
BREXIT BRIEFING

LIFE AFTER THE EU SINGLE MARKET AND CUSTOMS UNION:

Post-Brexit trade issues at the border



INTRODUCTION

Trade is critical to the UK economy, and approximately half of UK exports and imports are to and from the European Union (EU). The UK's decision to leave the EU will impact on its trading relationships with the EU, and the rest of the world. The UK's future success will be significantly influenced by the new model of UK-EU trade arrangements. While EEF is calling for a future comprehensive free trade agreement between the EU and UK that does not involve higher tariff and non-tariff costs or administrative burden for manufacturers, the potential remains for new trade arrangements to result in friction in the form of barriers to market entry. This paper highlights ways in which this friction may present itself at the border between the UK and EU and beyond, and raises some of the key issues that manufacturers need to consider and address across their supply chains.

The Government recently released a consultative position paper on the possible future customs arrangements between the UK and EU. The two options set out:

1. firstly, acknowledged administrative friction likely to result post-Brexit and proposed a series of measures to minimise customs procedures at the border, and the other
2. attempted to mimic the EU border in the UK and thereby extend the EU Customs Union to the UK

The paper acknowledges two important principles – the need for a transition period between withdrawal and a new relationship commencing, and that businesses should only face a single change to the new customs formalities.

Contrary to the Government's view, in EEF's view both proposals do in fact involve a two-step transition. The second proposal is unworkable and untested. The first option is more realistic, however, unless the transition period extends the current EU single market and customs union access until Brexit day 1, businesses will still have more than a single point of change to adjust to.

Currently the Single Market and EU Customs Union work 'hand in glove' to allow the free movement of goods inside a common external tariff wall. After the UK leaves the EU the key issues for manufacturers at the UK/EU border will be the introduction of **tariff** and **non-tariff barriers**, along the following lines:

Under current Single Market and Customs Union rules (*inter alia*):

- UK goods circulate freely throughout the EU
- All goods from the UK are automatically deemed to have EU origin

- No tariffs (customs duties) are levied on goods as they cross an EU border from the UK
- No customs administration or customs checks are applied as goods from the UK cross an EU border
- All EU member states including the UK, have a Common External Tariff that they apply to goods entering any member state from the rest of the world
- All EU member states negotiate external trade policy as a single EU entity in the World Trade Organisation (WTO) and when negotiating Free Trade Agreements (FTAs) with other countries

After UK exit from the EU:

- UK goods will not circulate freely between the UK and EU
- A hard border between the EU and UK will exist, requiring new customs administration documentation and the need for goods to be checked to ensure compliance with EU standards, market and legal requirements
- Manufacturers will have to prove goods entering the EU from the UK are of UK origin, in accordance with a pre-agreed set of rules of origin agreed between the EU and UK
- The UK will have to set its own external tariffs to be faced by EU and other country goods entering the UK. Tariffs will apply to goods both being exported to and imported from the EU. The UK will need to agree a Tariff Schedule with the WTO. It is expected that initially this will mirror that of the EU's. Any preferential zero tariff rates will need to be agreed between the EU and UK as part of a comprehensive FTA agreement.
- The UK will have to negotiate its own external trade policy in the WTO and in negotiating FTAs with other countries

TARIFFS

The most immediate trade instrument to affect manufacturers at the EU border after exiting the EU, will be a tariff (or customs duty) charged on imports. They give locally-produced goods a price advantage over similar imported goods and are a source of revenue for governments all over the world.

Every member of the WTO (the international organisation which sets global trade rules) has committed to reduce tariffs and “bind” their customs duties to levels which can’t be raised. These binding duties are set out in individual *WTO member’s Schedules of Commitments*. The rate at which each country actually applies its tariff may be at, or below this “bound” WTO level.

