

The Consequences of a Permanent Customs Union

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25th April 2019

A customs union with the EU would come with significant costs to the UK's economic, trade and foreign policies. Such an arrangement would also fail, by itself, to eliminate trade 'friction' with the EU. To do so would also require alignment with the Single Market rules for goods.

A customs union would also come with significant risk to UK consumers who would likely lack effective representation in new EU trade agreements. There would be a high chance that their interests would be subsumed to those of EU producers, and UK producers' defensive interests would not be represented. Furthermore, if the UK were required to follow the EU's trade defence policies, UK consumers would be left vulnerable to price rises to protect EU manufacturers, while British manufacturers would not necessarily be defended.

What is a customs union?

A customs union is defined in the GATT as a single customs territory with a common external tariff to be applied to substantially all trade with non-members, and no internal tariffs or quantitative restrictions to be applied to substantially all trade between members of the customs union.

Other features can be added to these arrangements, either to further reduce trade barriers or to maintain a 'level playing field'. In the former case, this might include alignment on goods regulation to further minimize checks, in the latter it might cover the harmonisation of state aid measures to limit 'unfair' competition. Members of a customs union may also harmonise their trade defences (such as anti-dumping duties).

The 'single customs territory' outlined in the Irish 'backstop' under the Withdrawal Agreement includes the above features, but some of them are absent in the EU's customs union agreement with Turkey. Turkey is obliged to apply the EU acquis on goods, although because there is no formal arrangement of the oversight and enforcement of these measures its exports to the EU are still subject to regulatory checks. In the backstop, only Northern Ireland is required to apply the acquis and in turn benefits from single market recognition and no border checks on its exports to the EU.

Key Points

- A customs union does not achieve 'frictionless' trade and would likely still involve documentary checks.
- Regulatory checks can only be eliminated with single market membership or significant alignment.
- It is unlikely that the EU would allow the UK to 'take back control' of policy areas such as state aid and agriculture under a customs union.
- The UK would be unable to raise or lower tariffs according to its interests.
- The EU would be able to grant market access to its FTA partners as a concession without the UK having a say or necessarily getting anything in return.

Why enter a customs union with the EU?

The purpose of entering a customs union with a trading partner is to remove tariffs and rules of origin between the two countries for the purposes of the goods covered by the arrangement. This is considered to foster greater economic integration than a free trade agreement, which might remove tariffs between the parties but would not unify external tariffs so rules of origin would still be required.

A customs union alone, however, will only eliminate tariffs and rules of origin. Documentation would still be required to clear customs. For instance, if Great Britain were part of a customs union as set out in the backstop, movement certificates would be required to demonstrate that goods qualify for tariff free preferences on entering the EU market. For Northern Ireland, being part of the EU's customs union and with all of the additional arrangements attached to it, these would not be required (but they would need such certification for goods to enter Great Britain).

Customs unions can also allow multiple countries to pool their negotiating leverage in trade negotiations if their objectives are sufficiently aligned and they agree to act as a bloc in making free trade agreements with other countries. In the EU this is the Common Commercial Policy. It applies to members states but is not a necessary part of a customs union, and for example it does not apply to Turkey, which can make its own trade agreements, but cannot negotiate on tariffs with third countries as these are set for it by the EU. Almost all of Turkey's FTAs are with countries that the EU already made an agreement with, and, in order to gain reciprocal benefits for its exporters, Turkey had to negotiate separately with the partner country having already had the tariffs for its market reduced or eliminated by the EU. This leaves Turkey with little leverage to pursue other benefits on services, regulation or investment in its agreements.

What are the downsides for the UK?

Without Single Market alignment and recognition, there would still be significant regulatory checks on UK-EU trade. Most interventions at the EU's external border relate to regulatory compliance (especially on food and agriculture) not tariffs and rules of origin compliance, which cannot be assessed by physical inspection of goods in any event.

Entering a customs union with the EU would foreclose the opportunity of an independent trade policy to the UK, as we would be unable to vary tariffs from the EU's Common Commercial Tariff. The UK has historically been more free trading than the EU so this loss of flexibility would likely cut against the UK's interests, as UK consumers are forced to pay for the protection of EU industries.

- UK consumers could be harmed by EU trade defence measures aimed at protecting EU producers.
- Customs union membership would mean reduced influence for the UK with historic partners in the developing world.
- The downsides of customs union membership are more likely to impact on small to medium enterprises which lack the ability to lobby at the EU level.

While this would theoretically leave trade agreements with third countries on services and regulations possible, these issues are the most difficult to progress in trade negotiations, and without being able to offer improved market access for goods (in particular as the UK will continue to align with single market regulation on goods unilaterally by way of a commitment in respect of Northern Ireland to protect the UK single market and intends to negotiate regulatory alignment with the EU under the Political Declaration), the UK's persuasiveness will be materially diminished.

It has been suggested that if the EU agrees to reduce or eliminate tariffs with a country pursuant to an FTA that the UK would not be compelled to adjust its tariffs accordingly, allowing it to maintain leverage to negotiate reciprocal market access for UK exporters to the partner country. This is important as, were the UK not in 'the' EU's customs union, the UK would not be party to the EU's FTA. Whether this would be possible would depend on the details of the agreement; however, it should be noted that existing models of customs unions with the EU (such as the backstop and the Turkish agreement) do not allow this to take place. The Turkish agreement, however, does allow alignment to be postponed subject to decision by a joint committee, which Turkey has used to retain tariffs against countries where it hasn't been able to secure agreement. This provision is not included in the backstop. Even if it were permitted, to operate effectively, it would necessitate increased border checks with the EU and the levying of duties, defeating much of the original rationale for a customs union.

Though not strictly required under the legal definition of a customs union, under the single customs territory in the backstop (which the Political Declaration intends to build on for the future relationship), trade defences would also be run by the EU. A recent DIT consultation has shown that, even as members, EU trade remedies are misaligned with UK interests. This would continue and likely worsen with the UK having reduced influence.

The UK would also be forced to follow the EU's trade policy towards the developing world. This would mean the loss of significant foreign policy influence with countries such as India, Pakistan, Sri Lanka, Kenya and Nigeria. Historically, the UK has been their ally in negotiations with the EU and has used the resulting leverage in tackling issues such as security and migration. This influence would be gone.

It should also be noted that many of these downsides are especially severe for small to medium enterprises which are less dependent on UK-EU supply chains and lack the ability to lobby effectively in Brussels. Instead, the beneficiaries would be large existing companies who are already adapted to the current arrangements and seek continued protection from foreign competition.

Conclusion

Any short-term benefits of securing supply chains and reducing disruption would be heavily outweighed in the long run by the loss of trade opportunities, asymmetric agreements, higher prices for UK consumers, the inability to defend UK producers from unfair trade practices and the loss of foreign policy influence. The disproportionate impact on smaller businesses is also likely to harm overall productivity in the long run.

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