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Brexit: trade in goods

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SUMMARY

Brexit will fundamentally change the UK's conditions of trade with the other 27 EU Member States, and with over 60 countries with which the EU has preferential trade agreements. Goods make up the bulk of the UK's global trade, and accounted for around 60% of all UK exports to the EU, and almost 77% of total UK imports from the EU in 2015. The manufacturing and primary commodities sectors are important employers across the UK. The production of goods is also often closely intertwined with the provision of services, multiplying the importance of these sectors to the UK economy. Minimising disruption to trade between the UK and the EU-27 after Brexit is crucial to the UK's future prosperity.

The Prime Minister, the Rt Hon Theresa May MP, set out her intention for the UK to leave the Single Market and the EU customs union in her speech on 17 January 2017. We acknowledge that the UK is in a unique position, as an EU Member State which is fully integrated into the Single Market. The Prime Minister's approach may result in the introduction of both tariff and non-tariff barriers to trade in goods between the UK and the EU. This report considers the impact of trade under World Trade Organisation (WTO) terms, and under a potential free trade agreement (FTA), on six major manufacturing and primary commodities sectors: chemicals and pharmaceuticals, capital goods and machinery, food and beverages, oil and petroleum, automotive, and aerospace and defence.

In the absence of a FTA with the EU after Brexit, tariffs would apply. These would incur additional costs for many UK businesses. Their significance varies considerably between sectors: while tariffs are zero on civil aerospace parts (under WTO agreements), EU tariffs set at the WTO are 10% on cars and can be more than 200% on some agricultural products. Tariffs would be particularly damaging for sectors with a highly integrated EU supply chain, such as the automotive sector—tariffs could be levied multiple times in the production process. It is therefore of considerable importance that the Government seeks to eliminate tariff barriers in its planned "ambitious and comprehensive free trade agreement" with the EU.[1]

Non-tariff barriers—such as rules of origin—would be more difficult to resolve. The Government's stated intention to leave the Single Market and the EU customs union would mean that additional non-tariff barriers would apply to all the sectors considered in this report, whether the UK and EU negotiate a FTA after Brexit or trade on WTO terms. We conclude that compliance with rules of origin requirements would introduce a significant additional administrative burden, with a particularly negative impact on sectors with a highly integrated EU supply chain. Companies in these sectors might be unable to comply with the local content requirements contained in the EU's preferential rules of origin.

We welcome the Government's decision to preserve current EU regulations through the Great Repeal Bill. Divergence from the current common standards and regulations between the UK and the EU would also act as a significant non-tariff barrier to trade. A FTA that went some way to mitigating this non-tariff

1 HM Government, *The United Kingdom's exit from and new partnership with the European Union*, Cm 9417, February 2017, p 35: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/589191/The_United_Kingdoms_exit_from_and_partnership_with_the_EU_Web.pdf [accessed 13 February 2017]

barrier would require a trade-off between the UK's desire to make domestic laws, and its wish to pursue close trade relations with the EU. It would be likely to entail a legal obligation to maintain a high level of harmonisation or mutual recognition of standards with the EU, and might also require the UK to agree an oversight or arbitration mechanism with the EU.

There may be significant benefits in continuing UK participation in EU agencies, such as the European Medicines Agency (EMA) and the European Aviation Safety Agency (EASA). However, such participation could require some form of oversight and dispute resolution in the specific areas covered by these agencies. We recommend that the Government should clarify at an early stage its intentions towards future membership or co-operation with these agencies.

The UK's proposed relationship with the EU, outside the customs union and Single Market, will also result in the introduction of a customs border between the UK and the EU-27. Customs procedures would result in delays and increased administration, which in turn would incur costs for businesses, and extra work for HM Revenue and Customs. The Prime Minister has proposed a new "customs agreement" to mitigate these costs.[2] To our knowledge, no precedent exists for an agreement outside a customs union that entirely eliminates the need for customs checks and the additional burden of associated administration and costs. We are also concerned that the introduction of a new IT system for customs—planned for the year the UK leaves the EU—may further complicate the change of trading conditions for businesses around Brexit.

We remain of the view that the UK is unlikely to be able to maintain access to the EU's preferential trade agreements with third countries, such as Switzerland and South Korea, after Brexit. The cessation of these preferential trade conditions is likely to result in significant tariff costs after Brexit, until such a time as the UK is able to conclude new FTAs. We welcome the Department for International Trade's commitment to delivering continuity in this regard, and recommend that it should focus its efforts on those countries with which the EU already has preferential trade agreements.