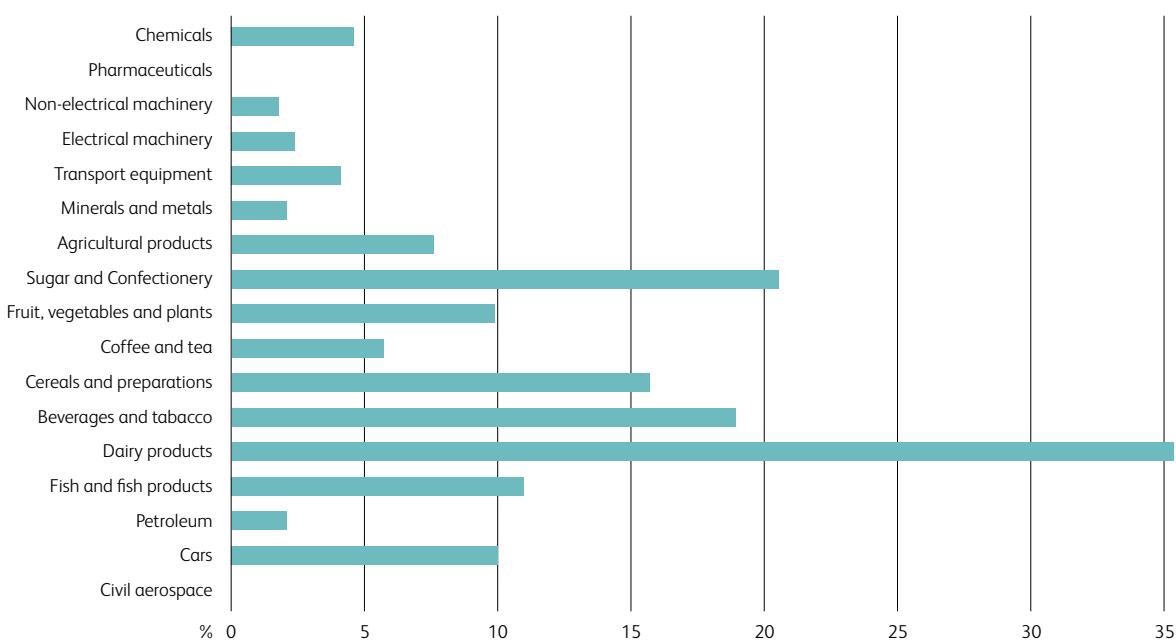
Currently there are zero rates of customs duty being applied between EU member states including the UK, as part of the EU Single Market and EU Customs Union. While the manufacturing industry is calling to maintain these zero levels between the UK and EU after exit, this will be entirely subject to negotiation - most likely through a Free Trade Agreement between the EU and the UK. In the event zero rates are not agreed, exporting manufacturers should familiarise themselves with

the EU tariff schedule¹, which indicates the rates of duty which will be faced at the EU border when exporting goods there. Also, as the UK intends to adopt this same EU schedule in setting its own tariffs, the UK will charge these same customs duties on imported goods from the EU, and the rest of the world. The chart below shows the levels of tariff that manufacturers could face when exporting to the EU by sector.

RULES OF ORIGIN

The next most important trade policy instrument which will affect all UK manufacturers are *Rules of Origin*. Currently, the movement of goods within the EU Customs Union is not based on where they originate but their compliance with free circulation inside the Single Market. For the customs clearance of goods after the UK exits the EU, specific *rules of origin* become necessary to determine the economic nationality of a product entering to and from the EU, and the UK. Given it is not easy to determine where a product comes from when raw materials and parts are sourced and manufactured often in different locations across the world within any one supply chain, a set of rules will need to be agreed between the UK and the EU to determine a single nationality of each product crossing each other’s borders.

