Fact – NOT Friction

Exploding the myths of leaving the Customs Union

A joint publication from the European Research Group and Global Britain

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20th November 2018

Cover picture: The Port of Southampton, Diego Torres

FOREWORD

By Simon Boyd FinstD, Managing Director of Reid Steel

It is often said that when the UK leaves the EU Single Market and its Customs Union that it will be far harder to trade whether it's import or export – that frictionless trade will become difficult with delays, obstacles and costs. From my own experience I can say the reverse is true.

In my experience trading with our European friends is infinitely more difficult than it is to trade with other countries outside the EU. It has, for instance, been easier for us to export to Mongolia than to France, despite the fact we were founded there in 1919.

The reasons for this are obvious, the EU is bureaucratic by its very nature and its Customs Union is a fortress designed to protect producers inside it rather than encourage open free trade where everyone can benefit. But we are not and never have been protected by this protectionist regime.

Instead we have seen the steady ebb of manufacturing move to other areas of the EU – and even to areas beyond – as a result of our membership. Add to the bureaucracy and protectionism; the uneven playing field, demise of our world renown British Standards (seen by many as the finest in the world) and the constant anti-competitive diet of bad EU Regulation and Directives which our civil servants gold plate, it is no wonder that our productivity and ability to grow has been held back.

The EU system suits only the multinationals who have the means to lobby and unfairly profit at the expense of the vast majority of UK businesses.

This paper is a revelation because it exposes the truth that we have been on the receiving end of a carefully orchestrated blizzard of false facts and predictions that are not born out by the evidence.

Indeed the seventeen myths that are taken down here are testimony to the prevalence of fear-mongering throughout the Brexit debate to make it appear "catastrophic" to live and trade outside the EU. Yet if we only ask ourselves how perfectly normal and successful countries such as China and Australia on the other side of the world – and the USA on the other side of the Atlantic – have been able to trade successfully with the EU and the UK from outside its customs Union we have to admit life and trade in such a circumstance is not catastrophic at all.

Indeed living under WTO rules is successful, profitable and life-enhancing for their societies. To be free to trade with the growing world will reap huge rewards for our country and our trading partners. We will then see the reversal of the huge trading deficit of circa £100 Billion per year in goods our EU membership has delivered.

I ask my fellow business colleagues to read this pamphlet and take its lessons on board – we can all adjust to trading under WTO rules and working towards a trade deal that reduces any friction to near zero – but it shall not be catastrophic, it should not even be uncomfortable, it should just be another business challenge that will be worth it.

We will succeed through our country taking back control of our laws, our money and our borders.

EXECUTIVE SUMMARY

The provision in the PM's draft Withdrawal Agreement that could keep the UK indefinitely in the EU customs union is driven not just by concern that customs procedures needed outside a customs union would require a hard border in Ireland but by fears that they will impose costs, cause delays, disrupt supply chains and undermine economic growth. However, many of the problems ascribed to leaving the EU's customs union are imaginary and most of the rest are exaggerated.

- References to "customs paperwork" having to be "checked at the border" after Brexit conjure up visions of lorry drivers filling in forms which are then laboriously checked against their loads, causing delays and queues. In fact, virtually all customs declarations are made electronically ahead of arrival at a port; most consignments are cleared within seconds of arrival; a tiny percentage are physically checked as a result of risk assessment by HMRC computers or intelligence information; and such checks may be carried out away from the border at importer's premises or warehouses.

- Most checks relate to dutiable goods, drugs or illegal immigrants and are made on the basis of risk or intelligence information. HMRC do not expect any of these risks to increase or new risks to emerge as a result of Brexit so they will not require more checks than at present. The same is true for checks of food, plants and animals. In any case they will 'prioritise flow over compliance' to prevent congestion.

- It is often assumed that there are no border procedures or checks on trade with the EU at present. Yet, in fact, companies have to report their transactions with EU countries separately in their VAT returns; pay duty on tobacco and alcohol (which yield far more revenue than tariffs would in the event of 'no deal'); they may be searched for illegal drugs or immigrants; drivers must show their passports; and companies of any size must submit details of their intra-EU trade to Intrastat. All but the latter (which will be replaced by customs declarations) will continue post Brexit and constitute the major element of border compliance.

- The claim that WTO rules require checks to be made at the border is incorrect. Checks of customs declarations are carried out electronically and physical checks often made at importer's or exporter's premises. Even the Union Customs code, which requires agri-food checks at border inspection posts 'in the vicinity of the border' allows them to be as far as 40 kms inland. This is particularly important for avoiding infrastructure and checks at the Irish border.

- Just-in-Time supply chains do not operate exclusively within the EU. Indeed, a fifth of components imported by UK motor manufacturers come from outside the EU, and their timely arrival is just as essential to the reliable operation of assembly lines. They are subject to customs procedures that do not cause the problems supposed to be likely when applied to future imports from the EU.

- The assumption that free trade agreements impose far more burdens on trade than do customs unions is not born out by economic studies or in the real world. Surveys of the literature show that free trade areas – e.g. NAFTA - are more 'trade creating' than the EU customs union. Businesses in Switzerland, Norway and other EEA countries are not complaining about completing customs declarations let alone calling to convert their free trade arrangements into a customs union. This may be because they welcome the free trade agreements their countries have been able to negotiate which would not be possible within a customs union. The Swiss

have FTAs with countries whose combined GDP is three times that of the FTAs negotiated by the EU.

- Although Switzerland and Norway have fewer checks on product compliance because they comply with EU single market rules the customs declarations required at their borders with the EU are similar to those that will be required at the UK border and they too have to comply with rules of origin.

- Of course, we should endeavour to minimise the cost of compliance with customs procedures. But as the Chair of the European logistics and customs association has said: "All the ingredients to ensure a smooth exit process of the UK from the EU and which allow *almost frictionless trade* after the exit, are already available [in the Union Customs Code]." So we do not need to negotiate simplified customs procedures.

