Brexit: the customs challenge
The European Union Committee

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In practice this means that the Select Committee, along with its Sub-Committees, scrutinises the UK Government’s policies and actions in respect of the EU; considers and seeks to influence the development of policies and draft laws proposed by the EU institutions; and more generally represents the House of Lords in its dealings with the EU institutions and other Member States.

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Evidence is published online at [https://www.parliament.uk/hlinquiry-brexit-customs-arrangements/](https://www.parliament.uk/hlinquiry-brexit-customs-arrangements/) and available for inspection at the Parliamentary Archives (020 7219 3074).

Q in footnotes refers to a question in oral evidence.
SUMMARY

On 17 January 2017 the Prime Minister, the Rt Hon Theresa May MP, set out the Government’s intention to leave the EU’s Single Market and its customs union. In its Chequers White Paper, published in July 2018, the Government reiterated this commitment and proposed the establishment of a Facilitated Customs Arrangement (FCA) with the EU. This aims to preserve the status quo for UK-EU trade, while enabling the UK to pursue an independent trade policy. Alongside a free trade area for goods and a ‘common rulebook’, there would be no tariffs and no routine customs controls.

HM Revenue and Customs estimates the FCA to cost UK importers £700 million a year. Under ‘no deal’, the estimated annual cost to UK traders would be £18 billion.

The proposed FCA includes the operation of a dual tariff: for goods from non-EU countries, either the EU or the UK tariff would be charged, depending on their final destination. If this cannot be firmly established, UK customs authorities would initially charge the higher tariff, but businesses would be able to claim back the difference on providing proof of the goods’ final destination.

We find the FCA proposal still raises a number of significant questions that need to be resolved, not only for it to be workable, but also acceptable to the EU. With only six months before the UK’s scheduled exit from the EU, agreement on the principles underpinning any future customs arrangements has become a matter of urgency.

The Government has not yet made clear how goods could be reliably tracked and who would carry liability for keeping EU and UK-destined goods separate. The EU might fear that the lack of a robust tracking mechanism could increase the risk of fraud. The EU could also argue that the FCA gives the UK an unfair competitive advantage. Most significantly, the UK’s proposal to collect revenue on behalf of the EU makes agreement particularly difficult, and Michel Barnier, Chief Negotiator of the European Commission on the UK’s exit from the EU, has stressed that the EU will not delegate duty collection to a non-Member State. The Government therefore needs to provide greater clarity on the operation of the scheme and on how it intends to address the EU’s concerns.

The FCA’s repayment mechanism is untested and we understand it will take several years to be developed and implemented. The operation of the repayment mechanism can be made easier by reducing the volume of businesses having to engage with it, through the expansion of trusted trader schemes. We recommend simplifying the application process for the trusted trader schemes to facilitate access for small and medium-sized enterprises and urge the Government to seek mutual recognition of its scheme by the EU. The Government’s estimate that 96% of UK goods trade would be able to pay the correct tariff up front has been challenged and we call on the Government to clarify how it arrived at this figure.

We find that, in the case of ‘no deal’, trading with the EU under World Trade Organisation (WTO) rules would be disruptive and costly. Tariffs would apply, and although tariffs are generally low, some sectors, such as the agricultural and automotive sectors, would be disproportionately affected. Businesses on both sides would have to meet additional administrative customs requirements,
such as import and export customs declarations. An estimated 145,000 VAT-registered UK businesses, and potentially a further 100,000 under the VAT threshold, currently trade exclusively with the EU. They would either have to gain expertise in customs procedures or outsource part of the customs process to a customs broker or freight forwarder at a cost.

Roll-on/roll-off ports process the majority of trade in goods between the UK and the EU. The introduction of new customs checks at the border under ‘no deal’ would cause delays at these ports, thus disrupting highly integrated supply chains. The Port of Dover’s ability to handle its trade volume, for example, depends on vehicles flowing through the port without stopping for customs controls. In the case of ‘no deal’, customs paperwork would need to be checked and some goods would be subject to additional time-consuming regulatory checks. This would particularly affect manufacturing businesses that rely on components being able to cross and recross borders swiftly, and just-in-time supply chains, upon which food manufacturers and retailers depend for freshness and convenience. As a consequence, the attractiveness of trading with UK businesses could decrease, and we urge the Government to set out its plans to protect existing supply chains.

The customs requirements that would be imposed in the event of ‘no deal’ would require some form of physical border infrastructure on all sides, which is of particular relevance to the Northern Ireland/Ireland border. Any form of infrastructure would risk re-introducing a hard border, which could have severe consequences for UK-Irish relations. Additional customs checks would also cause disruption at roll-on/roll-off ports dealing with UK-Irish trade and—given the UK’s position as a land bridge between Ireland and mainland Europe—could cause delays to the flow of goods between Ireland and the rest of the EU.

Options to mitigate the disruption caused by a ‘no deal’ Brexit are limited. We welcome the Government’s intention to join the Common Transit Convention and the preparations made by HMRC to deal with additional customs declarations. However, there are few other options available to the Government in the short term. Technology does not yet provide a means for eliminating border checks, and WTO anti-discrimination rules mean that the UK could only decide to waive customs checks on goods arriving from the EU as part of a wider framework open to all countries. The EU would also need to reciprocate for these measures to be effective, and it has indicated that it would not waive checks on UK goods.

We believe it is imperative that the UK and the EU continue to engage in a constructive dialogue and seek a mutually acceptable agreement, as the current lack of clarity about future customs arrangements and the possibility of a ‘no deal’ are having an adverse impact on UK businesses.
CHAPTER 1: INTRODUCTION

1. The EU is the UK’s largest trading partner for goods. From June 2017 to June 2018, UK goods exports to the EU accounted for 49% of the total value of UK goods exports, while imports from the EU were worth 54.9% of the total value of all UK goods imports.¹ The Government’s White Paper *The future relationship between the United Kingdom and the European Union*, published in July 2018,² makes it clear that once the UK leaves the EU, it will no longer be a member of either the EU’s customs union or the EU Single Market. But to preserve the close trade relationship with the EU after Brexit, the Government is seeking to ensure “the most frictionless trade possible in goods between the UK and the EU”, based on a new customs arrangement.³

2. In August 2017 the UK Government put forward two options for a post-Brexit UK-EU customs relationship in its *Future customs arrangements—a future partnership paper.*⁴ The first option, commonly referred to as ‘Max Fac’ (‘Maximum Facilitation’) aimed to decrease, as much as possible, the need to check goods at the border by implementing technological solutions. This option—even with the most advanced technological solutions currently available—would not have removed the need for the establishment of a customs border. The second option outlined by the Government was the ‘New Customs Partnership’. Under this option—characterised by the Government as ‘unprecedented’ and ‘challenging to implement’⁵—the UK would charge two different sets of tariffs on imports, depending on whether goods were destined for the UK or the EU market. This would include the UK collecting revenue on behalf of the EU, thus eliminating the need for a border for goods.

3. In its White Paper published in July 2018, the Government unveiled a new customs proposal—the Facilitated Customs Arrangement. This Arrangement incorporates the principal elements of the New Customs Partnership proposal alongside the use of new technology. It is proposed to

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³ Ibid., p 16


⁵ Ibid., p 2
be implemented alongside a free trade area for goods, including agri-food, as part of a wider UK-EU economic partnership.6

This inquiry

4. This report considers the Government’s proposed Facilitated Customs Arrangement (FCA), together with customs processes under a ‘no deal’ scenario. Given the similarities between the previously proposed New Customs Partnership and ‘Max Fac’ options and the new FCA, most of the evidence collected by the Committee on the two previously proposed options in 2017 is still relevant and has, therefore, been used in preparing this report. Follow-up written submissions on the FCA were also received from a number of witnesses who had provided oral evidence on the former proposals.

5. Chapter 2 introduces the EU’s customs union and its main characteristics, reflecting the current position for UK-EU trade. Chapter 3 considers the consequences of a possible ‘no deal’ scenario for UK-EU trade, with a focus on customs requirements for trade under WTO rules. It also provides a baseline against which the UK Government’s proposed FCA can be assessed. Chapter 4 sets out the options available to the UK Government to mitigate the adverse impact of customs controls that would be imposed if trade defaulted to WTO rules. Chapter 5 explores the Government’s proposed FCA, its challenges, the implications for UK businesses and how it might affect the UK’s ability to strike free trade agreements with third countries. It also considers the feasibility of the FCA from an EU perspective, as well as the EU’s initial response to the proposal. Where relevant, this report also touches on those aspects of trade (e.g. rules or origin or trade preferences) that may have an impact on customs procedures. It does not cover trade in services.

6. This inquiry was conducted between April and August 2018. The Committee took oral evidence from customs and trade experts, trade bodies and membership organisations, HM Revenue & Customs (HMRC) officials and Government representatives. While there was no open call for written evidence, the Committee approached a number of experts, businesses and organisations for written submissions (see Appendix 2). Members of the Committee also visited the Port of Felixstowe in May and the Port of Dover in July to gain a first-hand understanding of the impact of any new customs arrangements on the operations of container and roll-on/roll-off ports—the main route through which goods enter and leave the UK.

7. The Committee is grateful to all those who contributed and provided evidence to its inquiry (see Appendix 2).

8. We make this report for debate.

CHAPTER 2: HOW THE EU CUSTOMS UNION WORKS

The EU customs union

9. The EU has the most comprehensive customs union in the world. It has been in place since 1968 and comprises all EU Member States, Monaco (via an agreement with France), the Isle of Man and the Channel Islands.7

10. The legal basis for the EU customs union is Article 28 of the Treaty on the Functioning of the European Union.8 It 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.”9

11. The Article text sets out the three key characteristics of the EU customs union:

(a) By virtue of their membership of the EU, Member States are automatically members of the EU customs union.

(b) Trade in goods between Member States is tariff-free.

(c) All Member States treat imports from third countries in the same way by applying the Common External Tariff.

12. The application of the Common External Tariff means that goods from outside the EU are charged the same import tariff, irrespective of the Member State through which they enter the EU. To ensure uniform application of customs rules, the Union Customs Code (UCC) was developed. It provides the legal foundation for dealing with goods entering from third countries; its most recent iteration has been in force since 1 May 2016.10

13. Inherent in the EU customs union and the application of the Common External Tariff is the need for a single commercial policy. Under the EU’s Common Commercial Policy, trade agreements with non-EU countries are negotiated by the European Commission on behalf of all Member States.11 While the UK remains a member of the EU’s customs union, it is bound by the Common Commercial Policy and is unable to enter into its own free trade agreements.

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7 The Isle of Man and the Channel Islands are part of the EU’s customs union by virtue of Protocol No.3 to the UK’s Treaty of Accession. The Sovereign Base Areas of Akrotiri and Dhekelia on the island of Cyprus are also part of the EU’s customs union.

8 Treaty on the Functioning of the European Union (TFEU), OJ C 326 (consolidated version of 26 October 2012) Further detail is addressed by: Articles 30–32 of the Treaty (deals with the Customs Union); Article 53 TFEU (deals with Customs Cooperation); and Articles 34–37 TFEU (deals with the free movement of goods and the prohibition of quantitative restrictions on imports and exports between Member States and all measures having equivalent effect).

9 Article 28, Treaty on the Functioning of the European Union

10 The Community Customs Code was established in 1992 by Council Regulation 2913/92. This was replaced by Regulation 450/2008 which established the Modernised Customs Code. In 2016, the current iteration—the Union Customs Code—was introduced by Regulation 952/2013.

trade agreements with countries outside the EU. Rules of origin, which are used to determine where a product was produced to levy the appropriate customs duty, do not apply to trade between EU Member States. They are considered in Chapter 3.

Administrative requirements and customs procedures for intra-EU trade

14. Goods traded between EU businesses are generally not subject to customs procedures. They are regarded as ‘goods in free circulation’ within the customs union, which means that no customs duty or import VAT is charged on them. Clive Broadley, Consultant, Freight Transport Association, put this succinctly: “If the goods are going to an EU Member State customer, there are no requirements, full stop. It is no different from putting your goods on a lorry here in London and sending them to Leeds.” Only goods that require risk-based and highly targeted border checks—such as firearms—are controlled.

15. VAT-registered EU businesses that exceed a certain threshold when trading within the EU have to complete a monthly customs form—an Intrastat declaration. Susan Morley, Director, Morley Consulting Training Limited, explained that Intrastat declarations were “an equivalent customs entry”, which were done retrospectively. The information provided on the Intrastat reports is often less than satisfactory. Many businesses fail to identify the correct commodity codes and, she added, “it is known that a lot of the big players use one code”, on the grounds that nobody “checks on it anyway”.

Figure 1: Summary of administrative requirements for intra-EU trade

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Source: Written evidence from Freight Transport Association (BCA0001)

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12 Under Article 124(4) of the draft Withdrawal Agreement during the proposed transition period the UK may sign, negotiate and ratify its own international agreements provided they do not come into force before 31 December 2020.


15 ‘Intrastat’ is the system for collecting information and producing statistics on the trade in goods between EU Member States. If a firm’s trade with the EU27 exceeds £1.5 million imports, it must provide additional information on a monthly Intrastat declaration. For exports to the EU27, UK businesses are required to declare the total of their sales or acquisitions of goods from other EU Member States on their VAT return. However, if a firm’s trade with the EU exceeds £250,000 for goods exports, additional information must be provided on a monthly Intrastat declaration. See also: HM Government, ‘Declare goods you’ve moved in or out of the UK using Intrastat’: [https://www.gov.uk/intrastat](https://www.gov.uk/intrastat) [accessed 24 August 2018]

16 Q 73

17 Q 76 (Susan Morley)
Bilateral customs unions with the EU: Turkey, Andorra and San Marino

16. With the exception of Monaco and the Crown Dependencies, there is no precedent for a non-EU country being a member of the EU’s customs union. The EU, however, entered into three separate customs unions or partial customs unions with Turkey, and the microstates of Andorra and San Marino. The EU-Turkey and EU-Andorra customs unions are hybrid arrangements. The EU-Turkey customs union excludes agricultural and coal and steel products, whereas the EU-Andorra customs union’s scope is limited to industrial products and processed agricultural products. The customs union with San Marino is broader, but excludes coal and steel.

17. The UK Government has repeatedly ruled out entering into a customs union with the EU on the grounds that this would tie the UK to the EU’s Common Commercial Policy and limit its ability to negotiate free trade deals with third countries.

How is the EU’s customs union different from the Single Market?

18. The Single Market is wider in scope than the EU customs union. In addition to the free movement of goods, the Single Market also provides for the free movement of capital, services and people (the so-called ‘four freedoms’). Some European countries outside the EU (Iceland, Liechtenstein, Norway and Switzerland) participate in the Single Market, but are not part of the customs union. Iceland, Norway and Liechtenstein participate in the Single Market as Members of the EEA, and while they retain their ability to set their own external tariffs and negotiate free trade deals with third countries, they have to accept the EU’s four freedoms. The EEA Agreement does not eliminate the need for border checks between EU and non-EU EEA Member States entirely—special provisions apply for agricultural and fisheries products, for example. Switzerland’s position is somewhat different in that it has signed more than 100 bilateral agreements with the EU, ensuring partial membership of the Single Market, but with notable exclusions, such as financial services. It accepts the principle of freedom of movement of people.