FIGURE 1: AVERAGE FINAL BOUND TARIFF RATES APPLIED BY THE EU BY SECTOR²



¹https://www.wto.org/english/tratop_e/tariffs_e/tariff_data_e.htm

²Source: WTO, World Tariff Profiles 2016: applied MFN tariffs (2016) in <https://publications.parliament.uk/pa/l201617/lselect/ldeucom/129/12907.htm>

In international trade this is important because countries apply different trade policy measures (such as tariffs or quotas) to each other's goods, based on whether they have preferential FTA agreements in place. Determining the origin of goods through these rules allows countries to levy the correct import tariffs, allocate quotas and impose other measures such as anti-dumping duties, depending on their economic nationality. For example, the tariff levied on car parts originating from the EU compared to those originating from China may attract different levels of duty, based on the agreements in place between the UK and each trading partner.

In determining *rules of origin*, the same basic principles and structure apply. The measure is whether a good is *wholly obtained* in the originating country and whether (and where) they were *substantially transformed* through processing/manufacturing. Goods *wholly obtained* in a country are goods in whose production there is no connection to any other country than the originating country. This includes when the product is obtained by processing carried out only in the one country and without incorporating materials of any other country. For example, in relation to plants, minerals or live animals among other products it is understood that:

- vegetables originate in a country if they were harvested there
- animals originate in a country if they were born and raised there
- minerals originate in a country if they were extracted there

Assessment of whether a good has undergone *substantial transformation* in a country refers to a product in the production of which more than the partner country was involved - i.e. the product was produced with materials of other countries or was partially processed abroad.

Future rules of origin between the EU and UK are most likely to be *preferential rules of origin*, agreed inside the framework of an FTA. Usually preferential rules of origin are developed in response to specific trade interests between the partners of a free

trade area. They therefore differ from agreement to agreement. If a manufacturer is importing under a future EU-UK FTA, it is not enough that the product is exported from each other. The product needs to originate in that country and the *rules of origin* indicate if the product may be considered as originating in the UK, and therefore able to receive a preferential (or zero) tariff.

More broadly, attempts have been made to reach an internationally agreed definition on how to determine the origin of a good under the *WTO Agreement on Rules of Origin*. Within this Agreement, WTO members are paving the way for an internationally accepted definition on how to determine rules of origin for *non-preferential* purposes (that is rules of origin outside FTA type agreements). The agreement has established a harmonisation work programme, based upon a set of principles, including making rules of origin objective, understandable and predictable³.

CUSTOMS ADMINISTRATION AT THE BORDER

On leaving the EU, the UK will face a hard border and an increase in levels of customs administration when exporting and importing goods to/from the EU.⁴ This trade *friction* could take the form of:

- paperwork/electronic form-filling for pre/at-the-border measures, including potential:
 - export declarations, licences and supporting evidence
 - import declarations to identify the customs status of goods to determine whether the goods are subject to customs controls and/or customs charges (such as customs duty, import VAT, anti-dumping or countervailing duties)
 - use of the Single Administrative Document (SAD)
 - Providing proof of origin certification
- customs inspections of consignments at or in the proximity of the border between the UK and EU
 - a trusted trader scheme (i.e authorised economic operator)

³https://www.wto.org/english/tratop_e/roi_e/roi_e.htm#work

⁴The UK Government's policy line is that there is no return to a hard border between Northern Ireland and Ireland as a result of any new controls placed on the movement of goods. www.gov.uk/government/publications/northern-ireland-and-ireland-a-position-paper

- economic operators to lodge simplified customs declarations
- Customs declarations are used to control the movement of goods, and ensure compliance with customs regimes and protection of revenue, supporting the zero-rating of exports for VAT purposes, supplying data for risk assessment and supplying data for trade statistics. The format of customs declarations is currently standardised across the EU and is also used by members of the European Free Trade Association and countries wishing to join the EU.

