

Trade in Goods

Challenges caused by Brexit

27 February 2018

Core Recommendations

For decades, the European Union has been the foundation of economic growth and development in Europe. Its achievements are tremendous in terms of peace, stability, and prosperity. To safeguard the competitiveness of Europe, the way ahead is not disintegration and the introduction of new barriers, but rather the deepening of the Union. German business, while accepting the vote of the United Kingdom to leave the EU, thus deeply regrets this decision. The EU27 and the UK are highly integrated. Brexit will severely disrupt the economic relationship, entailing costs for both the EU27 and the UK – with considerably larger costs for the UK.

Ensure the Integrity of the EU: German business fully supports making the integrity of the EU single market and customs union, as well as the cohesion of the remaining EU27 a negotiating priority.

Allow for a Transition Period and Create Business Certainty: To prevent a cliff-edge scenario, the EU27 and the UK should decide on a clearly defined transition period that allows for enough time to negotiate the future relationship between the two parties. The interim agreement should extend the current regime and then only change once to the final future arrangement.

Avoid a Hard Brexit: No agreement on the future relationship between the EU27 and the UK would lead to a hard Brexit. The UK would become a so-called third country to the EU; i.e. the EU27 and the UK would no longer have a preferential relationship. As a consequence, the tariffs bound at the World Trade Organization would apply and new layers of bureaucracy would be introduced. Trade relations would be severely disrupted. This should be avoided.

Aim at Deep Integration of EU27-UK: For the future relationship between the EU27 and the UK, German business, while acknowledging the political difficulties, prefers a governance model which ensures deep integration, i.e. a model that continues the single market and customs union. A comprehensive free trade agreement (FTA) – while being better than no deal at all – would not be sufficient to guarantee frictionless trade.

Customs Facilitation: Both the EU27 and the UK need to invest in hard and soft infrastructure to ensure efficient customs clearance. Customs procedures need to be optimized to mitigate costs, allowing for self-assessment and centralized clearance. The EU27 should seek for the UK to become a party to the Common Transit Convention so that the use of the respective common transit procedures, including the New Computerised Transit System (NCTS), remains possible. They should also mutually recognize their Authorised Economic Operators schemes.

BDI-Task Force Brexit

The BDI is committed to supporting the Brexit negotiation teams with in-depth expertise in a number of areas of economic policy. In summer 2017, the BDI set up a Brexit task force together with its member organisations, company representatives and partners including the Association of German Banks (BdB), the German Insurance Association (GDV), the Federation of German Wholesale, Foreign Trade and Services (BGA), the Confederation of German Employers' Associations (BDA) and the Association of German Chambers of Commerce and Industry (DIHK).

The BDI Task Force Brexit has established ten project teams to address specific policy areas: (1) Trade in Goods, (2) Transportation and Logistics, (3) Data and ICT, (4) Taxation, (5) Legal consequences of Brexit in core areas of business law, (6) Energy and Climate Policy, (7) Market Access, (8) Workforce Mobility, (9) Banking, Finance and Insurance, (10) Negotiation Process (including Northern Ireland, Research and Development, Defence, Financial Commitments).

The objective of the project teams is to identify the potential risks posed by the exit of the UK from the EU and to propose constructive approaches to countering these risks. The project teams are looking at the regulatory issues in the individual policy areas on the European and the national level. The BDI is also a member of a similar task force at Business Europe, the umbrella organisation for European business. The work of the BDI Task Force Brexit will progress in line with the official negotiations.

This position paper is based on the background information developed by the BDI Brexit Task Force. The views expressed in this position paper are those of the BDI and do not necessarily reflect those of the other members of the Task Force.

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Introduction

June 23, 2016, marks the day that the United Kingdom (UK) narrowly voted to leave the European Union (EU). On March 29, 2017, the UK officially notified the EU of its intention to exit, thus triggering Article 50 of the Treaty on European Union (TEU). Under Article 50, EU Member States have the right to withdraw from the Union: “Any Member State may decide to withdraw from the Union in accordance with its own constitutional requirements.” The Article lays out the procedure for withdrawal. From the time of notification, the EU and the UK have two years to agree on the conditions of the withdrawal and the nature of their partnership. Membership in the EU then ends automatically, unless the European Council and the EU Member States agree on an extension of this period (Article 50(3) TEU). Almost one year into the negotiations, the nature of the future relationship between the EU27 and the UK remains uncertain.

One thing is certain, however: Brexit will significantly disrupt trade and will entail considerable economic costs for both the EU27 and the UK. The EU27 and the UK are deeply integrated through trade in goods and services, investment, and the movement of people. Trade between the EU27 and the UK is of similar magnitude as trade between the EU and the United States (2016). Trade within the EU, which is both a single market and a customs union, is currently almost frictionless. Any deviation from the status quo will lead to new trade barriers. The size of these barriers will depend on the model that the EU27 and the UK choose for their future relationship. There are currently various models under discussion. The worst possible outcome would be if the EU27 and the UK failed to agree on any future preferential trade relationship (hard Brexit).

1. **Single Market plus Customs Union:** This tailor-made model would be based on a customs union (CU) and a common customs policy, a single market, the constant adoption of the *acquis communautaire*, and joint jurisdiction in trade-related matters. While it is unlikely that the UK will accept the free movement of workers, German business regards the four freedoms – the free movement of capital, goods, people, and services – as inseparable and calls for their continuous application. In this model, the UK would lose its membership in the 34 free trade agreements (FTAs) and three customs unions (Andorra, San Marino, and Turkey) of the EU. Goods from these 37 partnerships could enter the customs union duty-free via the EU27, and could then be transported to the UK without further duty payments. At the same time, UK goods would no longer qualify as EU goods. They thus lose preferential market access to the preferential trade agreements of the EU. As a consequence, EU companies are likely to restructure supply chains and sort out components of British origin. This risk could be reduced, if the EU negotiated new cumulation agreements with its FTA partners. However, negotiations would take time, and a successful outcome would greatly depend on the willingness of the respective FTA partners. Despite these shortcomings, this model would come closest to the status quo. Acknowledging the considerable political impediments that this option faces, German business is strongly in favour of such a soft Brexit.
2. **EFTA and EEA Membership – the Norway Model:** Another option of the UK is joining the European Free Trade Association (EFTA) and the European Economic Area. Norway could serve as a model for this. EFTA is an intergovernmental organisation that consists of Iceland, Liechtenstein, Norway, and Switzerland. The Agreement on the European Economic Area (EEA Agreement) brings together three EFTA States (Norway, Iceland, and Liechtenstein) and the EU in a single market. The EEA provides for the free movement of persons, goods, services, and capital within the EU’s single market. As an EFTA and EEA member, the UK would have full access to the single market. It would also be obliged to make a financial

contribution and accept the majority of EU laws, including the “four freedoms”. This model does not comprise of a customs union. Therefore, there is no common external tariff. The usual border checks with the accompanying customs bureaucracy (including origin rules) would become necessary. This means that a whole new level of bureaucracy would be introduced in EU27 and UK trade. Moreover, the UK would yet again lose its membership in the EU’s preferential trade agreements with the consequences described above. This model would still ensure a high level of economic and political integration between the EU27 and the UK, albeit less than the previous option. While politically also difficult to achieve, German business believes it is a viable option. (For a more detailed description of the model, please see Annex II.)

3. **EFTA but no EEA Membership – the Swiss Model:** Another option would be EFTA membership without becoming a member of the EEA. This model would allow for greater autonomy for the UK while still allowing for a high degree of economic integration. Switzerland could serve as a model for this. The cornerstone of the relationship between the EU and Switzerland is the Free Trade Agreement of 1972. In addition, the relationship with the EU is governed by more than 100 bilateral agreements. These include free movement of persons, technical barriers to trade, public procurement, agriculture, and air and land transport. The FTA and sectoral agreements give Switzerland access – albeit not full – to the single market for most of its industries. Access to the single market is limited for the banking sector and other parts of the services sector. EFTA countries can individually negotiate and sign trade agreements with third countries. The Swiss model would still ensure a comparatively soft Brexit. However, it would be much more complicated and costly than the Norway model. The UK would again lose its membership in the EU’s trade agreements with the associated consequences. Again, this model faces considerable political hurdles, while being a viable option from a business perspective. (For a more detailed description of the model, please see Annex II.)
4. **Customs Union Model:** This option is politically much more feasible than the above-described. The Confederation of British Industry (CBI), the UK’s most influential business organisation, has recently advocated for a customs union between the EU27 and the UK. A customs union between the EU27 and the UK that covers all trade in goods and services would allow for less economic integration than the above-described models, while adding less bureaucracy and allowing for deeper integration than a free trade agreement. However, the CU model also features some drawbacks. Regarding market access, it offers much less than the single market. Regulatory cooperation in CUs is often insufficient; monitoring of the implementation of a CU is often weak. If the EU signed a trade agreement with a third country, the UK would not automatically be part of this agreement. The UK would not be granted preferential access to the FTA partner’s markets, while at the same time it must open its own market. Overall, German business prefers a customs union to an FTA.
5. **Comprehensive Free Trade Agreement:** The EU has 34 FTAs with third countries, including agreements with Canada and South Korea. A EU27-UK FTA currently seems to be the politically most viable option on the table. The Comprehensive Economic and Trade Agreement (CETA) with Canada is one of the most progressive trade agreements the EU has signed with a third country. Ninety-nine per cent of tariffs on industrial products were abolished immediately on day one when the agreement came provisionally into force (with the exception of automotive and ship duties, which will be reduced to zero over a period of seven years). Access to the Canadian public procurement market is significantly improved at federal and

sub-federal level. CETA makes it easier for European professionals to work in Canada: it allows for the mutual recognition of some qualifications and creates predictable conditions for both EU and Canadian investors. A EU27-UK FTA would be better than no deal – but it would be far from satisfactory. Negotiations of FTAs, ratification in the EU, and implementation usually take long. An FTA would eliminate almost all tariffs but add many new layers of costly bureaucracy, in particular rules of origin. Regulatory cooperation is insufficient; monitoring of the implementation of an FTA is often weak. Regarding market access, an FTA is light years away from today's depth of market integration. However, it would still be much more preferable than a hard Brexit.

Whichever arrangement ultimately governs future economic relations between the EU27 and the UK, it will inevitably be less deep and less extensive than full membership in the European Union. Brexit will entail economic costs on both sides. Not surprisingly, a hard Brexit would cause the largest costs for both trading partners. Due to the difference in market size and the lower market power of its companies, the UK faces much greater costs than the EU27. According to calculations of the RWI (2017), focusing on trade in goods and services, the UK would face costs amounting to 4.21 per cent of GDP over a period of ten years in case of a hard Brexit (when foreign direct investment is taken into account, welfare losses are considerably higher). Losses to the UK would be about 10 or more times higher than to the EU27.¹ In the medium- to long-run, Brexit will seriously hurt the British industrial sector (for an overview of EU27-UK market integration and costs of Brexit, please refer to the BDI background paper "Trade in Goods: What is at Stake?").

Within the EU27, costs will not be distributed evenly. According to calculations of the ifo Institute (2017), Germany will be hit particularly hard due to the volume of its exports to the UK. Passenger cars and road vehicles account for the largest share in German exports to the UK, followed by pharmaceuticals and medical products as well as machinery products. Trade in all three categories has grown dynamically over recent years, with trade in pharmaceuticals and medical products exhibiting the highest annual growth rates. Imported intermediate inputs from the respective partner are important to both Germany and the UK. Both countries have tightly knit production networks. According to the ifo Institute, British value added accounts for one to three per cent in the most important German sectors and is highest in the aviation industry with 3.3 per cent. The share of German value added in British sectoral value added is much higher with 7.1 per cent, for example, in the automotive sector and 5.3 per cent in the chemical sector.²

For decades, the European Union has been the foundation of economic growth and development in Europe. Its achievements are tremendous in terms of peace, stability, and prosperity. To safeguard the competitiveness of Europe, the way ahead is not disintegration and the introduction of new barriers but rather the deepening of the Union. German business, while accepting the vote of the United Kingdom to leave the EU, thus deeply regrets this decision.

¹ Ansgar Belke and Daniel Gros, *The Economic Impact of Brexit: Evidence from Modelling Free Trade Agreements*, RWI Leibniz-Institut für Wirtschaftsforschung, <http://www.rwi-essen.de/media/content/pages/publikationen/ruhr-economic-papers/rep_17_700.pdf>, (accessed February 19, 2018).

² Gabriel Felbermayr, Jasmin, Gröschl, Inga Heiland, Martin Braml and Marina Steininger, *Ökonomische Effekte eines Brexit auf die deutsche und europäische Wirtschaft*, ifo Institut, Munich, 2017.