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19 Ibid.
20 Ibid.
23 European Free Trade Association, ‘European Economic Area (EEA)/Relations with the EU’: http://www.efta.int/eea [accessed 24 August 2018]
CHAPTER 3: WHAT IF THE UK FAILS TO SECURE A DEAL WITH THE EU?

19. The EU is, by some distance, the UK’s largest trading partner. As we have noted, from June 2017 to June 2018, UK goods exports to the EU accounted for 49% of the total value of UK goods exports, while imports from the EU were worth 54.9% of the total value of all UK goods imports. The Prime Minister, in her speech at the Farnborough Air Show in July 2018, reiterated the Government’s commitment to preserving this frictionless trade, stating that friction at the border would “jeopardise the uniquely integrated supply chains and just-in-time processes on which millions of jobs and livelihoods depend”. She concluded that “anything else … will not deliver for Britain as a global trading nation.”

20. Central to an orderly Brexit will be the ratification of the Withdrawal Agreement and the signing of the political declaration on the framework for future EU-UK relations in time for the UK’s exit from the EU on 29 March 2019. Without these agreements, the UK would leave the EU’s structures with no formal arrangements and framework in place for continued cooperation. This is popularly referred to as the ‘no deal’ scenario. There would be no 21-month transition period, no future relationship discussions as currently envisaged, and UK-EU trade would need to be conducted on WTO rules. Even if there is a transition period, but the two sides fail to agree on their future relationship by the time it is due to end on 31 December 2020, there could still be a delayed ‘no deal’ Brexit.

21. The principal difference between ‘no deal’ on 29 March 2019, compared to 31 December 2020, is that in the absence of a Withdrawal Agreement, the UK would, with immediate effect, not only leave the EU’s Single Market and customs union, but also lose immediate access to any trade preferences and customs facilitations it currently enjoys with third countries through agreements secured by the EU. From 29 March 2019 trade with those countries, as well as with the EU, would need to be conducted on WTO terms, not leaving time to negotiate the roll-over of existing agreements. At

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29 Article 50(2), *Treaty on European Union*

30 Further information on ‘no deal’ scenarios can be found in our report *Brexit: deal or no deal* (7th Report, Session 2017–19, HL Paper 46)

31 By virtue of Article 124(1) of the draft Withdrawal Agreement all these agreements will apply to the UK during the transition period.
present, the EU has fully implemented preferential trade agreements with 33 countries, and over 40 arrangements are partly in place.  

**Trade with the EU under WTO rules**

22. While the UK is an EU Member State, UK businesses can trade with other Member States on the same terms as if they were sending or receiving goods from within the UK. If trade was conducted on WTO rules, tariffs would be applied and routine customs checks would need to be reintroduced.  

23. The UK, no longer tied to the EU’s Common External Tariff, would have discretion to lower its tariffs if it thought it desirable but, under WTO rules, the most-favoured nation (MFN) principle would apply. This states that WTO members cannot discriminate between other WTO members, unless they are part of a preferential trade agreement—such as a free trade agreement or a customs union. Therefore, in the absence of such a preferential agreement with the EU, the UK could not, for example, decide to lower its tariffs on a particular product for a specific EU country (or even the EU as a whole), but would have to do so for all other WTO members too.  

**Tariffs and their cost**

24. The UK’s draft schedule of tariffs submitted to the WTO for certification replicates the concessions and commitments currently applicable to the UK as an EU member. While current EU tariffs are, on average, relatively low, certain sectors, such as agriculture and the automotive sector, could be particularly affected by higher tariffs that could result from trading on WTO terms. John Foster of the CBI, in evidence to the European Union Select Committee for its Brexit: deal or no deal inquiry, stated that in a ‘no deal’ scenario, “The UK would face tariffs on 90% of our EU goods exports by value", and estimated that trading on WTO most-favoured nation terms...
would equate to “an average tariff of 4%, which is about £4.5 billion to £6 billion-worth of increased costs per year on our exports”.38

25. In addition to any tariff costs, from a business perspective, trade on WTO rules means that administrative and customs procedures previously reserved for the UK’s rest-of-the-world trade (for example, with the US or China) would apply to trade with the EU27.39

26. While some businesses are already trading with non-EU countries and may be familiar with the processes involved, others—including many small and medium-sized businesses and newly established businesses generally—may struggle, particularly if lead-in times are short.40 Ms Morley told us that for those companies that only traded with EU countries, “particularly those below the VAT-threshold, it would be a new world altogether”.41 She thought those businesses would “use someone else to do it”.42 Neil Warwick, Brexit Policy Chair, Federation of Small Businesses, expressed concern that businesses “do not know what they do not know”.43

27. HMRC estimates that, currently, there are 145,000 VAT-registered businesses and, potentially, a further 100,000 under the VAT threshold that export only to the EU.44 They are therefore unfamiliar with rest-of-the-world customs arrangements.45 From a survey of their members, the Federation of Small Businesses have found that 20% of members are exporting firms and nine out of ten of those businesses trade with the EU, with 20% doing so exclusively.46 However, they cautioned that these figures may underestimate the number of firms that deal with goods for export. This is because some smaller firms may not actually be aware that their products are part of an export supply chain.47

Current UK customs procedures when trading with non-EU countries

28. On 23 August 2018 the Government provided some clarity for businesses by confirming that, in the case of ‘no deal’, the requirements for ‘rest-of-the-world’ trade would apply to trade with the EU27. This information was not included in either of the UK Government’s two White Papers on customs. It is possible that, in the longer term, some of the administrative processes could be simplified, including through bilateral agreements with the EU, but

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38 Oral evidence taken before the European Union Select Committee, 7 November 2017 (Session 2017–19), Q 43
41 Q 77
42 Ibid.
43 Q 17
44 Oral evidence taken before the Public Accounts Committee, 5 September 2018 (Session 2017–19), Q 151 (Jim Harra)
45 Q 114 (Mel Stride MP)
46 Q 16 (Chris Walker and Neil Warwick)
47 Q 16 (Neil Warwick)
in the short and medium term at least, the existing ‘rest-of-the-world’ trade processes would apply.\footnote{HM Government, ‘How to prepare if the UK leaves the EU with no deal: Trading with the EU if there’s no Brexit deal’, 23 August 2018: \url{https://www.gov.uk/government/publications/trading-with-the-eu-if-theres-no-brexit-deal} [accessed 24 August 2018]}

29. HMRC has based its planning on the fact that, in a ‘no deal’ scenario, “customs controls would operate both ways on goods moving between the UK and the EU, meaning customs declarations and the potential for checks on goods”.\footnote{Q 87 (Jim Harra)} It has accordingly estimated that there would be a five-fold increase in customs declarations that would need to be submitted, from currently 55 million to 250 million a year.\footnote{QQ 82, 88 (Jon Thompson)}

\textit{Before non-EU goods arrive at the border}

30. Exporters—be they UK businesses exporting to non-EU countries or non-EU businesses exporting to the UK—must, as a first step, register for an Economic Operator Registration Identification (EORI) number with HMRC. This is a one-time process that involves completing a short application form. An EORI number is then usually allocated within three working days.\footnote{HM Government, ‘Get an EORI number’: \url{https://www.gov.uk/eori} [accessed 24 August 2018]} The EORI number will subsequently be needed to make any customs declarations.

31. Before a consignment of goods arrives at the border, a customs entry for that consignment needs to be built and other forms need to be completed, so that the goods can be cleared following their arrival.

32. The main customs form used to fulfil customs and duty obligations to HMRC is the Single Administrative Document (SAD) for import or export. It contains 54 data fields and comes in eight parts for use at different stages of the trading process, depending whether the goods are being exported, imported or are in transit.\footnote{HM Government, ‘Guidance: The Single Administrative Document for import and export’, 6 April 2017 \url{https://www.gov.uk/guidance/declarations-and-the-single-administrative-document} [accessed 24 August 2018]} Information about the goods, their arrival and value is required. Typically, this information must be sourced from a variety of documents, such as invoices and shipping documents. While both exports and imports need to be declared, it is the administration of import processes that is usually more onerous as, when exporting, there is no revenue collection involved.\footnote{Q 5 (Clive Broadley)}

33. Mr Broadley, using the import of goods from China as an example, told us:

“The Chinese exporter will … give certain key information, including the shipping document number which is unique to the shipment, the name of the vessel or the flight number, and when it is due to hit the border here. The exporter will then require the shipping invoice and any other commercial documents, such as an origin certificate, a packing list or a quality assurance document. Without that documentation, you cannot begin the process of working up the customs entry that is required to go into the system.”\footnote{Q 2}
Mr Broadley added that the requirement for all this information “can be the source of a delay” when attempting to build a customs entry.\textsuperscript{55}

34. The correct commodity code also needs to be identified and relies on the experience of the importer. Mr Broadley explained:

“It is the commodity code that determines whether duty, a special VAT rate or any other special requirements such as import licences, are required at that stage. One would hope that the importer will know this, but it is not always the case, because they may be inexperienced.”\textsuperscript{56}

35. One particular compliance requirement—obtaining proof of origin—can itself be a complex and time-consuming process, generating “significant additional administration, and therefore costs and delays, to UK businesses”.\textsuperscript{57} Proof of origin must be presented to the importing customs authority,\textsuperscript{58} although there are systems that allow for self-assessment and remove “the need for a physical check at the border”.\textsuperscript{59} Rules of origin are described in more detail in Box 1.

\textbf{Box 1: Rules of origin}

Goods imported into a customs territory must follow ‘rules of origin’, which determine where a product and its components were produced, in order to ensure that the correct customs duty is levied. If goods consist of materials from more than one country, special rules apply to determine which country will be judged to be the country of origin. This is based on the origins of the materials, the value added in the process, and where the final substantial production phase took place.\textsuperscript{60}

The rules may require that final processing results in a change to the commodity code of the final product. This is known as ‘sufficient transformation’. The rules may specify the percentage or value of non-originating materials that may be used.\textsuperscript{61} Such formalities are not necessary for goods manufactured and traded inside a customs union. The precise rule for determining origin differs from product to product.

\begin{itemize}
\item \textsuperscript{55} \textit{Ibid.}
\item \textsuperscript{56} Q 2
\item \textsuperscript{57} European Union Committee, \textit{Brexit: trade in goods} (16th Report, Session 2016–17, HL Paper 129) Chapter 5, para 179
\item \textsuperscript{58} Written evidence submitted to the EU External Affairs Sub-Committee, inquiry on \textit{Brexit: trade in goods}, Session 2016–17 (FTG0010)
\item \textsuperscript{59} Q 73 (Joe Owen)
\end{itemize}
There are two main types of rules of origin: non-preferential and preferential:

- ‘Non-preferential rules of origin’ apply to trade under WTO rules in the absence of a preferential trade arrangement, for example to trade between the EU and the US or China. They are related to anti-dumping duties, trade embargoes, quantitative restrictions, some tariff quotas, origin marking, and trade statistics, among others.\(^{62}\) Non-preferential rules of origin would by default apply to trade with the EU27 in the case of a ‘no deal’ Brexit.\(^{63}\)

- ‘Preferential rules of origin’ apply to countries which have concluded a preferential trade agreement and where proof of origin is required to claim a trade preference. They would not apply to UK-EU trade in the case of ‘no deal’.

36. Businesses exporting certain types of goods, such as those that may be used for both civil or military purposes, may also need an export licence or provide supporting documentation.\(^ {64}\)

37. Once traders have undertaken all the necessary compliance tasks they can submit a customs declaration to HMRC. This can currently be done via CHIEF (Customs Handling of Import and Export Freight), the UK’s electronic customs declarations system.\(^ {65}\)

*Customs controls on non-EU goods at the UK border*

38. Once goods from outside the EU reach the UK, they are subject to a number of customs procedures and checks.

39. The Port of Dover, which handles up to 17% of the UK’s trade in goods, provided an example of a recent non-EU customs clearance process for a typical groupage of eight consignments, broken down into various stages.\(^ {66}\) Overall, the process from the arrival of the lorry at Dover to its release took one hour and fifteen minutes, with manual tasks taking up much of the time. These tasks included parking, inspecting the exterior of the lorry, keying in information from the driver’s paperwork and waiting for a prescribed period of 30 minutes to give the Border Force personnel an opportunity to attend the lorry in person. The Port of Dover thought that the use of technology was unlikely to reduce this processing time significantly.\(^ {67}\)

40. It is also worth emphasising that the goods included in the consignment were not sensitive goods—they were textiles, clothing, automotive parts and other tools from Turkey—\(^ {68}\) and therefore did not require physical checks, for example those that could be required for animal products or plants. Mr Jon Thompson, First Permanent Secretary and Chief Executive, HM Revenue


\(^{63}\) HM Government, ‘How to prepare if the UK leaves the EU with no deal: Trading with the EU if there’s no Brexit deal’, 23 August 2018: [https://www.gov.uk/government/publications/trading-with-the-eu-if-theres-no-brexit-deal] [accessed 24 August 2018]

\(^{64}\) Ibid. See also: HM Government, ‘Do I need an export licence?’: [https://www.gov.uk/guidance/beginners-guide-to-export-controls#do-i-need-a-licence] [accessed 12 September 2018]

\(^{65}\) A new UK Customs Declarations System (CDS) is currently in development to replace CHIEF and is due for a phased roll-out starting in January 2019.

\(^{66}\) Written evidence from Port of Dover (BCA0007) (Annex 1)

\(^{67}\) Ibid.