Single Administrative Document (SAD)

The SAD is currently not required for the movement of goods inside the EU Single Market, and is a document used by traders and agents to facilitate the import, export and transit of goods with countries outside the EU. It also covers the movement of non-EU goods within the EU. Following EU exit this may be a tool that is applied to all imports and exports between the UK and EU. It is processed online and the document usually sets out:

- the nature of the goods
- the movement of the goods
- the commodity code or tariff code of goods
- the Customs Procedure Code (CPC) - which determines how customs treat the goods

It can also be used to declare any imported goods with economic impact such as:

- Inward Processing (IP) - allows imported raw materials or semi-manufactured goods to be processed for re-export within the EU by manufacturers without a requirement that the manufacturers have to pay customs duty and VAT on the goods being used.
- Outward Processing Relief (OPR) - allows EU traders to temporarily export goods from the EU for processing or repair to a third (non-EU) country and then claim full or partial duty relief when the goods are re-imported.

- End-Use Relief: End-Use Relief is available on certain goods imported into the EU that are to be put to a specific use. To be eligible for End-Use Relief, products must meet defined criteria and be identified in the Tariff.
- customs warehousing - allows traders to store goods with duty or import VAT payments suspended.

While the range of these and other measures are subject to negotiation between the UK and EU, it would be in manufacturers' interests to give serious thought to these mechanisms and the potential costs.

Authorised Economic Operators

Authorised Economic Operator (AEO) status is an EU system which is a globally recognised quality marking which demonstrates that an importer/exporter's role in the supply chain is secure and customs controls and procedures are efficient and compliant. It provides faster and simpler customs procedures and sometimes allows for 'fast-tracking' of shipments through customs and security inside the EU. For countries outside the EU, AEO status can also allow exporters benefits such as faster clearance at the border, less interventions and lower risk assessments. Once the UK has departed from the EU, the maintenance of this type of system will be vital for UK exporters.

Within the EU, businesses need to apply for AEO status to benefit from arrangements under mutual recognition agreements with third countries. Economic operators can be allowed to submit a simplified customs declaration, with fewer data requirements – the format of which is standardised across the EU and is used by members of the EFTA or countries wishing to join the EU.

