respective positions of the UK and the US suggest that the UK has a very weak hand and that there are good reasons to expect the parties to struggle to put a deal together with any rapidity—if at all (see table 5).<sup>111</sup>

*Table 5: Issues Determining the Prospects and Potential Benefits of a UK-US FTA*

|                           | <b>UK</b>   | <b>US</b>  |
|---------------------------|---|--|
| Strategic interest        | Imperative to demonstrate an upside to Brexit   | Lower priority than renegotiating the North America Free-Trade Agreement and tackling China. |
| Timeline and capacity     | Needs an early win, but can't proceed with negotiations until the EU-UK position is clear. Limited negotiating capacity.              | Other priorities and no time pressure. Significant negotiating capacity.                     |
| Tariff                    | Will have to make concessions and has little to gain.   | Will demand concessions.   |
| Non-tariff and regulation | Potential benefits in sectors like financial services are unlikely to be realised; concessions to US demands are politically fraught. | Will expect concessions on sectors like food, digital and healthcare. Likely to              |

<sup>110</sup> <https://www.ons.gov.uk/economy/nationalaccounts/balanceofpayments/datasets/>

9geographicalbreakdownofthecurrentaccountthepinkbook2016.

<sup>111</sup> Ed Balls, Mehek Sethi, Eleanor Hallam, Sebastian Leape and Nyasha Weinberg, “On the Rebound: Prospects for a US-UK Free Trade Agreement”, M-RCBG Associate Working Paper Series no. 89 (2018), p. 12.

|                            | UK  | US  |
|----------------------------|---|---|
|                            |   | concede little.   |
| Politics and negotiability | Must avoid looking desperate but must also avoid acknowledging that this could be a dead end. | Holds all the cards against the US. Even so, a UK-US FTA may be difficult to deliver. |

## CHINA

China is a country with which neither the EU nor the US has been able do a trade deal that they would consider fair. American officials have noted,

*It is tempting to group China in the “defensive” school of preferential trading – alongside large and developing economies like Brazil and India that are reluctant to open their borders through preferential trade. They stand opposed to the “offensive-minded” countries that want genuine liberalization (eg the US and EU) or are forced by their small market size to pursue trade agreements in order to remain competitive (eg Singapore and Chile).<sup>112</sup>*

It may well be conceivable that the UK could do a deal with China, but the question is whether it would be a fair one. Switzerland has a deal with China. However, that agreement is arguably neither fair nor comprehensive and would not suit the UK. In the China-Switzerland trade deal, China, as the much bigger partner, has set the terms of trade. It is allowed more time to remove tariffs on Swiss goods—up to 15 years in some cases—than Switzerland, which has to let in Chinese goods tariff free almost immediately. The agreement is also limited in scope: it does not cover cars or financial services, two major export areas for the UK.<sup>113</sup>

<sup>112</sup> US-China Security Review Commission, “China’s Trade Ambitions: strategy and objectives behind China’s pursuit of Free Trade Agreements”, Staff Research Report, May 2015, p. 13.

<sup>113</sup> <http://www.cbi.org.uk/business-issues/brexit-and-eu-negotiations/eu-business-facts/10-facts-about-eu-trade-deals-pdf/>.

## INDIA

It is widely cited that negotiations leading to a trade deal between the EU and India had failed to succeed because of UK objections to free-movement rights. The EU is apparently optimistic that after Brexit that it will be easier for the EU to do a deal with India. Indian sources indicate that free movement continues to be a block to doing a trade deal with the UK. According to the *Times of India*,

*Dinesh Patnaik, India's deputy high commissioner to the UK, told a gathering of the Indian Professionals Forum (IPF) at Chatham House in London on Thursday that "India had a choice to make post-Brexit - between a bloc of 27 nations that comprise the European Union (EU) or a single nation that is breaking away. If you look at it from an Indian perspective, unless the UK gets its act together, why should we get interested? We need the UK to take the first step," he said, adding that trade in goods, services and a free flow of people are the key elements that must come together for any new trade pact. Unless all three come together, you cannot have a trade agreement. And, the UK is still not ready for the third part. We are making the stage ready for the first two, but the third part is the most important.*<sup>114</sup>

In its suggested prioritisation of the UK trade deals, the Institute for Government recommended, unsurprisingly, that the UK should focus on replicating the deals for which it is already a beneficiary via its EU membership:

*The UK should avoid sinking resources into negotiations with the BRIC countries (Brazil, Russia, India and China) or the USA. The experience of other nations suggests that trade negotiations with Brazil, India or China would consume large amounts of precious negotiating resources, with little prospect of reaching an agreement. The USA can be a swift negotiator, but tends to move most quickly when its partners adopt a strategy of capitulation masquerading as negotiation. The UK needs to deploy its resources*

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<sup>114</sup> <https://timesofindia.indiatimes.com/india/uk-must-take-first-step-towards-new-trade-deal-indian-envoy/articleshow/63237094.cms>.

*strategically – it will be more productive to return to such negotiations in the future.*<sup>115</sup>

## **THE UK AND THE COMMONWEALTH**

In 2016, UK exports to the Commonwealth were £48.5 billion, or 8.9 per cent of the UK's total exports (roughly the same as UK exports to Germany). In the same year, UK imports from the Commonwealth totalled £45.9 billion, or 7.8 per cent of total imports.<sup>116</sup> The EU, meanwhile, accounted for 43 per cent of UK exports in goods and services in 2016 and 54 per cent of imports.<sup>117</sup>

This picture reflects the wider change in the nature of British trade away from the Commonwealth and towards the EU. In 1960, the top ten export partners for UK goods were the US, Australia, Canada, Germany, South Africa, India, Sweden, the Netherlands, New Zealand and Ireland. By 2011, because of the ease of trading within the single market, EU member states comprised eight of the top ten, which were Germany, the US, the Netherlands, France, Switzerland, Ireland, Belgium, Italy, Spain and Sweden.<sup>118</sup>

Analysis by the UK government, leaked in February 2018, set out that free-trade deals with non-EU countries would add less than 1 per cent to the long-term growth of the UK economy.<sup>119</sup> For instance, the UK's trade with the BRIC countries (Brazil, Russia, India and China), at £30.8 billion in 2016, is only very slightly larger than the UK's trade with a single member state—Ireland—at £26.7 billion.<sup>120</sup> UK Foreign Secretary Boris Johnson is this week visiting

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115 Oliver Illott, Ines Stelk and Jill Rutter, "Taking back control of trade policy", Institute for Government, 17 May 2017, p. 4.

116 Briefing Paper Number CBP 8282, 12 April 2018, Statistics on UK trade with the Commonwealth.

117 Briefing Paper Number 7593, 18 January 2018, Geographical pattern of UK trade.

118 House of Commons Library Standard Note SNEP 6211, UK trade statistics.

119 <https://www.thetimes.co.uk/edition/news/trade-deals-cannot-make-up-for-brexite-losses-says-leaked-report-j78lqwtgm>.

120 ONS figures 2016.

Argentina, Chile and Peru. UK combined exports to these countries were only 6 per cent of those with Ireland in 2016.<sup>121</sup>

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<sup>121</sup> Ibid.



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