The timetable for withdrawal negotiations under Article 50 is very tight, and we remain of the view that concluding a UK-EU FTA in that period is extremely ambitious. If the UK and the EU fail to agree a FTA within the two years set out by Article 50—and unless this period is extended by the unanimous agreement of the EU-27—WTO rules would apply to trade between the UK and the EU. This can only be avoided by negotiating a transitional agreement with the EU. It is unclear whether the Prime Minister's proposed "phased process of implementation"[3] of the new deal would fulfil this purpose. A transitional arrangement will be crucial for UK businesses, the decisions of foreign investors, and the stability of the sterling exchange rate. We urge the Government to give serious consideration to a transitional agreement, as it begins its negotiations.

2 *Ibid.*
3 Theresa May MP, Speech on the government's negotiating objectives for exiting the EU, 17 January 2017: https://www.gov.uk/government/speeches/the-governments-negotiating-objectives-for-exiting-the-eu-pm-speech [accessed 13 February 2017]

Brexit: trade in goods

CHAPTER 1: INTRODUCTION

1. In our December 2016 report, *Brexit: the options for trade*,[4] we analysed how the trade relationship between the UK and the EU will change after Brexit. Goods make up the bulk of UK trade globally—56% in 2015[5]—despite the dominant position of the services industry in the domestic UK economy.[6] The UK's trade with the EU is also dominated by goods: in 2015 they accounted for around 60% of all UK exports to the EU, and almost 77% of total UK imports from the EU.[7] The EU Member States combined were the single largest trading partner for the UK in goods in 2015: 47% (£134 billion) of the UK's goods exports were to the EU, and these countries accounted for 54% (£223 billion) of the UK's goods imports.[8]

2. Safeguarding the liberalised trading relationship that the UK currently benefits from in its trade with other EU Member States—so as to prevent a disruption to business—will be important to the UK's future prosperity. A range of trade barriers can impede the free flow of goods. These include tariffs (customs duties) and non-tariff barriers (including product labelling requirements, rules of origin and customs formalities).[9] Barriers to trade in goods between EU Member States have been reduced considerably by the customs union, regulatory harmonisation, and mutual recognition, which together make up the Single Market in goods.[10] The EU's trade agreements with third countries, such as the Republic of Korea,[11] also contain a range of preferential terms for trade in goods. On its withdrawal from the EU, the

4 European Union Committee, *Brexit: the options for trade* (5th Report, Session 2016–17, HL Paper 72); The report considered different frameworks for UK-EU trade relations post-Brexit: membership of the European Economic Area; a customs union with the EU; a free trade agreement with the EU; and trade under WTO rules.

5 Office for National Statistics (ONS), 'Statistical bulletin—UK Balance of Payments, The Pink Book: 2016': https://www.ons.gov.uk/economy/nationalaccounts/balanceofpayments/bulletins/unitedkingdombalanceofpaymentsthepinkbook/2016#trade [accessed 10 February 2017]

6 The services sector accounts for 80% of the UK economy. Full Fact, 'Everything you might want to know about the UK's trade with the EU': https://fullfact.org/europe/uk-eu-trade/ [accessed 9 February 2017]; See Tables 1–4 in Chapter 3 for a breakdown of the UK's trade in goods and services with the EU and the rest of the world. As discussed in Box 1 in Chapter 2, services are often bundled with goods. As not all companies report service revenue separately, the statistics for goods may include some data relating to the provision of services.

7 ONS, 'Statistical bulletin—UK trade: May 2016, Table 2—UK trade with the EU and percentages of World total, 2000 to 2015': https://www.ons.gov.uk/economy/nationalaccounts/balanceofpayments/bulletins/uktrade/may2016 [accessed 21 February 2017]; Exports of goods were £133,524 million, compared to £88, 909 million in services. Imports of goods were worth £222,992million, compared to £67,977 million in services.

8 ONS, 'Statistical bulletin—UK trade: May 2016, Table 2—UK trade with the EU and percentages of World total, 2000 to 2015': https://www.ons.gov.uk/economy/nationalaccounts/balanceofpayments/bulletins/uktrade/may2016 [accessed 21 February 2017]

9 The World Trade Organisation (WTO) has established an inventory of non-tariff measures that provides an overview. WTO, *Table of contents of the inventory of non-tariff measures (TN/MA/S/5/Rev.1)* (28 November 2003): http://wtocentre.iift.ac.in/NGMA1/TN-MA-S-5-R1.doc [accessed 9 February 2017] Rules of origin determine where a product was produced, in order to ensure that the correct customs duty is levied.