\(^{68}\) Ibid.
and Customs, told the Committee that processing time depended generally on three things: “The type and volume of goods on the lorry; whether or not the lorry is accompanied or unaccompanied, because it is quite common to get a trailer but no cab with an individual in it; and the method of importation or exportation.” He could provide examples where the clearance process “was shorter, but it might also be longer”.69

**Regulatory checks**

41. In addition to the customs paperwork checks, a small proportion of goods arriving from outside the EU are physically checked at the border. The Port of Felixstowe told us that “the number of physical examinations” only represented “3% of third-country import containers”.70

42. However, these regulatory checks for non-EU goods take longer than customs checks.71 They can include checks on product standards, safety regulations and phytosanitary and veterinary checks.72 Ms Allie Renison, Head of Europe and Trade Policy, Institute of Directors, thought that there was “not a huge amount that technology can do to mitigate that”.73

43. Considering industrial goods, Dr Peter Holmes, Reader in Economics, University of Sussex, stated that “the European Economic Area agreement provides that all mandatory requirements for industrial goods are essentially the same or equivalent and that common systems are established for testing the conformity of goods to these standards”. However, “Goods from outside the EEA need to be checked. The importer has to take responsibility for guaranteeing they are satisfactory.”74

44. Agricultural products of non-EEA origin are also generally subject to some checks. As Mr Broadley noted, “If you are bringing food or bone, dead or alive, holds may be put on while your inspections and checks are done.” However, he also stated that “if you have a good broker and an experienced importer”, then the goods should be able to “go through the system fairly quickly as it stands”. He saw the “logistical and paperwork side” as more likely to create hold-ups and delay “than the actual clearance through the system”.75

45. Mr Sam Lowe, Research Fellow, Centre for European Reform, made the point that requirements for checks on animal products could be particularly burdensome on businesses and those ports having to upgrade their facilities to accommodate those checks. Some key ports were currently unable to handle animal products:

69 Q 82
70 Written evidence from the Port of Felixstowe (BCA0003) We note, however, that the types of goods going through container ports are different to those going through roll-on/roll-off ports. For example, almost 80% of fresh and perishable produce imported into the UK comes from the EU, and most of it through roll-on/roll-off ports for fast delivery. In the event of ‘no deal’, fresh produce might have to be physically examined to establish compliance with sanitary and phytosanitary and other requirements. Written evidence provided by the British Retail Consortium (BRC) to the House of Lords European Union Energy and Environment Sub-Committee, Session 2017–2019, (BFS0007) We note that this could result in the proportion of physical examinations at those types of ports exceeding 3%.
71 Q 49 (Allie Renison)
73 Q 49
74 Written evidence from Dr Peter Holmes (BCA0002)
75 Q 2
"Every product of animal origin imported from outside the EU has to enter the EU via a veterinary border inspection post. The problem that UK exports to the EU have post Brexit is that Calais is not a veterinary border inspection post. The Eurotunnel is not a veterinary border inspection post. The closest is Dunkirk, which has low capacity for physical inspections. After that, we are thinking about Rotterdam and the like. You also have some issues on the UK side at Anglesey."\(^{76}\)

46. This, he explained, would have an impact on the ‘route to market’ chosen by businesses. While Calais and Eurotunnel were being upgraded, goods might need to be shipped via Rotterdam. However, this was not straightforward, as it would be “a different type of shipment and you have to think about whether you are doing it in bulk or in frequency, so refilling the supermarkets becomes a bit of an issue”.\(^{77}\)

*Existing customs facilitations*

47. A range of customs facilitations, designed to make the customs clearance process less onerous on traders, are available to businesses who meet certain qualifying criteria. As set out below, the bar is set high for businesses wishing to avail themselves of these facilitations.

*Authorised Economic Operator status*

48. The most comprehensive facilitation scheme currently in place is the Authorised Economic Operator (AEO) scheme.\(^{78}\) Mr Thompson told us that the current scheme enables trusted traders to make use of a total of 21 facilitations.\(^{79}\) Box 2 sets out the principal elements of this scheme.

**Box 2: The Authorised Economic Operator scheme**

The AEO scheme is a voluntary programme that requires participating traders to meet a range of criteria and work in close co-operation with customs authorities. In return, they enjoy various benefits that speed up procedures related to customs, such as simplified customs controls. The UK is part of the EU’s AEO scheme, established in 2008 and based on internationally recognised standards.

The scheme’s objective is to ensure the security of supply chains and to facilitate legitimate trade. There are two main types of AEO: economic operators authorised for customs simplification (AEOC), security and safety (AEOS) or a combination of the two.

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\(^{76}\) Q 73 (Sam Lowe)

\(^{77}\) Ibid.


\(^{79}\) Q 82
Criteria that need to be met to be granted either AEO status typically include:

- Compliance with customs legislation and taxation rules and absence of criminal offences related to the economic activity
- Appropriate record keeping
- Financial solvency
- Proven practical standards of competence or professional qualifications
- Appropriate security and safety measures.

Benefits include:

- Easier admittance to customs simplifications
- Fewer physical and document-based controls
- Prior notification in case of selection for physical control or customs control
- Priority treatment if selected for control
- Possibility to request a specific location for customs controls
- Other indirect benefits
- Mutual recognition with third countries (where an agreement has been negotiated).


49. Uptake of the AEO scheme has been low in the UK, with only 638 UK businesses currently registered. Stephen Adams, Senior Director, Global Counsel, linked this to the already satisfactory conditions in the UK: “People sign up for AEOs because of the margin of improvement from the baseline treatment.” In the UK, that margin was “not necessarily that great”, Ms Morley agreed that UK traders had “already had the benefits. Why do we want to do anything else?” Mr Robin Walker MP, Parliamentary Under-Secretary of State, Department for Exiting the European Union, told us that the UK had “one of the most effective customs systems in the world”, which might be the reason for there being “fewer incentives” for some businesses to join a trusted trader scheme.

50. One of the principal obstacles to increasing participation in the AEO scheme is the requirement to provide a three-year audit trail in order to qualify. For businesses that had only traded with the EU this was difficult to obtain. Mr Adams explained: “There is an established audit process for achieving AEO, and it generally requires a company already to be an exporter and/or importer and to have an audited customs profile.”

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81 Q 47
82 Q 75
83 Q 109 (Robin Walker)
84 Q 74 (Sam Lowe) and Q 44 (Stephen Adams)
85 Q 44
51. On SMEs specifically, Mr Adams thought that businesses did “not necessarily have the capacity at the moment to get themselves into an AEO system, to maintain the audit trail or to go back every three years and do it again”. While between 60% and 75% of goods imported and exported into the UK were currently covered by an AEO scheme in the UK, it was important to “keep our eye on that long tail of smaller businesses” that were outside the AEO system and ensure they received the necessary support. Mr Lowe said it was “not worth their time to try to get AEO status, because they probably could not even qualify for it”. The criteria were difficult to meet “because so much trust is put in a company once they have it”.

52. Mr Thompson also pointed out that obtaining AEO status “does not suit everyone”. It could take about eight months in total to complete, depending on available resources. Additionally, accreditation required businesses to free up “internal resource, or the contracting of external consultancy. It may for example require enhancements to physical security, IT, written processes, and management practices”.

53. Mr Chris Walker, Policy Chair for Trade, Federation of Small Businesses, considered that the reason for the low uptake of AEO in the UK was that “it is such an administrative burden and a liability”. The Freight Transport Association also commented on the complexity of the forms and that they could “put off would-be Applicants”.

54. Ms Morley, on the other hand, did not think that the challenges for SMEs were insurmountable. She told us that “you can get AEO very quickly and very simply”, and that filling in the application form was “not beyond the wit of a human being to do”. She thought that getting AEO status was “actually very, very much harder for a large organisation”, due to the amount of information they were required to submit.

55. The role of AEOs and other trusted trader schemes under the Government’s proposed Facilitated Customs Arrangement, and possible improvements to these schemes, are discussed in Chapter 5.

Special Procedures

56. The Union Customs Code provides for Special Procedures that allow—in certain circumstances and depending on the procedure used—for the relief, reduction or suspension of either customs duties or other taxes due on goods.

57. Mr Broadley told us that big importers and the automotive sector “may already use” a special procedure called the customs freight simplified procedure.

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86 Q 47 (Stephen Adams) and Q 109 (Mel Stride MP)
87 Q 47 (Stephen Adams)
88 Q 74 (Sam Lowe)
89 Q 82 (Jon Thompson)
90 Written evidence from the Freight Transport Association (BCA0001)
91 Ibid.
92 Q 31
93 Written evidence from the Freight Transport Association (BCA0001)
94 Q 75
95 Ibid.
(CFSP). Under this procedure, authorised importers can defer import duty and VAT payment by setting up a deferment account with HMRC. The advantage of this is that they can postpone payment by an average of 30 days, thus helping their cash flow, and goods can normally be cleared for release more quickly, as there is no need for a full customs declaration at the point the goods are released. He explained, though, that not all businesses qualified, as it was “a trusted relationship with customs, and you have to be approved to be competent enough to do that and have the appropriate software and systems in place to be allowed that particular procedure”. Ms Morley agreed: “Those authorised to pay less or to defer import duty under Special Procedures have been required to measure up to AEO status in order to run the Procedures even if they were not AEOs.”

58. Mr Broadley added that deferment accounts were a pre-condition for CFSP. This required a bank guarantee for twice the amount of what is being deferred in a month. Obtaining this, he said, was “a considerable burden on companies”. He explained that customs brokers and freight forwarders could offer deferment arrangements to smaller businesses at a cost of 1–3%, but only to a certain level. He cautioned: “It is not unlimited and if in a month the deferment has no scope left in it, you [the small business] have to make fast payments into the customs system.”

What would be the impact of new customs procedures under a ‘no deal’ Brexit?

Cost to businesses

59. In addition to the costs that may result from the imposition of tariffs when exporting to or importing from the EU, our witnesses were unanimous that any departure from current arrangements for UK-EU trade would add administrative costs. Mr Jim Harra, Tax Assurance Commissioner, Deputy Chief Executive and Second Permanent Secretary, HM Revenue and Customs, spoke of “a very substantial new admin burden” if customs controls between the UK and the EU were to be introduced. This was “because all UK-EU traders would have to comply with customs obligations that they do not have to comply with today”. Mr Adams explained: “Of course, the problem for the UK is that we are not dealing with frictional costs that are already in the price … Anything new now is an additional frictional cost on the price.” Mr Andrew Meaney, Head of Transport Team, Oxera Consulting LLP, agreed that “there is going to be a cost of change”.

60. Mr Warwick, of the Federation of Small Businesses, told us that “it costs a minimum of £20 to swear the declaration”—an additional cost which, for small businesses trading lower value goods, might not be sustainable. Ms

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97 Q 2 (Clive Broadley)
99 Q 2 (Clive Broadley)
100 Written evidence from Susan Morley (BCA0009)
101 Q 3 (Clive Broadley)
102 QQ 4, 8
103 Q 4
104 Q 85
105 Q 37
106 Ibid.
107 Q 23
Morley qualified this by noting that when “sending multiple goods there is no single customs entry for each item. It is per consignment”. But she too accepted that “there would be a cost”.108

61. Businesses would also need to upskill their workforce to ensure they were familiar with the new customs procedures. As Mr Broadley pointed out: “This is not just about how quickly the customs system can process the data … It is about whether you have the correct documentation, processes, knowledge and understanding to complete the declaration in the first place.”109

62. Mr Meaney also reminded us that it would not just be UK businesses that would be affected. As supply chains extend into other EU Member States, EU companies are also likely to be affected by any changes to existing customs procedures: “Remember that at the moment the supply chains are across the UK’s borders with other EU member states. All of that supply chain has to learn the new rules. They have to hire and train people.”110

63. Some organisations, particularly SMEs, may not have sufficient resources to allocate the management of the customs paperwork to dedicated staff. Instead, they may opt for outsourcing this to a customs agent or freight forwarder. This would come at considerable cost—as we noted earlier, Mr Broadley estimated the typical cost of such outsourcing at between £35 and £70 per declaration.111 And even if businesses decide to outsource the management of customs procedures, they cannot outsource everything, as Chris Walker explained: “The certificate of origin, the information about the goods, the tariff code classification—has to come from the small business … You cannot outsource it.”112

64. Those businesses that do not already trade outside the EU may also need specialist software to enable them to interact with CHIEF/CDS, unless they decide to outsource that part of the process to customs brokers or freight forwarders.113 Either option would come at a cost.

65. Overall, HMRC has estimated that if customs declarations were introduced between the UK and the EU, there would be “between £17 billion and £20 billion of administrative costs per year”.114 By contrast, HMRC estimate the additional administrative burden under the Government’s proposed Facilitated Customs Arrangement to be £700 million a year (see Chapter 5).

66. Other potential costs could arise from lorries having to stop for customs inspections at the border. Mr Broadley estimated that “a driver-accompanied trailer waiting for a day will probably cost £200 in what we call demurrage

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108 Q 77
109 Q 2
110 Q 37 (Andrew Meaney)
111 Q 8
112 Q 18
113 Q 4 (Clive Broadley)
114 Q 85 (Jon Thompson) Mr Thompson first mentioned this estimate to the House of Commons Treasury Select Committee in June. The figure was challenged by several economists and some Government ministers. See, for instance, ‘Is UK customs chief right that ‘max fac’ will cost £20bn a year?’, Financial Times (25 May 2018): https://ec.europa.eu/taxation_customs/business/union-customs-code/ucc-legislation_en#ucc [accessed 6 September 2018] In evidence to the House of Commons’ Public Accounts Committee, Mr Thompson clarified that the cost to UK businesses under ‘no deal’ would be £18 billion. He explained that this figure was composed of two elements—£13 billion for import and export customs declarations and £5 billion for tariffs. Oral evidence taken before the Public Accounts Committee, 5 September 2018 (Session 2017–19), Q 157 (John Thompson)
charges”. Such a wait could lead to a driver missing the next collection slot, which could result in losing a day’s work, “which you can never make up on a truck”.115

Impact on ports

67. Most of the goods traffic between the UK and the EU passes through ports.116 The evidence to this inquiry indicates that roll-on/roll-off ports like Dover are more likely to be adversely affected than container ports, such as Felixstowe. Ports that deal substantially with container traffic, such as Felixstowe, process freight that can be hauled off a ship and wait to be collected.

68. As it is non-EU goods (for example, from the US or China) that are usually shipped in containers to the UK, container ports are likely to be better prepared to deal with the processes and checks that would be required if trade with the EU defaulted to WTO rules. The Port of Felixstowe estimated that “if the level of examinations for EU traffic is the same as currently for non-EU traffic, that would result in approximately 10,000 additional examinations per annum”.118 They were “confident this could be handled through the existing facilities and systems with only a small increase in staffing levels”, and their current software “could be expanded relatively easily to cover EU traffic through the port post-Brexit”.119

69. By contrast, the challenges for roll-on/roll-off ports, which mainly deal with EU trade, are much more significant. The Port of Dover, the busiest roll-on/roll-off ferry port in Europe, processes about 17% of the UK’s total trade in goods. Its ability to handle this trade volume “is dependent on all vehicles passing straight through without stopping for any routine customs (or animal/plant health etc) controls”.120 Mr Joe Owen, Associate Director, Institute for Government, pointed out that there was “dwell time … which is time in which authorities can do the necessary checks if they need to. Dover and Eurotunnel market themselves by saying, ‘We are basically a continuous motorway that will take you all the way over to France, non-stop’, so where do you put that dwell time?”121

70. Dover is limited by its geography, wedged between the cliffs and the sea. The Port was unequivocal in its assessment that it would not be able to accommodate additional checks:

“There is no space in the Port for additional checks: no space for more examination sheds, no space for new checkpoints or barriers, and no space for lorries to park awaiting clearance. Any new checks, for Customs or any other purpose, must therefore be conducted away from the Port.”122

115 Q 8 (Clive Broadley)
116 Around 95% of all UK imports and exports are transported by sea. EU traffic is the most popular international route, accounting for 55% of all international traffic. See HM Government, ‘Port freight statistics: 2017 final figures’: https://www.gov.uk/government/statistics/port-freight-statistics-2017-final-figures [accessed 12 September 2018]
117 For example, only 19% of containers handled at the Port of Felixstowe contain goods being imported from the EU. Most containers handled by Felixstowe, i.e. 81%, contain goods from outside the EU (see written evidence from the Port of Felixstowe (BCA0003))
118 Written evidence from the Port of Felixstowe (BCA0003)
119 Ibid.
120 Written evidence from the Port of Dover (BCA0007)
121 Q 73
122 Written evidence from the Port of Dover (BCA0007)
71. This point was echoed by Mr Owen:

“Can you just tell people to ‘go and wait over there’ if they do not have the right documentation? Yes, absolutely, and I understand that Eurotunnel has a piece of software or is trialling a piece of software that would allow it to do that quite quickly. But the limitation at both Eurotunnel and Dover is just space. What is ‘over there’? If you are at Dover, ‘over there’ is the sea or the cliff.”

