Northern Ireland and Customs

We understand there is an assumption in Whitehall and Brussels that there are no technical obstacles to NI goods being classified as British or Irish, with businesses potentially able to choose based on their primary market. To test this assumption could you please advise on:

- **The classification of NI goods in a 'no deal' scenario**. Starting assumptions within this scenario include UK-EU trade falling back to WTO's MFN term, but to protect the land border NI has a customs agreement with the EU (e.g., Turkey, Andorra or San Marino) and maintains high alignment with the rules of the Single Market.

- **The classification of NI goods in a UK-EU FTA scenario where the UK is outside the Customs Union and Single Market.** Starting assumptions within this scenario include UK-EU trade facilitated by a preferential agreement which falls short of the level of market access available to EU members and potentially tariffs applied to some goods. To protect the land border NI has a customs agreement with the EU (e.g., Turkey, Andorra or San Marino) and maintains high alignment with the rules of the Single Market.

- **The classification of NI goods in an Independent Customs Territory scenario**. Starting assumptions within this scenario include NI becoming a fully independent customs territory and GB-EU trade facilitated by a preferential agreement which falls short of the same level of market access as membership of the EU and potentially tariffs applied to some goods.

- In the event of a NI customs arrangement with the EU, in terms of NI trading with third countries would goods manufactured in NI be classified as UK or EU (for simplicity, assume from a Rules of Origin perspective all inputs are from NI)? Is it feasible for NI goods to have "dual origin" (UK/EU) in this scenario if the UK negotiates new FTAs with third countries?

In all of these scenarios we're keen to test how NI goods would be treated when (a) sold to GB and (b) sold to Ireland. We are also keen to explore how the goods would be classified when they are produced in a cross border supply chain and then sold to GB, e.g. milk traded across the border and processed into cheese which is sold to GB.

Preliminary Comments

As a preliminary point, it should be stated that the Joint Report falls short of clarifying the scope of the Brexit negotiations with regard to Northern Ireland, as stated in paras 42-56 of the EU-UK Joint Report of 12 December 2017.

We have now set three different scenarios: 1) Northern Ireland part of the UK custom territory, but NI product able to qualify as double UK/EU origin; 2) Northern Ireland remaining in the EU Customs Union; 3) Northern Ireland as an independent custom territory.

SCENARIO 1: Agreement on Double Classification of NI Goods as either EU or UK produced goods depending on the destination market.

The determination of the origin of goods generally depends on the Rules of Origin applied by the customs authorities in the importing country. In order to determine the origin of the goods, various criteria are taken into account (mostly, the change in tariff classification, process rules, and the % of added value content). It is up to the exporter to apply for a certificate of origin that allows him to benefit from preferential customs duties.

However, there is nothing preventing a NI produced good from being qualified as either EU or UK good depending on the destination market. It will be ultimately up to customs authorities in the importing market to decide the true origin of the good. They will do so according to the Rules of Origin that they have in place (most likely, those that are agreed in the FTA). In practice, we foresee these scenarios:

1. NI good exported to Republic/EU:

   A. No Brexit deal between UK and EU: In absence of a comprehensive trade agreement between the UK and the EU, NI produced goods will be considered as UK origin according the current EU rules of origin regulation. The EU will apply MFN rates to the products.

B. **EU-UK FTA**: The EU and the UK will have to agree to a set of Rules of Origin whereby NI wholly produced or substantially produced goods can benefit from a special regime that exempts them from customs duties. It is unclear whether the goods will be exempt from customs duties only when they are exported to the Republic, or whether the exemption will cover all EU markets.

   The EU's main interest is to prevent UK producers from using NI as a backdoor to the EU market to avoid paying duties at the EU border, while NI's main interest is to ensure that NI producers are not facing extra burdens when they import/export from the Republic. It is objectively very difficult to accomplish both objectives at the same time. Realistically, NI producers that trade with the Republic will have to face some bureaucracy. In order to minimize disruptions, NI producers could register their products in advance with the EU authorities and, when approved, use a self-certification form.

