

## Understanding the EU customs union

### SUMMARY

In December 2016, the European Commission adopted its long-term plan to strengthen the governance and management of the EU customs union. The customs union, in place since 1968, is a pillar of the single market, and vital to the free flow of goods and services. According to the Commission, a strong customs system helps foster competitive businesses, increases wealth, and also protects against terrorist, health, and environmental threats.

The customs union operates under the legal framework of the Union Customs Code (UCC), in force since May 2016. However, while customs rules are the same across the EU, national customs authorities do not always apply them in a consistent manner. The Commission has therefore proposed structural and administrative changes, inter alia, on customs policy monitoring, formulation, and implementation. In addition, the Commission proposes to tackle administrative issues (e.g. application of EU law, competency building for custom officials, aligning new EU-wide IT systems dedicated to customs procedures), and border management coordination.

The European Parliament is critical of the differences between customs systems at the national level, in particular regarding customs duties and customs clearance, since these create fragmentation, additional administrative burdens (in particular for small and medium-sized enterprises), and hamper e-commerce. The Parliament suggests, among other things, the creation of more uniform electronic customs requirements and risk-assessment programmes. Parliament has also called on the Commission to present an interim report evaluating EU customs policy by 2017, including a review of the problems, overlaps, gaps, and complaints filed with customs authorities, and customs infringements.



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## Background

The customs union is an [important pillar](#) of the European Union's (EU) internal market and has been in place since 1968. The legal framework is set out in [Article 28](#) of the Treaty on the Functioning of the European Union (TFEU). The European Commission proposes EU customs legislation and monitors its implementation. Under its rules, the customs union forms a unique [trade bloc](#) where the Member States apply a uniform system for handling goods (imported, exported, transiting) and implement a common set of rules under the Union Customs Code (UCC). Once cleared by customs in one Member State, goods can move freely within the Union (whether they are made in the EU or imported from outside) on the basis that all Member States apply the same revenue and protection rules at external borders and negotiate trade deals as one.

The customs authorities implement EU rules, thereby facilitating international trade, collecting customs duties and indirect taxes upon import. According to the European Commission, customs authorities are also on the [front line](#) in the fight against fraud, terrorism and organised crime.

As the Commission admits, however, there is 'no successful overarching coordination of policy and operational aspects'.<sup>1</sup> While customs legislation is adopted at EU level, the Member States have the responsibility to implement it via their national customs administrations. At the same time, the EU grants Member States some leeway regarding the implementation and interpretation of certain rules.

### Article 28 of the Treaty on the Functioning of the European Union

'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.'

While new common customs rules entered into force in May 2016, the Commission published a communication on the development of the customs union and its governance in December 2016. The Commission addresses the implementation challenge and the different enforcement cultures in the Member States, amongst other things, and proposes changes related to governance.