10 The scope of the Single Market for goods is detailed in our report on the options for trade after Brexit. European Union Committee, *Brexit: the options for trade* (5th Report, Session 2016–17, HL Paper 72)

11 Hereafter, the names the Republic of Korea, South Korea and Korea are used interchangeably.

UK will no longer enjoy these conditions of trade with the EU, and EU free trade agreements (FTAs) are unlikely to continue to apply to the UK.[12]

3. In her speech on 17 January 2017, setting out the Government's negotiating objectives for exiting the EU, the Prime Minister, the Rt Hon Theresa May MP, announced her intention to "pursue a bold and ambitious Free Trade Agreement with the European Union … [to] allow for the freest possible trade in goods and services between Britain and the EU's Member States".[13] This was reiterated in the Government's White Paper, *The United Kingdom's exit from and partnership with the EU*, published in February 2017.[14]

4. The Prime Minister also announced a 'Plan for Britain', which "gets us the right deal abroad but also ensures we get a better deal for ordinary working people at home".[15] On 23 January 2017 the Government published a Green Paper, *Building our Industrial Strategy,* which the Prime Minister described as "a critical part of our plan for post-Brexit Britain", and which will "help to deliver a stronger economy and a fairer society—where wealth and opportunity are spread across every community in our United Kingdom, not just the most prosperous places in London and the South East".[16] The strategy made it clear that securing preferential trade arrangements for the UK and supporting the UK's manufacturing and primary commodities sectors—which are important sources of employment outside of London, and at the heart of the UK's global trade—will be essential to achieving this goal.

The EU Committee's work

5. Following the referendum on 23 June 2016, the European Union Committee and its six sub-committees launched a co-ordinated series of inquiries, addressing the most important cross-cutting issues that will arise in the course of negotiations on Brexit.[17] These inquiries, though short, are an opportunity to explore and inform wider debate on the major opportunities and risks that Brexit presents to the United Kingdom.

12 EU FTAs can either be signed by the EU alone ('EU-only') or by both the EU and its Member States separately ('mixed agreement'). In either case, witnesses to our previous inquiry said EU FTAs were unlikely to continue to apply to the UK post-Brexit. The Single Market and EU FTAs with third countries are discussed in our report on the options for trade after Brexit. European Union Committee, *Brexit: the options for trade* (5th Report, Session 2016–17, HL Paper 72)

13 Theresa May MP, Speech on the government's negotiating objectives for exiting the EU, 17 January 2017: https://www.gov.uk/government/speeches/the-governments-negotiating-objectives-for-exiting-the-eu-pm-speech [accessed 13 February 2017]

14 HM Government, *The United Kingdom's exit from and new partnership with the European Union*, Cm 9417, February 2017, p 35: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/589191/The_United_Kingdoms_exit_from_and_partnership_with_the_EU_Web.pdf [accessed 13 February 2017]

15 Theresa May MP, Speech on the government's negotiating objectives for exiting the EU, 17 January 2017: https://www.gov.uk/government/speeches/the-governments-negotiating-objectives-for-exiting-the-eu-pm-speech [accessed 13 February 2017]

16 HM Government, *Building our Industrial sSrategy* (January 2017), p 3: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/585273/building-our-industrial-strategy-green-paper.pdf [accessed 9 February 2017]

17 European Union Committee, *Scrutinising Brexit: the role of Parliament* (1st Report, Session 2016–17, HL Paper 33)

Brexit: future trade in goods

6. This report considers trade between the UK and the EU in goods. It is based on an inquiry conducted by the External Affairs Sub-Committee of the European Union Committee, and builds on our previous report, *Brexit: the options for trade*, published on 13 December 2016.[18] The EU Internal Market Sub-Committee has, in parallel, been preparing a report on trade in services.