72. Possible ways of conducting some customs checks away from the Port and taking strain off the border itself are discussed in Chapter 4.

Disruption to the flow of goods

73. The additional customs paperwork and checking requirements that would be introduced as a result of trade under WTO rules would also lead to the flow of goods being disrupted. Mr Lowe expected that “not all trade will stop from day 1, because emergency measures will be put in place on both sides, but after one, two or three months we will go to a new way of trading”.

74. Such delays occur not only at the border: the Freight Transport Association identified a common reason for delay as the sourcing of the information required for the customs paperwork and errors being made on forms. The Freight Transport Association provided a specific example of some paperwork having to “pass through the bank under something called a letter of credit. There can be delays in that paperwork coming in.”

75. Congestion at roll-on/roll-off ports could also cause significant disruption to the flow of goods, irrespective of whether customs paperwork has been completed accurately and to time. Mr Lowe gave the example of a company like Airbus, which has the resources and expertise to manage just-in-time production, and cautioned that “they are still going to get stuck behind someone else”. We note that congestion at Ports could have an impact on logistics more widely, affecting the availability of transportation to pick up goods or containers elsewhere.

Impact on supply chains

76. Supply chains are often complex and highly integrated, relying on a seamless flow of goods between the UK and the other EU Member States. Examples of supply chains that are highly integrated include the pharmaceutical and chemical sector, the manufacturing sector, the automotive sector, and the food and beverage sector.

77. Significant delays arising as a result of a ‘no deal’ outcome would disrupt the just-in-time supply chains that food manufacturers and retailers depend on, and could affect the availability of food in the UK, as stated in our report.

123 Q 73
124 Q 77
125 Q 2 (Clive Broadley) A letter of credit is a letter from a bank providing a guarantee that a buyer’s payment to a seller will be received in full and on time. It also provides a guarantee to the buyer that the seller will honour the contract. The bank carries the risk of non-payment. Letters of credit are used frequently in international trade and involve additional costs.
126 Q 71
Brexit: food prices and availability. Mr Broadley gave the example of a trailer bringing fruit and vegetables from Spain:

“At the moment, it can be in the UK in two or three days, or even faster with two drivers. It does not stop. The produce is in the supermarket probably the day after it has arrived here. If the trailer has to stop, that becomes an impossible supply chain for fresh, perishable goods.”

Mr Lowe warned that the ‘route to market’ “will alter quite considerably”, because of the need for fresh goods to go through veterinary border inspection posts, which neither Calais nor the Eurotunnel could currently provide. This would be “incredibly disruptive”.

To illustrate the benefits the car industry derives from the absence of customs requirements with the EU, the Society of Motor Manufacturers and Traders gave the example of the production of a single fuel injector. To make it, there are over 35 components, made in over 15 countries, that require over 39 UK-EU border crossings.

Mr Lowe cautioned that such disruption could potentially reduce the attractiveness of having UK companies within the supply chain:

“The supply chains that run through the European Union will no longer function as they did before. The UK companies will have to work out whether it is okay to have a component part of that supply chain within the UK, or whether it should go one way or even the reverse, and it completely changes the flow of trade.”

His assessment concurs with recent newspaper reports of warnings from companies like Airbus, BMW, and Jaguar Land Rover that a ‘no deal’ Brexit would lead to them having to scale back their UK operations, or even leaving the country.

The Northern Ireland/Ireland border

While this report does not focus on UK-Irish relations and the Northern Ireland/Ireland land border, the customs requirements that would flow...
from trade under WTO rules could severely affect the border and UK-Irish relations.

83. As set out in our report UK-EU relations after Brexit, a fully open border between Ireland and Northern Ireland requires the avoidance of customs controls. This is because customs checks necessitate some form of physical infrastructure. Technology does not yet provide the answer: as Swiss and Norwegian customs authorities told the EU Select Committee during its Brexit: UK-Irish relations follow-up inquiry, many technological developments that could reduce (though not fully eliminate) the need for physical checks at their borders with the EU remain a long-term aspiration.

84. The UK Government, the Irish Government and the EU have repeatedly stated their commitment to avoiding a ‘hard border’ in Northern Ireland. A ‘backstop’ is therefore envisaged to come into effect if future arrangements cannot be agreed on or turn out to be inadequate. We note, however, that the UK and the EU are still to agree what such a ‘backstop’ would look like. We also note that the Commission’s proposed ‘backstop’ is an integral part of the draft Withdrawal Agreement. If there is ‘no deal’ by 29 March 2019, the ‘backstop’ would not become operational. In that situation, there would have to be a separate agreement between the UK Government, the Irish Government and the EU to avoid a hard border.

Conclusions and recommendations

85. Trade with the EU on WTO terms would result in additional tariff costs being placed upon businesses. This could lead to an increase in the cost of goods, adversely affecting consumers and the competitiveness of UK businesses.

86. In addition to tariff costs, UK-EU trade on WTO terms would place a considerable administrative burden on businesses involved in that trade on both sides.

87. Customs procedures do not start at the border, but well before that. This requires resources to retrieve the necessary information, even if the information is not ultimately submitted by businesses themselves, but outsourced to customs brokers or freight forwarders.

88. An estimated 145,000 VAT-registered UK businesses trade only with the EU and there may be up to a further 100,000 businesses under the VAT threshold in the same position. In the case of ‘no deal’, they would have to gain expertise in customs procedures, which they do not yet have. While not an insurmountable challenge, this will require them to train or hire skilled staff, which will have cost implications. This might also apply to businesses that have traded with non-EU countries before.

135 European Union Committee, UK-EU relations after Brexit (17th Report, Session 2017–19, HL Paper 149)
136 Oral evidence taken before the European Union Select Committee, 6 February 2018 (Session 2017–19), Q113–120 (Lt Col Rebekka Strässle; Dr Christian Bock; Mr Pål Hellesylt; Mrs Hanne Solgaard Andersen)
89. Parts of the customs procedure can be outsourced to customs brokers or freight forwarders, but this too will incur a cost.

90. HMRC have estimated that, overall, the cost to UK businesses under ‘no deal’ would be £18 billion per year. We call on HMRC to provide an itemised breakdown of its figures and we urge the Government to set out its plans for supporting businesses in assessing the additional costs they would face under a ‘no deal’ scenario.

91. There are a number of existing customs facilitations, such as trusted trader schemes. While they may be appropriate for larger companies, we urge the Government to take account of the fact that they could place an unacceptably high burden on smaller businesses.

92. Any technological solutions will not wholly remove the need for checks on some goods at the border in the case of ‘no deal’. This is of particular relevance to the Northern Ireland/Ireland border, where trade under WTO rules risks re-introducing a hard border.

93. Trade with the EU under WTO rules would adversely affect UK roll-on/roll-off ports, in particular the Port of Dover. Any checks at the Port would introduce delays and lead to congestion. This poses a significant challenge to just-in time production and to agri-food businesses, and could lead to the disruption of supply chains.

94. Disruption to UK-EU supply chains could decrease the attractiveness of trading with UK businesses. We urge the Government to set out its plans for protecting existing supply chains in the case of ‘no deal’.

95. Container ports, such as the Port of Felixstowe, would be better able to accommodate the need for extra checks, while allowing time for authorities to carry out such checks. While this means that container ports may be able to absorb some trade from roll-on/roll-off ports, the ‘route to market’ of container goods is different to goods that require fast delivery.

96. In summary, the costs, disruption to the flow of goods and, potentially, the imposition of customs checks on the Northern Ireland/Ireland border in the case of ‘no deal’, all underline the need for the Government to succeed in its attempts to reach agreement with the EU on the future economic relationship.
CHAPTER 4: MITIGATIONS OPEN TO THE UK GOVERNMENT IN THE EVENT OF ‘NO DEAL’

The UK Government’s ‘trilemma’ in the immediate term

97. Mr Thompson stated that in the event of ‘no deal’ the Government would face a ‘trilemma’: “Ministers would need to make a decision about the free flow of trade, the security of the United Kingdom and the raising of revenue, because those are the current three objectives at the border … some choice may have to be made between those three objectives”.138

98. This was acknowledged by Mr Mel Stride MP, Financial Secretary to the Treasury and Paymaster-General, who told the Committee that, in the case of ‘no deal’, in the short term:

“The priority will be to keep the flow moving. There is a trade-off between keeping the flow moving, raising revenues, and security. We will not compromise on security, but particularly in a place such as Dover, where you have to keep flow moving very quickly or you end up with all sorts of problems, there may be a trade-off between keeping the flow going and revenue protection.”139

99. Ms Morley presented a unilateral reduction in regulatory checks as “a choice we can make” to keep the flow of trade moving, based on an assessment that the risk to the UK from EU goods entering the UK will be unchanged.140 However, Mr Lowe cautioned that such unilateral decisions “cannot just be on a whim”, but would have to be taken within a framework “setting out that, if you meet certain criteria, these are the checks that we would apply to your product upon import”. Simply deciding to waive any checks unilaterally without such a framework would risk the UK breaching the WTO’s anti-discrimination rules: the UK could not just decide to “discriminate in favour of the EU absent a preferential trade agreement”.141 If it did, Joe Owen told us, “Other countries have a rightful opportunity to try to take you to the WTO and say, ‘No, this is discrimination’.”142

“A border is like a tango—it takes two”143

100. The smooth flow of goods across borders relies on the two sides of the border co-operating. As Ms Morley pointed out, even if the UK decided to put in place unilateral facilitations to minimise disruption in the event of ‘no deal’, “we cannot influence it where we export to the EU27. They have been quite clear on this and have said they will instigate checks.”144

101. Mr Thompson described how additional checks being conducted in, for example, France, could adversely affect the capacity of UK roll-on/roll-off ports to process the flow of traffic and, therefore, the amount of goods entering and exiting the UK:

138 Q 87
139 Q 114
140 Q 71
141 Ibid.
142 Q 77 (Joe Owen)
143 Q 37 (Stephen Adams)
144 Q 71
“It would be reasonable to speculate that traffic would slow, because it is a closed-loop system in which vehicles exiting France may be subject to the EU’s checks … what happens then is that you end up with a French operations stack, the speed of the ferries slows down and there is an operations stack on the United Kingdom side.”

102. This point was echoed by the Port of Dover, which stated that, as a result of this closed-loop system, “the Port could be equally affected by checks and delays in Calais or Dunkirk”.

Contingency planning

103. James Hookham, Deputy CEO, Freight Transport Association, estimated that the EU27 were currently “about nine months behind us” in thinking about how Brexit would affect the UK-EU border. Mr Owen explained that a bilateral arrangement between the UK and France to keep the flow of goods through Dover and Calais moving was not an option, as “customs is exclusive EU competence”. He suggested that the European Commission “has been quite keen to prevent substantive dialogue … because customs is a future-relationship issue”. There was, however, potential for officials to work together to understand how each side was going to cope. The Port of Dover told us that “at an industry level, the ports of Dover, Calais and Dunkirk are working more closely together”, and this work would be accelerating over the summer.

Moving away from the border

104. Dr Lars Karlsson, President, KGH Border Services and Managing Director, KGH Global Consulting, and Mr Adams agreed that a shift was taking place “from transaction control to system-based controls”. According to Dr Karlsson, trusted trader programmes could facilitate a “move away from doing those formalities at the border, to doing them before and after in the natural process of the company itself, of course based on trust, which you have to prove”. Mr Adams agreed that this would “take the strain off the point of border crossing and transaction”.

105. Mr Owen observed that AEO programmes provided more than just information about separate consignments, but rather intelligence about the trader: “Often an organisation is a far better indicator of whether something is going to be dodgy or dangerous than the list of what is included in that consignment.” This allowed for “risk management” to be done before the actual trade transaction, which would mean “again moving away from the border issues”.

106. For businesses to reap the full benefits of trusted trader schemes in the case of ‘no deal’, as Mr Harra explained, such schemes would have to be mutually
recognised,\textsuperscript{155} for example via a bilateral agreement with the EU. Unilateral facilitations introduced by the UK “would help to some extent, but they would not be as good as mutual recognition of those facilitations, which is what you would seek to reach in an agreement”,\textsuperscript{156} New trusted trader programmes are considered in more detail in Chapter 5.

Joining the Common Transit Convention

107. Mr Thompson said that “besides the authorised economic operator scheme … we would still seek to become members of the common transit convention”.\textsuperscript{157} Mr Owen and the Freight Transport Association agreed.\textsuperscript{158}

108. The Common Transit Convention\textsuperscript{159} facilitates the flow of goods between the EU (where goods may need to cross several countries) and six common transit countries: Iceland, the former Yugoslav Republic of Macedonia, Norway, Serbia, Switzerland and Turkey (which are also signatories to the Convention). The Convention allows for the temporary suspension of customs duties for goods in transit—otherwise applicable at the point of entry into a customs territory—to the point of clearance at the destination.\textsuperscript{160}

109. UK membership of the Common Transit Convention could decrease some of the documentary burden for traders and maintain the UK’s access to EU declaration systems such as the New Computerised Transit System (NCTS).\textsuperscript{161} We note that joining the Common Transit Convention would also be of benefit to Irish trade with the rest of the EU after Brexit, as two thirds of Irish exporters choose to transport their goods via the UK land bridge, which takes on average 10.5 hours—compared to 20 hours to Cherbourg, France, or 38 hours to Zeebrugge, Belgium, when going around the UK. Using the land bridge is also the more cost-effective option.\textsuperscript{162} Holyhead, Milford Haven and Liverpool process the majority of Irish trade,\textsuperscript{163} with EU-destined goods being transported from there to ports like Dover, for onward delivery across the Channel.