- The HMRC estimate of the cost of completing customs declarations is an order of magnitude larger than actual costs incurred by companies and reported by the Swiss authorities. The HMRC figure is based on the charges by customs agents for large consignments of complex products. It ignores the fact that over two thirds of businesses complete their own declarations because it is cheaper and that for the small repeat consignments that characterise UK/EU trade the cost of replicating declarations is negligible compared with the cost of the initial declaration.

- Official estimates of the cost of complying with rules of origin are even less defensible. They are based on outdated and irrelevant studies of trade between underdeveloped countries and the USA or the EU. A more recent authoritative study by the WTO shows that, except for infrequent consignments, the costs of complying with rules of origin are 'negligible' – they do not even wipe out a 1% tariff preference. Moreover, the new REX system – which the EU has agreed to extend to the UK post Brexit – further simplifies the procedure for declaring origin.

- A particular concern has been fear that lengthy delays at ports and consequent congestion on motorways will disrupt plants dependent on Just-in-Time supply chains (JIT). As explained, HMRC do not expect more checks on imports from the EU post-Brexit and will prioritise flow over compliance. The fear is, however, that delays – either deliberate or through lack of preparation – on vehicles arriving at Calais from the UK will cause a back-up of vehicles extending back over the channel and up the UK motorway system, interfering even with supplies coming in the opposite direction. Deliberate delays would be a breach of three treaty commitments (the original WTO treaty, the Trade Facilitation Agreement (FCA) and the Lisbon Treaty requiring the EU to behave in a neighbourly fashion towards adjacent states). Of course, legal redress would take time but ports in Belgium and Holland are eager to take trade away from Calais.

- Moreover, queues resulting from problems at Calais are not unknown. Operation Stack has had to operate on 211 days since 1998 and did so for 23 almost continuous days in 2015 with delays of 35 hours. Yet JIT plants appear to have managed since none were reported halting production.

- It is natural that businesses contemplate the worst possible consequences in the event of the UK leaving without an agreement – due to lack of preparation combined with hostile non-cooperation by the EU. Sadly some commentators present these scenarios as if they represent what would be a permanent situation post-Brexit. But most such problems are not merely unlikely but, if they happen at all, essentially temporary.

INTRODUCTION

One of the most contentious provisions of the Prime Minister's draft Withdrawal Agreement is the commitment to keep the United Kingdom in a customs union with the EU which we will not be able to leave without EU approval. That is supposedly necessary to avoid a hard border between Northern Ireland and the Irish Republic[1] and a customs border between Northern Ireland and Great Britain. But it also reflects strong pressure from the Treasury and Department for Business, Energy and industrial Strategy (BEIS) to avoid the customs procedures which will apply to all our trade with the EU if we leave the customs union – even if we have a Canada style free trade agreement or if the UK leaves the EU on WTO terms. They claim that these customs procedures will cause unacceptable "friction" which will impose huge costs, cause damaging delays, disrupt just-in-time supply chains, undermine economic growth and provoke militant resentment on the Irish Border.

These fears are driven by a series of myths about how they think Customs procedures work. Unfortunately, few in government or the media are familiar with them.

This paper attempts to dispel these myths.

Of course, leaving the customs union and replacing it with a free trade agreement with the EU and/or other countries has both costs and benefits.

In a free trade area, unlike in a customs union, businesses have to make customs declarations and comply with rules of origin when trading with other member states. On the other hand, in a free trade area states are free to set their own external tariffs or abolish any of them either unilaterally or in negotiating additional free trade agreements with other countries.

This paper demonstrates how the possible costs, delays and congestion of customs procedures if we traded with the EU on the basis of a free trade agreement or on World Trade Organisation terms, have been exaggerated. Likewise, the benefits of wider free trade agreements have been understated. On the basis of their inevitably *theoretical* estimates the government argues that the cost of leaving the customs union would exceed the benefits of free trade agreements with the EU and/or the rest of the rest of the world.

Yet countries that have practical experience of both costs and benefits of free trade agreements have reached the opposite conclusion. Members of EFTA, the EEA, NAFTA and the Asian free trade areas are not lobbying to convert their free trade agreements into customs unions. Their businesses do not seem to find completing customs declarations and complying with rules of origin a significant problem. And member states have profited from the opportunity to negotiate additional free trade relationships with a swathe of other nations.

In the light of this, it is strange how much negotiating and lobbying effort has been expended on keeping the UK within a customs union in which the UK has historically been the loser. When the UK joined the Common Market in 1973 it was one of the fastest growing markets in the world. We hoped that getting within its then high external tariff would enable us to share that growth. Yet only four years later Britain was bust and had to be bailed out in the biggest ever IMF rescue. The main

[1] See *The Border between Northern Ireland and the Republic of Ireland post-Brexit* European Research Group 12th September 2018 which shows that the EU could avoid infrastructure or checks at the border while complying with its own rules. HMRC has said that the UK "does not require any infrastructure at the border between Northern Ireland and Ireland **under any circumstances**"

causes were domestic but they were aggravated by the huge trade deficit opening up as imports from the continent far outstripped British exports to the continent.

Forty years later that deficit in trade with the EU is approaching £100billion. On the other hand our trade with the rest of the world is growing more rapidly with a growing surplus. Meanwhile, the EU is now the slowest growing continental economy apart from Antarctica. The EU itself expects 90% of future trade growth to be outside Europe. And the EU external tariff now averages only 4% making it much less important to be inside it.

The decision to leave the EU is a political one, not an economic one. It was about restoring national self-government so that we could hold the people who make our laws democratically accountable. Not that prosperity and democracy are alternatives. In the long run they go hand in hand, because if a democratic government fails to deliver prosperity the electorate can throw it out. Furthermore, a national government can tailor laws to the nation's needs rather than having to accept one-size-fits-all rules across a continent.

It is domestic policy that overwhelmingly determines whether a nation is competitive or not. So taking back national control over our domestic law and economic policy will strengthen the UK's flexibility, agility and freedom to compete.

