



The
manufacturers'
organisation

BREXIT BRIEFING

UK TRADE WITH THE EU:

A New Trading Order for
the Manufacturing Industry



AT A GLANCE

- **The European Union (EU) remains the UK manufacturing industry’s single biggest trading partner** in a complex trading environment where the UK and EU-27 member states are closely interwoven. By potentially removing the building blocks of this relationship - the customs union and single market – the manufacturing industry faces a costly and difficult exercise.
 - **The Government needs to ensure the UK becomes a fully-fledged World Trade Organisation (WTO) member in its own right, as a first priority.** Being fully integrated into the international trading system provides an independent trading nation such as the UK with better access and non-discriminatory treatment when trading with the EU and the rest of the world.
 - **In leaving the single market, to maintain certainty and minimise costs** the industry must retain some key trading conditions such as the continued ability to participate in developing ‘harmonised product standards’.
 - **The Government must be forthcoming about the shape of a new customs arrangement sooner rather than later and the arrangement must genuinely maintain ‘frictionless’ trade** including through retaining zero tariff rates, agreed and favourable rules of origin, mutual recognition and enforcement of customs border procedures, the prevention of other potential non-tariff barriers and ensuring the UK can strike trade agreements with the rest of the world.
 - **A transition period is essential to ensure the manufacturing sector can adjust** to the significant changes in the trading environment; the timing of the transition period will be important alongside an assurance it will be agreed upfront in negotiations.
 - **Industry cannot accept that “no deal for Britain is better than a bad deal for Britain”** and we remain concerned about the future partnership arrangement and EU Exit negotiations being conducted in parallel, in such a short a timeframe.
 - **The Government must engage in close consultations with industry going forward** in including formalising a joint mechanism that sets out the general approach, determines objectives and identifies commercially significant issues in the negotiations.
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INTRODUCTION

The case for the British manufacturing industry remains strong:

- The UK is currently the world's 9th largest industrial nation.
- Manufacturing makes up 45 % of UK exports, 10 % of Gross Value Added (GVA) and directly employs 2.7 million people.

The strength of the sector is further underpinned by its trading relationship with the EU where 52 % of total manufactured exports, by value, went to EU member states in the 12 months to April 2016¹. This trading relationship with the EU is interwoven to a significant degree where supply chains across Europe can be particularly complex.

Some of our members report that their production processes can criss-cross over European borders numerous times in each production process.

Many manufacturing companies in the sector which trade predominantly with the EU, have only ever known this trading environment. Therefore to make predictions about a future trading mechanism not previously encountered, is proving to be very difficult. To extricate the industry from this long established trading system will be costly and require a gradual adjustment process to ensure a smooth and successful transition to a new trading order.

While over 70 per cent of our manufacturing members have in the recent past held the strong view that membership of the EU Single Market (and Customs Union) was vital to their business models, they now face a future in which the UK may not hold membership of either, with no compelling alternative to plan for.

This paper sets out the industry's position in recreating the UK's trade relationship with its single biggest and most closely-linked trading partner - the EU.

THE IMPORTANCE OF WTO MEMBERSHIP

In order to seamlessly trade with the EU and the rest of the world, the UK first needs to establish

itself as a fully-fledged WTO member in its own right, within the internationally agreed framework of trading rules. The UK's trading partners operate inside this WTO trade framework and without doing so the UK cannot commence negotiating Free Trade Agreements (FTAs) including with the EU – as FTAs are also based on WTO rules.

Therefore, **becoming a fully-fledged WTO member must be the Government's first priority.** In doing so, the industry is looking to the

Government to (at the very least) adopt the current EU schedule of WTO commitments as the UK's own so that some degree of certainty can be ensured and inward and outward trade can continue to flow at the same tariff levels. We welcome the Government's early commitment to do so noting indications that the UK's new schedule will offer third countries the same level of market access they currently enjoy.

Beyond the UK's WTO tariff schedules, the industry will benefit from a system of rules embodied in WTO agreements which prevent non-discrimination by trading partners, making trade more open, predictable and fair. Such WTO agreements include the Agreement on Trade Facilitation, the Agreement on Technical Barriers to Trade, the Agreement on Subsidies and Countervailing Measures, as well as a range of trade remedy rules.