2. NI export to third-countries:

- It will be up to the customs authorities in the importing country to determine the origin of the goods as either UK or EU. In absence of specific arrangements, national rules apply.
- If Northern Ireland remains officially part of the UK custom territory, NI goods will qualify as UK origin.
- In order for NI goods to be considered as EU origin, it will be necessary that the EU negotiate a specific rule in the RoO chapter in its FTA with the partner country. For example, if the EU agrees to allow NI goods to benefit from the market access concessions in an hypothetical future EU-Iran FTA, it will have to negotiate a specific rule for NI produced goods with Iran. NI exporters wishing to benefit from the preferential tariffs when exporting to Iran, will have to apply for the specific certificate of origin and demonstrate that they qualify as EU origin according to the rules set in the FTA. The same applies with the current EU FTAs, which will have to be amended in their RoO chapter.

SCENARIO 2: Northern Ireland in the EU Customs Union

In this scenario, NI will remain part of the EU Customs Union, while the rest of the United Kingdom will become an independent custom territory outside of the EU Single Market. De facto, NI will remain a EU territory from an economic perspective and <u>will not have an independent trade policy in the area of goods,</u> which will be set by Brussels. This arrangement mimics the current agreement between EU and Turkey. While Turkey has, in theory, the power to conduct a limited trade policy on IPRs, government procurement, services (in fact, Turkey has around 20 FTAs in place), de facto none of them grants Turkey any substantial market access concessions because of the Turkey-EU Customs Union, which forces Turkey to align all its FTAs to the EU's trade in goods policy.

In the event of a NI-EU Customs Union arrangement, NI goods will be considered as EU origin goods. This means that NI goods exported to the Republic or to any other EU country will face not be subject to customs controls. NI regulations will be aligned with those of the EU. However, NI/EU goods exported to the UK will have to pay taxes at the UK border. The same will apply to goods imported into NI.

NI goods exported to third countries with which the EU has an FTA will benefit from the reduced customs duties. On the other hand, NI goods exported to countries with which the UK has FTA do not benefit from reduced customs duties.

It is unclear the status of services as they do not fall under customs arrangements. If NI services sector fall under the UK competence, while goods remain in the EU Customs Union, there could be problems. These could arise because movement of persons will become more difficult (including intra-corporate transfers), costs of services will be higher and in turn rise up the costs of production, discrepancy between the Republic of Ireland and Northern Ireland. To avoid problems, it would be advisable to include NI in the Single Market as well.

- Pros:
  - Supply chain between EU/Republic and NI will remain unaffected.
  - Imports and export with EU unaffected
  - Benefit from EU FTA (particularly important with regards to Canada with Bombardier)
- Cons
  - Increased cost of production for goods relying on NI-UK supply chains

- Increased costs of doing business with UK and increased cost of export/import with UK

SCENARIO 3: Northern Ireland as an Independent Customs Territory

One possible solution to avoid tariffs at the border between NI and the Republic and at the same time avoid any regulatory discontinuities or duties between NI and the rest of the UK is to grant trade policy powers to NI.

Northern Ireland will become an independent custom territory with the power to set its own trade policy. The actual level of devolution is to be agreed between London and Belfast but it can go from a simple power to set customs duties on goods to deeper powers on agriculture, industrial goods, services, and investment.

Goods produced in NI will qualify as “NI goods” as opposed to UK or EU-originating goods. In order to remove all obstacles to the NI-UK trade and the NI-EU trade, Northern Ireland will enter into two separate agreements with the EU and the UK. The main benefit of this option is that it allows NI to get a full market access to both markets, thereby avoiding custom duties and economic barriers between NI and the UK and between NI and the Republic. On the other hand, this solution does require Northern Ireland to implement customs checks at the NI border for all goods entering NI to check the origin of the goods.