Membership of the customs union in practice entails remaining subject to the bulk of EU single market law including all future laws – with no say over them. The paradox of the debate about remaining in the customs union is that those who are entirely happy to forego the right to lighten the burden of over 10,000 EU laws and regulations[2] somehow baulk at the requirement to complete a customs form and declaration of origin. Is it really credible that customs procedures alone are more damaging than all the REACH, MiFiD and countless other directives and regulations, imposed on industry over the years? Furthermore, new industries like BioTech, FinTech, AI, GM and Gene Editing in which the UK is strong, face the risk of being regulated by other EU countries which have no interest in their prosperity.

Apologists for EU legislation are right to say that regulation is a necessary evil in a complex modern economy. There will be little scope for a bonfire of regulations. But there will be considerable scope, and cumulatively enormous benefit, from being able to streamline the rules we inherit from the EU, to minimise compliance costs and above all to reduce the barriers to entry. We should of course seek to do the same thing for customs procedures. Indeed, one of the myths that we debunk is that there is no scope for simplification within the current EU customs code. There is and it should be a priority to encourage and facilitate British businesses to take advantage of these simplifications when trading with the EU.

So, it makes no sense to try to preserve the trade *status quo* with the EU. There is far more opportunity for the UK by gaining freedom to simplify regulatory standards on goods, to set our own tariffs and quotas and trade policy, and to use these levers to achieve better trading relationships with the rest of the world, which is growing so much faster than the EU. This is why it is so odd that the UK government should have become so preoccupied with defending a deficit trading relationship with the EU at the expense of the growing surplus we generate from trade with the rest of the world.

[2] "At the end of 2008, the rules of the Treaty were supplemented by some 8,200 regulations and just under 1,900 directives in force throughout the 27 Member States" European Commission's 26th Annual Report on Monitoring the Application of Community Law (2008)

Only after we leave, and retake control of our own trade policy, will we have regained the flexibility to adapt ourselves to a changing world, and build a strong foundation for our future prosperity.

So, the UK should welcome the prospect of a Canada+++ trade deal with the EU, as was offered by President Tusk back in March 2018. Combined with the ERG proposals for customs frontiers without new infrastructure, which removes the need for the so-called “back-stop” or a “hard border” between Northern Ireland and the Republic, a Canada+++ advanced Free Trade Agreement offers the best and only deliverable Future Economic Partnership with the EU.

MYTHS SURROUNDING A UK-EU FREE TRADE DEAL

(but may also underlie discussions of 'no deal')

MYTH 1

- **Customs declarations are pieces of paper that are examined and compared with loads at the border.**

"*trucks from non-EU countries … have to park and fill in a form at the freight clearance office. A computerised system known as the Customs Handling of Import and Export Freight (CHIEF) logs details automatically, indicating what the goods are and what the import duty might be, but it has to be checked*." The Economist 6 April 2017

The reality:

- **Virtually 100% of customs declarations for goods arriving in the UK are made electronically *ahead of arrival* at the port.** They are sent to, and checked electronically by, the Customs Handling of Import and Export Freight computer system (CHIEF)[3].
- CHIEF carries out computerised risk assessment processes to identify consignments, or goods within a consignment, that need to be physically examined or their documentation examined. **Checks are normally carried out only if a risk of non-compliance is identified**.
- Fewer than 1% of imports are physically checked as a result of CHIEF.
- Around 94% of imports are cleared in 5 seconds and 96% of the remaining 6% are cleared within 2 hours[4].
- Fewer than 3% of non-EU imports are subject to document checks and 96% of those are cleared within 2-3 hours.
- Most "border" processes – like customs declarations – are not carried out at the border but electronically or at the exporter's or importer's premises, inland warehouses etc.
- Post Brexit, in the vast majority of cases, the only new customs check needed under a free trade agreement would be confirmation of the customs declaration similar to the check on the drivers' passports (which already take place) where there are border posts as at Dover, or at the destination premises.

MYTH 2

- **Customs declarations at Channel ports will require checks and delays at the border.**

The reality:

- **There need be no more checks on goods entering the UK than at present as a result of Brexit**. Jon Thompson, CEO of Customs and Revenue, in evidence to the Select Committee explained that ***there need be no extra Customs checks*** because checks are related to risk (most of which relate to goods liable to excise duties and illegal drugs) and imports from the EU will be no riskier post Brexit than before.[5]

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[3] CHIEF will soon be upgraded to the new Customs Declaration Service (CDS) further facilitating trade.

[4] HMRC briefing to MPs October 2018.

[5] Evidence to DEXEU Select Committee 29th Jan 2017.

Q220 Mr Rees-Mogg: If I have understood your evidence correctly today, customs and excise can … minimise any delays at the border to ensure they are no worse than they currently are on our side? …

Jon Thompson: In relation to imports, yes.

MYTH 3

- **There will need to be far more checks on food and animal imports entering the UK.**

"Our system for importing and exporting food implodes almost instantly … We don't have enough inspection posts, we don't have the staff to man them, we don't have the means to divert product to them and we don't have the cold storage capacity to handle product going in and out. Many ports don't have space to install more facilities." Ian Dunt, Editor, Politics.co.uk July 2018

The reality:

- **There need be no extra Sanitary and Phyto-Sanitary checks on food and animals entering the UK post Brexit** – unless in future EU goods represent a greater health risk than now, which seems unlikely**.** John Bourne, Policy director of Animal and Plant Health for DEFRA, confirmed that, because physical inspections (like customs checks) are risk related they see no reason to increase their frequency[6].
- Fresh fruit etc is flown in from Israel and other non-EU countries with negligible delays at UK airport Customs/SPS controls. As long as fresh food clearance points are geared up to operate at Dover in the same way as at freight airports , there need be no delays.
- Indeed, EU rules requiring arbitrary high percentage checks on imports regardless of risk need no longer apply in the UK.
- The EU may impose additional checks on food, plants and animals entering the EU from the UK. The UK's SPS measures will, however, initially be not just equivalent, but identical, to the EU's. The WTO SPS agreement appears to disallow additional EU checks in such circumstances since it requires that: *"Members shall accept the sanitary or phytosanitary measures of other Members as equivalent, even if these measures differ from their own or from those used by other Members trading in the same product, if the exporting Member objectively demonstrates to the importing Member that its measures achieve the importing Member's appropriate level of sanitary or phytosanitary protection."* However, the EU may impose checks to ensure that equivalent rules in non-member countries including the UK are being adhered to.