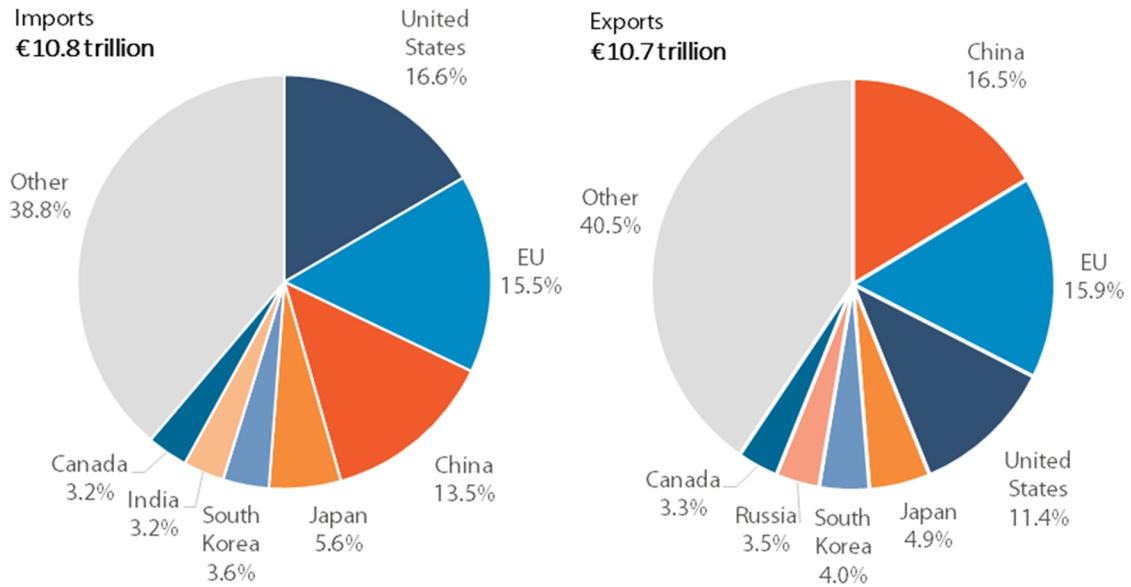
## Customs union in figures

The EU customs union has become the world's largest trading bloc. In 2015, the EU [accounted](#) for some 15 % of world trade in goods, worth €3.5 trillion (€1.73 trillion in imports and €1.79 trillion in exports). The main EU trade partners are the United States, China, Switzerland, Russia and Turkey. The EU is the only customs union which is itself a [member](#) of the World Trade Organization (WTO). At the same time, the EU is a [signatory](#) to 30 free trade areas and 3 customs unions, with 56 partners that are WTO members or observers. These 33 arrangements cover about one third of EU trade.

In 2015, some 293 million customs declarations were handled by more than 2 000 EU customs offices. About 4.8 million [businesses](#) are registered in the customs Economic Operators Identification and Registration system ([EORI](#)), and carry out commercial activities related to importing and exporting goods in the role of consignee, declarant or representative.

Some [120 000 officials](#) work for customs authorities across the EU. In 2015, EU customs authorities seized 7 000 weapons and around 3.2 million items of ammunition. More than 450 tonnes of drugs were seized by EU customs authorities in 2014.

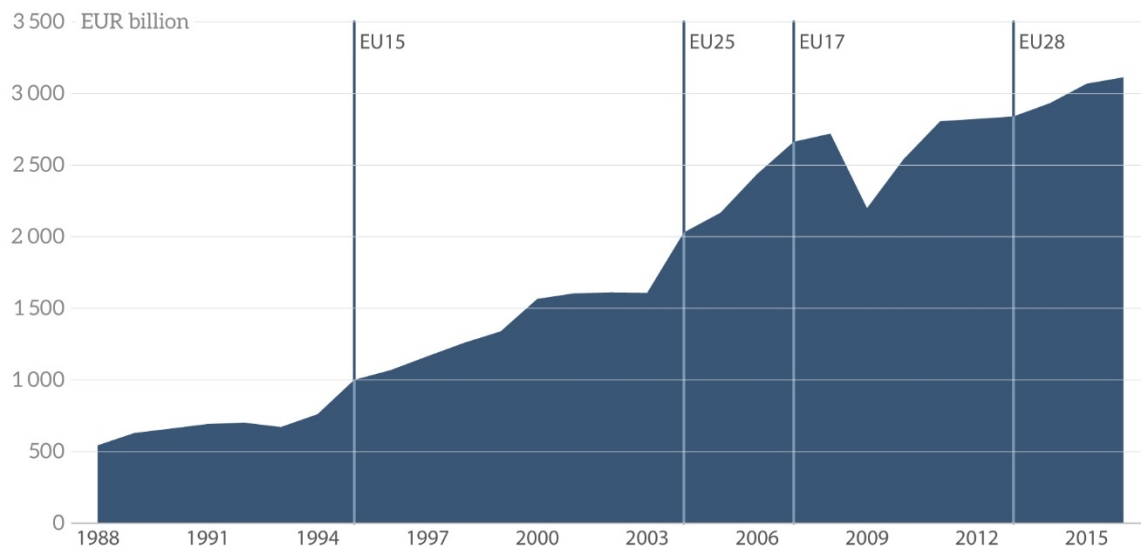
**Figure 1 – The EU's share in world trade, 2014**



Source: Eurostat.

Sea transport is the most commonly used form of transport for goods in and out of the EU. It accounted for a 54 % of EU trade in 2014, followed by air transport at 19 %. The customs union provides for the status of [Authorised Economic Operator \(AEO\)](#). AEOs play an increasing role in the supply chain, and are given more favourable treatment in simplification and facilitation areas. There were over 14 000 AEO certificates in the EU at the end of 2015. AEO status can be granted to economic operators who meet criteria specified in customs legislation, such as customs compliance, appropriate record-keeping, financial solvency and, where relevant, appropriate security and safety standards.

**Figure 2 – Intra-EU trade, 1988-2015, in € billion**



Source: Eurostat.