Future EU27-UK Trade Relations

Core Recommendations of German Business in Greater Detail

- **Ensure the Integrity of the EU:** German business fully supports the integrity of the EU single market and customs union, as well as the cohesion of the remaining EU27 as a negotiating priority. The competitiveness of the EU27 has precedence over the quality of the EU27-UK relationship. At the same time, the EU27 and the UK should ensure that they maintain a respectful relationship.
- **Allow for a Transition Period and Create Business Certainty:** To prevent a cliff-edge scenario, the EU27 and UK should decide on a clearly defined transition period that allows for enough time to negotiate their future relationship. The interim agreement should extend the current regime and then only change once to the final future arrangement. During the transition period the UK would thus remain bound by the obligations stemming from the agreements by the Union. At the same time, the UK should continue to have access to the 37 FTAs and CUs of the EU to prevent disruptions in value chains and to allow business to adjust. Negotiations with the 37 FTAs and CUs will likely be long and arduous. The priority should therefore remain on the bilateral relationship between the EU27 and the UK and not on the UK's relationship with the respective third countries. Furthermore, as arrangements with the 37 FTAs and CUs require the goodwill of the respective partners, the EU needs to ensure that its relationships with these countries and ongoing negotiations to modernize trade agreements are not negatively affected.
- **Avoid a Hard Brexit:** No agreement on the future relationship between the EU27 and the UK would lead to a hard Brexit. The UK would become a so called third country; i.e. the EU27 and the UK would no longer have a preferential relationship. As a consequence, the tariffs bound at the World Trade Organization would apply, and new layers of bureaucracy would be introduced. Trade relations would be severely disrupted. This should be avoided. Negotiating, ratifying and implementing trade agreements usually takes considerably time, in particular, if the agreement is of mixed character, i.e. falls into the competency of the EU and its Member States. The EU should thus first focus on those trade areas, which fall into the exclusive competence of the EU in order to allow for swift ratification and implementation.
- **Aim at Deep Integration of EU27-UK:** For the future relationship between the EU27 and the UK, German business, while acknowledging the political difficulties, prefers a governance model, which ensures deep integration, i.e. a model that continues the single market and the customs union. Such a model would allow for a comparatively soft Brexit. If this option is politically out of reach, German business would prefer a customs union which not only ensures tariff free trade but also fosters regulatory cooperation to prevent the emergence of non-tariff barriers. A comprehensive FTA – while being better than no deal at all – would not be sufficient to guarantee frictionless trade. No matter which model is chosen, the EU27 and the UK should keep conversion costs low.
- **Enhance Customs Facilitation:** Both the EU27 and the UK need to invest in hard and soft infrastructure to ensure efficient customs clearance. Customs procedures need to be optimized to mitigate costs. The EU should tackle remaining hurdles to centralised clearing, and the UK should implement a 'Single Window' system – a one-stop shop where traders can lodge all customs documentation. Implementing a simplified import/export procedure for the free circulation of goods will enable the exchange of goods between the EU and the UK with minimized administrative efforts for economic operators and customs authorities. By utilizing a self-assessment scheme, economic operators would further be able to exchange their goods without any interruption within the flow of goods. Furthermore, goods would then be available to economic operators at all times (e. g. just-in-time supplies for manufacturing or service parts) without waiting for release response of the customs authorities. The EU27 and the UK should negotiate a customs cooperation agreement, allowing the UK to become a party to the Common Transit Convention, so that the use of the respective common transit procedures, including the New Computerised Transit System (NCTS), remains possible. They should also mutually recognize their respective Authorised Economic Operators schemes.




Business View

In the following, German business outlines five options how to govern the future relationship between the EU27 and the UK.

The order of preference is as follows:

1. **The Best Case Scenario – Maintaining the Status Quo:** As the UK continues its path towards exiting the European Union, this option is politically unlikely – but it would be by far the best of all scenarios. Only the status quo can ensure almost frictionless trade between the EU27 and the UK.
2. **The ‘Single Market plus Customs Union’ Model:** Acknowledging that the status quo is politically not an option, German business favours a governance model, which ensures deep integration, i.e. a model that continues the single market and customs union. Such a model, while politically facing many hurdles, would allow for a comparatively soft Brexit. The single market and customs union should, inter alia: (a) encompass all sectors of the economy, (b) feature no physical customs at the border between the EU27 and the UK, and (c) foster regulatory cooperation between the EU27 and the UK to prevent the emergence of new non-tariff barriers.
3. **The ‘Customs Union Only’ Model:** A customs union, while not offering the same degree of economic integration as the single market, would still be a viable option from a business point of view. Such a customs union should, inter alia: (a) encompass all sectors of the economy, (b) introduce no new tariffs and quantitative barriers (no exceptions), (c) feature clear and restrictive rules on subsidies, (d) foster regulatory cooperation between the EU27 and the UK to prevent new non-tariff barriers, (e) cover services and investment as well as trade-plus issues such as competition, government procurement, and protection of intellectual property rights (to which degree needs further deliberation), and (f) create a structure for monitoring and dispute settlement.
4. **A Comprehensive and Deep Free Trade Agreement:** This seems to be the politically preferred option among policy-makers. While being better than no deal at all, an FTA would not be sufficient to guarantee frictionless trade. If the EU27 and the UK decided to negotiate an FTA, EU FTAs with South Korea, Singapore, and Canada could model as starting point. However, a EU27-UK FTA should go well beyond the Level of ambition of existing FTAs of the EU. Such an FTA should, inter alia: (a) encompass all sectors of the economy, (b) introduce no new tariffs and quantitative barriers (no exceptions), (c) contain simple rules of origin (incl. cumulation), (d) feature clear and restrictive rules on subsidies, (e) foster regulatory cooperation between the EU27 and the UK to prevent new non-tariff barriers, (f) cover services and investment as well as trade-plus issues such as competition, government procurement, and protection of intellectual property rights (to which degree needs further deliberation), and (g) create a structure for monitoring and dispute settlement.
5. **The Worst Case Scenario – Hard Brexit:** German business is strongly opposed to such a cliff-edge scenario as trade relations would be severely disrupted. The EU27 and the UK would cease to have any kind of preferential relationship. The UK would become a so-called third country to the EU. Hence, the EU tariffs bound at the WTO would apply, and many new layers of bureaucracy would be introduced.

Summary of Brexit Options and Evaluation

	Status Quo	The Single Market Plus Customs Union Model	Norway Model	Swiss Model	Customs Union à la EU-Turkey	Deep and Comprehensive FTA – The CETA Model	Hard Brexit
Comparison with current market integration							
(1) Customs duties							
Trade between the EU27 and the UK	■ ■	■ ■	■ ■	■ ■	■ ■	■ ■ **	■ ■
Exports from third countries with EU-FTAs to the UK	■ ■	■ ■	■ ■	■ ■	■ ■	■ ■	■ ■
Exports from UK to third countries with EU-FTAs	■ ■	■ ■ *	■ ■ *	■ ■ *	■ ■ *	■ ■ *	■ ■ *
Exports from third countries to the EU	■ ■	■ ■	■ ■	■ ■	■ ■	■ ■	■ ■
Exports from the EU to third countries with EU originating material only	■ ■	■ ■	■ ■	■ ■	■ ■	■ ■	■ ■
Exports from the EU to third countries with EU-FTAs with British components	■ ■	■ ■	■ ■	■ ■	■ ■	■ ■	■ ■
Exports from EU to third countries with EU FTAs with British components and cumulation	■ ■	■ ■	■ ■	■ ■	■ ■	■ ■	■ ■ ****
(2) Costly and complicated customs procedures							
Trade between the EU27 and the UK	■ ■	■ ■	■ ■	■ ■	■ ■	■ ■	■ ■
Direct exports from the UK to third countries with EU-FTAs	■ ■	■ ■ *	■ ■	■ ■	■ ■	■ ■	■ ■
Direct exports from the EU to third countries	■ ■	■ ■	■ ■	■ ■	■ ■	■ ■	■ ■
(3) Proof of preferential origin							
Trade between EU27 and the UK	■ ■	■ ■ ***	■ ■	■ ■	■ ■	■ ■	■ ■
Direct exports from the UK to third countries with EU-FTAs	■ ■	■ ■ **	■ ■ **	■ ■ **	■ ■ **	■ ■ **	■ ■ **
Direct exports from the EU to third countries	■ ■	■ ■	■ ■	■ ■	■ ■	■ ■	■ ■
Exports from the EU to third countries with EU originating material only	■ ■	■ ■	■ ■	■ ■	■ ■	■ ■	■ ■
Exports from the EU to third countries with EU-FTAs with British components	■ ■	■ ■	■ ■	■ ■	■ ■	■ ■	■ ■
Exports from EU to third countries with EU-FTAs with British components with cumulation	■ ■	■ ■	■ ■	■ ■	■ ■	■ ■	■ ■ ****
Overall evaluation in comparison to status quo from an economic point of view	■ ■	■ ■	■ ■	■ ■	■ ■	■ ■	■ ■
Evaluation of political likelihood	Politically unlikely due to pro-Brexit UK government	Politically unlikely but not impossible; UK ruled our CU.	Possible that the UK negotiates EFTA-membership, while, according to David Davis, "not at the top of our list", as UK prefers tailored option	UK gov. ruled out such a CU, wants independent FTAs, UK business for CU	Likely but cumbersome negotiations/ratification if not an "EU-only"-FTA	Still possible due to prominent vocal Brexiters	
 market access deteriorates  market access deteriorates to some extent  market access stays the same							
Note: * new FTAs needed; **new FTAs and more complex origin calculation needed; *** if meant for re-export, the impact would be negative; **** cumulation is not possible in case of a hard Brexit, as there is no preferential treatment any longer.							
■ ■	■ ■	■ ■	■ ■	■ ■	■ ■	■ ■	■ ■
ideal option	best option, if Brexit happens	deterioration of market access	considerable deterioration of market access	significant deterioration of market access	very significant deterioration of market access	worst case scenario	

The Best Case: The Status Quo

Business View

For decades, the European Union has been the foundation of economic growth and development in Europe. Its achievements are tremendous. German business, while accepting the reality, deeply regrets the decision of the United Kingdom to leave the EU. The EU27 and the UK are highly integrated. Brexit will severely disrupt the economic relationship, entailing costs for both the EU27 and the UK – with much greater costs for the latter. German business fully supports the integrity of the EU single market and customs union as well as the cohesion of the remaining EU27 as a negotiating priority. The stability and competitiveness of the EU27 have precedence over the quality of the relationship between the EU27 and the UK. At the same time, the two parties should aim for a respectful partnership.

Trade in goods within the EU is currently governed by the EU single market and the customs union. The single market is characterised by four basic freedoms: free movement of goods (Article 30 of the Treaty on the Functioning of the European Union), the freedom to establish and deliver services (Article 49 and 56 TFEU), the free movement of capital (Article 63 TFEU), and the free movement of workers (Article 45 TFEU). Additionally, a common set of internal trade- and competition-orientated regulations guarantees the elimination of further hurdles to the free movement of goods, services, workers, and capital. These regulations are found in the EU's primary and secondary law, which is called the *acquis communautaire*. The EU-wide harmonized implementation is guaranteed by the jurisdiction of the EU courts. Goods can therefore transit internal borders by road, maritime ports, airports, or the channel tunnel without facing tariffs or customs procedures – just as companies deliver products from Berlin to Frankfurt, or from Oxford to London. Trade is thus almost frictionless.

The EU is not only a single market, it is also a customs union. Within the common customs territory, all duties are eliminated and a single external customs tariff is applied. Article 28 TFEU states: “The Union shall comprise a customs union which shall cover all trade in goods and which shall involve the prohibition between Member States of customs duties on imports and exports and of all charges having equivalent effect, and the adoption of a common customs tariff in their relations with third countries.” Once goods have been cleared in one country of the Union, they can be shipped to others without facing further tariffs. This greatly facilitates trade between third countries and individual countries within the EU. EU customs procedures are currently being modernized. The Union Customs Code (UCC) entered into force on 1 May 2016, with the aim to further streamline customs legislation and procedures across the EU. The UCC is designed to provide greater legal certainty to businesses, simplify customs rules and procedures, and allow for faster customs procedures for trustworthy businesses.

Trade outside the EU belongs to the exclusive competence of the EU. The EU's responsibilities cover trade in goods and services, the commercial aspects of intellectual property, such as patents, public procurement, and foreign direct investment. The rules for EU trade policy are set in Article 207 of the TFEU. The EU can negotiate trade agreements with third countries on behalf of its members.

Currently, the EU has 34 free trade agreements and three customs unions with countries and regions around the world, in place, including CETA, the trade agreement with Canada (see Annex III, Figure 1).³ The EU is currently negotiating FTAs with several other third countries, including Japan, Mexico,

³ 34 trade agreements include EU free trade agreements, association agreements, stabilisation agreements, and economic partnership agreement that reduce or eliminate customs duties and that are at least partially in force (but not partnership and

and the Mercosur. Draft mandates for negotiations with Australia and New Zealand were submitted to the Council of Ministers in September 2017 (see Annex III, Figure 2).

Modern FTAs do much more than simply dismantling tariffs. Market access is improved by removing non-tariff trade barriers (for example, through regulatory cooperation) and liberalizing trade in services. The trade agreements go well beyond the scope of the WTO. Rules on competition, the protection of foreign direct investments, and sustainability issues (labour rights and environmental protection) are all included. Being a member of the EU not only facilitates trade with third countries. The EU has much more market and bargaining power than individual Member States and can thus secure a much better deal for the Union.

Any deviation from the status quo will lead to new trade barriers. The size of these barriers will depend on the model the EU27 and the UK choose for their future relationship. There are currently various options under discussion, among them a customs union and a free trade agreement. None of them offer the same depth of integration and benefits to consumers and producers as the EU does.

The Worst Case: No Preferential Deal (Hard Brexit)

Business View

If the UK and the EU27 fail to reach an agreement governing their future relationship, the consequence will be a hard Brexit. The UK would become a so-called third country to the EU. Hence, the tariffs bound at the WTO would apply, and new layers of bureaucracy would be introduced. Trade relations would be severely disrupted. German business is strongly opposed to such a cliff-edge scenario.

The Hard Brexit: Major Consequences at a Glance

Negative

- No preferential relationship between the EU27 and the UK;
- Duty payments become necessary in EU27-UK trade and on third country goods;
- Full customs procedures are necessary for EU27-UK trade; more customs officers needed. Delays at the borders to be expected with negative effects on supply chain reliability;
- The introduction of a substantial level of bureaucracy in EU27-UK trade;
- The UK loses preferential market access to the 37 preferential trade agreements of the EU.