MYTH 4

- **WTO rules require member states to operate border controls**

"the legal requirement we will have … to operate the WTO-compliant border, which does require checks at the border. That's what the WTO rules require." Philip Hammond[7]

The reality:

Q237 Jon Thompson: The fundamental question here is whether what is currently intra-EU traffic will be any more risky post leaving the European Union than it is now? What we intervene on now is risk and intelligence-based. That is a system we will continue to apply in the future. We may not intervene any more than we do now,

[6] Ibid Q237 ***John Bourne:*** From our point of view, we absolutely agree with you: we do not think there are significant reasons to alter our risk assessments on day one. We have been doing this for a long time and nothing has really changed; hopefully, we have got relatively appropriate risk management processes in place now.

[7] https://www.politico.eu/article/philip-hammond-brexit-ireland-uk-will-enforce-hard-border-in-ireland-if-there-is-no-brexit-deal/

- **Despite repeated requests, the government has been unable to provide us with the text of the WTO rules that allegedly require checks at the border.**
- WTO rules are designed to facilitate trade – *not to hinder it.* They prohibit discrimination between goods on the basis of their country of origin.
- Most declarations are made electronically, not at the border; checks can be, and often are, made away from the border at company premises, warehouses etc.
- Even Border Inspection Posts that the Union Customs Code (which in any case the UK will be able to amend) requires to be 'in the vicinity of the border' and are often sited 20kms or more away.
- WTO/GATT rules require goods to be treated in similar ways regardless of origin and destination.[8] However, it is normal for procedures to differ between ports (for example, not all will have full-time customs posts) and between land and sea borders. So, as long as the UK does not discriminate between goods at a particular location on the basis of origin or destination *it is not obliged to perform its checks at the border.*
- The WTO also allows waivers – albeit temporary but renewable – even from non-discrimination rules on the very security grounds that underlie the concern about the procedures applying to trade across the UK/Irish border.

MYTH 5

- **There are currently no checks or procedures required for importing into the UK from the EU**

"Currently, goods moving between the EU and UK don't need to be checked at borders"
Jon Stone, *Independent*, 23 July 2018

The reality:

- **There are currently several border processes and checks on trade crossing the UK/EU border which will remain the principal procedures when it becomes a customs border.** Current checks involve:
    - Companies have to report their transactions with EU countries in their VAT returns because exports to the EU are zero rated whereas transactions within the UK incur 20% VAT. (This will continue and requires much of the information that will be necessary for customs declarations.)
    - Excise taxes on imports of tobacco, alcohol etc are several times the value of import tariffs[9]. (That will remain the case post Brexit whether we trade with the EU on FTA, WTO or FCA terms.)
    - Illegal Drugs – involve a significant proportion of checks (which will not change post Brexit).

[8] *"with respect to all rules and formalities in connection with importation and exportation, and with respect to all matters referred to in paragraphs 2 and 4 of Article III, any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties."* GATT Article 1

[9] Ibid Q217 … **John Thompson:** the major risk from an HMRC perspective is actually excise. Perhaps I can give you an illustration. A packet of 20 cigarettes, which retails in this country for, say, £9, you can buy in Eastern Europe for £1. If you are prepared to try to import it from somewhere in the Middle East across an eastern European boundary, you can almost certainly get it for 10p. Now, given that £7 billion of excise revenue is raised at the border, there is a significant challenge in relation to tobacco and alcohol at the border. That is the major risk here, not really the £3 billion of customs. At the minute, we pass 80% of that on to the European Union. That is the area where HMRC is particularly exercised about risk over time.

- Illegal migrants – are, likewise, a cause of checks at present (which will not change).
- Statistical returns. All but smaller companies have to submit details of their intra-EU trade comprising much of the information which will be required by customs declarations, though on a monthly basis rather than with each consignment. Next plc say they expect little extra work as a result[10]. (Customs declarations will replace this, not be additional.)
- Drivers (and passengers) must show their passports since the UK is outside Schengen. (This will not change.)

- In the event of an outbreak of disease, epidemiological controls may be introduced at the border.

MYTH 6

- **Just-in-Time supply chains cannot operate across customs frontiers**

"I don't think it's feasible for the carmakers to carry on running the JIT supply chains if …UK leaves the EU customs union." Tim Lawrence, PA Consulting *Financial Times* June 2018

The reality:

- **Just-in-Time and Just-in-Sequence supply chains can and do operate across customs frontiers in the UK and worldwide**.
- **21% of auto manufacturers' bought-in supply chain comes from outside the EU against 36% from the EU and 43% from within the UK**[11]. The reliable operation of production lines is as dependent on these non-EU imported JIT/JIS supply chains as those from the EU. Customs procedures at UK ports have never been cited as a problem for these supply chains.
- Ford and General Motors depend on supply chains that operate across the Canadian/US/Mexico borders where, because NAFTA is a free trade area not a customs union, there is a customs border.[12]
- Fresh cut flowers (which are very time sensitive) travel daily from the Netherlands across the customs border to Switzerland. (Because single market rules apply both sides of the Swiss border, flowers do not face SPS checks there but the example illustrates that ordinary customs declarations, which apply to flowers as to all goods, do not result in delays.)
- Although delays in deliveries are undesirable, UK motor manufacturers already have to cope with the sometimes prolonged delays at Channel ports (resulting in Operation Stack – see Myth 13), delays on motorways such as the M25 and across Europe between EU suppliers and UK plants, caused by bad weather and other incidents.