LEAVING THE EU SINGLE MARKET

For the manufacturing sector, the single market - under the pillar of the free movement of goods - has been the most important facilitator of 'frictionless' trade with the EU. UK companies have operated in a zero tariff environment, with minimum non-tariff barriers and low costs of time delays, transport and facilitated movement across EU borders, in a uniform and single regulatory environment. Moving out of this arrangement - and suddenly - will incur significant costs for manufacturing businesses in the form of proving the UK origin of products, levying of tariffs, documentation and customs checks – all potentially numerous times in each production and sale process where there are complex cross border supply chains.

In order to maintain certainty and minimise the costs of adapting to a new arrangement,

¹<https://www.eef.org.uk/resources-and-knowledge/research-and-intelligence/industry-reports/britain-and-the-eu-manufacturing-an-orderly-exit>

the industry needs to retain some key trading conditions such as:

- **The ability to participate in developing ‘harmonised product standards’** where they currently exist (which covers the majority of manufactured goods traded within the EU) to demonstrate compliance with regulation.
 - Harmonised product sectors are subject to common rules across the EU. They provide a clear and predictable framework for manufacturers so products can be sold freely in the EU.
- **Continued adoption of European standards and technical requirements** and ensuring the participation of UK experts in their development to enable compliance with EU harmonised regulatory regimes will be important.
- **Access to the principle of mutual recognition** ensures market access for products that are not subject to EU harmonisation (currently covered by UK rules). This principle guarantees that any product lawfully sold in one EU country can be sold in another. This is possible even if the product does not fully comply with the technical rules of the other country.
 - The Mutual Recognition Principle differs from mutual recognition agreements that facilitate market access between the EU and non-EU countries.²
 - Iceland, Norway and Liechtenstein, members of the European Economic Area (EEA) but not of the EU itself, have agreed to the Mutual Recognition Principle.

LEAVING THE EU CUSTOMS UNION?

The EU Customs Union is a single trading area where all goods circulate freely, whether made in the EU or imported from outside. Tariffs on goods from outside the EU are usually paid when they first enter the EU, but thereafter there is nothing more to pay and no further checks.³

The UK’s departure from the Customs Union and movement to a new Customs arrangement remains unclear. While in principle the industry supports the Government’s ambitions to seek a new customs arrangement which enables trade between the UK and the EU to continue to be as ‘frictionless’ as possible while allowing independent trade with non EU countries, we remain concerned that the two objectives could be mutually exclusive. The Government must be forthcoming about the shape of a new customs arrangement sooner rather than later to allow industry to plan, minimise costs and adjust in a reasonable timeframe.

In any new customs arrangement maintaining ‘frictionless’ trade is the industry’s main objective. To do so, a number of key conditions must be satisfied including:

- **Continuing zero tariff rates between the UK and EU:** any new arrangement must be a genuine free trade arrangement, where the tariffs applied on imports and exports between the UK and EU remain at current levels. Without an FTA in place on day one (and in the event the UK adopts the EU WTO schedule as its own) all UK imports and exports between the UK and EU will immediately face higher tariff rates (equal to those the EU currently levies on non EU countries).
 - For many of our members facing even a relatively low percentage tariff is likely to have significant cost implications.
 - *Estimates in the chemicals sector have shown the impact of 4-6 % average tariffs to increase direct trading costs by over £50 million for a single company.*
- **Agreeing preferential rules of origin:** Origin is the “economic” nationality of goods in international trade, which is important to identify for the customs clearance of goods. It is used to determine the origin of goods which are subject to various commercial policy instruments (such as tariffs or anti-dumping measures). Determining a product’s country of origin will allow other countries to levy

²https://ec.europa.eu/growth/single-market/goods/free-movement-sectors/mutual-recognition_en

³https://europa.eu/european-union/topics/customs_en

the correct trade measures to that product, including a zero tariff if that was the case. There are a range of practices amongst countries as to how to determine these rules of origin, the “substantial transformation” of a good being the most universal. For the manufacturing industry, agreeing a preferential set of rules of origin with the EU will be crucial given the complexity of the supply chain, the origin of component parts and the degree of processing undertaken in the UK, before export and re-export.

- **Mutual recognition** of customs border procedures and related enforcement including, *inter alia*, fewer inspections and priority treatment for inspections, recognising Authorised Economic Operators (AEO), reduced security and guarantee requirements, expedited release and pre-clearance and simplified procedures.
- **The prevention of non-tariff and technical barriers to trade** through an extension of certain Internal Market benefits to third countries in the European neighbourhood, in sectors for which technical regulations and standards have been aligned to European ones. These could be potentially based on the principles enshrined in Agreements on Conformity Assessment and Acceptance of Industrial Products (ACAAs) and the European Economic Area (EEA).
- Ensuring the UK has the **ability to enter into trade agreements with key markets** in the rest of the world (This will be set out in a separate briefing note).