## Customs unions and free trade areas

A distinction exists between customs unions and free trade areas (FTAs). According to the [WTO](#) interpretation, an FTA abolishes most of the barriers to trade in goods between the countries participating in the area. A customs union goes deeper in terms of trade cooperation and integration: the participating countries not only abolish all barriers to trade in goods within the customs union, they also have the same set of rules for trading with third countries – as in the case of the EU customs union. This implies that the [28 national customs services](#) in the Member States are acting as if they were a single entity. The EU imposes a common external tariff. If one of the customs union's member states was allowed to unilaterally lower its external tariffs, this would lead to goods entering the EU through the ports of the country with the lowest tariffs and then being re-exported to other Member States tariff-free inside the customs union ('trade deflection'). To the contrary, in an FTA, no common external tariff is instituted. Therefore, border controls within FTAs are maintained. In order to avoid trade deflection, FTAs institute preferential [rules of origin](#) to distinguish goods from FTA partners from third countries' goods.<sup>2</sup>

The EU's common rules go beyond the customs union and extend to all aspects of trade policy, such as preferential trade, health and environmental controls, common agricultural and fisheries policies, or the protection of economic interests by non-tariff instruments. In general, the EU's (external) trade agreements do not contain provisions allowing the free movement of workers, except for the members of the European Free Trade Area (EFTA).

Being part of the customs union, EU Member States are not allowed to negotiate other trade deals with non-member countries or to individually place embargos. Trade agreements and embargos are covered by the EU's common commercial policy.

### EU customs union and participating third countries

The EU has [agreed](#) the creation of separate individual customs unions with three countries: Turkey, Andorra and San Marino. In general, these customs unions include:

- free movement of goods between the two parts of the customs union for goods either wholly produced or put in free circulation after their importation from third countries;
- alignment on external tariffs, including preferential arrangements, and harmonisation of commercial policy measures;
- approximation of customs law and some other laws (intellectual property, competition, taxation, etc.);
- mutual assistance in customs matters.

Exchanges between the EU and the customs union partner countries are covered by two different types of provisions: (1) For products covered by the customs union, goods will be able to circulate freely, if they are wholly obtained or produced in the customs union or coming from third countries and have been through all customs formalities, including, when necessary, the payment of customs duties. (2) For products not covered by the customs union, most of the time trade will be based on the free trade area concluded between the partners involved and the rules of origin will be established in the relevant protocols.

In the case of San Marino, the customs union applies to all products except coal and steel and no preferential arrangements based on origin were signed.

The customs union with Turkey is limited to industrial products and processed agricultural products. Goods which are wholly obtained or produced in the customs union or which have been put into free circulation in the customs union can circulate anywhere in its territory, as long as they are accompanied by the proof of this customs status. Turkey has a [provision](#) asking for alignment with EU preferential agreements, which is not however implemented in practice. Furthermore, the customs union does not cover agricultural products, nor coal and steel products.

Canada, the USA, and Mexico, for example, form a free trade area within the [North American Free Trade Agreement \(NAFTA\)](#). While the USA upheld an embargo on trade with Cuba for several decades, Canada and Mexico continued to trade with the country.

The EU, on the other hand, forms an association and a free trade area with the EFTA countries (Iceland, Liechtenstein, Norway) – known as the [European Economic Area \(EEA\)](#). These EFTA countries participate in the EU single market (although there are exclusions for several sectors, such as agriculture, fisheries, and some services), but they have not joined the EU customs union. The countries had to implement parts of the *acquis communautaire*, but are free (like the NAFTA countries) to negotiate trade deals with third countries. For instance, Iceland and Switzerland have free trade agreements with China, while the EU has not. The EU has just concluded an FTA with Canada and is about to finalise its negotiations with Japan. In addition, the EU is currently negotiating FTAs with e.g. Indonesia, Singapore, and Vietnam. Bilateral customs union arrangements, as in the case of Andorra, San Marino, and Turkey,<sup>3</sup> are the exception.

### New Union Customs Code (UCC)

In May 2016, for the first time in over 20 years, the EU changed its customs code. The [Union Customs Code \(UCC\)](#) is the new framework regulation for the rules and procedures relating to customs throughout the EU. It represents a major overhaul of existing EU customs legislation and the replacement of the Community Customs Code (CCC), which dated back to 1992.

According to the Commission, [numerous](#) developments, such as EU enlargement; the development of e-commerce; the threat of terrorist attacks; internationalisation of organised crime and increasing counterfeiting; piracy and violation of intellectual property rights; have altered the environment in which customs operate. The new regulation aims to complete the reform process, which was launched with a [Modernised Customs Code](#) and a [Decision](#) on a paperless environment for customs and trade.