[10] *Brexit Preparation and Impact Analysis,* Next CEO's Report for Half Year ended July 2018. "Although there is no customs border between the EU and UK, any company importing more than £1.5m or exporting more than £250k pa is required to submit Intrastat declarations for all goods flowing into the UK from the EU and vice versa. Intrastat declarations contain almost entirely the same data that is required to make a customs declaration. Therefore, we do not anticipate any additional data will be needed in order to import goods from the EU post-Brexit and so there is little additional work in respect of data collection."

[11] *Trade Post Brexit* Boston Consulting Group, Herbert Smith Freehills and Global Counsel

[12] This was highlighted by the recent agreement on revisions to the North American Free Trade Agreement. https://www.cnbc.com/2018/10/01/ford-general-motors-rally.html

MYTH 7

- **Customs Unions are far more beneficial than Free Trade Agreements.**

"[A Canada-style Free Trade Agreement] would be a bad Brexit outcome for the UK…a customs union should serve as a practical, real-world answer" Carolyn Fairbairn, Director General of the CBI[13]

The reality:

- **Norway and Switzerland are not calling for creation of a customs union with the EU. Nor is Canada calling to convert NAFTA into a customs union. They do not find these customs procedures cause onerous 'friction'.**
- Comprehensive reviews of studies of the impact of trade agreements provide no evidence that a customs union would be more beneficial for UK-EU trade than a standard free trade agreement (FTA). One found no evidence that customs unions outperform FTAs in trade creation[14]. The more recent study found membership of the EU customs union had modest trade-boosting impacts (15-20%) but that these were on all their measures smaller than the trade-creating effects of FTAs such as NAFTA[15].
- Turkey has a customs union with the EU but delays at the EU/Turkish border are legendary not least because of checks for illegal immigrants (which are and would remain a feature of UK/EU trade since we are outside Schengen). When the EU does trade deals with third parties, these third countries gain tariff-free access to Turkish markets but Turkish exporters do not gain automatic reciprocal access to these third countries and Turkey has to try to negotiate parallel arrangements (not always successfully). Notably, Turkey came close to cancelling its customs union with the EU when the EU was negotiating the TTIP trade deal with the US. Britain in a customs union would be in the same position as Turkey.[16]
- A customs union would rule out UK negotiating our own trade deals.
- Switzerland has negotiated trade deals (some in conjunction with EFTA) with countries whose GDP (excluding the EU) is 3 times[17] that of the countries with which the EU has trade deals. However, Swiss trade deals can be one-sided because adherence to single market rules means they can offer no regulatory flexibility in their trade negotiations.
- Nonetheless, a third of Swiss FTAs have a significant services component whereas 90% of EU FTAs have almost no service component[18]. Yet over half of the UK's exports by value added is in services, giving us a different interest from the rest of the EU.

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

[14] "Looking at the most widely studied agreements – EU, EFTA and NAFTA –, the largest impact is for NAFTA (131%), while the European agreements register much lower, but possibly more realistic values: 27% in the case of EFTA, 41% for the EU. It is also worth noting that custom unions – EU, CARICOM, MERCOSUR, CACM, CISCU – do not seem to consistently outperform the free trade areas in terms of trade impact. Indeed, in the meta-analysis regression the coefficient of the CU variable was never significant." *Reciprocal trade agreements in gravity models: a meta-analysis* Maria Cipollina and Luca Salvatici (University of Molise)

[15] Table 6 *Gravity Equations: Workhorse, Toolkit, and Cookbook* Head and Mayer (2013)

[16] 14 Reasons Why a UK-EU Customs Union Remains a Terrible Idea. By Gudgin and Weston, Briefings for Brexit

[17] ***Myth and Paradox of the Single Market: How the trade benefits of EU membership have been mis-sold*** **Michael Burrage Civitas Jan 2016. Switzerland has trade deals with counties whose collective GDP is $39.8 trillion of which $16.7 trillion is with the EU which has FTAs with countries whose total GDP is only $7.7trillion.**

[18] Ibid

MYTH 8

- **Customs compliance between the EU and EEA countries or Switzerland is very light only because they have to comply with EU rules.**

Switzerland, Norway, Iceland and Liechtenstein are not part of a Customs Union with the EU. So they have negotiated their own free trade agreements with the rest of the world and levy tariffs on imports from non-EU countries at rates that differ from the EU external tariffs.

The reality:

- **The same customs procedures apply to trade across the borders between the EU and Switzerland and Norway as will operate at UK/EU borders post Brexit under a 'Canada style FTA'. However, their alignment with Single Market rules reduces the extent of non-customs checks below those the UK would face in a Canada style FTA.**
- All goods crossing the borders between EU and EFTA countries have to complete customs declarations, declare their origin and either declare their conformity with EU rules of origin or pay full EU duty on imports where the EEA country has a preferential low tariff.
- The requirement for these customs and origin declarations is not removed or reduced because EEA countries adopt (or in Switzerland's case, closely align with) Single market rules. (Adherence to Single Market rules does remove the need for certification of compliance with those rules)
- Agricultural products and animals face additional checks at EU borders with Norway and Switzerland.
- UK membership of the EEA would not remove the need for customs declarations for goods crossing the Irish border nor address the EU demand for a backstop incorporating NI or the UK in a customs union.
- Despite the supposedly damaging 'friction' caused by customs borders, Switzerland, Norway, Liechtenstein and Iceland have higher GDP per capita than any country within the EU customs union.

MYTH 9

- **Customs procedures cannot be simplified without EU agreement.**

It is widely assumed that the UK would have to negotiate with the EU to simplify procedures to minimise friction for our exporters and importers post Brexit.

The reality:

- **"All the ingredients to ensure a smooth exit process of the UK from the EU and which allow *almost frictionless trade* after the exit, are already available." Paper[19] by CLECAT representing 19,000 EU customs agents handling 80% of EU clearances.**

[19] Position Paper: The future economic partnership between the EU and UK CLECAT – European Association for Forwarding, Transport, Logistics and Customs Services – October 2018

- There is a range of simplifications already available in the Union Customs Code that can be implemented by WTO member states immediately.
- CLECAT lists 60 simplifications already available in the Union Customs Code that can be used by UK customs, British importers and exporters and customs agents.