Impact

EU and UK

- Considerable delays anticipated at the border;

cooperation agreements that do not cover customs tariffs or that are not yet in force). Sources: WTO, *Online Data Base on Regional Trade Agreements/ EU Profile*, <<http://rtais.wto.org/UI/PublicSearchByMemberResult.aspx?MemberCode=918&lang=1&redirect=1>>, European Commission, DG Trade, *Countries and Regions*, <<http://ec.europa.eu/trade/policy/countries-and-regions/>> / *Overview of FTAs and Other Trade Negotiations*, <http://trade.ec.europa.eu/doclib/docs/2006/december/tradoc_118238.pdf>, (accessed on January 16, 2018).

- Restructuring of supply chains;
- Increasing costs due to customs procedures.

UK

- UK production would lose competitiveness;
- UK suppliers risk to be sorted out from European supply chains to avoid the loss of preferential origin.

If the EU27 and the UK fail to reach an agreement (no single market, no customs union, no FTA), this will put an end to their preferential partnership. The UK would become a so-called third country to the EU27 (for more information on the EU and the UK in the WTO, please see Annex Info Box A3.1).

WTO Rules and Procedures

The relationship of the EU27 with the UK would be the same as that of the EU27 with any other WTO member with whom the EU27 does not have a preferential trade agreement. The principle of most-favoured-nation (MFN) treatment (GATT Article I) stipulates that countries cannot normally discriminate between their trading partners. If a country grants another one a special favour, it must do the same for all other WTO members. In case of a hard Brexit, the EU's tariffs, which are bound at the WTO, would then also apply to trade with the UK. The UK would need to establish its own schedules of commitments at the WTO, including fixing and binding the maximum tariff rates.

A hard Brexit would entail substantial new trade barriers for EU27-UK trade. Although the WTO is the undisputed guardian of free and fair trade globally, it is only very basic compared to the status quo or any other model outlined below. For instance, the WTO agreement on Technical Barriers to Trade only offers mechanisms for transparency and non-discrimination, while the single market (the Norway and even the Swiss model) largely prevents regulatory discrepancies. Apart from an expanding set of rules on domestic support and subsidies in the area of agriculture, the WTO has no provisions on domestic and international competition policy, such as antitrust, competition/merger, or state-owned enterprises. Such competition instruments are a vital part of the single market. The WTO agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) establishes minimum standards of protection and enforcement that each government has to give to the intellectual property held by nationals of other WTO members. However, the TRIPS Agreement allows WTO members considerable scope to tailor their approaches to IP protection and enforcement. The EU law and agreements provide significantly better protection of documents and patents, as well as against counterfeiting. The WTO agreement on Trade-Related Investment Measures (TRIMS) recognizes that certain investment measures can restrict and distort trade. It states that WTO members may not apply any measures that discriminate against foreign products or that lead to quantitative restrictions. However, this does not guarantee the openness of the investment market as such (as provided by the free movement of capital in the EU single market). The UK would also not automatically remain a member of all plurilateral agreements of the WTO (see Annex III, Figure 3). Consequently, regarding bilateral market access and rules, the "WTO-only"-model offers much less in scope compared to any other model under discussion.

Some industries will continue to benefit from international duty free agreements, in which countries have made sector-specific tariff concessions. Examples of such agreements are the Information Technology Agreement (ITA), the Agreement on Trade in Civil Aircraft (TCA), and the WTO Uruguay

“zero-for-zero” initiative on pharmaceutical products that grants reciprocal duty-free market access for WTO members that decide to cut duty rates down to zero per cent. The UK is a member of the TCA in its own right – therefore, exiting the EU would not affect its rights and commitments. The agreed tariff reductions of the two other agreements have already been implemented in the GATT schedules of all participating WTO members. The UK has indicated that it intends to replicate the EU tariff schedule. Therefore, the trade preferences would remain available to the UK and all WTO members as well. In order to participate in future talks to further develop the ITA, the UK would, however, first have to become a member in its own right. The UK government has also stated that it is aiming to stay party to the Government Procurement Agreement (GPA) with the same rights and obligations as it has at present. As the UK is not an independent GPA member, it will have to negotiate a seamless transition and formalization of membership. This might cost the UK concessions on top of those taken as an EU member.

Furthermore, the UK government has announced that it is planning to participate in the plurilateral negotiations of the Environmental Goods Agreement and the Trade in Services Agreement (both negotiations are currently on hold). So far, the UK government has been represented in those talks by the EU. Participants of the negotiations are unlikely to have any objections to include the UK as an independent party, especially once the future relations between the UK and the EU27 have been clarified.

To avoid disruptions to supply chains, the UK has indicated its intention to have the same tariff schedules as the EU, i.e. the WTO bound maximum tariff rates, and is likely to transfer existing EU legislation into domestic UK law. However, there are still open issues on potential deviations in tariffs, quantitative commitments, and procedures. Regarding trade remedy measures vis-à-vis third WTO members (countervailing duties and anti-dumping duties), the UK government has indicated that it will apply the same protection as the EU at that time of Brexit. Despite this, differences might still arise quite quickly. The same is true in the area of unilateral trade preferences granted via the EU General System of Preferences (even if the UK were to establish a similar system).

According to GATT Article II, the UK will have to determine its schedules of commitments and bind them under the GATT – the same must take place for commitments in services under the GATS. The EU also needs to adjust its GATT schedule. This is due to the fact that the GATT schedules do not only include (qualitative) tariff rate commitments but also quantitative commitments in the form of tariff rate quotas (TRQs) and maximum subsidy levels (covering agricultural products in particular). TRQs determine the quantities of each type of product that can be imported duty free or with a duty discount. Maintaining the TRQs would mean giving other WTO members considerably more market access. TRQs should therefore be divided on a fair and sustainable basis between the EU27 and the UK. Leaving the maximum subsidy level unchanged would allow more subsidies for a considerably smaller constituent territory – this would certainly spark objections from competing WTO members.

On 11 October 2017, the UK government and the European Commission sent a joint letter to all WTO member countries, stating that the UK and the EU plan to take a cooperative and transparent approach in order to minimize disruptions to trade as the UK leaves the EU. In this letter, the EU and the UK expressed their intention to maintain the existing levels of market access available to other WTO members. The letter sets out the plan by both sides to apportion the EU's existing commitments on TRQs, as well as subsidy ceilings among themselves (based on trade flows under each tariff-rate quota for TRQs, subsidies according to similar calculations).

That a member of the WTO has to establish its own schedules of commitments is unprecedented. As there are only rules for accessions, amendments of schedules by members, and precedence cases of state successions, there is some uncertainty regarding necessary and generally accepted procedures. Following on from the joint letter, the EU and the UK are consulting individually with other WTO members in Geneva about suitable ways forward. The UK government has indicated that it wished to follow the rectification procedure (as opposed to the modification procedure). A rectification has the character of a formality and only covers amendments or rearrangements which do not alter the scope of a concession. Regarding tariffs, it can easily be argued that there is no change in the scope of concessions, as the UK is expected to adopt the existing EU tariff schedules of commitments (and the EU is not planning to change its MFN tariffs).

However, the GATT schedules also include the TRQ's and subsidy levels. Other members might argue that the indicated split of concessions between the UK and the EU constitutes a significant change of concessions. Any WTO member, even unaffected ones, may object to rectifications. The alternative would be the modification procedure that is, for instance, used for the amendments of EU schedules in the process of new accessions (Croatia being the latest case). A modification implies a more substantive change of concessions and requires prior notification. The procedure entails negotiations about compensation with all WTO members that can demonstrate an economic interest. While members can already implement notified schedules, the official certification by the WTO Director General only takes place if there are no remaining objections.

Initial reactions by other members to the letter support the notion that the certification of new EU and UK schedules (especially regarding TRQs) may take several years (subsidies seem to be a less controversial issue as the EU has so far only used fractions of the allowed level). However, as long as the EU and the UK follow a liberalising approach in these talks, there is no reason to expect major trade disputes on the way to an arrangement.

Costly and Complicated Customs Procedures

In the 'WTO only'-model, trade between the EU27 and the UK would not only face tariffs but also costly customs procedures.

Costly Customs Procedures: Customs procedures trigger compliance costs and additional logistic costs for companies. This includes additional costs for IT-structures and personnel. The overall costs vary according to the size of the company, export volume, and the degree of added value of the product. Products with multiple border crossings and a high degree of added value and processing steps in various countries will bear a greater burden. The automotive industry and the machinery sector, where products easily count thousands of components, will be hit particularly hard. A car, for example, consists of 30,000 parts, according to a recent study of the IW.⁴

Delays: The anticipated setbacks in the supply chain will also pose major challenges. Most companies anticipate delays of 24 to 72 hours per shipment. One company has calculated that it will affect about 120,000 of its consignments per year. In addition, some companies expect that 24-hours services will be delayed, which will severely effect just-in-time deliveries. These are, among others, particularly common in the automotive sector. As a consequence, companies need to invest in additional warehouse capacities to guarantee larger stocks of spare parts and intermediate goods closer to

⁴ Berthold Busch, Produktions- und Lieferverflechtungen zwischen britischen Branchen, der EU und Deutschland, Institut der deutschen Wirtschaft Köln, 2017, <https://www.iwkoeln.de/fileadmin/publikationen/2017/342202/IW-Trends_2017_2_Produktionsverflechtungen.pdf> (accessed February 19, 2018)

production sites. Not all companies, however, will have the financial resources to do so. In particular small- and medium-sized companies will face higher logistic costs.

Compliance Costs: Some companies estimate an 18 to 20 per cent rise in customs compliance costs. One company in the electronics industry expects additional customs compliance costs of €7 million per year.














Rules of Origin Procedures

In leaving the EU, the UK will lose preferential market access to the 34 free trade agreements and three customs unions of the EU. While no origin procedures will be required in EU27-UK trade (no preferential relationship) under the 'WTO only'-scenario, they become necessary if British components or intermediate products are later re-exported to a third country via the EU27 and these products stand to benefit from preferences through EU FTAs/CUs. (For more information on RoO, please refer to the scenario "Deep and Comprehensive FTA" and the Annex Info Box A3.2.)

Duty preferences in FTAs are often linked to a concrete maximum threshold of non-originating material. The EU-South-Korea FTA, for example, allows for a maximum of 45 per cent of non-originating material, meaning material that does not originate in the EU. When the customs territories are separated, UK origin will no longer qualify as EU origin. Companies will need to re-calculate origin thresholds and could eventually decide to reduce UK originating components. EU producers might thus be tempted to restructure their supply chains and eliminate British components from their products. Particularly supply chains that cross the border several times during the production process would no longer be economically viable.

The certification of origin and the required internal company compliance is costly: For proving origin, companies will have to classify products according to the combined nomenclature, to calculate origin thresholds of the product or to proof against certain product-specific treatment, and strictly archive documentation. To this end, companies will need to invest in extra IT-structures and personnel. Missing due diligence can trigger administrative consequences and lead to fines. The rules for preferential origin typically vary among different trade agreements. They are usually complex and count dozens of pages of product specific rules. Additionally, thresholds of maximum non-originating material are often quite strict. In times of regional and global supply chains and a high degree of value added in intermediate processing stages, this threshold is easily exceeded. According to studies and business experience, the costs of complying with rules of origin account for approximately three to six per cent of customs or product value. In some cases, the costs of complying with the rules of origin can outweigh the benefits of the preferential trade agreements. Particularly small and medium-sized enterprises struggle with the costs of RoO.

Figure 1: The Hard Brexit Scenario: Market Access Compared to the Status Quo

(1) Customs Duties		
Trade between the EU27 and the UK		
Exports from third countries with EU-FTAs to the UK		
Exports from the UK to third countries with EU-FTAs		*
Exports from third countries to the EU		
Exports from the EU to third countries with EU-FTAs with EU originating material only		
Exports from the EU to third countries with EU-FTAs with British components		
(2) Costly and Complicated Customs Procedures		
Trade between the EU27 and the UK		
Direct exports from the UK to third countries with EU-FTAs		
Direct exports from the EU to third countries		
(3) Proof of Preferential Origin		
Trade between the EU27 and the UK		
Direct exports from the UK to third countries with EU-FTAs		**
Direct exports from the EU to third countries		
Exports from the EU to third countries with EU-FTAs with EU originating material only		
Exports from the EU to third countries with EU-FTAs with British components		



market access deteriorates



market access deteriorates to some extent



market access stays the same

Note: * new FTAs needed; **new FTAs and more complex origin calculation needed.

Options for Governing EU27-UK Relations

In the following, we will discuss three possible governance models for future trade relations between the EU27 and the UK. While politically difficult to achieve, the model 'Single Market plus Customs Union' is the preferred option for German business, followed by the 'Customs Union only'-model. While an FTA is better than no deal at all, there are many shortcomings to this model.

The 'Single Market plus Customs Union' Model

Business View

The 'Single Market plus Customs Union' Model

Acknowledging that the status quo is politically not an option, German business favours a governance model, which ensures deep integration, i.e. a model that continues the single market and customs union. Such a model, while politically facing many hurdles, would allow for a comparatively soft Brexit.

The single market and customs union should:

- Encompass all sectors of the economy;
- Feature no physical customs at the border between the EU27 and the UK;
- Foster regulatory cooperation between the EU27 and the UK to prevent new non-tariff barriers;
- Foster trade by streamlining and facilitating communication between business and administrations on trade-related tax issues and statistical matters;
- Include all of the EU's four freedoms – the free movement of goods, services, capital, and people.