\textsuperscript{155} Mutual recognition means that two customs administrations agree to recognise the AEO authorisation issued under the other administration’s programme and provide reciprocal benefits to AEOs of the other programme. The EU has concluded and implemented Mutual Recognition of AEO programmes with Norway, Switzerland, Japan, Andorra, the US and China, with further negotiations currently taking place: European Commission, ‘Authorised Economic Operator (AEO)’: https://ec.europa.eu/taxation_customs/general-information-customs/customs-security/authorised-economic-operator-aeo/authorised-economic-operator-aeo_en [accessed 24 August 2018]

\textsuperscript{156} Q 87 (Jim Harra)

\textsuperscript{157} Q 87 (Jon Thompson)

\textsuperscript{158} Q 77 and written evidence from the Freight Transport Association (BCA0001)

\textsuperscript{159} The Common Transit Convention was agreed in 1987. It has subsequently been amended on numerous occasions to accommodate changes in EU membership and legislation, most recently in December 2017 by EU/EFTA Joint Committee Decision 1/2016 which aligned it with the Union Customs Code. Convention between the European Economic Community, the Republic of Austria, the Republic of Finland, the Republic of Iceland, the Kingdom of Norway, the Kingdom of Sweden and the Swiss Confederation, on a common transit procedure (OL 226, 13 August 1987).


\textsuperscript{161} Joe Owen, Marcus Shepheard and Alex Stojanovic, Implementing Brexit: Customs, p 18, p 29: https://www.instituteforgovernment.org.uk/sites/default/files/publications/IfG_Brexit Custom_WEB_0.pdf [accessed 5 September 2018] The report also notes that not all EU customs systems can be accessed by non-Member States.

\textsuperscript{162} Written evidence from Port of Dover (BCA0007)

Mr Thompson thought that joining the Common Transit Convention “could make some difference, and there are ongoing negotiations … After that, I am slightly struggling with whether there is much more that you can do.” Mr Owen concluded: “there are some levers that you could pull in a no-deal scenario, but they would far from mitigate it.”

HMRC preparedness

In the case of a ‘no deal’ Brexit, HMRC has estimated that it will need to process a five-fold increase in customs declarations. Mr Thompson and Mr Harra were confident that they would be able to cope with the additional workload. A recruitment drive was underway and a total of 1,113 additional staff had been recruited by the end of May 2018, with job offers having been extended to almost a further 1,500. Mr Thompson told us: “I expect us ultimately to need between 4,000 and 5,000 additional staff to cope with the volume of increased administration from the increased numbers of customs declarations.”

Mr Harra told us that HMRC would carry out this recruitment plan regardless of the final shape of post-Brexit customs arrangements “If, as we expect, we end up in an agreement with the EU, we will put those staff to other work and get the benefits to the Exchequer from that, but we are not waiting for certainty to execute our no-deal plan. We are making progress on it as we speak.”

Longer term improvements to customs controls

While HMRC reassured us that a plan was in place to introduce customs controls between the UK and the EU from March 2019 if necessary, Mr Harra confirmed that “it would not be optimal from day one. We would need to make a number of improvements from March 2019 to try to reduce friction and costs in that system.”

Mr Stride referred to an “end-state model with no deal” that would include “a very highly streamlined and very facilitated and efficient border”, but recognised that this would not be ready for 29 March 2019. He added:

“One component would be an inventory-based system at the port that allows you to match pre-declarations made en route to Calais, via vehicle number plate recognition technology, to the inventory system, which would tell you what is on the particular truck. That would help to control the whole process and keep it moving.”

We note that this ‘end-state model’ does not take account of the specific sensitivities relating to surveillance at the Northern Ireland/Ireland border.
31BRExit: The Customs Challenge

(*Future digitisation of customs procedures*)

116. Witnesses also discussed the increasing digitisation of customs procedures, which is happening independently of Brexit and which could be of some benefit to the UK in the longer term.

117. Ms Morley, for example, expected the need for customs declarations, as they exist today, to be gone “in five or 10 years’ time … because it will be all about technology, data flow and risk management. It will almost be untouched by human hand, because it is data flow.”

118. HMRC officials explained that they were seeking to build a business case for emulating the Singaporean model of single-window technology. Mr Thompson said: “Singapore has very much thought about the trader and integrated all of government around the trader. That is the fantastic thing they have done there.” Mr Owen said this meant “a single point of contact” for traders, which would integrate all of the 26 Government organisations involved at the border. While in the UK, some Government agencies at the border require a “a so-called wet stamp … an actual stamp on a piece of paper”, in Singapore “everything is done electronically and you can remove the wet stamp”. Yet Mr Thompson also cautioned that the technology would be costly and take time to implement:

“We have set out the bones of it and Ministers are very interested, but, to be transparent with you, it is a significant technology programme—hundreds of millions of pounds—and will take five years to implement, to be up front about it.”

We note that while this will facilitate the interaction between traders and Government agencies, it will not remove the need for checks of goods, where necessary.

Conclusions and recommendations

119. There are only limited options available to the Government to mitigate the disruption that would be caused by a ‘no deal’ Brexit. The Government would face a ‘trilemma’ between keeping trade moving, ensuring security of the border, and the collection of revenue.

120. The Government’s position that, in the case of ‘no deal’, customs checks of goods arriving from the EU could be unilaterally suspended, may be in breach of WTO rules. We call on the Government to set out its plans to ensure fair and equal treatment of all imported goods coming in on most-favoured nation terms.

121. Even if the UK decided unilaterally not to introduce customs controls in the case of ‘no deal’, the EU has indicated that it would introduce such controls. As the ports of Dover and Calais operate as a ‘closed-loop system’, this would lead to delays on both sides of the Channel. To mitigate this, the ports of Dover and Calais will need to collaborate on contingency arrangements and we urge the Government to

172 Q 70
173 Q 90
174 Q 74
175 Q 90 (Jon Thompson)
176 Q 89 (Jon Thompson)
177 Q 90
support such efforts. The Government should also articulate a plan for continued co-operation with EU customs authorities in the event of a ‘no deal’ Brexit.

122. Globally, there is a trend towards moving some of the physical controls and risk assessments of goods away from the border. This can assist with the goods clearance process. The Government should consider utilising and building on such systems at the UK-EU border in the case of ‘no deal’.

123. We welcome the Government’s intention to join the EU’s Common Transit Convention after Brexit.

124. We also welcome HMRC’s recruitment of additional staff to prepare for a ‘no deal’ Brexit, and the assurance that these staff will be put to good use even in the (preferred) event of agreement being reached.

125. Customs procedures are likely to rely increasingly on electronic data in the future, rather than on paper declarations. We welcome the Government’s consideration of single-window technology, which would provide traders with a single point of interaction with various UK Government agencies. At the same time, we note that this technology is untested in the UK, will not obviate the need for checks and will not be available in the short term.
CHAPTER 5: THE UK GOVERNMENT’S PROPOSED CUSTOMS ARRANGEMENT

The Facilitated Customs Arrangement

126. In its White Paper The future relationship between the United Kingdom and the European Union, published on 12 July 2018, and as part of its proposed economic partnership with the EU, the Government proposed a ‘Facilitated Customs Arrangement’ (FCA), to be established between the UK and the EU from the end of the transition period in December 2020.\(^\text{178}\) The Government told us that the FCA was “the best of all worlds”,\(^\text{179}\) combining elements of the ‘maximum facilitation’ option and the ‘customs partnership’ option, both proposed by the Government in its August 2017 White Paper Future customs arrangements—a future partnership paper.\(^\text{180}\) The FCA aims to “remove the need for customs checks and controls between the UK and the EU as if they were a combined customs territory”, and “would enable the UK to control its own tariffs for trade with the rest of the world”.\(^\text{181}\) The EU’s initial response to this proposal is considered later in this chapter. The main features of the FCA are set out in Box 3.

**Box 3: The Facilitated Customs Arrangement**

The UK Government’s suggestion is for the proposed Facilitated Customs Arrangement to be negotiated in combination with a UK-EU free trade area. Together they would cover the following elements:

- The UK would continue applying the EU External Tariff and the EU’s trade policy for goods that are intended for the EU market;
- The UK would set its own tariff levels and trade policy for goods intended for the UK market;
- The application of the EU’s trade policy and the EU’s External Tariff would eliminate the need for a customs border and any customs procedures between the UK and the EU, thus preserving frictionless trade;
- In addition, an agreement would be negotiated with the EU, in which both parties commit to not imposing “tariffs, quotas, or routine requirements for rules of origin on any UK-EU trade in goods”;
- Goods would include manufactured goods, as well as agricultural, food, and fisheries products;


179 Q 103 (Mel Stride MP) As mentioned in Chapter 1, some of the evidence taken by the Committee was on the Government’s previous options, the customs partnership and the maximum facilitation proposal. Due to the similarity of the FCA and the customs partnership, evidence on the customs-partnership will also be used in this chapter, as and when suitable.


• Businesses participating in a trusted trader scheme would be able to pay the correct tariff level at the border; other businesses would pay the EU tariff and then be able to claim back the difference in case of a lower UK tariff;

• There would be a ‘common rulebook’ as part of the free trade area, which would mean common rules and standards would apply to both UK and EU goods. According to the Government, “This would remove the need to undertake additional regulatory checks at the border—avoiding the need for any physical infrastructure, such as Border Inspection Posts, at the border between Northern Ireland and Ireland.” It would also protect supply chains.


127. Mr Stride explained that the FCA could be divided “conceptually in two parts: An inner part and an outer part”. The inner part referred to trade with the EU27, where “we will have frictionless trade without customs arrangements in place”, based on the common rulebook which “covers the regulatory alignment issues, on goods and agricultural products and on having a free trade area”. This would mean “no tariffs between us and the EU27”. Robin Walker MP clarified that this arrangement would only extend to “the areas that are required to avoid friction at the border”, and would not involve “maintaining dynamic alignment with the whole of the acquis”.

128. The outer part of the FCA, Mr Stride told us, referred to the UK’s international trade with non-EU countries, for which the UK would “in effect … act as the customs agent for the EU27 at our border, and we would apply the EU’s tariff at that point”. Wherever the Government was “confident” of the good’s destination, it would charge either the EU or the UK tariff level at the border. Mr Stride explained:

“If you cannot be certain about the ultimate destination of goods coming in … goods coming into the UK where the UK tariff was lower than the EU tariff would pay the higher EU tariff, but they would be able to reclaim the difference once they had proved to us that those goods did indeed have their final destination as the United Kingdom”.

Arrangements for services and financial services are also proposed to form part of the future UK-EU economic partnership, but are separate from the proposed customs arrangement and therefore not considered in this report.


183 Arrangements for services and financial services are also proposed to form part of the future UK-EU economic partnership, but are separate from the proposed customs arrangement and therefore not considered in this report.

184 Q 101
185 Q 101 (Mel Stride MP)
186 Q 101 The Acquis Communautaire refers to the accumulated body of EU law, comprising of all EU treaties, laws, declarations and resolutions, international agreements, measures relating to the common foreign and security policy, justice and home affairs, and judgements of the European Court of Justice. It is binding on all EU Member States.
187 Q 101 (Mel Stride MP)
188 Ibid.
189 Ibid.
129. Ms Morley observed that the FCA was “principally the same as the proposed Customs Partnership Arrangement”. Mr Adams characterised the customs partnership as “an attempt to square the circle of an autonomous UK tariff policy and a frictionless, non-existent internal border with the EU”. This, he said, “would resemble being in the single market for goods”. Mr Lowe thought that a customs partnership was “essentially a customs union with the option to diverge, as a clever means of still being able to have a fully independent trade policy”. Dr Karlsson, however, cautioned that “it is very difficult for a customs administrator to operate different operational models towards different trading partners. It is also extremely difficult over time.” This mechanism and the tracking of goods will be considered in further detail later in this chapter.

130. Mr Stride stressed the differences between the FCA and the Government’s earlier proposal, saying that the new FCA focused more on trusted trader schemes rather than relying on the rebate system.

Authorised Economic Operators and other trusted trader schemes

131. Authorised Economic Operators (AEOs) and other trusted trader schemes play a potentially significant role in facilitating the operation of a parallel UK and EU tariff policy, as proposed under the FCA.

132. As described in Chapter 3, uptake in the UK of the current AEO scheme is low, because of the small margin of improvement over baseline conditions, and because obtaining accreditation under the existing AEO scheme can be an onerous process for businesses, which sometimes outweighs the benefits of the facilitations obtained. In its latest White Paper, however, the Government proposes that the UK and EU “agree a new trusted trader scheme to allow firms to pay the correct tariff at the UK border without needing to engage with the repayment mechanism. This is most likely to be relevant to finished goods.”

Possible shape of a new trusted trader scheme

133. Our witnesses provided suggestions for what a new trusted trader scheme could look like.

134. First, Ms Morley said that trusted trader schemes could expand to certify traders in the whole supply chain. Mr Adams agreed that any new scheme should cover the supply chain and said that, in order to manage the scope for fraud and/or error, “there would either need to be an agreed system of distributing liability, or potentially an obligation that any businesses in a distribution chain beyond the importer of record must also have credentialed status for self-certification”. Ms Morley said that “part of the benefits given to those traders could be no checks—you are a trusted trader; it is all done

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190 Written evidence from Susan Morley (BCA0009)
191 Q 39
192 Q 70
193 Q 41
194 Q 103
196 Q 74
197 Written evidence from Stephen Adams (BCA0010)
on audit”. Such a scheme would be based on self-policing, alongside regular audit: “You are audited quite rigorously from time to time to make sure that you are still doing what you are supposed to do.” 198

135. Second, Mr Owen and Dr Karlsson suggested lowering the threshold for entry into the AEO programme to facilitate the participation of SMEs. The AEO system currently operated by the UK and the EU was a ten-year old “legacy system”. 199 There were newer types of trusted trader programmes, which, Dr Karlsson estimated, operated at approximately “25% of today’s costs” and could be established within two to three years. 200 Newer programmes were in use in Brazil and Australia and included different tiers for “different types of companies”. 201 Dr Karlsson suggested that a new UK programme “could be designed to be very similar to VAT registration at the lowest levels to make SMEs a part of it”. 202 Mr Owen explained that in the Australian system, “at the lowest tier you just have to complete a self-assessment and you can get a basic level with basic benefits. Then, the more you commit to auditing and sharing information … the more benefits you can unlock. It is a tiered system.” 203 Such extended compliance activities, however, were “more intrusive and costly” for businesses. 204

136. Third, according to Ms Morley, a new trusted trader scheme could be expanded to include agricultural produce, which accounts for the majority of checks at the border. 205 This would mean “not being checked and not needing a border inspection post because you are a trusted trader”. In this case “you are offering everyone the same benefit, so long as they reach a certain standard”. 206

