

## BREXIT ESSENTIALS

### IS A CUSTOMS UNION THE PATH TO BREXIT?

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The possible formation of a customs union between the EU and the UK after Brexit has recently emerged as a central topic of discussion, including between the Conservative and Labour Parties. Whilst we covered customs unions early in this series of briefings, this change in the political agenda has made it more important for business to be in a position to assess their advantages and disadvantages. So, this briefing recalls the characteristics and consequences of a potential customs union between the EU and the UK.

#### What is the EU customs union?

The EU Treaties establish a customs union between all EU Member States which covers all trade in goods and prohibits the imposition of customs duties on imports and exports, as well as all charges of equivalent effect. It requires all EU Member States to apply the same customs tariff, known as the Common External Tariff, in their relations with third (i.e. non-EU) countries. The EU customs union means that EU Member States have no power to conduct an independent trade policy in respect of matters covered by the EU customs union or common commercial policy.

#### Can non-EU Member States enter into a customs union with the EU?

Yes. Each of Turkey, Andorra and San Marino has a customs union with the EU. This is not, however, the EU customs union.

#### What is a customs union?

The EU is not the only example of a customs union in the world. MERCOSUR in South America is another example. A customs union is an arrangement between customs territories that meets the requirements set out in the GATT, which is part of the World Trade Organization treaties governing international trade. There are two basic requirements for a customs union:

- a) the duties and other restrictive regulations of commerce are eliminated on substantially all the trade between the territories of the union within the scope of that union; and
- b) the same duties and regulations of commerce are applied by each member of the union.

Point (b) is the main distinction between customs unions and free trade agreements. It should be noted that there are exceptions, and the EU has, despite its customs union with Turkey, imposed anti-dumping measures on Turkey.

### Are there legal restrictions on the terms of a customs union under international law? Can they be enforced?

Yes. Any WTO Member that believes it is disadvantaged by a purported customs union that does not comply with a) and b) above may bring a case before the WTO dispute settlement bodies. The UK would face litigation risk entering into a non-compliant customs union with the EU.

#### *What are the main advantages of a customs union?*

The principal advantage of a customs union is the elimination of all customs duties and measures of equivalent effect on goods covered by the union which, once they have entered the union and the common external tariff has been paid on them, may circulate without further tariffs. Customs unions also eliminate the need for “rules of origin” (i.e. rules determining the trade origin of goods) as between members of the union because there is a common external tariff on all goods entering the customs union from outside. Most economists consider that these features reduce the costs and friction to trade. The principal disadvantage of a customs union is that it restricts the ability of the members of the customs union to conduct an independent trade policy for goods.

### What does a customs union not cover?

This depends on the terms of the customs union and is, therefore, a subject for negotiation between the parties. The EU-Turkey customs union excludes agricultural products (except processed agricultural products) as well as certain other goods. There is no legal reason why the UK could not

negotiate a customs union with the EU that covered all goods (including agricultural products) or only certain categories, if both parties considered it to be advantageous.

### What does a customs union mean for services?

Nothing. A customs union applies to tariffs and other customs duties levied at the border on goods. The barriers to the cross-border provision of services are generally regulatory. About 80% of the UK economy is composed of services industries.

### What does a customs union mean for combined goods and services agreements?

Many goods are provided alongside related services, for example in the IT, telecoms and engineering sectors. In the context of a customs union, it is necessary to separate the goods element from the provision of services. The goods provided under the agreement will generally be able to move between countries in the customs union free of tariffs. Unless otherwise agreed between the EU and UK, the services element will need to comply with the relevant local rules that apply to the provision of the service.

### Can countries in a customs union negotiate free trade agreements with third countries?

Yes, and they are expected to do so. However, in the context of an EU-UK customs union, the terms of the UK’s free trade agreement must, so far as goods are concerned, replicate those agreed by the EU. This would be similar to Turkey’s position under the EU-Turkey customs union: Turkey may not enter into a free trade agreement with a third country unless a free trade

agreement has been entered into between that country and the EU. Whenever the EU opens negotiations with a trading partner for a new free trade agreement, it requests the other party to negotiate in parallel with Turkey a free trade agreement in the same terms. This is known as the “Turkey clause”. A third country’s refusal to negotiate with Turkey does not, however, prevent the EU from entering into a free trade agreement with the third country.

### Would the UK automatically have the benefit of existing EU free trade agreements negotiated before Brexit with third countries?

No. The UK would need to roll over or re-negotiate those agreements, while complying with the terms of the customs union. The Department for International Trade (DIT) has already rolled over a number of FTAs to apply after Brexit.

### Could the UK pursue an independent trade policy on goods if it entered into a customs union with the EU?

No. The UK would be prohibited from concluding free trade agreements on goods with countries with which the EU did not have a free trade agreement, or from offering more advantageous terms to such countries. The EU would remain free to negotiate free trade agreements with countries that did not wish to enter into a free trade agreement with the UK.

As services are excluded from a customs union, the UK could negotiate free trade agreements with third countries on services. This would also be the case for

any goods that are not covered by a customs union.