MYTH 10

- **Customs and Rules of Origin declarations could cost £17-20 billion.**

"Taken together, [Rules of Origin and Customs Declarations] indicate a burden on UK-EU trade in goods of around £17-20bn a year." – Letter from Jon Thompson, CEO of HMRC to the Treasury Select Committee

These HMRC estimates include the costs of declarations both in the UK and the EU on both exports and imports (£6.5 billion for declarations in each direction plus £3-5 billion for Rules of Origin – see Myth 13). So half would be borne by EU businesses and consumers.

The reality:

- **Measures of actual border costs turn out to be a fraction of these theoretical estimates.**
- Switzerland calculated the cost of border compliance at less than 0.1% of the value of trade. Because Switzerland adopts EU single market rules its total border compliance costs would be expected to be lower than those the UK would experience in Canada-style FTA. But that does not explain why HMRC's estimate just of the cost of making customs declarations and complying with rules of origin is over 50 times higher than total Swiss costs!

	Regulatory costs/million CHF		
Duties to act	Imports	Exports	Total
Presentation and registration	230	105.9	335.9
Controls and inspection	2.9	0.4	3.3
Payment of import duties	19.6	0	19.6
Archiving and backing-up of data	12.9	7.5	20.4
Foreign trade statistics	39.4	16.1	55.5
Proof of origin	16.7	27.4	44.1
Total	**321.5**	**157.3**	**478.8**
Value of trade	277,000	293,000	570,000
Percentage cost of customs	**0.116**	**0.054**	**0.084**

The paper notes: "The estimated customs clearance costs in this study are less than 0.1% of the value of imported and exported goods. The costs per case are higher for imports than exports."[20]

- A study for the Dutch government by KPMG,[21] which went into much more detail than the HMRC, put the cost of customs declarations (excluding compliance with Rules of Origin) if

[20] Bericht über die Regulierungskosten: Schätzung der Kosten von Regulierungen sowie Identifizierung von Potenzialen für die Vereinfachung und Kostenreduktion. Dec 2013

[21] Impact of non-tariff barriers as a result of Brexit KPMG for Ministry of Economic Affairs and Climate Policy and Ministry of Agriculture, Nature and Food Quality January 2018

the UK trades on WTO terms at 1% of UK/Netherlands trade – one quarter of the HMRC figure (and KPMG, like HMRC, did not allow for the much reduced cost of replicating multiple similar declarations).

- NEXT plc, which has published a detailed impact assessment of 'No Deal'[22], estimates the additional costs of customs compliance on the £170m stock they import from the EU/Turkey will be £100k – i.e. less than 0.1%.
- Tate & Lyle reports that for all its imports via its own terminal it employs just two people (who also undertake other tasks) to handle their customs declarations at a cost of less than 0.02% of the value of imports. Even for consignments of specialist cane arriving at other ports for which Tate & Lyle employs customs agents, the cost of customs procedures adds less than 0.06% to the cost of the consignment.[23]
- The HMRC estimate assumes that the very large number of small consignments which comprise UK/EU trade, many of them regular repeat deliveries for industries like the car industry, will have costs similar to the one-off costs of agents handling the far larger, less regular, consignments which comprise trade from outside the EU.
- Making the first of many declarations can be time consuming and costly – it involves assembling data about name, number and location of exporter, transporter, importer etc. and the commodity code and value of the consignment and inserting it in the data fields of the CHIEF form. But repeating the process for subsequent consignments can be digitalised if only a few elements change, reducing the marginal cost of making subsequent declarations to negligible amounts.
- The HMRC estimate was based on three studies –
    - a study (Grainger)[24] involving just 3 importers of chilled and frozen meat and 2 freight forwarders (agents) specialising in the meat trade – a highly complex and untypical trade. The study quoted agent's costs of handling customs declarations of £20 to £40.
    - a study (Ipsos-MORI)[25] covering compliance costs of all taxes. The average cost of a customs declaration handled by agents was £41 but 68% of companies do this themselves, presumably because it is much cheaper.
    - the study (KPMG) referred to above for the Dutch government estimating the cost of customs declarations in the event of no deal, which came up with a cost for declarations of 1% of the value of trade.
- The reason the HMRC estimate is so out of line with companies' experience appears to be:
    - They base their estimate on the charges of customs agents
        - These often cover other services including calculating duty due which would be irrelevant in a free trade arrangement.
        - Customs agents are often used for more complex consignments like frozen meat, which involve more than completing the declaration, or for irregular consignments that do not benefit from repetition.
        - 68% of firms[26] complete their own declarations presumably because it is much cheaper. Of those who used agents most did so for calculating duty payable or for goods requiring inspections.

[22] CEO Report: Brexit Preparation and Impact Analysis, Next plc Results for Half Year ending July 2018

[23] Brexit, Movement of Goods and the Supply Chain by Shanker A. Singham and Victoria Hewson, Legatum Institute Feb 2017

[24] Trade and Customs Procedures: The Compliance Costs of Meat Imports Dr Andrew Grainger Nottingham University Business School 3rd September 2013

[25] Understanding tax administration for businesses Ipsos MORI HM Revenue and Customs Research Report 375 July 2015

[26] Understanding tax administration for businesses Ipsos MORI HM Revenue and Customs Research Report 375 July 2015 p33

- HMRC also based its estimates on costs incurred on imports from outside the EU whereas trade with the EU typically involves consignments that are far smaller and more frequent. ***The cost of replicating multiple, similar repeat declarations will tend to fall to near zero once digitalised.***[27]

MYTH 11

- **Motor manufacturers will face high costs of completing customs declarations.**

"Honda expects it would need to handle 60,000 additional customs declarations, requiring a new IT system and additional staff. HM Revenue & Customs says this would cost Honda £2.1m a year in form-filling alone." Financial Times June 2018

The reality:

- **Honda's estimate (which assumes the HMRC estimated cost of £35 per consignment even though an IT system would reduce the unit cost to a fraction of this figure) nonetheless implies the cost of declarations would add just 0.2% to the cost of components and less than 0.1% to the cost of the average car.**
- Moreover, it implies they will employ some 50 to 60 staff full-time on completing customs declarations meaning each completes only 4 or 5 per day. This is a surprisingly low throughput.