137. Fourth, there is the possibility of streamlining. The Freight Transport Association highlighted “the confusions, duplications, and complexity” 207 of current processes, and Mr Warwick noted that the UK required six pieces of evidence to be submitted for an AEO application, including one form of 17 pages. He suggested that “streamlining the process for applying in this country would be an easy fix”. 208 As set out in Chapter 3, the audit trail required for registering might be difficult to obtain for businesses that had only traded with the EU before. 209 Mr Adams therefore thought there would be a need to allow for “some proxy for that import/export pattern” to be used, “in order to audit them for this status”. 210

138. Mutual recognition of the UK’s new AEO scheme with the EU would be as important under the FCA as under a ‘no deal’ scenario (see Chapter 4). Mr Lowe thought that mutual recognition was “far from a given”. 211 Mr Owen agreed that this was “the big caveat” to the AEO scheme: “To have any value
for UK-EU trade it has to be mutually recognised by the EU.”212 The Freight Transport Association and the Turkish Industry & Business Association (TÜSIAD) shared the view of the importance of mutual recognition for AEO programmes.213 No such agreement had yet been signed between the EU and Turkey.214 Mr Stride told us that “we have to end up with mutual recognition between ourselves and the EU27 on AEOs”, and said that this would form part of the negotiations.215

139. Summarising the significance of trusted trader schemes for the UK after Brexit, Ms Morley said the AEO scheme was “a facilitator for Brexit”, which could be used by “a great many more companies”.216 Nevertheless, she highlighted that the process of becoming a trusted trader “requires effort” and may be seen by some as “either too hard or too costly”.217 Mr Owen was also cautious: “Yes, there is potential in the trusted trader schemes and there are possible benefits that you can unlock, but there are big caveats. It is far from a silver bullet to the Brexit problem. It has long-term benefits, but you could not pin your hopes on it for 2020 or shortly afterwards.”218

Tracking of goods

140. The Government’s White Paper proposes a distinction between goods that are intended for the UK market and those that are intended for the EU market. Depending on their final destination, a different tariff would need to be paid. The White Paper explains the concept as follows:

“(1) Where a good reaches the UK border, and the destination can be robustly demonstrated by a trusted trader, it will pay the UK tariff if it is destined for the UK and the EU tariff if it is destined for the EU. This is most likely to be relevant to finished goods; and

(2) Where a good reaches the UK border and the destination cannot be robustly demonstrated at the point of import, it will pay the higher of the UK or EU tariff. Where the good’s destination is later identified to be a lower tariff jurisdiction, it would be eligible for a repayment from the UK Government equal to the difference between the two tariffs. This is most likely to be relevant to intermediate goods. Under the UK’s proposals, it is estimated up to 96 per cent of UK goods trade would be most likely to be able to pay the correct or no tariff upfront, with the remainder most likely to use the repayment mechanism.”219

We note that the figure of 96% refers to total UK trade in goods, rather than to imports only. The proportion of goods imports where the correct tariff could be paid at the border would therefore be lower. Mr Oliver Wright, writing in The Times, has estimated that in respect of goods imports only,
“the percentage of goods requiring additional checks and monitoring would be about four times the estimate”.220

141. The Government foresees that businesses included in new trusted trader schemes would be able to pay the correct tariff at the UK border and not need to use the repayment mechanism.221 Mr Harra expected that most businesses would be covered by such a trusted trader scheme, and therefore only a small proportion would “have to engage with the repayment mechanism to adjust the tariff to the correct level”.222 Ms Morley, however, thought that the difficulties of becoming a trusted trader were such that “the majority of UK Traders” would be left outside both the trusted trader and the Special Procedures scheme,223 and thus “unable to access the reduced duty rates except on a reclaim basis”.224

142. Mr Adams said that “the principle of varying tariff levels for otherwise identical goods is not in itself unusual”, and was commonly operated under free trade agreements between WTO members. The Facilitated Customs Arrangement, however, “proposes to vary tariffs not on the basis of the origin of the import, but its destination within an integrated trading space. This is immediately more complex because it can imply different destinations for a single consolidated consignment at the point of import.”225 Dr Karlsson agreed that “keeping track” of products that were exported, manufactured and assembled multiple times was “a complex activity”.226 Mr Adams added that “the goods would not be ‘tracked’ in real time, but via a documentary evidence chain that established either ex ante or post facto their point of consumption/sufficient transformation”.227 Mr Lowe thought that “at the moment, it is difficult to see what that effective tracking mechanism would look like”.228

143. Ms Morley agreed that “the difficulty will be tracking the goods”.229 While AEOs or other trusted traders “could use existing methods to track the goods”, for other businesses “it is hard to see how a sufficiently robust tracking mechanism could be created or policed”.230 Dr Holmes cautioned that this would be particularly difficult for intermediate goods: “There would be extremely challenging burdens on firms who might themselves not be importing or exporting but are in the middle of value chains. It would be hard for firms to know where their products would end up when they are buying and selling intermediate goods.”231


222 Q 93


224 Written evidence from Susan Morley (BCA0009)

225 Written evidence from Stephen Adams (BCA0010), emphasis in original.

226 Q 39

227 Written evidence from Stephen Adams (BCA0010)

228 Q 67

229 Q 66

230 Written evidence from Susan Morley (BCA0009)

231 Written evidence from Dr Peter Holmes (BCA0002)
Witnesses raised a number of specific questions over the tracking of goods.

**Question 1: Who carries liability for ensuring compliance?**

145. Our witnesses thought that the Government’s proposal did not make clear how goods intended for the UK or for the EU would be separated, and who would be responsible for making such a separation. Mr Hookham said that members of his association felt the proposal “puts a lot of expectation and requirement on businesses to make that separation”, and that it required businesses to “take that responsibility for keeping UK-only goods separated”. The Freight Transport Association thought the importer of goods was “placed in the position of Customs agent”, which represented “an onerous new liability for businesses, especially smaller importers”. Ms Morley therefore asked: “Where in the supply chain would the liability end?” Mr Stride said an option would be “making the end importer in the United Kingdom liable and responsible for ensuring that those goods have paid the appropriate duty”. The Freight Transport Association warned that “the consequences of failing to make the correct assessment, and the time constraints under which they must be made is not clear from the description available”.

**Question 2: Does this create a fraud risk?**

146. Mr Adams told us that under the proposed FCA, “the burden would essentially be on the UK to prove that a good had been placed on the UK … retail single market”. Unless there was proof of “the point of consumption … the prospect of the good being moved into the single market remains a fraud risk for the EU”. Mr Broadley and Mr Lowe agreed. Ms Morley told us that if UK duties did not differ “significantly” from those of the EU, there would be less of an incentive for fraud. In cases of greater divergence between tariff levels, “you are creating a situation that could lead to fraud. It just depends on how many current tariffs you decide to alter.”

147. Furthermore, despite trader systems being able to track the use of goods and this being audited by Customs authorities, Ms Morley said that “once in free circulation and in use, they can go anywhere”. She thought that in the absence of an adequate tracking mechanism, “fraud would be easy”.

**Question 3: Could goods be funnelled to the EU via the UK?**

148. The difficulty in effectively tracking goods also arose with regard to tariff rate quotas (TRQs). Mr Lowe said that even once the UK had become a separate customs entity and WTO member, it would have to work with the EU to manage TRQs in respect of third countries:

> “Otherwise, you could have a situation where the EU has hit its limit on a tariff rate quota for, say, lamb coming in at a preferential rate, but the

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232 Q 9
233 In this context, customs agent refers to the role usually assumed by a freight forwarder, who handles customs clearance and procedures on behalf of a trader.
234 Written evidence from the Freight Transport Association (BCA0011)
235 Written evidence from Susan Morley (BCA0009)
236 Q 110 (Mel Stride MP)
237 Written evidence from the Freight Transport Association (BCA0011)
238 Q 38
239 Q 5 (Clive Broadley) and Q 66 (Sam Lowe)
240 Q 68
241 Q 66
242 Written evidence from Susan Morley (BCA0009)
UK has not. If you were the exporter from, say, New Zealand, it could just be funnelled through the UK, and once it was in free circulation it could go into the EU.”

Similarly, Mr Meaney gave as an example “the famous chlorine-washed chicken coming in from the US” under a trade agreement with the UK, where there was “a risk that this type of food product ends up somehow in the EU supply chain because of the way in which this model is working”.

149. This would similarly apply to anti-dumping measures or trade defence instruments. Mr Lowe gave an example of the UK hypothetically levying “different rates on, say, imported Chinese steel, or no tariffs at all”. Without checks at the border, steel imported into the UK “could then funnel into the EU”. Mr Stride shared this concern, and said that in these cases “co-operation and having access to each other’s systems and processes will be really important”. This might be “a challenge”, resulting in “a discrete set of goods where, as a consequence, the relative ease of tracking and intercepting is important”.

Question 4: Could the model give the UK a competitive advantage over the EU?

150. Robin Walker MP explained that, in comparison to the previous customs partnership model, the FCA only required a good to be tracked to the point of substantive transformation, not to consumption: “If that process took place in the UK, a UK tariff would be eligible.” Mr Stride added that “the point at which we would trigger the ability to reclaim a tariff difference, if there was one, would be at the earliest stage of the supply chain”. He thought that “it would not be absolutely straightforward, but it is manageable”. Mr Walker said that this “would need to be agreed between the UK and the EU”, and that the UK Government proposed “a detailed negotiation on how that arrangement will work and how it will recognise, on an agreed basis, substantial transformation, so that we can then have differential tariff collection”.

151. Mr Adams told us that the FCA would “require an audit system for proving the location in which a good is consumed or sufficiently transformed”, alongside a self-certification system. The determination of consumption or sufficient transformation could be done by “using a methodology similar to that used for determining origin”.

152. Mr Lowe argued, however, that in the absence of an effective tracking process, the UK car industry, for instance, could gain a competitive advantage over that of the EU, by passing on a lower cost for the import of an intermediate good to the manufacturer, “who then benefits from that and is selling across Europe”. Mr Adams said that “the EU may be concerned that the dual tariff system operated as a de facto subsidy to UK importers by allowing

243 Q 66 (Sam Lowe)
244 Q 40
245 Q 66
246 Q 66 (Sam Lowe)
247 Q 110 (Mel Stride MP)
248 Q 108
249 Ibid. (Mel Stride MP)
250 Ibid. (Robin Walker MP)
251 Written evidence from Stephen Adams (BCA0010)
252 Q 67
them to import for the domestic UK market at a lower price that allows them to cross subsidise onward exports of the same good to the EU”.253

**Revenue sharing**

153. The FCA proposal foresees the UK collecting tariffs on behalf of the EU, which would then, on the basis of a negotiated agreement, be in part or fully transferred to the EU. Dr Holmes pointed out that revenue sharing was rare and difficult in customs unions, noting there was none between the EU and Turkey.254 Mr Owen told us: “The EU will be concerned to understand how a third party that is potentially outside its institutions will be able to collect its revenue.”255 The EU’s initial response to the UK’s proposed Facilitated Customs Arrangement is considered at the end of this chapter.

**Costs**

154. Mr Harra told us that the FCA added “a small amount of admin burden to UK-rest of the world importers, because instead of just paying the tariff they will have to decide which of two tariffs is the correct tariff to pay”.256 He estimated this additional amount to be around £700 million a year for UK trade “based on a static view of trade in 2017”,257 which would be “significantly less than if there were customs controls between the UK and the EU”,258 the cost of which HMRC placed at between £17 billion and £20 billion per year.259

155. A number of witnesses pointed to the voluntary nature of the rebate system. Mr Harra contended that businesses would face “no net cost”, but rather “a net advantage”, as they would only engage with the repayment system “if the tariff differential makes it worth their while”.260 Mr Lowe agreed that the system could be “cost neutral for business”, assuming the maximum tariff level would not be higher than now.261 Mr Stephens concurred with this assessment and added that those businesses wanting to benefit from potentially lower tariffs “will need to maintain staff sufficient to manage the documentation and/or maintain the necessary audit trail for AEO/Trusted Trader status”.262 Ms Morley, however, thought that asking businesses “to pay more and then claim it back” had “a cash-flow implication and an administrative cost”. She said that current rebate systems for reclaiming accidentally overpaid duties were “slow and … cumbersome”.263

156. For SMEs, gaining an understanding of the requirements under the FCA would be particularly difficult. Ms Morley said: “They have no one who actually understands customs now. They rely entirely on agents and freight agents, rightly or wrongly, and may or may not get it right by doing so, but

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253 Written evidence from Stephen Adams (BCA0010)
254 Written evidence from Dr Peter Holmes (BCA0002)
255 Q 66
256 Q 85
257 QQ 85, 93
258 Q 85 (Jim Harra)
259 Q 85 (Jon Thompson) In evidence to the House of Commons’ Public Accounts Committee, Mr Thompson clarified that the cost to UK businesses under ‘no deal’ would be £18 billion. Oral evidence taken before the Public Accounts Committee, 5 September 2018 (Session 2017–19), Q 157 (Jon Thompson)
260 Q 93
261 Q 66
262 Written evidence from Stephen Adams (BCA0010)
263 Q 68
they are relying on others. They do not even really know that they are doing customs work.”\footnote{Q 69} In contrast, big car manufacturers, for instance, “probably have a department of customs specialists who can be on top of it”.\footnote{Ibid. (Susan Morley)} The Freight Transport Association told us that, if SMEs had to take on the role of customs agents under the FCA, they might be “required to secure bank covenants or bonds to the value of twice their estimated monthly declarations. This would be a major extension of financial resources for most SMEs and the availability of such insurances or covenants and the ability of SMEs to afford them needs to be better understood.”\footnote{Written evidence from the Freight Transport Association (BCA0011)}

157. Another point raised by Ms Morley was that it was unclear what ‘phased introduction’ of the FCA meant. It was therefore “difficult to say how difficult and expensive this would be for Trade and Government”.\footnote{Written evidence from Susan Morley (BCA0009)} The Government’s White Paper, Ms Morley said, “again ignores the cost to businesses of running two systems for their global trade instead of one”.\footnote{Ibid.}

Negotiations of free trade agreements (FTAs) with third countries

158. Witnesses highlighted two areas related to the UK’s ability to negotiate FTAs with third countries—tariffs and regulatory issues.