If the 'Single Market Plus Customs Union' model is politically not feasible, German business would favour a customs union over a free trade agreement.

The Single Market plus Custom Union: Major Consequences at a Glance

Positive

- Access to the single market;
- Constant adoption of the *acquis communautaire*;
- Trade between the EU27 and the UK would remain duty free and without costly customs procedures;
- The inseparability of the EU's four freedoms – the free movement of goods, capital, services and people – would be maintained;
- Proof of preferential origin does not become necessary when trading goods between the EU27 and the UK.

Negative

- In a UK-EU27 customs union, goods from the EU's 37 preferential trade agreements could enter the customs union duty-free via the EU27 and then be transported to the UK without further duty payments. UK exporters, on the other hand, would no longer be entitled to send their products duty-free to those 37 external markets or to import from them on preferential terms. This would put the UK in an asymmetric trade position as free trade is applied in one direction only;
- New layers of bureaucracy would be introduced in trade between the EU and its preferential trading partners, if export products contain British components.

Impact**EU**

- Higher costs because of new level of bureaucracy;
- Restructuring of supply chains.

UK

- UK production would lose competitiveness vis-à-vis EU production;
- UK suppliers may be sorted out from European supply chains to avoid the loss of preferential origin.




















Leaving the EU but remaining in the single market and customs union is theoretically possible. This scenario would resemble the European Economic Area/the Norway model (see Annex II), adding a customs union (see 'Customs Union only'-model below). This tailor-made model would preserve the four freedoms: the free movement of goods, the freedom to establish and deliver services, the free movement of capital, and the free movement of workers. In addition, the UK would commit itself to continuously adjust to the *acquis communautaire*. As part of the customs union, the UK would continue to have the same external tariff as the EU27.

One major element would be missing in this model, however: the transfer of competence to negotiate preferential trade agreements with third countries to the EU. This is not part of the single market but is defined in Article 207 TFEU as a separate concept and competency. By 30 March 2019, the 34 EU free trade agreements and three customs unions will no longer apply to the UK. Goods from the 67 EU partners (that is to say, the 67 individual countries with whom the EU has these 34 FTAs and 3 CUs) could enter the customs union duty-free via the EU27 and then be transported to the UK without further duty payments. At the same time, as UK goods would no longer qualify as EU goods, they would lose preferential market access to these third countries, both if directly exported from the UK or re-exported as a component of an EU export product. Exports from preferential trading partners of the EU would also cease to have direct preferential access to the UK market – at least, as long as the UK has not itself signed trade agreements with these countries. As a consequence, EU companies are likely to restructure their supply chains and sort out components of British origin.

This risk could be reduced if the EU negotiated new cumulation agreements with its 34 FTA partners. Cumulation essentially widens the definition of originating products and helps manufactured goods to meet the relevant rule of origin. Typically, this would be diagonal cumulation, a form similar to bilateral cumulation but operating between more than two countries, provided they have concluded preferential trading agreements between one another. Sensitive agricultural products should be excluded from the cumulation.

Overall, this model would come closest to the status quo and provide for a comparatively soft Brexit. While this model faces considerable political hurdles, it would entail the least costs of all options under discussion. It is therefore the preferred option for German business.

Figure 2: The 'Single Market Plus Customs Union' Model: Market Access Compared to the Status Quo

(1) Customs Duties		
Trade between the EU27 and the UK		
Exports from third countries with EU-FTAs to the UK		
Exports from the UK to third countries with EU-FTAs		*
Exports from third countries to the EU		
Exports from the EU to third countries with EU-FTAs with EU originating material only		
Exports from the EU to third countries with EU-FTAs with British components		
Exports from the EU to third countries with EU FTAs with British components and cumulation		
(2) Costly and Complicated Customs Procedures		
Trade between the EU27 and the UK		
Direct exports from the UK to third countries with EU-FTAs		*
Direct exports from the EU to third countries		
(3) Proof of Preferential Origin		
Trade between the EU27 and the UK		***
Direct exports from the UK to third countries with EU-FTAs		**
Direct exports from the EU to third countries		
Exports from the EU to third countries with EU-FTAs with EU originating material only		
Exports from the EU to third countries with EU-FTAs with British components		
Exports from the EU to third countries with EU-FTAs with British material with cumulation		
		
market access deteriorates	market access deteriorates to some extent	market access stays the same

Note: * new FTAs needed; **new FTAs and more complex origin calculation needed; *** if meant for re-export, the impact would be negative.

The 'Customs Union Only' Model

Business View

The 'Customs Union Only' Model

If the Single Market plus Customs Union' model remains politically out of reach, the 'Customs Union Only' model, while not offering the same degree of economic integration, would still be a viable option from a business point of view. German business favours a CU over an FTA.

A customs union should:

- Encompass all sectors of the economy;
- Introduce no new tariffs and quantitative barriers; no exceptions should be allowed;
- Apply a common external tariff;
- Foster trade by streamlining and facilitating communication between business and public authorities on trade related tax issues and statistical matters;
- Feature clear and restrictive rules on subsidies;
- Foster regulatory cooperation between the EU27 and the UK to prevent new non-tariff barriers. This should go beyond mutual recognition of equivalent certification agencies and procedures;
- Cover services and investment as well as trade-plus issues such as competition, government procurement, and protection of intellectual property rights (the degree of which needs further deliberation)⁵;
- Introduce a committee structure which monitors the implementation of the agreement and compliance;
- Establish a mechanism to settle trade-disputes.

The 'Customs Union Only' Scenario: Major Consequences at a Glance

Positive

- Duty-free movement for all or almost all products;
- No RoO required for EU27-UK trade.

Negative

- Customs procedures will become necessary in EU27-UK trade, which will cause delays at the borders and harm supply chain reliability;
- EU products continue to have preferential access to the 34 FTAs and three CUs of the EU. UK products, on the other hand, would no longer classify as EU products anymore and consequently lose preferential access to these markets;
- Compliance with RoO would be required in EU trade with preferential trading partners for EU exports containing British components. If the share of UK components is higher than the percentage allowed under the RoO, the respective EU product loses preferential market access;

⁵ The concrete arrangement of how and to which degree market access for investments as well as the incorporation of trade in services can be obtained, requires further detailed elaboration among EU Member States.

- Ex post negotiations are needed with EU-FTA partners to obtain cumulation agreements for existing FTAs in order to reduce the risk of UK products being sorted out of supply chains.

Impact

EU

- Costs arise due to new bureaucracy;
- Restructuring of supply chains.

UK

- Costs arise due to new bureaucracy;
- The EU27-UK relationship would become asymmetrical, disfavours the UK;
- UK production would lose competitiveness;
- UK suppliers risk being eliminated from EU27 supply chains to avoid the loss of preferential origin.

Leaving the EU and the single market, but remaining in the customs union, is a scenario comparable to the EU-Turkey customs union.

According to Article XXIV, paragraph 8(a) of the GATT, a customs union means the substitution of two or more customs territories by a single customs territory. Thereby, duties and other restrictive regulations of commerce are eliminated with respect to substantially all trade between the constituent territories of the union, or at least with respect to substantially all trade in products originating in such territories. Additionally, the members of the customs territories apply substantially the same external duties and other external regulations of commerce.

The EU-Turkey CU is one of the older trade agreements of the EU. It only relates to industrial goods and processed agricultural products, excluding agricultural products and coal and steel products. Neither trade in services, nor new areas of trade policy such as public procurement and investments are covered by the CU. The EU and Turkey have a common external tariff. To guarantee the free movement of goods within the customs union, the economic operator attaches a free movement certificate (A.TR.) to the merchandise. Non-originating merchandise qualifies for the free movement of goods, once it is released into free circulation.

A customs union between the EU27 and the UK covering all trade in goods is more attractive than an FTA, especially considering that no rules of origin would have to be fulfilled. A document comparable to an A.TR. would certify the free movement of goods qualification. Specific proof of origin for trade between the EU27 and the UK would not be required. An EU27-UK CU would be compatible with the above-described WTO rules.

However, such a trade deal also has some shortcomings. Even in a customs union, simplified customs procedures remain. This model would therefore lead to a rise in bureaucracy. HM Revenue and Customs, for example, expects the total number of customs declarations to undergo a fivefold increase when the UK leaves the EU. These declarations are simplified because no duty payments are involved. Nevertheless, delays at the EU27-UK border are to be expected, potentially demaging supply chain reliability. According to the port authority of Dover, more than 2.5 million commercial (“road haulage”) vehicles are entering or leaving the UK mainly from and to France, Belgium, and the Netherlands per year. On the British side, Holyhead, the main port for deliveries between Wales (UK) and Ireland

(EU27), may not be as notable, but it still handles an astonishing 286.000 trucks per year.⁶ Goods imported via land from continental Europe to Ireland would have to undergo the aforementioned procedures twice, and as such, considerable delays can be expected.




















Furthermore, a customs union entails a much lower degree of economic and political integration than the single market. One of the greatest risks is a divergence of standards. If the EU27 and the UK agreed on a customs union, it should therefore include regulatory cooperation to prevent the emergence of new non-tariff barriers. Regulatory cooperation could be fostered by introducing a bilateral committee structure. These committees could provide an intergovernmental platform to regularly monitor the implementation of the agreement and to discuss and agree on solutions for emerging problems. Such committees have been introduced in the CETA agreement, but still have to prove their effectiveness in practice.

In addition, the trade relationship between the EU27 and the UK would be asymmetrical. The UK would lose membership in the 34 FTAs and three customs unions of the EU. Goods from the EU's preferential trade partners could be imported via the EU, transferred with an A.TR. via the customs union and enter the British market. At the same time, British goods could not enter the markets of the preferential trading partners under the same conditions. In short: the UK would not have direct access to these partners (at least as long as it has not signed its own trade deals with them), whereas the 67 partners would still have preferential access to the customs union and therefore also to the UK market. If the EU signs a trade agreement with a third country, the UK would not automatically be part of this agreement. The UK would need to negotiate its own trade deal with the respective country. The costs of RoO could be reduced if the EU27 negotiated respective cumulation agreements with its FTA partners. Whether or not the EU's 67 free trade partners would be willing to accept a diagonal cumulation rule to the benefit of UK origin is not clear.

Again, this model constitutes a considerable deterioration from the status quo, entailing costs for both the UK and EU27, with considerably greater costs for the UK.

⁶ Institute for Government, *Implementing Customs: Brexit*, <https://www.instituteforgovernment.org.uk/sites/default/files/publications/IfG_Brexit_customs_WEB_0.pdf> (accessed February 19, 2018)

Figure 3: The 'Customs Union Only' Scenario: Market Access Compared to the Status Quo

(1) Customs Duties		
Trade between the EU27 and the UK		
Exports from third countries with EU-FTAs to the UK		
Exports from the UK to third countries with EU-FTAs		*
Exports from third countries to the EU		
Exports from the EU to third countries with EU-FTAs with EU originating material only		
Exports from the EU to third countries with EU-FTAs with British components		
Exports from the EU to third countries with EU FTAs with British components and cumulation		
(2) Costly and Complicated Customs Procedures		
Trade between the EU27 and the UK		
Direct exports from the UK to third countries with EU-FTAs		
Direct exports from the EU to third countries		
(3) Proof of Preferential Origin		
Trade between the EU27 and the UK		
Direct exports from the UK to third countries with EU-FTAs		**
Direct exports from the EU to third countries		
Exports from the EU to third countries with EU-FTAs with EU originating material only		
Exports from the EU to third countries with EU-FTAs with British components		
Exports from the EU to third countries with EU-FTAs with British components with cumulation		
		
market access deteriorates	market access deteriorates to some extent	market access stays the same
Note: * new FTAs needed; **new FTAs and more complex origin calculation needed		

Deep and Comprehensive FTA

Business View

A Comprehensive and Deep Free Trade Agreement

A comprehensive and deep FTA currently seems to be the politically preferred option among policy-makers. While from a business point of view being better than no deal at all, an FTA would not suffice to guarantee frictionless trade. If the EU27 and the UK decided to negotiate an FTA, EU FTAs with South Korea, Singapore, and Canada could serve as starting point. However, an EU27-UK FTA should go well beyond the ambition of existing FTAs of the EU.

An FTA should, among others:

- Encompass all sectors of the economy;
- Introduce no new tariffs and quantitative barriers, with no exceptions should be allowed;
- Contain simple rules of origin, including cumulation;
- Foster trade by streamlining and facilitating communication between business and administrations on trade related tax issues and statistical matters;
- Feature clear and restrictive rules on subsidies;
- Foster regulatory cooperation between the EU27 and the UK to prevent new non-tariff barriers. This should go beyond mutual recognition of equivalent certification agencies and procedures;
- Cover services and investment as well as trade-plus issues such as competition, government procurement, and protection of intellectual property rights (the degree of coverage needs further deliberation)⁷;
- Introduce a committee structure to monitor the implementation of the agreement and compliance;
- Establish a mechanism to settle trade-disputes.

The FTA Model: Major Consequences at a Glance

Positive

- Trade between the EU27 and UK would remain fully or almost fully duty free.

Negative

- Negotiations for an FTA are usually lengthy (averaging four years). Ratification in the EU could potentially prove difficult;
- Full customs procedures would be necessary for UK-EU trade; delays are to be expected which would negatively affect supply chain reliability;
- Duty payments become necessary on third country goods and goods that fail to achieve preferential origin;

⁷ The concrete arrangement of how and to which degree market access for investments as well as the incorporation of trade in services can be obtained, requires further detailed deliberation by EU Member States.

