Global Counsel

Customs union: soft Brexit or hard sell?

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Summary

When Theresa May's UK's government was stripped of its majority in last week's general election, the result was widely interpreted as a demand that the UK government focus on minimising the impact of its exit from the EU. One concrete consequence has been to put the question of customs union with the EU back in play as one possible variant of a soft Brexit, although it had been explicitly ruled out by the government in January. So, what would customs union mean? Have the politics in the UK shifted in a way that makes it feasible? And would the EU accept it?

When Theresa May's UK's government was stripped of its majority in last week's general election, the result was widely interpreted as a demand that the UK government focus on minimising the impact of its exit from the EU. 'Softening' the UK's Brexit strategy and pursuing an 'open Brexit' are very slippery political currency, often used to suggest a general outlook rather than any particular outcome of the negotiation ahead. But one more concrete consequence of the election result has been to put the question of customs union with the EU back in play as one possible variant of a soft Brexit, although it had been explicitly ruled out by the government in January. So what would customs union mean? Have the politics in the UK shifted in a way that makes it feasible? And would the EU accept it?

A customs union is created by a group of two or more states sharing a single external tariff with the rest of the world and removing the tariffs on goods traded between them. The EU is itself a customs union, and it maintains a customs union with Turkey, covering industrial and processed agricultural goods. This provides the basic model for what the UK might seek.

The benefits

It has some obvious benefits for trade. It eliminates any tariffs on covered goods traded between the two markets. It removes any obligation to meet origin requirements for goods seeking this preferential treatment, because they originate inside the single tariff of the customs union, which is controlled by the EU. While it does not remove the hard border for trade processing between the two markets, it helps streamline the process of shipping goods across the border, chiefly by aligning the documentation (and underlying product) standards of the two markets and institutionalising cooperation between their customs officials. With political will and smart use of technology, this kind of cooperation could streamline things even further. There are other marginal benefits, such as ease of securing trade finance to a market like Turkey.

Objectively, this is a highly preferential status for goods trade that would remove some of the administrative and cost implications for the EU and the UK of having to face each other's external tariffs for the first time in 45 years. While the two sides could replicate some of this with a free trade agreement and what the UK government has obliquely referred to as a 'customs agreement', neither of these things would put the UK back inside a shared external tariff with the EU, which is the key to breaking the link between preferential treatment and origin requirements.

However, the Turkish variant of customs union with the EU covers only industrial and processed agricultural goods, which would make it only

a partial solution to some important potential UK problems. This is especially the case for the hard border between Northern Ireland and the Republic of Ireland, where some of the supply chain issues created by Brexit concern agricultural goods, for which high new tariffs and new origin requirements would not necessarily be mitigated by an arrangement on the Turkish model. In principle, you could extend a customs union arrangement to cover agricultural goods, or recreate some aspects with a flanking free trade agreement that eliminated tariffs.

The compromises

Customs union is underpinned by a wide range of supporting commitments to the EU designed both to maximise the benefits of goods market integration but also to prevent the arrangement becoming a source of regulatory arbitrage. There is also a requirement for security and law enforcement cooperation for issues such as counterfeiting, but this should be seen as an upside. The UK would be expected to adopt and maintain a wide range of EU standards for industrial products (and potentially agricultural goods if an arrangement extended to them), and in return would be granted a high level of mutual recognition of its product standards in the single market. The UK would be expected to commit to mirroring EU rules on state aid and competition policy, and standards of protection of intellectual property. These standards are already embedded in UK law and practice, but customs union would constrain the ability to change them in future.

This requirement to transpose EU standards would obviously be controversial. It would mean the UK agreeing to mirror ECJ judgements on aspects of these standards over time – which is undeniable indirect influence by the court. Moreover, the EU could be expected to want a direct role for the ECJ in settling disputes. The current Turkish customs union gives both sides a veto on disputes going to the ECJ – something that Ankara has always blocked – but the EU has long sought to change this and would probably not agree to the same system for the UK.

However, the most important constraint on UK policy space would come with the commitment to maintain a single external tariff with the EU for goods covered by the customs union. This would apply not only to the EU's basic external tariff applied to all other WTO members, but to any tariff reductions agreed by the EU in bilateral free trade agreements with other countries and to any emergency tariffs applied under the EU's trade defence system. The UK would not, however, be party to negotiations or deliberations that