In addition, the UCC intends to make European business more competitive, advancing the EU strategy for growth and jobs. More specifically, it aims to:

- streamline and simplify customs legislation and procedures across the EU to make customs transactions more efficient and cost-effective;
- offer greater legal certainty and uniformity to businesses and increase clarity for customs officials;
- link the Member States' national systems through a single interface and complete the shift to a paperless and fully electronic and interoperable customs environment through a centralised clearance system and a single customs office (once the necessary supporting IT systems are in place).

The UCC was adopted on 9 October 2013 as [Regulation \(EU\) No 952/2013](#) of the European Parliament and of the Council. It entered into force on 30 October 2013, although most of its substantive provisions applied only from 1 May 2016. Some of these may take until 31 December 2020 to become fully operational – the date by which all Member States must have their information technology (IT) infrastructure ready to support the electronic flow of customs data. Transitional rules will apply ad interim.

The cost of developing and maintaining the UCC's IT systems over the years to come will be some €380 million (to be covered by the budget of the Customs 2020 programme). Member States' costs when taken together will be higher.<sup>4</sup>

At present, not all Member States share the same vision of how and when to use common systems. Some Member States prefer what is known as 'hybrid system architecture', which enables them to opt in to shared EU services or to maintain national solutions on their own or in parallel.<sup>5</sup>

In an attempt to improve the balance between heightened security and easier international trade, the UCC aims to reduce customs compliance costs for 'compliant and trustworthy economic operators', who should enjoy [Authorised Economic Operator \(AEO\)](#) status (see recitals 24 and 25 of [Regulation \(EU\) No 952/2013](#)). In addition, AEOs will be able to make their customs declarations in the form of 'entries in the declarant's records' (EIDR) and without having to present the goods physically.<sup>6</sup>

Some business associations and experts in academia, however, argue that the EU remains far from a 'true' customs union – despite the replacement of the CCC with the UCC.<sup>7</sup> For instance, the way companies clear goods and the amount of import duties they pay, may still vary, depending on the Member State in which the companies operate. Further shortcomings are: (1) no central EU customs agency exists, most Member States are still reluctant to give up sovereignty; (2) broad discretion is afforded to implement certain rules, as the EU grants its Member States some flexibility to decide how they implement customs rules. As a result, for instance, some Member States currently allow companies to use certain simplified procedures (without requiring a financial guarantee). (3) There are no consistent EU penalties for infringement, the same infringements can create different consequences across the Member States.<sup>8</sup>

Further challenges for companies which may derive from the UCC include, inter alia, increased AEO criteria, which could make the customs process more difficult for non-AEOs. Another is the introduction of new valuation rules and higher duties. According to White & Case, EU importers will no longer be able to use the 'first sale rule' for customs valuation: 'The first sale rule previously allowed importers to pay customs duties based on the (usually lower) price paid by a middleman (an intermediary vendor) to a manufacturer of goods instead of the (usually higher) price paid to that middleman by an EU importer. Instead, the "last sale price" before goods are released for free circulation in the EU now must be the basis for a customs valuation.'<sup>9</sup>

### Future customs union development and governance

In its December 2016 [communication](#) on the development of the customs union and its governance, the Commission proposed some structural and administrative changes. The communication deals, amongst other things, with the governance of policy monitoring, formulation and implementation. In addition, it tackles administrative issues (e.g. application of EU laws, competency building for custom officials, IT systems), the coordination of different policy areas, and authorities involved in border management, as well as the question of resources and financing.

#### Customs 2020 programme

[Customs 2020](#) is an EU cooperation programme that aims at providing opportunities for national customs administrations to create and exchange information and expertise. It allows major trans-European IT systems development and operations, and brings national officials from across Europe together. The programme has a budget of some €547 million and runs for seven years from 1 January 2014. All measures are open to customs administration officials in the EU Member States, as well as to those in candidate and potential candidate countries that have joined the programme (e.g. Bosnia and Herzegovina, Serbia and Turkey).

Today, much of the customs union policy coordination is carried out through the [Customs Policy Group](#) (CPG). The CPG is an informal expert group set up by the Commission which brings together the heads of customs administrations. It has no formal legal decision-making powers. More informal are the meetings of the directors-general of the national customs administrations. A similar type of meeting was set up recently in the Council of the EU. The Council, in its role of coordinating Member States' policies and negotiating and adopting EU law, has an additional two groups working on the customs union. Under its competitiveness configuration, customs-related work is handled primarily in two Council working parties – one on the customs union and one on customs cooperation – but, as the Commission points out, 'arguably without a structured vision of policy development and in a somewhat ad hoc manner'.<sup>10</sup>

The Commission therefore proposes to formalise and develop the role of the CPG 'to focus its work on overall coordination of policy and operational aspects' and 'to increase joint meetings between the Commission, national administrations and traders and review the mechanism for consultation of trade'. In addition, the Commission proposes to establish a set of key performance indicators and to submit a regular biennial report to the Council and Parliament on the results of the working of the customs union.