- Introduction of a completely new type of bureaucracy is introduced with rules of origin. These rules would entail pre-shipment calculations of origin, and the burdensome requirement of documentation of input to production lines;
- The UK would lose preferential market access to the 37 EU FTAs/ customs unions. New negotiations for ex post cumulation agreements would be required.

Impact

EU

- Further delays at the border are to be expected. A de-facto control of goods by customs officers leads to a sharply reduced reliability of delivery times. This is especially burdensome for just-in-time shipments;
- Restructuring of value chains is likely.

UK

- Additional delays at the border are to be expected;
- UK production would lose competitiveness vis-à-vis EU production;
- UK suppliers risk being sorted out from European supply chains to avoid the loss of preferential origin.

An alternative model for future EU27-UK trade relations is a deep and comprehensive FTA. The Comprehensive Economic and Trade Agreement (CETA) between the EU and Canada has been referred to as one possible option, but there are other examples to reference, such as the EU-South Korea FTA and the EU-Singapore FTA.

CETA has been provisionally applied since September 21, 2017. The trade deal represents one of the most comprehensive and ambitious free trade agreements that the EU has negotiated to date. In conformity with WTO rules, all trade between the EU and Canada has essentially been liberalised. Ninety-nine per cent of all industrial customs duties have been abolished since the agreement entered into force provisionally. Within seven years at the latest, industrial products will be entirely exempt from tariffs. The agreement with Canada supplements the WTO accords: CETA is not only more ambitious in its liberalisation aims (e.g. by eliminating tariffs, liberalising services and protecting intellectual property) but also features many so-called WTO-Plus areas, such as investment, competition, regulatory cooperation, and public procurement. CETA also makes it easier for European professionals to work in Canada, allows for the mutual recognition of some qualifications, and creates predictable conditions for both EU and Canadian investors.

With an FTA, the EU27 and the UK would neither establish a customs union and a common commercial policy, nor would they install a single market or follow a common external trade agenda. An FTA (as all other models discussed) would need to be WTO-compatible: According to Article XXIV paragraph 8(b) GATT, a free-trade area is a group of two or more customs territories in which the duties and other restrictive regulations of commerce are eliminated on substantially all the trade between the constituent territories in products originating in such territories. In general, this means eliminating about at least 90 per cent of all duty tariff lines for about at least 80 per cent of all bilateral trade in goods (manufactured goods and agricultural produce). Preferential tariffs can be triggered if imported products qualify according to the lists of preferential rules of origin. Regarding services, Article V of GATS entails similar provisions.

A future EU27-UK FTA would therefore reduce nearly all customs duties potentially to zero. However, an FTA would not be able to avoid new bureaucratic barriers for two reasons: First, costly and complicated customs procedures would burden trade. Second, and in contrast to trade within a customs union, proof of origin is mandatory if importers wish to benefit from duty preferences. This applies both to trade between the EU27 and the UK and to trade with EU FTA partners. Third country goods and goods that fail to achieve preferential origin become liable for duty payments. This is especially unwelcome news for shipments that enter from third countries and are destined for the EU via the UK or vice versa. These goods would then have to be declared twice, controlled, and would be liable for customs duties twice.

Components of British origin therefore risk being substituted in cases where they jeopardise the EU origin of a product. Simplified and harmonized rules of origin could mitigate these costs. RoO should reflect those set out in other EU FTAs, such as the FTA with South Korea. Many German businesses are critical of the CETA RoO regime, preferring the RoO model in the FTA with South Korea, some also pointing at the FTA with Singapore. The risk of substitution might be reduced if the parties agreed on ex post and ex ante cumulation agreements, as described above.

The aforementioned bureaucratic hurdles are a major reason why EU trade agreements have a rather mixed track record in terms of utilization. For instance, the utilization rate of the EU-Korea FTA by European exporters, i.e. the extent to which businesses are using the available tariff preferences, has only reached 71 per cent in 2016. This was the highest rate recorded in more than four years of implementation. In that year, only 48 per cent of machinery exports to Korea made use of the preferential tariff.⁸ A new report by UNCTAD and the National Board of Trade Sweden concludes that the full potential of EU FTAs remains untapped to the tune of almost €72 billion.⁹ This is the amount that European exporters are overpaying because they have not taken full advantage of the reduced tariffs offered by the EU's FTAs. Complicated RoO have been identified as a major reason for the low utilization rates. The implementation and enforcement of FTAs has also proven to be difficult in areas where there is political leeway and rather vague provisions. While dismantling tariffs usually takes place as agreed, non-tariff measures (e.g. certification requirements, new regulations) are more difficult to address via FTAs. The latest EU FTAs, like CETA, have more provisions on regulatory cooperation and try to avoid non-tariff barriers by establishing a number of bilateral committees. These provide an intergovernmental platform to regularly monitor the implementation and to discuss and agree on solutions for emerging problems. These committees and the dispute settlement procedures in EU FTAs, however, have yet to prove their effectiveness in practice.

⁸ EU Commission, Report from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of Regions, on Implementation of Free Trade Agreements, <<http://ec.europa.eu/transparency/regdoc/rep/1/2017/EN/COM-2017-654-F1-EN-MAIN-PART-1.PDF>> (accessed February 19, 2018).

⁹ UNCTAD, The Use of the EU's Free Trade Agreements, <<https://www.kommers.se/Documents/dokumentarkiv/publikationer/2018/Publ-The-use-of-the-eus-ftas.pdf>> (accessed February 19, 2018).








Info Box 1: German Business Proposals for Simplified RoO for an EU27-UK FTA

- **Uniform cross-sectoral value-added rules:** An EU27-UK FTA should contain a uniform, cross-industry value-added rule of 50 per cent based on the EU calculation method (EEU). This excludes agricultural products covered in chapter 1-24 of the Combined Nomenclature (CN).
- **Sector-specific alternative rules:** As an alternative to the cross-industry value-added rule, the criterion of “change of tariff classification” should apply. As a further alternative, selected product-specific processing rules should apply for certain products as defined by the sectors. The affected sectors should be closely involved in defining these rules. For processed sugar, the product-specific rule should be based on the weight of the end product only.
- **Averaging:** The possibility of averaging should be allowed. By contrast with the product specific calculation of origin, averaging enables a summary view of series, calculation periods and/or production sites. A calculation based on average material prices should be permitted.
- **Cumulation:** For all industrial goods (chapters 25-96 CN), a diagonal cumulation with other EU free trade regions should be the objective. Local content from the other 67 EU free trade partners should qualify for originating material just as EU27 or UK origin products. Therefore, particularly the cross-industry value added rule should be subject to application across the EU and the UK. Additionally, the general rules of origin such as the provisions of general tolerance and territoriality, the gradual acquisition of origin and the duty drawback should be harmonized. Where negotiations with FTA partners have already been concluded, they should not be excluded from this option of cumulation in the long run.
- **General tolerance and territoriality:** A limited outsourcing of production stages to third countries should, in principle, be possible without compromising eligibility for the preferential status. A tolerance of up to 15 per cent value added outside the preferential area should therefore be considered as a general rule in the agreement. The tolerance for the sugar sector should be based on the weight of the end product only.
- **Proof of origin:** Proof of origin should be simplified. Exporters should be able to choose freely, whether they submit the consignment-based proof (preferential invoice declaration and the formal certificate such as EUR.1) or a certificate of origin that is valid for multiple shipments for a specified long-term period. Non-formal proof of origin, such as the invoice declaration, should also be allowed as it would significantly simplify the handling of the preferential origin of goods. Up to a certain amount, the use of non-formal origin certification should always be possible (e.g. 6,000 euros as in the EU-Korea FTA). Furthermore, if an exporter has been granted the status of “Approved Exporter”, they should be able to issue an invoice declaration without being restricted by a monetary threshold. This is already practiced in several countries such as South Korea, Mexico, and Switzerland.
- **Supplier’s declaration for products with preferential origin status:** A declaration stating the non-originating content of a product is already legally possible under European law in order to enable a pro-rata consideration in the preferential calculation. Economic operators can deliver these declarations in the form of a single or a long-term supplier declaration. German industry believes that this should be permitted on a cross-border basis under a potential EU27-UK FTA.
- **Direct transport:** Goods should maintain their preferential status irrespective of the transport route. Proof of preferential status shall be considered adduced, as long as customs authorities do not cast or claim reasonable doubt on the non-manipulated condition/status of a good. This adjustment is necessary in times of global value chains. In modern logistics networks, goods are often not delivered directly from the country of origin to the destination country offering preferential treatment. Rather, they are first delivered to a regional hub which then supplies the region at short notice and generally falls outside the application area of the preference agreement. This kind of distribution system makes an essential contribution to improve flows in the supply system and enables widespread just-in-time deliveries.

An FTA is a considerable deterioration from the status quo. Negotiations are expected to be complicated and lengthy. The UK would lose preferential access to all 37 FTAs and CUs of the EU. The EU27-UK FTA would introduce several new layers of bureaucracy, entailing considerable costs for both the UK and the EU27. The costs of RoO could be reduced by cumulation agreements. However, it would be difficult to obtain *ex post* cumulation agreements from the existing 67 preferential partners of the EU. Furthermore, if the EU and the UK agreed on an *ex ante* cumulation agreement, this could weaken their negotiation power vis-à-vis future FTA partners, or provoke unexpected trade-offs.

Nonetheless, an FTA would be much better than no deal at all. It currently seems to be the only politically viable option on the table. From a business point of view, the level of ambition of a EU27-UK FTA should surpass the ambition of previous EU FTAs.

Figure 4: The FTA Model: Market Access Compared to the Status Quo

(1) Customs Duties		
Trade between the EU27 and the UK		**
Exports from third countries with EU-FTAs to the UK		
Exports from the UK to third countries with EU-FTAs		*
Exports from third countries to the EU		
Exports from the EU to third countries with EU-FTAs with EU originating material only		
Exports from the EU to third countries with EU-FTAs with British components		
Exports from the EU to third countries with EU FTAs with British components and cumulation		
(2) Costly and Complicated Customs Procedures		
Trade between the EU27 and the UK		
Direct exports from the UK to third countries with EU-FTAs		
Direct exports from the EU to third countries		
(3) Proof of Preferential Origin		
Trade between the EU27 and the UK		
Direct exports from the UK to third countries with EU-FTAs		
Direct exports from the EU to third countries		
Exports from the EU to third countries with EU-FTAs with EU originating material only		
Exports from the EU to third countries with EU-FTAs with British components		
Exports from the EU to third countries with EU-FTAs with British material with cumulation		
		
market access deteriorates	market access deteriorates to some extent	market access stays the same

Note: * new FTAs needed: ** under the assumption that all tariffs are zero.

Transition Period

Business View

To prevent a cliff-edge scenario, the EU27 and the UK should decide on a clearly defined transition period that allows for enough time to negotiate the future relationship between the two parties. The interim agreement should extend the current regime and then only change once to the final arrangement. During the transition period, the UK would remain bound by the obligations stemming from the agreements by the Union. At the same time, the UK should continue to have access to the 37 FTAs and CUs of the EU to prevent disruptions in value chains and to allow business to adjust.

Negotiations with the 37 FTAs and CUs will likely be long and arduous. The priority should therefore remain on the bilateral relationship between the EU27 and the UK and not on the UK's relationship with third countries. Furthermore, as a continuation of benefits to the UK requires the goodwill of the respective partners, the EU needs to ensure that its relationships with these countries and ongoing negotiations to modernize trade agreements are not negatively impacted.

On March 29, 2017, the UK officially notified the EU of its intention to exit, thus triggering Article 50 of the Treaty on European Union (TEU). From the time of notification, the EU and the UK have two years to agree on the conditions of the withdrawal and the nature of their partnership. Membership in the EU then ends automatically. This leaves the EU27 and the UK too little time to negotiate a trade agreement and to ensure its ratification. Therefore, a transition period becomes necessary. Both the length of the transition period and the content of the agreement have not yet been defined. The EU has offered a 21-month period. A European Parliament resolution of 3 October 2017 states that a transition period could “only happen on the basis of the existing EU regulatory, budgetary, supervisory, judiciary, enforcement instruments and structures”. The UK has indicated that it would, in principle, agree to a Norway-style Brexit transition period. This means that the UK would have to accept all EU rules but would no longer be able to shape them. Both the single market and the customs union would remain in force. According to the EU, the UK would be bound to all obligations under the existing 37 trade agreements of the EU – but it would not have preferential access to these markets anymore, as this would require a separate agreement with the respective trading partners. The UK would not be permitted to negotiate its own FTAs in this period, according to the EU.

The transition period should be long enough to allow the EU27 and the UK to negotiate a trade agreement and to ratify it according to the respective legal requirements (see Annex Info Box A3.3). Negotiating ambitious trade agreements takes time, as shown by negotiations with South Korea, Canada, and Japan. CETA illustrated how difficult ratification can be for agreements of so-called mixed character, i.e. agreements which fall under the shared competence of the EU and the Member States. In view of the short transition period the risk of a second cliff-edge scenario is considerable. To ensure that a trade agreement can be swiftly ratified, the EU27 and the UK should first focus on issues that fall into the exclusive competence of the EU before tacking on more far-reaching topics.

Even a successfully negotiated trade agreement could result in a cliff-edge scenario – if it is entered at last minute. Policy-makers should keep in mind that business also needs time to implement new rules and processes before complying with them. In this sense, a realistically measured transition or implementation period for business should be considered in any deal.

During the transition period, the status quo should continue to apply. This should also include the EU's 37 trade agreements. During the transition period, the UK should continue to have access to the 37 FTAs and CUs of the EU to prevent disruptions in value chains and to allow businesses to adjust. As

this requires the goodwill of the respective partners, the EU needs to ensure that its relationships with these countries and ongoing negotiations to modernize trade agreements are not negatively affected. The priority of negotiations should remain on the bilateral relationship between the EU27 and the UK and not on the UK's relationship with the respective third countries.