159. First, on tariffs, Mr Adams told us that the UK was only able to offer contingent benefits under the FCA, which would be “very hard to see … not turning into a big drop-off in the utilisation of UK preferential tariffs and probably a hindrance for the UK in negotiating free trade agreements on goods with third countries”. He explained that UK trading partners might take the view: “Well, that’s a contingent benefit that you’re offering me, and I’m offering you a real tariff cut at the border. You’re trying to sell me a rebate system.”\footnote{Q 38} A tariff cut at the border and a “tariff cut in the form of a rebate system … those two things are not the same”\footnote{Q 40 (Stephen Adams)}

160. Mr Lowe, in contrast, argued that “all preferential access afforded by trade agreements is a contingent benefit. You still have to qualify for it, so there is already an admin cost that comes with utilising a preference.” Nevertheless, he agreed that “the uptake of this zero-tariff rate would potentially be lower”, which made it “slightly less attractive if you are attempting to negotiate an agreement with a third country”.\footnote{Q 78} Ms Renison told us that “a lot of companies do not even use existing trading agreements and tariff preferences”. She estimated that of the Institute for Directors’ membership only 15% had made use of existing trade agreements.\footnote{Q 59}

161. Ms Renison thought that among tariffs, those on industrial goods were not the main element in free trade agreement negotiations. They were “not really used as pieces of leverage in negotiations perhaps in the way agricultural goods are”, since tariffs had “been brought down to about 2% to 3% on average” over the past ten years. Cars and textiles were exceptions to this
general trend. She explained that agricultural goods, in particular when the country was “not a big producer, or it is not a competitive item for a country” were “used as a piece of bartering leverage”. A country looking to negotiate a trade agreement was “quite happy to bring down the tariff on olive oil if they do not produce any of their own. There would still be a substantial amount of leverage in a lot of the tariffs that remain.”

162. Robin Walker MP told us:

“You need to look at the volume of trade that we have with a number of significant third countries that are able to trade with us on the basis of current standards but that potentially face tariff barriers in trading with the UK as a result of our application of the Common External Tariff. There is no reason why we could not remove those tariff barriers and significantly increase the volume of trade by doing that.”

163. Mr Walker also thought that “the combination of divergence on tariffs in potential individual agreements and a more open approach to services can give us a lot to negotiate with”. Mr Adams agreed, saying that “the quality of the UK’s tariff reduction and services binding offer” were “likely to be the focus for most trading partners”.

164. Mr Lowe concurred that the UK would “still be able to negotiate on services, intellectual property, procurement and movement of people in terms of professional visas and the like”. There were caveats, however: FTAs did “very little” on services, and “there are no real examples of, say, a services-only bilateral free trade agreement”, apart from the plurilateral trade in services agreement currently being negotiated at the WTO, “which the UK might be able to engage with”.

165. Second, on regulations, Robin Walker MP described “the idea that a common rulebook and common standards on the agricultural and industrial products related to avoiding a frictionless border would prevent us doing trade deals with third countries” as a myth. Mr Adams agreed and said that although “regulatory alignment is now a part of most advanced FTAs, the level of detail in such commitments varies”. He told us that “there are likely to be many areas where commitments of this kind are compatible with alignment with the EU rulebook on product standards, state aid and competition”. In some cases the UK could even “leverage mutual recognitions secured by the EU for itself”. Nevertheless, Mr Adams pointed out that regulatory

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273 Q 57 As set out in Chapter 3, the EU MFN average final bound tariff on non-electrical machinery, for instance, is 1.7%; it is 2.4% on electrical machinery; and 3.1% on petroleum. Higher tariffs are levied on textiles (6.6%), clothing (11.5%) and on cars (10%). WTO, World Tariff Profiles, 2018, p 79: [https://www.wto.org/english/res_e/booksp_e/tariff_profiles18_e.pdf](https://www.wto.org/english/res_e/booksp_e/tariff_profiles18_e.pdf) [accessed 21 August 2018] and European Commission, ‘EU Tariffs’: [http://madb.europa.eu/madb/euTariffs.htm?productCode=87032210&country=CN](http://madb.europa.eu/madb/euTariffs.htm?productCode=87032210&country=CN) [accessed 24 August 2018]

274 Q 57 (Allie Rension)

275 Q 112

276 Q 112 (Robin Walker MP)

277 Written evidence from Stephen Adams (BCA0010)

278 Q 78

279 Q 79 (Sam Lowe)

280 Q 78 (Sam Lowe)

281 Q 112

282 Written evidence from Stephen Adams (BCA0010)

283 Ibid.

284 Ibid.
convergence was an essential element for the FCA to work: “It is very difficult to see how you can have a frictionless border while not being an EU member state without accepting that you are a regulatory satellite of the European Union.”

166. Sanitary and Phytosanitary (SPS) measures were likely to pose more of a challenge in FTA negotiations. Mr Lowe used the example of US beef and chlorinated chicken, which “has become a joke, but it is actually an aggressive ask of the US.” The US is currently unable to export beef and chicken to the EU under the EU’s SPS regime. Mr Lowe thought that, in possible future trade negotiations, “that is one of the trade-offs that the Government have to work through”. Mr Adams agreed that the UK “could also expect to be challenged [by the US] to revise specific practices”, for instance on agri-food standards, and “find itself constrained in doing so”.

167. The Minister, Robin Walker MP, said:

“I do not think there is the political appetite in this country to do trade deals that would lower standards of food or product safety. We have to be honest about that in our trade negotiations. We are going to be negotiating on volumes of trade, on removing tariffs and being a champion of free trade in the world, but we are not going to win trade by lowering standards, because that would not be in the interests of the public we represent.”

**Timescale for implementation of the FCA**

168. Mr Stride told us that he “could not pin a precise date on the full implementation of the FCA, but that the Government intended to have the repayment system “up and running by the end of 2020”. Mr Walker said that “the repayment mechanism is the element of the scheme that might take longest to implement, but it will not be needed until at least the time when we leave the implementation period”. This was because the final agreement was “contingent on a number of different factors, not least the negotiation, what it looks like and what the requirements are”.

169. Mr Thompson also thought that “the operation of a dual tariff should be there by the end of December 2020”, but that the establishment of the repayment mechanism “would take a bit longer”. Mr Adams thought it was not unrealistic “that such a system of audit can be developed and implemented over perhaps 12–24 months with sufficient resources”.

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285 Q 39
286 Sanitary and phytosanitary measures can be put into place to protect human, animal or plant life or health, according to Article 20 of the General Agreement on Tariffs and Trade of the WTO. World Trade Organization, ‘Standards and safety’: https://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm4_e.htm [accessed 24 August 2018]
287 Q 73
288 Q 73 (Sam Lowe)
289 Written evidence from Stephen Adams (BCA0010), emphasis in original.
290 Q 112
291 Q 105
292 Q 103
293 Q 104
294 Q 105 (Mel Stride MP)
295 Q 96 (Jon Thompson)
296 Written evidence from Stephen Adams (BCA0010)
170. The Freight Transport Association thought that “it would be unrealistic to expect” the FCA to be “negotiated and agreed; specified and procured; delivered and tested with sufficient time for User Acceptance Testing by business” by 29 March 2019; and moreover they doubted “whether the proposed 21 month transition implementation period … will be sufficient without herculean effort and unprecedented goodwill on both sides to make it work”.297

171. Mr Thompson pointed to the need for industry to adapt to any new system and said that it “has been clear with us that it takes between 18 and 24 months for it to adapt”;298 Mr Adams found it “hard to judge the time it would take for businesses to understand and adapt to the new protocols”.299

**Lack of clarity**

172. Our witnesses pointed to the lack of clarity about future arrangements with the EU as one of the main issues preventing UK businesses from preparing for trade with the EU after Brexit. One fundamental element of this was that “terms such as hard border and physical infrastructure” only had “ambiguous definitions”.300

173. Mr Meaney told us that it was “vital … to have a degree of certainty about what the model is going to be … and to have some clarity about which regulations people are going to have to meet”.301 Businesses were telling him:

“We do not have sufficient certainty in order to jump one way or the other. Why would we hire people today to fulfil one set of customs standards if it’s going to be the other one? Why should I invest in a particular facility here in order to cope with volumes of lorries going through the Dover Straits when that might not be necessary?”302

174. Mr Meaney thought that “most people will adapt to whatever model is ultimately put in front of them”. Uncertainty, however, could have a detrimental effect on investment decisions. He therefore concluded: “The quicker we make these decisions, the less likely it is that those things will happen.”303

175. Ms Renison agreed with this assessment:

“The majority of our members will make adjustments when they know how the arrangements have changed … a lot of companies will be waiting to know not only what the technical detailed agreements are, what tariffs are and are not changing, and what the rules of origin look like—forget the outline—but what extra data they have to submit to HMRC.”304

Some work could “probably begin in parallel with the trade agreement”, but “some of it cannot really be prepared for until you have reached an agreement”.305

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297 Written evidence from the Freight Transport Association ([BCA0011](#))
298 Q 96 (Jon Thompson)
299 Written evidence from Stephen Adams ([BCA0010](#))
300 Q 37 (Stephen Adams)
301 Q 42
302 Ibid.
303 Ibid.
304 Q 62
305 Ibid.
176. The lack of clarity was of particular concern to small businesses. Mr Chris Walker said: “Small businesses with up to 50 people cannot dedicate the resources to spend a lot of time looking at and planning for different scenarios over which they have no influence.” Of 150 companies the FSB had contacted, “Not one single company has a [contingency] plan because the uncertainty is too great for them to do anything other than scenario-plan or add risk registers together.” Mr Hookham pointed out that the process of “trying to understand exactly what is needed and what systems need to be deployed” had only started recently on the EU side.

The view from Brussels

177. The future UK-EU customs arrangements form part of the broader UK-EU economic partnership. According to the European Council Guidelines on the framework for the future EU-UK relationship, adopted on 23 March 2018, the European Council is ready “to initiate work towards a balanced, ambitious and wide-ranging free trade agreement (FTA)”.

178. According to the European Council, this future trade agreement should address, among other things:

- Trade in goods, with the aim of covering all sectors and seeking to maintain zero tariffs and no quantitative restrictions with appropriate accompanying rules of origin …
- Appropriate customs cooperation, preserving the regulatory and jurisdictional autonomy of the parties and the integrity of the EU Customs Union;
- Disciplines on technical barriers to trade (TBT) and sanitary and phytosanitary (SPS) measures; [and]
- A framework for voluntary regulatory cooperation.”

179. The Guidelines further refer to the importance of ensuring “a level playing field”, which aims to “prevent unfair competitive advantage that the UK could enjoy through undercutting of levels of protection with respect to, inter alia, competition and state aid, tax, social, environment and regulatory measures and practices”. The prevention of such a competitive advantage “will require a combination of substantive rules aligned with EU and international standards, adequate mechanisms to ensure effective implementation domestically, enforcement and dispute settlement mechanisms in the agreement as well as Union autonomous remedies, that are all commensurate with the depth and breadth of the EU-UK economic connectedness.”

180. In evidence to the EU Select Committee on 17 July 2018, Mr Michel Barnier, Chief Negotiator of the European Commission on the UK’s exit from the EU, said the “customs arrangement that we saw in the White Paper

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306 Q 17 (Neil Warwick)
307 Q 24
308 Ibid. (Neil Warwick)
309 Q 14
311 Ibid., p 4
312 Ibid., p 5
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is not new as far as we were concerned”, and was only “a little different” from the future partnership paper produced last August. He said that “at the time, with regard to the technical feasibility of such a solution, we said that it would be difficult”. The EU did “not want a solution that creates additional problems, red tape and additional burdens for European companies”. We note that additional burdens for EU businesses would be difficult to avoid, given the requirements to track goods and the implications for supply chains, as set out earlier in this chapter. Nevertheless, the EU was “certainly prepared to work on a customs partnership” with the UK, which “could be on top of an ambitious free trade agreement, but … would be in the framework of our current partnerships with other countries”.

181. On 26 July 2018, in an initial reaction to the UK’s proposal to establish a Facilitated Customs Arrangement, Mr Barnier said at a press conference: “The EU cannot—and will not—delegate the application of its customs policy and rules, VAT and excise duty collection to a non-member, who would not be subject to the EU’s governance structures.” Any customs union “would come with our Common Commercial Policy for goods”, a point he also made to the Select Committee. Any customs arrangement would “also have to be workable and must protect EU and national revenue, without imposing additional costs on businesses and customs authorities”.

Conclusions and recommendations

182. The objective of the Facilitated Customs Arrangement appears to be to combine the advantages of remaining in a customs union with developing a fully independent trade policy. This involves having different operational models for EU and non-EU trading partners and the levying of tariffs depending on whether goods from non-EU countries are destined for the UK or the EU—all of which is complex.

183. Ministers stressed to us that complexity could be mitigated by a greater role for trusted trader arrangements such as the Authorised Economic Operator (AEO) scheme, and this does indeed offer some opportunities for facilitation.

184. However, the AEO scheme can be difficult to access by small and medium sized enterprises that have so far only traded with the EU. As part of its new AEO scheme under the Facilitated Customs Arrangement, we call on the Government to consider offering different tiers of AEO status, including one that is easy to obtain for SMEs.

185. Signing up to an AEO scheme involves costs for businesses. If the Government wants to ensure that the uptake under the new scheme is higher than under the existing one, it needs to provide guidance to businesses and simplify the process for applying.

313 Oral evidence taken before the European Union Select Committee, 17 July 2018 (Session 2017–19), Q.2
315 Ibid., and oral evidence taken before the European Union Select Committee, 17 July 2018 (Session 2017–19), Q.2
186. Mutual recognition of AEO schemes is of utmost importance. We welcome the Government’s intention to negotiate such mutual recognition with the EU.

187. Albeit much lower than under a ‘no deal’ scenario, the Facilitated Customs Arrangement introduces potential additional costs to trade for UK businesses.

188. It is unclear how goods will be tracked under the proposed Facilitated Customs Arrangement, and this is likely to impose additional administrative burdens on businesses. The lack of clarity on the tracking mechanism makes it difficult to assess the extent of that burden. The proposal also raises significant questions around liability, fraud and competitive fairness. We call on the Government to address these questions at the earliest opportunity, and to set out its detailed plans for a tracking mechanism that manages the risk of fraud but also minimises the cost to business.

189. A clear definition of what constitutes ‘sufficient transformation’ of intermediate goods will be important in the tracking of goods. We invite the Government to elaborate on its intended definition and to share with us its analysis of the cost impact that proving sufficient transformation would have on businesses.

190. The repayment mechanism under the FCA is a unique and untested proposition. We are concerned that it will take an unspecified number of years to be developed and that it would only be operational after the implementation of the dual tariff. Only then will businesses be able to benefit fully from new UK trade agreements. We call on the Government to set out a timeline for full implementation, setting out the specific steps it intends to take.

191. The UK Government’s estimate that 96% of UK goods trade would be able to pay the correct or no tariff up front and not go through the repayment mechanism has been challenged. We call on the Government to clarify the methodology it used to arrive at the 96% figure.

192. Tariffs on industrial goods are on average very low. Because of the administrative burdens of engaging with the repayment mechanism under the FCA, preference uptake under UK FTAs could be low and thus reduce the attractiveness of negotiating FTAs with the UK. We call on the Government to explain how it will seek to mitigate this effect.

193. We welcome the Government’s stated intention to uphold current UK food standards and not lower them in free trade agreements with third countries.

194. We are concerned that, only six months before the UK’s exit from the EU, agreement has not yet been reached on the principles underpinning any future customs arrangements. The UK’s proposal under the FCA to collect revenue on behalf of the EU crosses a red line for the EU and has thus been rejected. We urge the Government to set out what options or alternatives it has identified to meet the EU’s concerns.
195. The uncertainty over whether there will be a negotiated agreement between the two sides hinders both UK and EU businesses in their preparations for Brexit. It also adversely affects the ability of UK and EU customs authorities to plan for possible changes. The Government should provide clarity at the earliest possible time.