MYTH 12

- **Compliance with Rules of Origin is so complicated that it will outweigh the benefits of free trade agreements.**

"costly 'rules of origin' that could render a tariff-free deal meaningless for many companies in these sectors." Customising Brexit, Institute of Directors 2018

A Canada-style free trade agreement with the EU (unlike a Customs Union) would allow the UK to enter into free trade agreements with third countries as well. However, where such FTAs reduce UK tariffs below those charged by the EU, the EU would want to stop goods avoiding their external tariff by entering the UK on a low or zero tariff then being re-exported to the EU (either unchanged or as components of finished goods). Consequently, all goods moving from the UK to the EU will have to declare their origin; and those deemed under the EU's Rules of Origin to come from outside the UK/EU free trade area will have to pay the EU's external tariff on export to the EU.

The reality;

- **Rules of Origin apply to exports from Switzerland and Norway to the EU. It is scarcely an issue for most of their traders though Switzerland's strong engineering and**

[27] HMRC estimate from VAT returns that 217,000 firms will make an extra 205 million customs declarations post Brexit. That means on average each firm will make nearly 1,000 shipments pa averaging just £2,000 each. By contrast, the 150,000 UK firms trading with third countries make 55 million declarations – on average roughly 370 pa per firm, nearly £7,000 per shipment. It is probable that the unit cost of multiple/repeat declarations on trade with the EU will be far lower than on high value, less frequent shipments.

pharmaceuticals industries, in particular, involve supply chains with both the EU and the rest of the world.

- **The new Registered Exporter system (REX) in the Union Customs Code allows self-reporting of the origin of goods exported to the EU[28]. It is no longer necessary to have this certified by the national authorities.**
- The EU has agreed that REX will be applicable to UK firms under a post Brexit FTA, as it is for other countries trading with the EU on preferential terms.
- This will significantly simplify the process of complying with rules of origin:
    - REX only requires firms to register with their home country authority.
    - Firms then simply self-declare the origin when making a customs declaration.
    - They must also keep records of the origin of raw materials and trace back the origin of components so that they can prove, if required, that the declared origin of their exports complies with EU Rules of Origin.
- Companies producing goods using non-UK/EU components and materials will still need to show, if required, a calculation that establishes whether the local value added meets the Rules of Origin. This is usually a one-off calculation for each model of car/derivative. The calculation does not need to be repeated for each unit, so the cost per unit is usually trivial, being spread over all the firm's exports to the EU (though for food products, for example, whenever sourcing of raw materials changes, then the calculation may need to be repeated).
- Most UK exports will qualify as of UK origin[29] – across the NI/Irish border it is virtually 100%.
- The administrative cost of demonstrating compliance to rules of origin is exaggerated, the substance of those rules will be very important for industries like motor manufacturing. In particular, the level of 'local content' will be important as will the ability to include as 'local' components from countries that also have mutual free trade agreements.

MYTH 13

- **The cost of compliance with Rules of Origin exceeds tariff preferences that will be negotiated in UK free trade deals with third countries.**

HMRC has put the cost of compliance with rules of origin at £3-5bn . A BIS Review of Competences quoted costs negating tariff preferences as high as 15% of the value of trade. The CBI quotes costs up to 8% of trade.

The reality:

- **These estimates are not credible.**
    - **A more recent WTO study[30] concluded that the cost of complying with rules of origin is 'negligible' – insufficient even to cancel out a 1% tariff preference[31].**
    - **They ignore the simplification introduced by REX.**
    - **They ignore the actual costs incurred complying with Rules of Origin between EEA countries and the EU that are too low to cause any concern.**

[28] **https://ec.europa.eu/taxation_customs/sites/taxation/files/rex_registered-exporter-system_en.pdf**
[29] Assuming the EU applies the Pan-Euro Med system, which it now applies to all other regional preferential agreements.
[30] *New evidence on preference utilization* Alexander Keck and Andreas Lendle World Trade Organization Economic Research and Statistics Division
[31] *"By value, at least 80% of preference-eligible imports in both the EU and US with margins of less than 1% enter under preferential regimes. In the US, many low-value imports with low margins still enter under a preference, even when saved duties are less than USD 10.* ***This strongly suggests that utilization costs are often negligible****."* *New evidence on preference utilization* Alexander Keck and Andreas Lendle World Trade Organization Economic Research and Statistics Division

- **They are based on discredited[32], outdated and irrelevant studies of trade between developing countries and the EU or USA that ignore the volume of trade.**

- The WTO study suggests the only significant cost is the one-off cost of assembling the information to demonstrate compliance with rules of origin. They calculate this ranges between $15 and $1,500 but spread over all of a firm's consignments this is usually negligible.
- If the cost of compliance exceeds the tariff preference, a company can simply pay the tariff instead. That is only likely to be the case if the tariff is extremely low and the goods are exported in very small quantities. Given that the average EU external tariff on industrial goods is about 2.5% the average cost of compliance could not exceed that amount – way below figures quoted by the CBI.

[32] The BIS Review of Competences claimed that studies showed the cost of complying with RoOs was between 4% and 15% of the value of imports. Nearly all the studies analysed related to trade with developing countries, which may find it difficult to prove compliance with RoOs. In calculating the likely range of costs it excluded without explanation the most relevant study – of RoOs between EEA and EU – which showed compliance costs below the lower end of the quoted range. The upper end of the range came from double counting elements of a study that actually showed maximum costs of half that level.