A COMPREHENSIVE FREE TRADE AGREEMENT (FTA)

We note that the main alternative framework on the table to replace current arrangements is a comprehensive FTA. We note also that while existing models of EU engagement are unlikely to be replicated, the Canada Comprehensive Economic and Trade Agreement (CETA) model may at this stage to be considered as the most likely basis for a FTA framework. While ambitious in its own right we are aware that the **CETA Agreement falls far short of the current levels of market**

access afforded to the UK through single market and customs union membership.

Given the EU and UK will commence any FTA negotiations from a point of almost complete convergence, we urge the Government to push for **mutual recognition of most aspects covered by the single market and customs union** as its starting point in the negotiation, as this will be strongly in both the UK and EU-27’s manufacturing industry interests.

TRANSITION PERIOD

The recognition of the need for a transition period is welcomed by the sector. A transition period is essential to ensure the sector can adjust to such extreme changes to the trading environment without a significant shock and wider ripple effects on the economy. In doing so, we are seeking a **greater commitment to the timing of such a period**, and an assurance that a transition period will be **secured upfront in the negotiation**. We would expect any transition period to apply to all aspects of the EU/UK relationship that will be subject to change on day one, including those that fall both within and outside of an FTA framework. As such there is a need for clarity on the definition of phasing of the implementation period.

PARALLEL NEGOTIATIONS

We remain concerned about the future partnership arrangement and EU Exit negotiations being conducted in parallel in such a short a timeframe, with no fall-back position set out, in case both are unachievable within the two year time period.

We are particularly concerned about the concept that “no deal for Britain is better than a bad deal for Britain” – where there is a risk of the Government walking away from the negotiating table, leaving the industry with no preferential access to the EU or international markets on day one of Brexit. While this is may be an acceptable opening bid in a typical FTA-type negotiation where either party could walk away and return to its status quo being no worse off, this will not be the case between the EU and UK. The UK would walk away from a current mutually converged status to an immediate, less than optimal and costly scenario of:

1. Loss of zero rate tariffs;
2. Reverting to higher WTO tariffs for exports to the EU and trading partners under current EU FTAs; for manufacturing, average tariffs for exports to the EU would increase to approximately 5.3 %, however this masks significant tariffs for certain products such as automotive goods;
3. Potentially higher WTO tariffs on imports, including component parts from the EU;
4. Any UK tariff reductions would have to be offered also to the rest of the world, under WTO Most Favoured Nation rules;
5. Changes to and potential loss of inwards processing relief;
6. Changes to customs warehousing arrangements;
7. New non-tariff barriers in the form of customs documentation and checks and administration in the levying of tariffs;
8. Having to meet non-preferential rules of origin for exports to the EU;
9. Higher compliance costs for any changed EU standards; and
10. Loss of preferential arrangements with third countries under current EU FTAs.

No deal for Britain is not an acceptable position for the UK manufacturing sector to be placed in.

WHERE TO FROM HERE?

While we **cautiously welcomed the broad direction of travel** of the future relationship between the EU and UK as set out in the White Paper, *The United Kingdom's exit from, and new partnership with, the European Union*, we are looking to the Government to work more closely with industry on any new arrangement.

In the rest of the Anglosphere (including Australia, Canada⁴, New Zealand⁵ and the USA) close consultation with industry is a seamless and integrated mechanism in setting out the general approach, determining objectives, identifying commercially significant impediments to increasing trade and investment with negotiating partners⁶ and industry committees are provided the opportunity to comment on all draft proposals before they are shared with other countries⁷.

As we continue to work with the broader manufacturing sector to carefully manage the industry's transition to a new relationship with our single largest trading partner - the EU - **we call on Government to ensure it works more closely with our sector on the way forward, including through a formal consultation mechanism.**

⁴<http://www.international.gc.ca/trade-commerce/consultations/china-chine/info.aspx?lang=eng>

⁵<https://www.mfat.govt.nz/en/trade/free-trade-agreements/about-free-trade-agreements/>

⁶<http://dfat.gov.au/trade/agreements/Pages/public-consultations.aspx>

⁷<https://ustr.gov/about-us/policy-offices/press-office/blog/2014/February/a-note-on-stakeholder-consultation>



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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 for your business.

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