NI-EU Trade: NI and the EU will enter into a Free Trade Agreement that will guarantee no regulatory or tax barriers at the border between the NI and the EU. NI will commit to zero tariffs to EU originating goods and vice-versa. Even if the NI government refuses to adopt EU regulations on goods, regulatory convergence between NI and EU in the area of agriculture, industrial goods (chemicals, pharmaceuticals, etc) can be nonetheless achieved through the mutual recognition of regulations. However a system that would require the signing of multiple of MRAs in different sectors would be very difficult to implement and would require the establishment of an institutional framework to continuously monitor regulatory equivalence. The only known example of that type of trading relationship is the Swiss model, though it should be noted that (i) Switzerland complies with most EU internal market rules on goods and that (ii) the EU is not particularly keen on replicating the Swiss model because the oversight mechanisms have proved to be very complex and time-consuming to operate. sl . NI authorities will administer their own customs checks. The trade between NI and the Republic will rely on self-certifications system for NI produced goods,[1] and on a different certification for goods originating from third countries (see discussion on NI-Third Countries Trade), and goods produced in the UK.

NI-UK Trade: NI and the UK will enter into special trade relationship similar to Hong Kong-China whereby NI and the UK will agree to a total removal of regulatory and tax barriers between the two customs territories. NI will commit to zero tariffs to UK originating goods and vice-versa. Regulatory convergence between NI and UK in the area of agriculture, industrial goods (chemicals etc) can be achieved through the mutual recognition of regulations. NI authorities will administer their own customs checks. The trade between NI and the UK will rely on self-certifications system.

NI-Third Countries Trade: While in theory NI will be able to conduct its own external trade policy, most likely it will align it with the UK's. From an operational viewpoint, NI will commit to enter into parallel FTAs with all UK partners and to grant them the same the level of market access concessions. As an independent custom territory, NI exports will be subject to duties at the border of any jurisdiction in the world. In order to avoid paying excessive duties, NI should accede to the WTO as an independent member. This will guarantee MFN rates to all NI goods. However, NI can avoid becoming a WTO Member and simply enter into specific FTAs with countries that are particularly strategic to NI producers. The risks with this option are that the UK will sign FTAs with its strategic targets rather than NI's necessarily. Moreover, if NI is to negotiate its own trade deals that means losing the benefit of all EU and future UK FTAs whilst having very little leverage on account of the small market size it has to offer.

There is a risk that NI will become a backdoor to the EU market. For instance, Chinese traders that face higher import duties in the EU, might decide to export to NI in order to then export to the EU market with no additional duties. Given this risk, third-country goods entering the EU from NI will have to carry a specific form that would allow them to be distinguished from UK goods or NI goods.

[1] The definition of what is a NI-produced good will be decided by rules of origin.

- Cons
    - The main problem with this option is that it requires a lot of manpower from the side of the NI government. NI will have to set up the entire customs infrastructure, hire specialized personnel to design and conduct the trade policy.
    - It does not totally eliminate the need of border checks between NI and the UK/EU, which still need to be present given the status of NI as an independent custom territory. Northern Ireland will effectively build its own customs and trade administration and will have to run it independently. However, it does eliminate customs duties and regulatory barriers to business, thus preserving supply chains and market access.
    - Regulatory convergence through MRAs can be problematic in the long term as NI will have to align convince both the UK and the EU of the quality of its regulations. One possible solution is to align the regulation to the market that is most important for the sector.
    -
- Pros
    - Favourable to business as it avoids tax and regulatory barriers between the NI and the UK/EU
    - Supply chains remain intact.

To sum up

In our view, none of the scenarios are perfect.

The first scenario would work perfectly if the UK and the EU agree to collaborate on NI. For instance, by agreeing to negotiate specific RoO for NI in the EU-UK FTA, and in all the UK and EU FTAs with third countries.

The second scenario clearly favours the access to the EU internal market over the access to the UK and, for this reason, is politically very difficult. On top of it, all the NI-UK supply chains will be negatively affected.

The third scenario preserves full market access to the UK and the EU and safeguards the current supply chain dynamics. If implemented properly it can boost NI’s economy and make it a hub to both the EU and the UK. However, it would need to build a huge administrative machine to make it work (customs policy, regulations, etc), and it does not eliminate customs checks when goods enter the NI border.