MYTHS SURROUNDING 'NO DEAL' – OR TRADING ON WTO TERMS
(but may also underlie criticisms of a UK/EU free trade deal)

MYTH 14

- **There will be lengthy delays on clearing imports entering through Dover if we leave without a deal (or even with a conventional free trade deal).**

"The risks of a No Deal Brexit – delays to lorries at Dover" Hilary Benn MP

The reality:

- **HMRC has said it will "prioritise flow over compliance"**.[33] So, even if initially some hauliers have not correctly made their customs declarations, they will be waved through to prevent delays, and followed up later.
- The idea that the UK will itself hold up flows of goods entering the EU post Brexit (whether or not there is a Deal) would be absurd and is not the government's policy given their commitment to prioritise flow and avoid new checks.
- It is equally inconceivable that the French or other EU authorities will deliberately prevent or delay their exports through Calais to the UK as the local French authorities have made clear.[34] (See Myth 15 below for UK exports through Calais).

MYTH 15

- **Delays in clearing UK exports through Calais are likely to cause a backlog of lorries on the M20 if we leave without a deal (or even with a conventional free trade deal).**

"We also need to prepare for the worst-case scenario where the authorities at Calais are deliberately directing a go-slow approach". Dominic Raab, October 2018

The reality:

- **A deliberate go-slow at Calais would be a breach of three treaty obligations**
  - The original WTO Treaty forbids discrimination against goods from any country so procedures at Calais would have to apply to Irish goods that have crossed the UK as well as British goods.
  - The Trade Facilitation Agreement, which came into force in February 2017, requires signatories (including all EU member states) to facilitate – not hinder – trade.
  - The EU's own Constitution (Article 8)[35] requires them to co-operate with neighbouring countries to establish an area of good neighbourliness.
- Other channel ports – especially Zeebrugge and Rotterdam – are eager to win trade away from Calais. It is estimated that other roll-off-roll-on ports could handle 40% of Dover/Calais trade.

[33] HMG Border Delivery Group presentation to ACITA conference 18th Oct 2018
[34] https://www.bbc.com/news/uk-politics-45990243
[35] Article 8. 1. The Union shall develop a special relationship with neighbouring countries, aiming to establish an area of prosperity and good neighbourliness, founded on the values of the Union and characterised by close and peaceful relations based on cooperation.

- A third of lorries going from Dover/Folkestone to Calais are returning empty[36] (reflecting the huge EU surplus on trade with us) so Calais authorities will have a third fewer declarations to clear.
- The new head of the French equivalent of the UK Border Delivery Group is talking about a "risk-based approach" to checks[37].
- The Hautes de France authorities have made clear that far from hindering trade – an idea they describe as "economic suicide"[38]– they are making preparations to ensure smooth flow post Brexit.

MYTH 16

- **JIT supply chains will be interrupted by unprecedented lorry queues backing up the M20 – for which we are unprepared.**

"Just minor delays at the Channel Tunnel and Dover would force hundreds of its trucks to wait for the equivalent of 90 hours a day… it is very difficult to see how cross-border Just In Time systems can survive in their current form." UK in a Changing Europe April 2018

The reality:

- **There have been frequent and prolonged delays causing blockage of the M20 yet with no reports of production being interrupted at motor manufacturers or other JIT plants.**
- Operation Stack[39] has been activated on 211 days between 1998 and 2015 as a result of:
    - Blockades of Calais by fishing boats
    - Industrial disputes on ferries
    - Immigrants besieging security fences
    - Fires and breakdowns in the Channel Tunnel
    - Severe weather in the English Channel
    - Snow blocking roads exiting Calais
- In summer 2015 Operation Stack was in force almost continuously for more than three weeks between 23 June and 1 August 2015.
- At the peak, 7,000 Heavy Goods Vehicles (HGVs) were queued on the M20, taking 36 hours to work their way through.
- There is no record of any JIT manufacturing plants having to halt production in the UK as a result of these delays.
- Operation Brock, with enhanced capacity and improved traffic routing, will replace Operation Stack ahead of Brexit though permanent lorry parks may also be needed in future, regardless of Brexit, to cope with a recurrence of past problems.

[36] Richard Everitt, Chairman Dover Port**: "**I would like to think they could go through relatively easily... One third of lorries are empty going back." DEXEU Select Committee 29/11/17
[37] UK Border Delivery Group presentation to CLECAT conference 18th October 2018
[38] BBC: "French officials dismiss UK fears of Calais 'go-slow'" https://www.bbc.com/news/uk-politics-45990243
[39] *Operation Stack* House of Commons Transport Committee 23rd May 2016

MYTH 17

- **Short term problems following 'no deal' will be permanent**

Project Fear Mark 2 postulates short term disruption in the event of no deal – either as a result of deliberate non-cooperation or lack of preparation by governments and businesses – and then portrays what is intrinsically temporary as if it will be the permanent state.

The reality:

- **Conceivably some firms will initially be unfamiliar with customs procedures which might cause or excuse delays in Calais (though not in Dover where flow will be prioritised over compliance), but businesses will soon learn the procedures as have firms trading with non-EU countries.**
- It is theoretically possible, though extremely unlikely, that the French or EU authorities will deliberately provoke a period of disruption 'pour décourager les autres', but inconceivable that it will be permanent – both because it would be a breach of treaties (see Myth 15) and because it would inflict great harm on French and European businesses. Legal remedies (possibly taken by disadvantaged EU businesses or their governments) take time but would ensure that treaty breaches would not be permanent.
- It is important that Customs and all government agencies prepare for exiting the EU with no trade deal. That means not only ensuring that staff are trained, equipped and informed of the need to give priority to flow, but also ensuring businesses which trade solely within the EU are made familiar in advance with ordinary customs procedures.

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Global Britain Limited
Registered office: Lynton House, 7-12 Tavistock Square, London WC1H 9BQ
Registered in England No 03502745

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Exploding the myths of leaving the Customs Union

A joint publication from the European Research Group and Global Britain

20 November 2018