196. We welcome the EU’s readiness to negotiate a free trade agreement and a customs arrangement with the UK. The two sides should continue to engage in a constructive manner to find a mutually acceptable agreement.
SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

What if the UK fails to secure a deal with the EU?

1. Trade with the EU on WTO terms would result in additional tariff costs being placed upon businesses. This could lead to an increase in the cost of goods, adversely affecting consumers and the competitiveness of UK businesses. (Paragraph 85)

2. In addition to tariff costs, UK-EU trade on WTO terms would place a considerable administrative burden on businesses involved in that trade on both sides. (Paragraph 86)

3. Customs procedures do not start at the border, but well before that. This requires resources to retrieve the necessary information, even if the information is not ultimately submitted by businesses themselves, but outsourced to customs brokers or freight forwarders. (Paragraph 87)

4. An estimated 145,000 VAT-registered UK businesses trade only with the EU and there may be up to a further 100,000 businesses under the VAT threshold in the same position. In the case of ‘no deal’, they would have to gain expertise in customs procedures, which they do not yet have. While not an insurmountable challenge, this will require them to train or hire skilled staff, which will have cost implications. This might also apply to businesses that have traded with non-EU countries before. (Paragraph 88)

5. Parts of the customs procedure can be outsourced to customs brokers or freight forwarders, but this too will incur a cost. (Paragraph 89)

6. HMRC have estimated that, overall, the cost to UK businesses under ‘no deal’ would be £18 billion per year. We call on HMRC to provide an itemised breakdown of its figures and we urge the Government to set out its plans for supporting businesses in assessing the additional costs they would face under a ‘no deal’ scenario. (Paragraph 90)

7. There are a number of existing customs facilitations, such as trusted trader schemes. While they may be appropriate for larger companies, we urge the Government to take account of the fact that they could place an unacceptably high burden on smaller businesses. (Paragraph 91)

8. Any technological solutions will not wholly remove the need for checks on some goods at the border in the case of ‘no deal’. This is of particular relevance to the Northern Ireland/Ireland border, where trade under WTO rules risks re-introducing a hard border. (Paragraph 92)

9. Trade with the EU under WTO rules would adversely affect UK roll-on/roll-off ports, in particular the Port of Dover. Any checks at the Port would introduce delays and lead to congestion. This poses a significant challenge to just-in-time production and to agri-food businesses, and could lead to the disruption of supply chains. (Paragraph 93)

10. Disruption to UK-EU supply chains could decrease the attractiveness of trading with UK businesses. We urge the Government to set out its plans for protecting existing supply chains in the case of ‘no deal’. (Paragraph 94)

11. Container ports, such as the Port of Felixstowe, would be better able to accommodate the need for extra checks, while allowing time for authorities...
to carry out such checks. While this means that container ports may be able to absorb some trade from roll-on/roll-off ports, the ‘route to market’ of container goods is different to goods that require fast delivery. (Paragraph 95)

12. In summary, the costs, disruption to the flow of goods and, potentially, the imposition of customs checks on the Northern Ireland/Ireland border in the case of ‘no deal’, all underline the need for the Government to succeed in its attempts to reach agreement with the EU on the future economic relationship. (Paragraph 96)

**Mitigations open to the UK Government in the event of ‘no deal’**

13. There are only limited options available to the Government to mitigate the disruption that would be caused by a ‘no deal’ Brexit. The Government would face a ‘trilemma’ between keeping trade moving, ensuring security of the border, and the collection of revenue. (Paragraph 119)

14. The Government’s position that, in the case of ‘no deal’, customs checks of goods arriving from the EU could be unilaterally suspended, may be in breach of WTO rules. We call on the Government to set out its plans to ensure fair and equal treatment of all imported goods coming in on most-favoured nation terms. (Paragraph 120)

15. Even if the UK decided unilaterally not to introduce customs controls in the case of ‘no deal’, the EU has indicated that it would introduce such controls. As the ports of Dover and Calais operate as a ‘closed-loop system’, this would lead to delays on both sides of the Channel. To mitigate this, the ports of Dover and Calais will need to collaborate on contingency arrangements and we urge the Government to support such efforts. The Government should also articulate a plan for continued co-operation with EU customs authorities in the event of a ‘no deal’ Brexit. (Paragraph 121)

16. Globally, there is a trend towards moving some of the physical controls and risk assessments of goods away from the border. This can assist with the goods clearance process. The Government should consider utilising and building on such systems at the UK-EU border in the case of ‘no deal’. (Paragraph 122)

17. We welcome the Government’s intention to join the EU’s Common Transit Convention after Brexit. (Paragraph 123)

18. We also welcome HMRC’s recruitment of additional staff to prepare for a ‘no deal’ Brexit, and the assurance that these staff will be put to good use even in the (preferred) event of agreement being reached. (Paragraph 124)

19. Customs procedures are likely to rely increasingly on electronic data in the future, rather than on paper declarations. We welcome the Government’s consideration of single-window technology, which would provide traders with a single point of interaction with various UK Government agencies. At the same time, we note that this technology is untested in the UK, will not obviate the need for checks and will not be available in the short term. (Paragraph 125)

**The UK Government’s proposed customs arrangement**

20. The objective of the Facilitated Customs Arrangement appears to be to combine the advantages of remaining in a customs union with developing
a fully independent trade policy. This involves having different operational models for EU and non-EU trading partners and the levying of tariffs depending on whether goods from non-EU countries are destined for the UK or the EU—all of which is complex. (Paragraph 182)

21. Ministers stressed to us that complexity could be mitigated by a greater role for trusted trader arrangements such as the Authorised Economic Operator (AEO) scheme, and this does indeed offer some opportunities for facilitation. (Paragraph 183)

22. However, the AEO scheme can be difficult to access by small and medium sized enterprises that have so far only traded with the EU. As part of its new AEO scheme under the Facilitated Customs Arrangement, we call on the Government to consider offering different tiers of AEO status, including one that is easy to obtain for SMEs. (Paragraph 184)

23. Signing up to an AEO scheme involves costs for businesses. If the Government wants to ensure that the uptake under the new scheme is higher than under the existing one, it needs to provide guidance to businesses and simplify the process for applying. (Paragraph 185)

24. Mutual recognition of AEO schemes is of utmost importance. We welcome the Government’s intention to negotiate such mutual recognition with the EU. (Paragraph 186)

25. Albeit much lower than under a ‘no deal’ scenario, the Facilitated Customs Arrangement introduces potential additional costs to trade for UK businesses. (Paragraph 187)

26. It is unclear how goods will be tracked under the proposed Facilitated Customs Arrangement, and this is likely to impose additional administrative burdens on businesses. The lack of clarity on the tracking mechanism makes it difficult to assess the extent of that burden. The proposal also raises significant questions around liability, fraud and competitive fairness. We call on the Government to address these questions at the earliest opportunity, and to set out its detailed plans for a tracking mechanism that manages the risk of fraud but also minimises the cost to business. (Paragraph 188)

27. A clear definition of what constitutes ‘sufficient transformation’ of intermediate goods will be important in the tracking of goods. We invite the Government to elaborate on its intended definition and to share with us its analysis of the cost impact that proving sufficient transformation would have on businesses. (Paragraph 189)

28. The repayment mechanism under the FCA is a unique and untested proposition. We are concerned that it will take an unspecified number of years to be developed and that it would only be operational after the implementation of the dual tariff. Only then will businesses be able to benefit fully from new UK trade agreements. We call on the Government to set out a timeline for full implementation, setting out the specific steps it intends to take. (Paragraph 190)

29. The UK Government’s estimate that 96% of UK goods trade would be able to pay the correct or no tariff up front and not go through the repayment mechanism has been challenged. We call on the Government to clarify the methodology it used to arrive at the 96% figure. (Paragraph 191)
30. Tariffs on industrial goods are on average very low. Because of the administrative burdens of engaging with the repayment mechanism under the FCA, preference uptake under UK FTAs could be low and thus reduce the attractiveness of negotiating FTAs with the UK. We call on the Government to explain how it will seek to mitigate this effect. (Paragraph 192)

31. We welcome the Government’s stated intention to uphold current UK food standards and not lower them in free trade agreements with third countries. (Paragraph 193)

32. We are concerned that, only six months before the UK’s exit from the EU, agreement has not yet been reached on the principles underpinning any future customs arrangements. The UK’s proposal under the FCA to collect revenue on behalf of the EU crosses a red line for the EU and has thus been rejected. We urge the Government to set out what options or alternatives it has identified to meet the EU’s concerns. (Paragraph 194)

33. The uncertainty over whether there will be a negotiated agreement between the two sides hinders both UK and EU businesses in their preparations for Brexit. It also adversely affects the ability of UK and EU customs authorities to plan for possible changes. The Government should provide clarity at the earliest possible time. (Paragraph 195)

34. We welcome the EU’s readiness to negotiate a free trade agreement and a customs arrangement with the UK. The two sides should continue to engage in a constructive manner to find a mutually acceptable agreement. (Paragraph 196)
APPENDIX 1: LIST OF MEMBERS AND DECLARATIONS OF INTEREST

Members

Baroness Armstrong of Hill Top
Baroness Brown of Cambridge
Baroness Chalker of Wallasey
Lord Dubs
Lord Horam
Earl of Oxford and Asquith
Lord Risby
Lord Stirrup
Baroness Suttie
Baroness Symons of Vernham Dean
Lord Triesman
Baroness Verma (Chairman)

Declarations of interest

Baroness Armstrong of Hill Top
   No relevant interests declared
Baroness Brown of Cambridge
   No relevant interests declared
Baroness Chalker of Wallasey
   No relevant interests declared
Lord Dubs
   No relevant interests declared
Lord Horam
   No relevant interests declared
Earl of Oxford and Asquith
   No relevant interests declared
Lord Risby
   No relevant interests declared
Lord Stirrup
   No relevant interests declared
Baroness Suttie
   No relevant interests declared
Baroness Symons of Vernham Dean
   No relevant interests declared
Lord Triesman
   Board Member of European Leadership Network
Baroness Verma (Chairman)
   No relevant interests declared

The following Members of the European Union Select Committee attended the meeting at which the report was approved:

Baroness Brown of Cambridge
Baroness Browning
Lord Boswell of Aynho (Chairman)
Lord Jay of Ewelme
Earl of Kinnoull
Baroness Neville-Rolfe  
Baroness Noakes  
Lord Soley  
Baroness Suttie  
Lord Teverson  
Lord Whitty  

During consideration of the report the following Members declared an interest  

Baroness Brown of Cambridge  
Share ownership as declared in the House of Lords Register  
Lord Jay of Ewelme  
Interests as recorded in the House of Lords Register  
Baroness Neville-Rolfe  
Business Minister 2014–16  
Chairman, Assured Food Standards Ltd 2017–  
Commercial Secretary (Minister of State) (HM Treasury) Dec 2016–Jun 2017  
Shareholdings, Amazon.com  
Shareholdings, Tesco plc  

A full list of Members’ interests can be found in the Register of Lords’ Interests:  
APPENDIX 2: LIST OF WITNESSES

Evidence is published online at [https://www.parliament.uk/hlinquiry-brexit-customs-arrangements/](https://www.parliament.uk/hlinquiry-brexit-customs-arrangements/) and available for inspection at the Parliamentary Archives (020 7219 3074).

Evidence received by the Committee is listed below in chronological order of oral evidence session and in alphabetical order. Those witnesses marked with ** gave both oral and written evidence. Those marked with * gave oral evidence and did not submit any written evidence. All other witnesses submitted written evidence only.

** Oral evidence in chronological order **

James Hookham, Deputy CEO, Freight Transport Association **

Clive Broadley, Consultant, Freight Transport Association **

Chris Walker, Policy Chair for Trade, Federation of Small Businesses *

Neil Warwick, Brexit Policy Chair, Federation of Small Businesses *

Andrew Meaney, Head of Transport Team, Oxera Consulting LLP **

Stephen Adams, Senior Director, Global Counsel **

Dr Lars Karlsson, President KGH Border Services and Managing Director, KGH Global Consulting *

Allie Renison, Head of Europe and Trade Policy, Institute of Directors *

Susan Morley, Director, Morley Consulting Training Limited **

Joe Owen, Associate Director, Institute for Government *

Sam Lowe, Research Fellow, Centre for European Reform *

Jon Thompson, First Permanent Secretary and Chief Executive, HM Revenue and Customs *

Jim Harra, Tax Assurance Commissioner, Deputy Chief Executive and Second Permanent Secretary, HM Revenue and Customs *

Robin Walker MP, Parliamentary Under Secretary of State, Department for Exiting the European Union *

Mel Stride MP, Financial Secretary to the Treasury and Paymaster General, HM Treasury *
Alphabetical list of all witnesses

** Stephen Adams, Senior Director, Global Counsel (QQ 34–48)  
BCA0010

** Clive Broadley, Consultant, Freight Transport Association (QQ 1–14)  
BCA0001
BCA0011

Food and Drink Federation  
BCA0006

* Jim Harra, Tax Assurance Commissioner, Deputy Chief Executive and Second Permanent Secretary, HM Revenue and Customs (QQ 81–99)

Dr Peter Holmes, Reader in Economics, University of Sussex  
BCA0002

** James Hookham, Deputy CEO, Freight Transport Association (QQ 1–14)  
BCA0001
BCA0011

* Dr Lars Karlsson, President KGH Border Services and Managing Director, KGH Global Consulting (QQ 34–48)

* Sam Lowe, Research Fellow, Centre for European Reform (QQ 65–80)

* Andrew Meaney, Head of Transport Team, Oxera Consulting LLP (QQ 34–48)

** Susan Morley, Director, Morley Consulting Training Limited (QQ 65–80)  
BCA0009

* Joe Owen, Associate Director, Institute for Government (QQ 65–80)

Port of Dover  
BCA0007

Port of Felixstowe  
BCA0003

* Allie Renison, Head of Europe and Trade Policy, Institute of Directors (QQ 49–64)

The Society of Motor Manufacturers & Traders  
BCA0005

* Mel Stride MP, Financial Secretary to the Treasury and Paymaster General, HM Treasury (QQ 100–118)

* Jon Thompson, First Permanent Secretary and Chief Executive, HM Revenue and Customs (QQ 81–99)

Turkish Industry and Business Association (TÜSİAD)  
BCA0004
BCA0008

* Chris Walker, Policy Chair for Trade, Federation of Small Businesses (QQ 15–33)

* Robin Walker MP, Parliamentary Under Secretary of State, Department for Exiting the European Union (QQ 100–118)

* Neil Warwick, Brexit Policy Chair, Federation of Small Businesses (QQ 15–33)