### *Would the UK have a say in free trade agreements negotiated by the EU?*

Under the EU Treaties the Council authorises the Commission to open negotiation on free trade agreements as it is an exclusive EU competence. The Commission is an organ of the EU and cannot represent non-Member States, so the UK would need to negotiate free trade agreements in parallel. Whilst the terms of an EU-UK customs union could require the EU to consult with the UK, this would be a matter for political negotiation. In the context of the EU-Turkey customs union, the EU looks at its own commercial interests and has no duty to take into account the interests of Turkey.

### Would a customs union ensure frictionless trade between the UK and EU?

Of itself, the answer is no. Unless the customs union covered all goods, and the regulatory standards were the same in the UK and EU, there would need to be regulatory checks to ensure that imports from the EU into the UK comply with UK requirements and vice versa. As a result of its partial nature, there are considerable delays at the EU-Turkish border while regulatory checks are carried out in areas not harmonised by the customs union. These relate mainly to certain “technical barriers to trade” (i.e. those EU regulatory standards which Turkey does not apply) and sanitary and

phytosanitary checks (i.e. animal and plant welfare and standards) as the EU-Turkey customs union excludes agricultural (other than processed agricultural) products. Unless the UK agreed to form a common regulatory area with the EU, and a common veterinary area, checks would be inevitable absent mutual recognition of standards (which is not current international or EU practice).

***Would a customs union obviate the need for customs declarations and customs checks?***

The EU's view would seem to be no and customs declarations would need to be filled out as is the current practice between the EU and Turkey. Customs checks would be simplified, but checks for illegal immigration, people smuggling, contraband and fraud would presumably be needed. If there is no common veterinary area, then current EU law requires plant and animal checks to take place at the border.

**Would a customs union entail free movement of people?**

No.

**Would a customs union eliminate the need for visas for business travel or other permits?**

No. This would be a matter for negotiation between the EU Member States and the UK. The EU Member States currently require visas for Turkish nationals entering the EU and may require UK business visitors (including UK truckers) to obtain visas. For Schengen area

countries this would be a common decision. Countries outside of Schengen (such as Ireland and Cyprus) would make their own decision as immigration is a national competence. EU Member States currently place quotas on Turkish vehicles entering the EU, while Turkey maintains a monopoly on loading at Turkish ports. As these are national competences, the UK would need to negotiate appropriate arrangements with the Schengen countries and individually with each other EU Member State.

**Would a customs union give the UK access to EU agencies?**

No. Access to EU agencies such as the European Medicines Agency or the European Aviation Safety Agency (EASA) would not be part of a EU-UK customs union and would need to be separately negotiated. Turkey is not a member of EASA or the European Medicines Agency, although the EFTA Member States are members of EASA.

**Are there additional steps the UK could take to facilitate free trade in goods or services beside a customs union?**

Yes. If the UK wished to secure free trade in goods and services it could, in addition to forming a customs union, participate in the single market. There is no existing model that incorporates single market membership with a customs union, but there would not seem to be any legal impediment to such an arrangement being negotiated provided that the parties agreed (including Iceland, Liechtenstein, Norway and Switzerland). It would, however, require not only UK compliance with EU trade

policy, but also regulatory alignment with the EU in areas covered by the single market. The UK would not have any vote on single market measures that would apply to the UK.

*Would an EU-UK customs union avoid the need from the EU's perspective for the Irish backstop?*

This is most unlikely as an EU-UK customs union could be terminated by the UK giving notice. The EU is therefore likely to insist on a backstop in the case that, on the expiry of any transition period, alternative arrangements have not been found to maintain a frictionless border on the island of Ireland.

**Would the UK need to contribute to the EU budget under a customs union?**

Not directly, but, under a customs union, it would be a matter for negotiation how customs receipts were allocated.

**What would be the role of the Court of Justice of the European Union (CJEU) in**

**interpreting the common rules applicable under a customs union?**

The CJEU takes the view that the autonomy of EU law means that it must have the exclusive right to interpret EU law. This is reflected in the draft Withdrawal Agreement negotiated by the UK with the EU. That said, under the customs union with Turkey, Turkey has to agree for a dispute to be submitted to the CJEU. The EU is unhappy with the existing dispute settlement mechanism with Turkey.

**Will the EU negotiate a customs union with the UK without ratification of the draft Withdrawal Agreement?**

The EU has stated publicly that ratification of the Withdrawal Agreement is a precondition to negotiations on the future relationship between the EU and the UK.

## OUR TEAM






Slaughter and May is equipped to help you across the full spectrum of legal issues triggered by Brexit.

Our team has advised and continues to advise clients in a range of sectors on issues arising out of the referendum result and the various options for the shape of the UK's future relationship with the EU. These include the effects of Brexit on M&A, financing transactions and other types of investment activity, its likely impact on the

regulatory environment and on the cost of cross-border trade.

We are also able to assist with contingency planning, lobbying efforts and the formulation of restructuring options.

For further information on the contents of this Briefing or in relation to Brexit, visit [www.slaughterandmay.com/brexit](http://www.slaughterandmay.com/brexit)

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