The communication lists some further proposals. The Commission intends to:

- establish a coherent body of guidance on the application of the UCC;
- provide a toolbox to facilitate policy- and law-makers' application of EU customs rules;
- present an action plan on enhancing human resources development;
- review the management and funding of IT customs networks and databases;
- coordinate with the Council on the integration of joint law enforcement activities into the overall governance of the customs union;
- find a workable solution for the creation of an EU [single window](#) environment;
- integrate the communication on a VAT action plan into customs policy;
- evaluate the possibility of financing equipment needs from future Commission financial programmes.

### European Parliament and EU customs union

The European Parliament has discussed the customs union on several occasions, such as the [ongoing legislative procedure](#) on the Union's legal framework for customs infringements and sanctions (rapporteur: Kaja Kallas, ALDE, Estonia), and the [resolution](#) on tackling the challenges of Union Customs Code implementation, adopted in January 2017. In this resolution, for instance, the Parliament criticised the different customs systems at national level, in particular as regards customs duties and customs clearance, which would create fragmentation, additional administrative burdens (in particular for small and medium-sized enterprises) and delays. These shortcomings could cause uncertainty, market disparity and undermine economic operators' compliance with the Union's customs legislation.

The Parliament suggests, among other things, stepping up efforts to create more uniform electronic customs requirements and risk-assessment programmes at EU level. Regarding the digital single market, the Parliament stresses that 'every economic operator should respect standards on customs processes in order to avoid loopholes in customs procedures ... Existing simplified customs procedures should not be taken away from

economic operators if they are compatible with safety, security and intellectual property rules, for example in the case of the express delivery operators of low-value shipments, who with the UCC provisions will be subject to standard customs processes that could constitute red tape and hamper growth in e-commerce<sup>1</sup>.

The European Parliament has also called on the Commission to present, by 2017, an interim report evaluating EU customs policy (including e.g. review of problems, overlaps, gaps, complaints filed with customs authorities, and infringements of the UCC, which have been the result of the loopholes in [Regulation \(EU\) No 952/2013](#)). By 2021, the Parliament expects a fitness check, including an independent impact assessment, to ensure that the regulatory framework of EU customs policy, including the new UCC, is effective both for Member States and for trade operators.

### Main references and further reading

Gormley, L. W., *EU Law of Free Movement of Goods and Customs Union*, Oxford, 2009.

Limbach, K., *Uniformity of Customs Administration in the European Union*, Oxford, 2015.

Rivera-Batiz, L. A. and Oliva, M. A., *International Trade – Theory, Strategy, and Evidence*, New York, 2003.

White & Case, [Trade in the balance: Europe's new Union Customs Code](#), April 2016.

### Endnotes

<sup>1</sup> cf. Commission communication, [Developing the EU Customs Union and Its Governance](#), COM(2016) 813, p. 4.

<sup>2</sup> On this topic, see Puccio, L., Understanding EU practice in bilateral free trade agreement: Brita and preferential rules of origin in international law, *European Law Review*, 2011, Vol. 36, No 1, pp. 124-134.

<sup>3</sup> Turkey, however, is a special case. Turkey is the only accession candidate to achieve a customs union with the EU (31 December 1995) before joining the Union or even commencing negotiation talks (3 October 2005). On the political and institutional involvement of Turkey with the EU in and beyond the bilateral customs union, see Karakas, C., EU-Turkey: Integration without Full Membership or Membership without Full Integration? A Conceptual Framework for Accession Alternatives, *Journal of Common Market Studies* (JCMS), 2013, Vol. 51, Issue 6, pp. 1057-1073.

<sup>4</sup> See Commission communication, [Developing the EU Customs Union and Its Governance](#), 2016, p. 8.

<sup>5</sup> Ibid.

<sup>6</sup> See e.g. [point 2.12](#) in UK HM Revenue and Customs, Notice 275: Customs export procedures, 2016.

<sup>7</sup> Such as Kathrin Limbach, p. 193ff.

<sup>8</sup> See White & Case: [Trade in the balance: Europe's new Union Customs Code](#), 2016, p. 2.

<sup>9</sup> cf. White & Case: [Trade in the balance: Europe's new Union Customs Code](#), 2016, p. 8.

<sup>10</sup> See Commission communication, [Developing the EU Customs Union and Its Governance](#), 2016, p. 4.

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