Mitigating Costs of Customs Procedures

Business View

Both the EU27 and the UK need to invest in hard and soft infrastructure to ensure efficient customs clearance. Customs procedures need to be optimized to mitigate costs. The EU should tackle existing hurdles to centralised clearance, and the UK should implement a 'Single Window' system – a one-stop shop where traders can lodge all customs documentation. Implementing a simplified import/export procedure for the free circulation of goods would enable the exchange of goods between the EU and the UK with minimized administrative efforts for economic operators and customs authorities. The implementation of a self-assessment scheme would enable economic operators to continue exchanging their goods without any interruption of the flow of goods. Furthermore goods will be available for economic operators at all time (e. g. just in time supplies for manufacturing or service parts) without waiting for release response of the customs authorities. The EU27 and the UK should negotiate a customs cooperation agreement allowing the UK to become party to the Common Transit Convention so that the use of the respective common transit procedures, including the New Computerised Transit System (NCTS), remains possible. They should also mutually recognize their Authorised Economic Operators schemes.

The term "customs" refers to much more than merely the collection of tariffs on goods as they are traded. It also encompasses the enforcement of a wider set of rules and regulations that stipulates what can be traded and how it is treated by authorities. With higher volumes of trade, the focus has shifted from revenue generation towards security, regulations, and standards. Governments are focused on preventing smuggling, diseases control, food safety, and so on. To minimise unnecessary checks, decisions on what to check are driven by information such as the origin of goods, the volume and type of goods, and the trading history of the importer or exporter.

Brexit inevitably means significant changes to the way the UK border operates, irrespective of whether or not the UK continues as a member of the single market, creates a new customs union, or signs a comprehensive FTA. Without an EU27-UK agreement, traders would be required to submit entry and exit summary declarations for goods moved between the UK and the EU. Traders who are used to moving goods freely to the EU will face new requirements for paperwork, and their goods could face substantial border checks. Approximately 180,000 additional traders would need to make customs declarations (on top of the 141,000 traders who already have to today). The sheer volume of UK trade with the EU means that the number of checks is expected to increase substantially after Brexit.¹⁰

In the following, several customs challenges are discussed. The UK should mirror the EU's customs approach. However, this will not suffice. The EU27 and the UK need to take further unilateral and

¹⁰ House of Commons/Home Affairs Committee, *Home Office Delivery of Brexit: Customs Operations*, <<https://publications.parliament.uk/pa/cm201719/cmselect/cmhaff/540/540.pdf>> (accessed 11. January 2018).

bilateral action to at least (partially) mitigate costs, e. g. by modifying the UCC and its delegated acts and/or the corresponding future UK's customs union regime. In doing so, they will need to find a good balance between trade facilitation by simplifying and streamlining customs arrangements and wider safety and security.

Issue 1 Hard Customs Infrastructure

Assumptions

Expected difficulties

- More stress on physical infrastructure due to greater number of border controls.

Dover is a key artery for UK trade heading to continental Europe. In 2015, over 2.5 million heavy goods vehicles (HGVs) passed through the port. The value of goods passing through Dover amounted to £119 billion in 2015, representing around 17 per cent of the UK's total trade in goods. Another 1.6 million HGVs passed the Channel Tunnel in 2015. Dover, the Channel Tunnel and Holyhead (0.3 million HGVs) together account for almost half of total UK trade in goods in terms of value.¹¹

The physical customs infrastructure supporting trade has been carefully calibrated to bolster the growing flow of goods. Non-EU unitary trade (in contrast to trade with bulk goods such as coal or gas) is handled almost exclusively in containers. These arrive on big ships and remain at ports for a period of time until the importer takes them inland. Customs processing can be done while the containers are at sea. It is different for arrivals and dispatches between the UK and the EU, which rely overwhelmingly on a continuous movement of trucks, carried by ferries or trains ('roll-on, roll-off', or RoRo). There are more truck movements between the UK and EU through major ports each year than there are container shipments to or from the rest of the world. RoRo trade accounts for 45 per cent of all (non-bulk) trade with the EU. Today, less than one per cent of trucks arriving in the UK through Dover or the Channel Tunnel require customs checks.¹²

A "no deal scenario" could result in 100 per cent of trade effectively becoming "non-EU", which means a hundredfold increase in the number of customs declarations. Infrastructure enlargements will be required to cope with the increased volume and the expected delays. However, there are severe constraints on expansion at some ports. The port of Dover is situated between cliffs, and the sea-front does not allow for any increase in size. Additional infrastructure will also be needed at the Channel ports in France and Belgium.¹³ Constraints also apply to the rail infrastructure. On a rail network, which is one of the most intensively used in Europe, delays due to greater border controls could have significant follow-on delays for domestic freight and passenger services. Additional rail infrastructure may be required for customs purposes and to manage delayed trains. Construction of additional rail infrastructure requires lead times of often up to several years due to long plan approval procedures and legal obstacles.

¹¹ IFG, *Implementing Customs: Brexit*, <https://www.instituteforgovernment.org.uk/sites/default/files/publications/IfG_Brexit_customs_WEB_0.pdf> (accessed on 9. January 2018).

¹² IFG, *Implementing Customs: Brexit*, <https://www.instituteforgovernment.org.uk/sites/default/files/publications/IfG_Brexit_customs_WEB_0.pdf> (accessed on 9. January 2018).

¹³ House of Commons/Home Affairs Committee, *Home Office Delivery of Brexit: Customs Operations*, 2017, <<https://publications.parliament.uk/pa/cm201719/cmselect/cmhaff/540/540.pdf>> (accessed 11. January 2018).

Measures

- Investment in physical infrastructure at key arteries for EU27-UK trade by the EU27 and the UK;
- Implementation of customs solutions based on self-assessment and simplification for customs declarations to speed up the process of clearing customs. As a consequence, less physical space and fewer officials would then be needed to execute the control procedures;
- To reduce pressure on infrastructure and personnel, the location where checks and control take place could be moved. For veterinary and phytosanitary checks, for instance, the UK and the EU could agree on mutual recognition of SPS checks or on periodic checks in each other's jurisdictions.

Issue 2 Soft Customs Infrastructure (ICT Systems)

Assumptions

Expected difficulties

- More stress on ICT systems due to a large increase in the number of customs declarations.

Customs clearance is not just about the physical infrastructure but requires many people and organisations to work together effectively. Therefore, ICT systems are very important. The rapid sharing of data is critical and is, as such, a coherent approach to risk assessment.

If the EU27 and the UK do not agree on a customs union, the UK will no longer be part of the EU Customs Area.¹⁴ The UK will have to introduce its own customs legislation, including detailing customs procedures, customs permits, customs codes, customs declarations, customs duty levels and simplifications. The EU is just in the starting phase of implementing the UCC. The two new EU customs simplifications, centralised clearance and self-assessment, will not incorporate the UK.

The UK has its own ICT infrastructure, the backbone of which is the Customs Handling of Import and Export Freight (CHIEF). CHIEF is in the process of being replaced by a new system, the Customs Declaration Services (CDS), which was designed to meet the EU's new customs requirements in the UCC. However, the British system is likely to struggle to meet the new requirements after Brexit. Updated IT systems will be fundamental to ensure the effectiveness of any new customs arrangements.¹⁵

The New Computerised Transit System (NCTS) is a system within the EU and other parties to the Common Transit Convention, based on electronic declarations and processing. It is designed to improve the management and control of Union and Common Transit.

Measures

- The UK should replicate the UCC in domestic legislation;

¹⁴ Miriam Gonzalez, Andrew Hood, Roger Matthews and Richard Tauwhare, *Brexit: Authorised Economic Operators (AEO)*, November 20 2017, <<https://www.lexology.com/library/detail.aspx?g=b0b42339-816d-488b-8bf1-feae7175b32e>>.

¹⁵ House of Commons/Home Affairs Committee (2017).

- The UK needs to accelerate the upgrading of its computer systems for electronic customs declarations;
- The EU27 should seek for the UK to become a party to the Common Transit Convention so that the use of the respective common transit procedures, including NCTS, remains possible for transports to the UK.

Issue 3 Processing and Customs Authorisations:

Assumptions

Expected difficulties

- Rising number of AEO applications, longer application processes.

Two promising ways to minimize the burden caused by the increase of customs declarations are self-assessment and simplified procedures. Both should be extended to Authorised Economic Operators (AEO).

The AEO concept is based on the Customs-to-Business partnership of the World Customs Organisation (WCO). The AEO status is established in Article 39 of the EU Union Customs Code Regulation. The AEO is a certified trustworthy company that meets certain criteria and is granted simplifications in customs procedures on this basis. AEO goods can move more quickly, which translates to lower costs. At the same time, customs authorities benefit, as they can focus their scarce inspection capacities on the cargo of unknown and potentially unsafe operators. Mutual recognition of AEOs would further facilitate customs procedures. The EU has concluded and implemented Mutual Recognition of AEO programmes with Norway, Switzerland, Japan, Andorra, the United States, and China.

However, applying for AEO status is time-consuming and expensive, and the benefits do not always justify the costs. Thus application for AEO status should be simplified.

The potential scope of this remedy is relatively extensive given that UK companies with AEO status currently account for around 60 per cent of UK imports and 74 per cent of the country's exports, according to estimates by British customs authorities.¹⁶

Measures

- To make AEO status more attractive and to facilitate trade, the system should move away from a transaction-based controls approach towards general risk analysis including business process-based controls. Trustworthy companies need more tangible simplifications in administrative proceedings, such as real discounts in customs securities and fast-track procedures;
- The UK is currently part of the EU's AEO concept. After Brexit, the UK would need to either adopt the provisions of the AEO scheme into UK law, or develop its own AEO scheme. German business therefore calls upon the UK to act quickly in setting up such a system;

¹⁶ UK Parliament, Costs of Administering Tariff and Non-Tariff Barriers, <<https://publications.parliament.uk/pa/ld201617/ldselect/ldcom/129/12909.htm>> (accessed February 19, 2018).

- To further simplify customs and to facilitate trade, German business calls upon the EU27 and the UK to mutually recognize the respective trusted traders status of companies domiciled in the partner's customs area.

Issue 4 Centralized Clearance

Assumptions

Expected Difficulties

- Customs clearance and customs duty collection.

Centralized Clearance (CC) would greatly facilitate EU27-UK trade. CC allows businesses to deal with all their import and export declarations at a single customs office, i.e. a single one-stop shop and deal with all their import and export declarations at one customs office. The concept is enshrined in articles 179-181 of the new Unions Customs Code. CC permits the economic operators to centralise and integrate their accounting, logistics, and distribution. This enables savings in administrative and transaction costs.

However, there are several hurdles to overcome. Declarations for VAT tax at import, prohibition or restrictions at import (PoR) and exports cannot yet be lodged at the one-stop shop. Major problems are the unharmonised import VAT – the VAT still varies among EU Member States – and national tax collection. German business asks to advance a real centralised clearance and strongly believes that this can be achieved through digital means.

Measures

- The EU should tackle existing hurdles to centralised clearance.
- The EU should speed up its work on a 'Single Window' system. It should also introduce VAT tax declarations into its 'Single Window' system.
- The UK should also implement a 'Single Window' system – a one-stop shop where traders can lodge all customs documentation.

Issue 5 Import Customs Procedures

Assumptions

Expected difficulties

- Rising number of import customs declarations / capacity for import declaration system;
- Rising number of applications for simplified / special procedures (inward processing, customs warehouse, outward processing, end-use-use and temporary admission);
- Pre-arrival notifications.

Measures

Simplification of Imports: Customs Import Declarations

If the EU and the UK mutually recognised their AEOs as trustworthy operators, there is ample scope for simplifying import declarations through self-assessment. Accordingly, a large part of the necessary customs registration process and customs procedures would then be carried out by the company itself, with periodic (e.g. monthly) reporting of summary data replacing the necessity for repeated customs procedures for each and every transaction conducted.

After obtaining AEO status, the company has to apply for self-assessment. Customs authorities then have to check the processes, products, and partners of the company. If all these aspects are in line with customs regulations and the requirements for self-assessment are fulfilled, the company should be authorised for self-assessment and obtain a registration number that is listed in a separate database.

Variant 1: Strongest Form of Simplification

- An ATB – the approval number received when a carrier declares a manifest to customs before arrival – is granted upon entrance into the EU and/or within the framework of completing a transit procedure. Customs will only examine whether the economic operator has been granted the relevant simplification (using an EU database and by checking that the simplification has been authorised in the accompanying documents). If this is the case, the goods will be released automatically and the ATB number will also be completed, indicating the simplification.
- There is no “provisional declaration“. The operator can subsequently enter the goods without any further delay. Entrance should be registered in the operating records and customs declarations made periodically (e.g. either monthly, quarterly etc.).
- In principle, the method is the same as for value-added tax (VAT), i.e. submission of a periodic customs declaration to provide data that is summarised to the greatest possible extent. This could even go so far as only informing the customs authorities of the total charges (division of the statistical data depending on the “category of goods“, according to percentage of total charges, or percentages determined on the basis of empirical values).
- On a random basis, the customs authorities can subsequently check whether the information was correct (only using random spot-checks!).