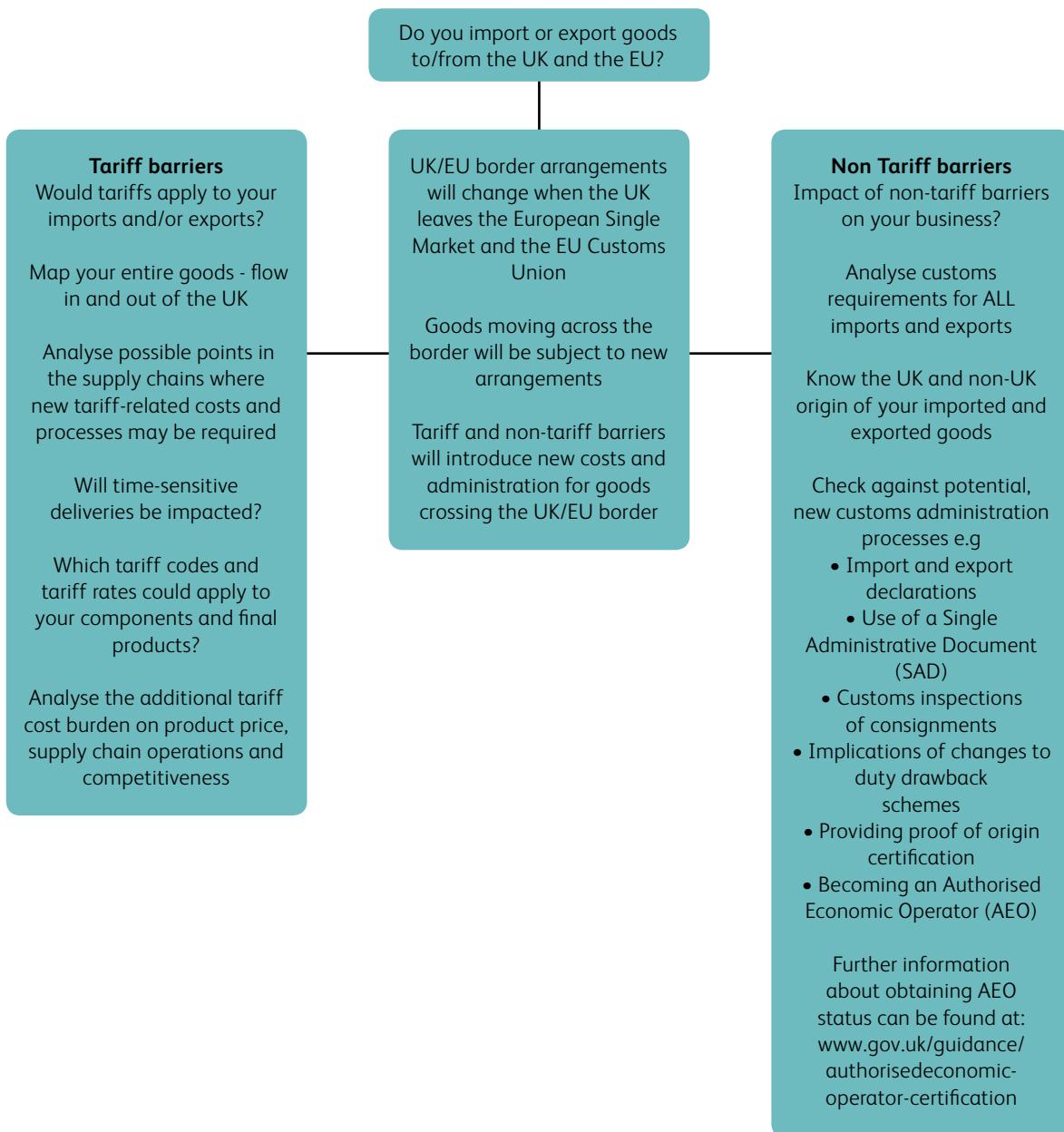
Although the AEO system has been in place for several years, the UK lags significantly behind other EU countries in the number of business registrations. In the UK, there are just over 500 approved AEO registrations compared to Germany, which has 6031, the Netherlands with 1514 and

France with 1438 approved registrations⁵. With the post-brexit environment likely to bring about significant changes in customs procedures at the border, it is in UK manufacturers' interests to assess the merits of applying for AEO status.

NEXT STEPS

As manufacturers, you can prepare for these issues by carrying out an audit of your requirements in some of the following areas:

CONSIDERATIONS FOR MANUFACTURERS



⁵<http://www.export.org.uk/news/320338/AEO--what-is-it-and-could-your-business-benefit.htm>



The manufacturers' organisation

EEF is dedicated to the future of manufacturing. Everything we do, from business support to championing manufacturing and engineering, is designed to help our industry thrive, innovate and compete locally and globally.

In an increasingly uncertain business environment, where the UK is now on a path to leave the European Union, we recognise that manufacturers face significant challenges and opportunities. We will work with you throughout this period of uncertainty to ensure that you are on top of any legislative changes and their implications for your business.

Furthermore, as the collective voice of UK manufacturing, we will work tirelessly to ensure that our members' voices are heard during the forthcoming negotiations and will give unique insight into the way changing legislation will affect their business.

Our policy, employment law, health, safety and sustainability and productivity experts are on-hand to steer you through Brexit with rational, practical advice to help your business succeed.

Namali Mackay

Trade Advisor
07834967396
nmackay@eef.org.uk

Fergus McReynolds
Director of EU Affairs
+32 28 086 829
FMcReynolds@eef.org.uk

For information on how EEF can support your business call:
0808 168 5874

www.eef.org.uk

For more information contact the EEF Policy and External Affairs team on **020 7654 1555**

[@EEF_Press](http://www.eef.org.uk)

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Published by EEF, Broadway House, Tothill Street, London SW1H 9NQ
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