Six political tests for customs union

Would it require the government to change policy?	Yes, the Lancaster House speech ruled out customs union. The UK's apparent ambitions for a new wave of bilateral trade deals would also need to be heavily caveated.
Does it require the UK to extend freedom of movement to the EU?	No. This single fact is probably all that makes customs union even conceivable politically. However, the EU could, in principle, push for rights for short-term entry to the UK – for truck drivers for example.
Does it require the UK to align with EU rules?	Yes, in many areas, chiefly related to product standards, IP, competition and state aid law. It would require cooperation on security and counterfeiting. Although arguably this helps ease of trade and in ways which may not bother UK voters.
Does it require the UK to make a contribution to the EU budget?	You could expect Brussels to ask for a contribution to the management of the system.
Does it reduce UK policy autonomy?	Yes, very materially, especially in product market regulation, and potentially in big aspects of trade policy. It also raises difficult questions about the role of the ECJ. There is no question that customs union makes the UK a satellite jurisdiction of the EU in key respects. The question is whether the benefits outweigh the constraints.
What might the UK have to give to get customs union from the EU?	Fundamentally, probably nothing. It is an off-the-shelf model, that involves minimal concessions from the EU and clear mutual benefits.

produced these reductions or rises. Moreover, customs union would not compel the EU's FTA trading partners to lower their own tariffs to the UK – this concession would have to be sought by the UK in its own separate agreements.

This would be a material rolling back of any UK ambitions for an autonomous trade policy after Brexit, at least in terms of its ability to strike trade deals by cutting its external tariffs. In a customs union scenario, UK bilateral deals would generally be counterparts to agreements already struck by the EU, in which the UK sought to confirm its own access to the concessions extended to Brussels. The UK would be free to make and secure concessions in these agreements where it was not constrained by the customs union – above all in services trade, public procurement, investment or agricultural goods, if they remained outside of a customs union arrangement. How much this matters depends, to some extent, on how much you think the UK's autonomy to further reduce its external tariffs (which are generally already very low for industrial goods), either unilaterally or as part of future trade deals actually matters – or rather, if it matters more than the benefits from customs union.

The politics

Is such an arrangement politically feasible? To be sure, it raises some hard questions about where the UK might strike a balance between policy autonomy and preferential and simplified access to its largest regional market. It leaves the UK's ability to dictate its external migration policy untouched, which is politically important. Whether the other concessions on trade policy and regulatory autonomy are acceptable will often look different to politicians and policymakers who want to guard their future prerogatives and those businesses (which is not all of them) that want the greatest possible continuity as the UK leaves the EU.

Would the EU accept a UK request to maintain a form of customs union? It seems highly likely. Such an arrangement would preserve continental distribution networks in the UK and any supply chains that included UK firms. It would assuage many of the EU's basic concerns about locking the UK into regulatory alignment in areas where UK goods compete with EU ones and obviously involves no concessions of regulatory autonomy on the EU's part. The EU has a natural instinct to cooperate on customs facilitation. Being able to offer market access to the UK in its own trade deals would be a very material increase in its own negotiating leverage – indeed, the UK could be expected to insist that this was linked to greater UK input into EU negotiating positions than has ever been granted to Turkey, and explicit support from the EU in securing flanking agreements for the UK from FTA partners.

Ultimately, customs union would test the proposition that UK voters have signalled that they are willing to compromise on some areas of sovereignty to secure a closer relationship with the EU in trade. Some UK politicians will judge that protecting autonomy in migration policy is the only area where voters have been unequivocal. The Labour opposition is clearly considering turning its own vague support for customs union into something more explicit. Even the government's new minority partner, the Northern Irish DUP, who are no fans of 'soft' Brexit, might see customs union's benefits for Northern Ireland as attractive. Others – including most Conservative backbenchers and ideological Brexiters - will inevitably see the concessions built into customs union as leaving the UK too much of a satellite market of the wider EU regional market and too much of a crimping of their ambitions for the UK as a global champion of free trade.

One obvious compromise may be to propose that customs union be central to a transitional arrangement with the EU – a proposal attractive to some Conservative cabinet ministers - possibly as part of a wider temporary arrangement with the EU that keeps the UK inside the EU in most respects. A temporary extension of customs union might then be formalised if both sides ultimately concluded it suited them.

Customs union is a genuine trade-off. When it was debated inside Whitehall and Westminster in the wake of the referendum, both politicians and policymakers ultimately concluded that the compromises of policy space involved were either practically or politically unacceptable. Whether this judgement still stands is not clear, but the weeks ahead will probably answer that question.

This Global Counsel Insight note was written by Stephen Adams, Senior Director, and Jade Rickman, Senior Associate at Global Counsel.

To contact the authors, email:
s.adams@global-counsel.co.uk
j.rickman@global-counsel.co.uk

A: 5 Welbeck Street, London, W1G 9YQ
T: +44 (0)203 667 6500
E: info@global-counsel.co.uk
www.global-counsel.co.uk
@global_counsel