Variant 2: Registration of the Procedure on Entrance but Periodic Declaration

- An ATB is issued upon entry into the EU and/or within the course of completing a transit procedure. Should the alternative to the upstream NCTS procedure be selected, the NCTS will

automatically be completed once the ATB has been issued. Economic operators only have to state that this strongest form of simplification has been authorised. Customs will only examine, whether or not the economic operator has been granted the relevant simplification (via an EU database, and by verifying that the simplification has been authorised in the accompanying documents). If this is the case, release of the goods is automatic, as the allocation of the ATB is equivalent to the clearance of goods.

Note: In the case of variant 2A), the ATB number will, at the same time, automatically be allocated under indication of the simplification.

- The economic operator will be informed of the ATB number.
- The import duties are then calculated as part of the in-house self-assessment, if appropriate, automatically, in the company's existing customs system, whereupon a monthly payment will be made to the Main Customs Office.

Regarding further management, there are two variants (variant A and variant B):

Variant A

- In the payment declaration, in addition to stating the charges, the customs procedures applied are also established, as well as the respective customs value assigned to this customs procedure.
- On a random basis, the customs authorities subsequently examine whether the information is correct (only using random spot-checks!).
- The statistical reporting is done separately in coordination with the Federal Statistical Office, whereby as many simplifications as possible should be allowed.

Variant B

- Parallel to this, the Main Customs Office receives a monthly report with consignment-related data containing all reported ATB items (forwarded via the company's certified customs software – for example, to ATLAS). This procedure also includes the completion of the ATBs granted.
- As the items have been forwarded, the data can continue to be reported to the Federal Statistical Office via the customs administration.

Issue 6 Customs Export Procedures

Assumptions

Expected difficulties

- Rise in the number of pre-departure declarations;
- Capacity constrains within the export declaration system;
- Applications for simplified procedures.

Measures

Simplifications of Exports

Pre-Departure Declarations: Summary declarations instead of individual advance declarations

- Summary declarations by AEOs are to replace individual declarations. Holders of AEO status only need to state the number of the approval in an accompanying document. With this approval number the exports customs office can see that the AEO is not required to provide an individual declaration, but only a summary declaration. AEOs that are granted these simplifications are registered in a customs database to which only the customs authorities have access. Thereby AEOs are obliged to enable controls at any time.

Pre-Departure Declarations: Waiver

- Similar to the above case but with the addition that a summary declaration is not required either.

Customs Export Declaration: Summary declarations instead of individual declarations

- As in the case of pre-departure declarations, periodic summary declarations are to replace individual declarations (every month or quarter). The owner of an AEO certificate only needs to state the number of his status authorisation in an accompanying document. On the basis of this authorisation number, the customs point of exit can see that an individual export declaration is not necessary required. Using a customs database to which only the customs authorities have access, the customs authorities can check whether the participant has actually been granted this simplification.

Customs Export Declaration: Waiver

- Like the above but with the addition that a summary declaration is not required either.

Issue 7 Prohibitions and Restrictions in Export

Assumptions

Expected difficulties

- Increasing stress on the export control process

Measures

Simplified export control procedures should be implemented for EU exports of dual use goods to the United Kingdom and for defence goods. In general, and for the purpose of controlling proliferation risks worldwide, EU companies need to apply for individual export control procedures at their national export control agency, if they wish to export to a third country outside the EU. This is regulated for instance by the EU Dual-Use Regulation 428/2009.

Such export procedures can take weeks to be approved, as the process involves technical, country- and end-user-specific risk analysis. However, the dual-use and national defence regulations provide for exemptions for exports to countries with no or close to zero risk of proliferation. These country-specific simplifications are endorsed in the general authorization licenses. Among other general licenses, the EU001 is the general authorisation under which (nearly) all dual-use items can be exported without a single licence to the following countries: Australia, Canada, Japan, New Zealand, Norway, Switzerland, and the United States. In future, the United Kingdom should be added to the countries listed in EU001.

It would also be necessary for the United Kingdom to be listed in Annex 2 Part 3 of the EU Dual-Use Regulation 428/2009 as many national general licences refer hereon. In addition, it has to be ensured that the United Kingdom can still participate in the simplified export control procedures of global licences with respect to projects within the Letter of Intent/HMR-Agreement and the certification under Directive 2009/43/EC of the European Parliament and of the Council of 6 May 2009 simplifying the terms and conditions for the transfer of defence-related products within the EU.

Since it is unlikely that the required adaptations in the Dual-Use Regulation can be finalized before Brexit via the required ordinary legislative procedure, they should be part of an EU Brexit law. EU Member States and their national export authorities (like the German BAFA) should ensure early clarification for exporters and national implementation, including the timely preparation of customs authorities. In case these steps cannot be taken on the EU level in time, Member States should take the necessary administrative action to clarify the legal status of existing licences and to allow for simplified export procedures in the future exchange with the UK.

Annex I: List of Abbreviations

AEO	Authorised Economic Operator
ATLAS	Automatisiertes Tarif- und Lokales Zollabwicklungssystem, the German Customs Administration Automatic Rate and Local Customs Clearance System
BAFA	Federal Office for Economic Affairs and Export Control
CC	Centralized Clearance
CDS	Customs Declaration Services
CETA	Comprehensive Economic and Trade Agreement
CHIEF	Customs Handling of Import and Export Freight
CN	Combined Nomenclature
CU	Customs Union
DSU	Understanding on Rules and Procedures Governing the Settlement of Disputes
EEA	European Economic Area
EFTA	European Free Trade Association
EU	European Union
FTA	Free Trade Agreement
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GPA	Agreement on Government Procurement
HGVs	Heavy Goods Vehicles
ICT	Information Communication Technologies
ITA	Information Technology Agreement
MFN	Most Favoured Nation
NCTS	New Computerized Transit System
PoR	Prohibition or Restrictions at Import
RoO	Rules of Origin
RoRo	Roll-on, Roll-off

TCA	Agreement on Trade in Civil Aircraft
TEU	Treaty on European Union
TFEU	Treaty on the Functioning of the European Union
TRIMS	Agreement on Trade-Related Investment Measures
TRIPS	Agreement on Trade-Related Aspects of Intellectual Property Rights
UCC	Union Customs Code
UK	United Kingdom
US	United States of America
VAT	Value-Added Tax
WTO	World Trade Organisation

Annex II: Additional Possible Governance Models

A2.1 The Norway Model: Joining EFTA and the EEA

A ready-made option would be the Norway model. Norway is a member of the European Free Trade Association (EFTA), an intergovernmental organisation of Iceland, Liechtenstein, Norway, and Switzerland. Unlike the EU, the EFTA is not a political union. EFTA provides for a free trade area but it is not a customs union. Thus, while there are no tariffs on trade among the EFTA countries, each of them maintains its own tariff regime towards third countries. EFTA members are not obliged by the EFTA Convention to conclude preferential trade agreements as a group – each member maintains its right to individually sign bilateral trade agreements with third countries.¹⁷ While EFTA's network of preferential trade relations consists of 27 FTAs covering 38 countries, EFTA members have also signed a number of trade deals individually.¹⁸

The Agreement on the European Economic Area (EEA Agreement) grants the EFTA states Norway, Iceland, and Liechtenstein virtually full access to the single market of the EU. The European Economic Area (EEA) provides for the free movement of persons, goods, services, and capital. Apart from the four freedoms, the EEA Agreement covers horizontal areas such as social policy, consumer protection, environment, company law, and statistics. The EU common agriculture and fisheries policies are not covered. The EEA does not include a common trade policy. It establishes a free trade zone, not a customs union. EEA EFTA exporters, while not facing tariffs, have to go through customs procedures such as import/export declarations, and rules of origin for all goods exports and VAT payments. Thus, in order for a product to benefit from preferential treatment under the EEA Agreement, it has to originate in the EEA. Products from third countries, which enter the EU, can cross internal EU borders duty free. To cross the EU/EEA border duty free as well, they have to fulfil the requirements set by the rules of origin. EFTA countries have not harmonized their tariffs with the EU's external tariffs.

To become a party to the EEA Agreement a country needs to be a member of the EU or EFTA. Were the UK to join EFTA and the EEA, it would have almost full access to the single market. It would also be obliged to make a financial contribution and accept the majority of EU laws, including the four freedoms, while at the same time removing the UK's ability to influence those rules by losing its seat at the negotiation table in Brussels. Furthermore, the Norway model is not the same as the status quo, adding a new level of bureaucracy and new barriers to trade. Global and regional value chains have become more and more complex; determining the origin of a product often is administratively complex, time-consuming, and costly. Enforcing RoO would also entail customs checks between the EU27 and the UK. There is a real risk that the rules and their enforcement could disrupt value chains and production patterns.¹⁹ This risk could be reduced by negotiating new cumulation agreements with the 34 FTAs of the EU. However, this would take time, and the outcome of such negotiations is anything but certain.

¹⁷ EFTA, About EFTA, <<http://www.efta.int/about-efta>>, (accessed January 2, 2018).

¹⁸ European Parliament Think Tank, Free Trade Agreements between EFTA and Third Countries: An Overview, April 2016, <[http://www.europarl.europa.eu/RegData/etudes/BRIE/2016/580918/EPRS_BRI\(2016\)580918_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/BRIE/2016/580918/EPRS_BRI(2016)580918_EN.pdf)>.

¹⁹ Peter Holmes, ROOS and Rules, Why the EEA is not the same as Membership of the Single Market, Brief Paper 3, October 5, 2016, <<https://www.sussex.ac.uk/webteam/gateway/file.php?name=briefing-paper-3.pdf&site=18>>.

The Norway Model: Major Consequences at a Glance

Positive

- Almost full access to the EU single market;
- Preserves the “four freedoms”;
- Trade between the EU27 and the UK would remain duty free;
- The UK would gain access to the FTAs of EFTA.

Negative

- The UK would have to negotiate EFTA and EEA membership;
- New customs procedures would become necessary in EU27-UK trade;
- Introduction of new, costly bureaucracy such as rules of origin;
- Delays at the borders are to be expected with negative effects on supply chain reliability;
- The UK would no longer be part of the EU’s FTAs; preferential (duty free) treatment within all 37 EU preferential trade agreements would continue for EU goods, but would no longer apply to UK goods. The UK would need to negotiate its own preferential trade agreements.

Impact

EU

- Introduction of costly bureaucracy;
- Restructuring of value chains.








UK

- UK production would lose competitiveness;
- UK suppliers risk to be sorted out from EU27 supply chains to avoid the loss of preferential origin.




The Norway model would represent a considerable deviation from the status quo. Nonetheless, it would provide for a comparatively soft Brexit. As its legal framework has existed since 1994, the EEA option has the advantage of simplicity. The required acceptance of the free movement of people calls the political feasibility of this option into question.

Annex II, Figure 1: The Norway Model: Market Access Compared to the Status Quo







(1) Customs Duties

Trade between the EU27 and the UK		
Exports from third countries with EU-FTAs to the UK		
Exports from the UK to third countries with EU-FTAs		*
Exports from third countries to the EU		
Exports from the EU to third countries with EU-FTAs with EU originating material only		
Exports from the EU to third countries with EU-FTAs with British components		
Exports from the EU to third countries with EU FTAs with British components and cumulation		

(2) Costly and Complicated Customs Procedures

Trade between the EU27 and the UK		
Direct exports from the UK to third countries with EU-FTAs		
Direct exports from the EU to third countries		

(3) Proof of Preferential Origin

Trade between the EU27 and the UK		
Direct exports from the UK to third countries with EU-FTAs		**
Direct exports from the EU to third countries		
Exports from the EU to third countries with EU-FTAs with EU originating material only		
Exports from the EU to third countries with EU-FTAs with British components		
Exports from the EU to third countries with EU-FTAs with British components with cumulation		



market access deteriorates



market access deteriorates to some extent



market access stays the same

Note: * new FTAs needed; **new FTAs and more complex origin calculation needed

A2.2 The Swiss Model: Joining EFTA but not the EEA

The Swiss model would be another comparatively ready-made option. Switzerland is also a member of the EFTA but not of the EEA. The cornerstone of the Swiss-EU relationship is the free trade agreement of 1972. In addition, its relationship with the EU is governed by more than 100 bilateral agreements, including the free movement of persons, technical barriers to trade, public procurement, agriculture, and air and land transport. The FTA and sectoral agreements give Switzerland access – albeit not full – to the single market for most of its industries. However, Switzerland has no agreement on services with the EU. Financial services are an area of considerable importance to the UK. EFTA countries can individually negotiate and sign trade agreements with third countries. As in the case of the Norway model, Swiss exporters do not face tariffs when crossing the border to the EU, but have to go through customs procedures such as import/export declarations, and rules of origin for all goods exports and VAT payments. They also lose preferential access to the EU's FTAs.

The Swiss Model: Major Consequences at a Glance

Positive

- The UK would have extensive but not full access to the EU single market;
- Preserves the “four freedoms”;
- Trade in goods between the EU27 and UK would remain duty free;
- UK would have access to the FTAs of EFTA.

Negative

- The UK would have to negotiate EFTA membership;
- The UK and the EU would have to negotiate a multitude of bilateral deals to govern their relationship;
- New customs procedures would be necessary with the introduction of new, costly bureaucracy such as rules of origin;
- Delays at the borders are to be expected with negative effects on supply chain reliability;
- The UK would not be part of the EU's FTAs anymore; preferential (duty free) treatment within all 37 EU preferential trade agreements would continue for EU goods, but would no longer apply to UK goods. The UK would need to negotiate its own preferential trade agreements.

Impact

EU

- New costly bureaucracy;
- Restructuring of value chains.

UK








- UK production would lose competitiveness;
- UK suppliers risk to be sorted out from EU27 supply chains to avoid the loss of preferential origin.

The Swiss model would be an even greater deviation from the status quo than the Norway model. The necessity of a multitude of bilateral deals adds several levels of bureaucracy and would entail considerable costs for EU27-UK trade. Nonetheless, the Swiss model would still ensure a comparatively soft Brexit. The fact that for the UK would be required to accept the free movement of people just as the limited access for services calls the political feasibility of this option into question. The EU is also rather unhappy with the workings of the Swiss model – from a political perspective it is




therefore unlikely that the EU will offer this option to the UK, although it is a viable model from an economic perspective.

Annex II, Figure 2: The Swiss Model: Market Access Compared To The Status Quo







(1) Customs Duties

Trade between the EU27 and the UK		
Exports from third countries with EU-FTAs to the UK		
Exports from the UK to third countries with EU-FTAs		*
Exports from third countries to the EU		
Exports from the EU to third countries with EU-FTAs with EU originating material only		
Exports from the EU to third countries with EU-FTAs with British components		
Exports from the EU to third countries with EU FTAs with British components and cumulation		

(2) Costly and Complicated Customs Procedures

Trade between the EU27 and the UK		
Direct exports from the UK to third countries with EU-FTAs		
Direct exports from the EU to third countries		

(3) Proof of Preferential Origin

Trade between the EU27 and the UK		
Direct exports from the UK to third countries with EU-FTAs		**
Direct exports from the EU to third countries		
Exports from the EU to third countries with EU-FTAs with EU originating material only		
Exports from the EU to third countries with EU-FTAs with British components		
Exports from the EU to third countries with EU-FTAs with British components with cumulation		



market access deteriorates



market access deteriorates to some extent



market access stays the same

Note: * new FTAs needed; **new FTAs and more complex origin calculation needed

Annex III: Background Information

Annex III, Figure 1: Overview of current EU FTA and Customs Unions

Number of agreements in place	Countries	Number of these agreements which are partly / provisionally in place	Countries
Customs Union			
3	Andorra San Marino Turkey	0	
Trade Agreements			
34	Albania Algeria Andean Community (Peru, Colombia, Ecuador) Bosnia and Herzegovina Cameroon Canada Cariforum (Antigua and Barbuda, Bahamas, Barbados, Belize, Dominica, Dominican Republic, Grenada, Guyana, Jamaica, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Suriname, Trinidad and Tobago) Central America (Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, Panama) Chile Cote d'Ivoire Eastern and Southern Africa (Madagascar, Mauritius, the Seychelles, Zimbabwe) European Economic Area (Iceland, Liechtenstein, Norway) Egypt Faroe Islands Georgia Ghana Israel Jordan Kosovo Lebanon Macedonia Mexico Moldova Montenegro Morocco Pacific (Fiji, Papua New Guinea) Palestine Serbia South Africa Southern African Development Community (SADC) (Botswana, Lesotho, Mozambique, Namibia, South Africa, Swaziland) South Korea Switzerland Tunisia Ukraine	12	Andean Community (Peru, Colombia, Ecuador) Cameroon Canada Cariforum (Antigua and Barbuda, Bahamas, Barbados, Belize, Dominica, Dominican Republic, Grenada, Guyana, Jamaica, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Suriname, Trinidad and Tobago) Central America (Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, Panama) Cote d'Ivoire Eastern and Southern Africa (Madagascar, Mauritius, the Seychelles, Zimbabwe) Ghana Pacific (Fiji, Papua New Guinea) South Africa Southern African Development Community (SADC) (Botswana, Lesotho, Mozambique, Namibia, South Africa, Swaziland) Ukraine

*Trade Agreements include: Association Agreements, Stabilisation Agreements, Stabilisation and Association Agreements, Free Trade Agreements, Economic Partnership Agreements, Economic Integration Agreements, Global Agreements

Source: DG Trade, <<http://ec.europa.eu/trade/policy/countries-and-regions/negotiations-and-agreements/>> (accessed January 11, 2018).

Annex III, Figure 2: EU Trade Agreements in Negotiation

Politically concluded	In negotiations	Pausing	Planned
Haiti (Cariforum)	Central Africa	ASEAN	Australia
Japan	Chile (update)	Armenia	New Zealand
Singapore	Indonesia	Gulf Cooperation Council (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, UAE)	Turkey (update customs union)
Vietnam	Mercosur (Argentina, Brazil, Paraguay, Uruguay)	India	
	Mexico (update)	Malaysia	
	Philippines (likely to pause 2018)	Morocco (update)	
	Tunisia	Thailand (likely to restart 2018)	
		USA	

Source: DG Trade, <<http://ec.europa.eu/trade/policy/countries-and-regions/>> (accessed 11 January 2018).



Annex III, Info Box A3.1: The EU and the UK in the World Trade Organization (WTO)

The WTO, based in Geneva, has 164 members, including the EU and all individual EU Member States. Consequently, the UK will remain a WTO member after exiting the EU. Both sides will remain subject to WTO law and procedures, i.e. they are bound by the rules on free trade agreements and customs unions (GATT Article XXIV and GATS Article V) or may use the dispute settlement system, regardless of the Brexit scenario.

With its rules, principles and procedures, the WTO is the backbone of the global trading system. It provides a forum for negotiating agreements aimed at reducing obstacles to international trade and ensuring a level playing field for all. The WTO also provides a legal and institutional framework for the implementation and monitoring of these agreements, as well as for settling disputes arising from their interpretation and application.

Functions of the WTO

- Administering WTO trade agreements
- Forum for trade negotiations
- Handling trade disputes
- Monitoring national trade policies
- Technical assistance and training for developing countries
- Cooperation with other international organisations

The WTO agreements cover goods, services, and intellectual property rights. They spell out the principles of liberalisation and the permitted exceptions, and include individual countries' commitments to both lower customs tariffs and other trade barriers, and to open and keep open services markets. Sixteen different multilateral agreements, to which all WTO members are parties, make up the current body of WTO trade agreements, as well as several plurilateral agreements to which only some WTO members are parties (including on government procurement and on trade in civil aircraft).

Overview of Key Agreements

- Agreement Establishing the WTO
- General Agreement on Tariffs and Trade (GATT)
- General Agreement on Trade in Services (GATS)
- Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS)
- Agreement on Government Procurement (GPA, plurilateral)
- Agreement on Trade in Civil Aircraft (TCA, plurilateral)
- Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU)
- Information Technology Agreement (ITA, unofficial plurilateral WTO agreement)

The EU in the WTO

The European Commission represents the EU and its members in the WTO's decision-making bodies (Ministerial Conference, General Council, Dispute Settlement Body, etc.), subsidiary WTO bodies (Council for Trade in Goods, Committee for Trade and the Environment, etc.), and in WTO negotiations. The Commission initiates and handles WTO complaints. When an agreement is negotiated at the WTO, the Commission signs the agreement on behalf of the EU (following the formal authorisation of the Council and the European Parliament). In general, rights and obligations in the WTO framework are scheduled for the EU as a whole. While all EU members are allowed to participate in meetings of bodies, they neither negotiate, nor vote on their own, nor do they usually take the floor for interventions.

After Brexit, the UK government and administration will have to take over the role of the European Commission in WTO bodies and negotiations on behalf of the United Kingdom, and define relevant positions. This will require a high degree of capacity building in the UK (staff, expertise, structures, etc.). Furthermore, there are several open issues about the UK's and – to a lesser extent – the EU's rights and obligations as WTO members.

Annex III, Figure 3: WTO Agreements and Brexit Implications for the United Kingdom and the EU

Agreement Establishing the WTO Understanding on Rules and Procedures Governing the Settlement of Disputes Agreement on Trade-Related Aspects of Intellectual Property Rights	Both remain members
General Agreement on Tariffs and Trade General Agreement on Trade in Services	Both remain members, schedules of commitments need to be adapted
Agreement on Government Procurement	EU remains member, no major changes UK consulting with members on possible options of how to become member in its own rights without dropping out of the agreement. The UK might be forced to grant additional market access.
Trade in Civil Aircraft Agreement	Both remain members
Information Technology Agreement	EU remains member UK membership only a formality (MFN agreement)

Annex III, Info Box A3.2: Preferential Rules of Origin

“Preferential rules of origin” (RoO) are used in reciprocal trade preferences (i.e. FTAs) or in non-reciprocal trade preferences (i.e. preferences in favour of developing countries) to determine where a product was originally made according to “origin criteria”. The basic rules of origin specify that products may only be regarded as originating in that country if 1. they are produced entirely in a specific country (wholly obtained), 2. if a certain predetermined percentage of value-added parts or components is derived from the FTA area, 3. if a change in tariff classification has taken place because of a change in the nature of goods, or 4. if they are sufficiently processed according to the relevant origin rules. To benefit from preferential tariffs, traded goods within an FTA must comply with the respective RoO. These rules can vary from FTA to FTA.

Source: World Trade Organization, Understanding the WTO, <https://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm9_e.htm#origin>, (accessed: January 11, 2018); Peter Holmes and Nick Jacob, Certificates and Rules of Origin: The Experience of UK Firms, Briefing Paper 15, January 2018, <<http://blogs.sussex.ac.uk/uktpo/files/2018/01/BP15-CRoO.pdf>>.

Cumulation

The concept of cumulation, or cumulative rules of origin, is a deviation from the core concepts of rules of origin determining that goods must be produced entirely in the country of exportation, or have undergone sufficient working or processing there. With cumulation provisions, producers in one country are allowed to source parts and inputs from other countries without losing the originating status of that input provided that countries are operating with identical origin rules. Cumulation can therefore reduce the costs of RoO in FTAs.

Sources: EU Commission, Taxation and Customs Union, <https://ec.europa.eu/taxation_customs/business/calculation-customs-duties/rules-origin/general-aspects-preferential-origin/common-provisions_en#cumulation>, (accessed January 11, 2018). World Customs Organization, Topics: Origin, <<http://www.wcoomd.org/en/topics/origin/instrument-and-tools/comparative-study-on-preferential-rules-of-origin/specific-topics/study-topics/cum.aspx>>, (accessed January 11, 2018).

Annex III, Info Box A3.3: Ratification of Free Trade Agreements in the EU

Once the European Commission and the UK Government have completed the negotiations for an FTA, the Commission submits the texts to the Council and the European Parliament (EP) for immediate information. The legal experts of the Commission and the UK then review the negotiated texts (the “legal scrubbing” can take several months, usually three to nine). Often, the chief negotiators initial the legally reviewed English text before the EU co-legislators receive an updated copy of the FTA text. The EU subsequently translates the negotiated agreement into all official languages (this usually takes more than six months, although this can be faster if large parts of the texts are copied and pasted from existing EU agreements). The Council decides on whether to sign and conclude of the FTA following a proposal by the Commission and its own legal screening and internal debate.

All Member States have to sign the agreement, if it also covers topics that are not in the exclusive competence of the EU but in the shared or exclusive competence of Member States. This could be the case if the FTA included provisions outside of the areas of trade in goods and services, commercial aspects of intellectual property, patents, public procurement and foreign direct investment (e.g. investor-state dispute settlement). After the agreement has been signed by both partners, the Council transmits the agreement together with the draft decision to conclude the agreement to the EP for consent. The EP gives its consent following the necessary preparation on committee level. Formally, the power of the EP is limited to saying yes or no. After a yes-vote by the EP plenary, in case of an EU-only agreement, the Council adopts the final decision to conclude the FTA. If the Council regards the agreement as a mixed competence agreement, it would decide on the provisional application of the EU-only parts of the FTA. The mixed parts would only enter into force after all EU Member States have ratified the agreement according to their relevant procedures. If the ratification fails in one Member State, the final conclusion would be blocked, and the FTA might fail completely.

Source: European Commission, DG Trade, *Policy Making*, <<http://ec.europa.eu/trade/policy/policy-making/>> (accessed on 22 January 2018).

Annex IV: Official Papers by the European Commission and UK Government / House of Commons

Collection of Official EU Documents (position papers, negotiation directives, agendas, etc.)

<https://ec.europa.eu/commission/brexit-negotiations/negotiating-documents-article-50-negotiations-united-kingdom_en> (accessed 12 January 2018)

Of special interest:

European Commission, *Position paper transmitted to EU27 on Customs related matters needed for an orderly withdrawal of the UK from the Union*, September 2017,

<https://ec.europa.eu/commission/publications/position-paper-transmitted-eu27-customs-related-matters-needed-orderly-withdrawal-uk-union_en> (accessed 12 January 2018).

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European Commission, *Position paper transmitted to EU27 on Intellectual property rights (including geographical indications)*, July 2017, https://ec.europa.eu/commission/publications/position-paper-transmitted-eu27-intellectual-property-rights-including-geographical-indications_en (accessed 12 January 2018).

Collection of Official UK Documents (position papers, white papers, etc.)

<<https://www.gov.uk/government/collections/article-50-and-negotiations-with-the-eu#joint-report-on-progress>> (accessed 12 January 2018).

Of special interest:

HM Government Great Britain, *Future customs arrangements - a future partnership paper*, August 2017,

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BDI – Federation of German Industries
Breite Straße 29, 10178 Berlin
Germany
www.bdi.eu
T: +49 30 2028-0

Editors

Dr. Stormy-Annika Mildner
T: +49 30 2028-1562
s.mildner@bdi.eu

Steven Heckler
T: +49 30 2028-1523
s.heckler@bdi.eu

Verena Kantel
(former BDI-employee,
worked on the paper until 12/2017)

Klara Schwobe
T: +49 30 2028-1723
k.schwobe@bdi.eu

Dr. Christoph Sprich
T: +49 30 2028-1525
c.sprich@bdi.eu

Eckart von Unger
T: +32 2 792-1011
e.vonunger@bdi.eu

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