7. In *Brexit: the options for trade*, we explored the different possible frameworks for trading relations with the EU post-Brexit.[19] On 17 January 2017, the Prime Minister confirmed that the UK would leave the Single Market and the customs union, and seek a FTA with the EU.[20]

8. In this report we therefore focus on issues relating to a FTA, and the fall-back position, were the UK and EU not to agree a FTA, namely trade under World Trade Organisation (WTO) rules. Through the course of the inquiry, we considered the potential barriers specific to UK-EU goods trade after Brexit, and took evidence from six sectors to explore these potential barriers in practice. The sectors were: pharmaceuticals and chemicals; capital goods and machinery; food and beverages; oil and petroleum; automotive; and aerospace and defence.

9. The EU External Affairs Sub-Committee, whose members are listed in Appendix 1, met in October and November 2016 and in February 2017 to take oral evidence from the witnesses listed in Appendix 2. The Committee is grateful for their participation in this inquiry. We also thank our Specialist Adviser, Dr Holger Hestermeyer of King's College London.

10. **We make this report for debate.**

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18 European Union Committee, *Brexit: the options for trade* (5th Report, Session 2016–17, HL Paper 72)

19 *Ibid.*

20 Theresa May MP, Speech on the government's negotiating objectives for exiting the EU, 17 January 2017: https://www.gov.uk/government/speeches/the-governments-negotiating-objectives-for-exiting-the-eu-pm-speech [accessed 13 February 2017]

CHAPTER 2: UK PRODUCTION OF GOODS

Goods and services

11. The term 'goods' is rarely used in the context of the domestic economy, but is an important category in trade. Both manufactured products and primary commodities are goods.

12. In the context of trade, exports and imports are commonly divided into 'goods' and 'services'. These categories are subject to different legal obligations under world trade law. Within the WTO, trade in goods is primarily regulated by the General Agreement on Tariffs and Trade (GATT), while measures relating to trade in services are largely subject to the General Agreement on Trade in Services (GATS).[21]

13. The division between 'goods' and 'services' is considered in Box 1 below. While recognising that some overlap between goods and accompanying services occurs, our report focuses primarily on goods, reflecting the fact that 'bundled' services are inherently reliant on the production of the underlying goods.

Box 1: Dividing goods and services

Although the GATT and GATS do not define 'goods' and 'services', world trade law draws a deceptively clear line between the two concepts. Generally 'goods' are tradable tangible items, while services are intangible.[22]

Despite this legal distinction, in practice goods and services are often combined. For example, the WTO Appellate Body stated in 1997 that a periodical (such as a newspaper) "is a good comprised of two components: editorial content and advertising content. Both components can be viewed as having services attributes, but they combine to form a physical product—the periodical itself."[23] Services also often play an important role in the production of goods.

Services are also increasingly often 'bundled' with goods. The Government Office for Science report cited a 2011 study which found that 39% of UK manufacturers with over 100 employees derived value from services related to their products. It suggested that future sources of revenue for manufacturers would include: the increasingly extensive packaging of services with products; capturing value by selling technological knowledge and leaving production to others; and 'remanufacturing' used goods.[24]

Mr Fergus McReynolds, Director of EU Affairs, EEF—The Manufacturers' Organisation (EEF), agreed that "goods plus services models" were becoming more prevalent.[25]

21 There are a number of additional WTO agreements which also affect trade in goods and services. WTO, 'Legal texts: the WTO agreements': https://www.wto.org/english/docs_e/legal_e/final_e.htm [accessed 9 February 2017]

22 Diana Zacharias, 'Article I GATS' in *WTO–Trade in Services* by Rüdiger Wolfrum, Peter-Tobias Stoll and Clemens Feinäugle (eds), (Leiden: Brill, 2008)

23 WTO, *Appellate Body, Canada—certain measures concerning periodicals* (*WT/DS31/AB/R*) (30 June 1997), p 17: https://docs.wto.org/dol2fe/Pages/FE_Search/FE_S_S006.aspx?Query=(%40Symbol%3d+wt%2fds31%2fab%2fr*+not+rw*)&Language=ENGLISH&Context=FomerScriptedSearch&languageUIChanged=true# [accessed 9 February 2017]

24 Government Office for Science, *Future of manufacturing: a new era of opportunity and challenge for the UK—summary report* (October 2013), p 16: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/255923/13-810-future-manufacturing-summary-report.pdf [accessed 9 February 2017]

25 Q 34

In evidence to the EU Financial Affairs Sub-Committee, Ms Lowri Khan, Director of Financial Stability, HM Treasury, explained that "industry does not segment itself neatly into the buckets that policy necessarily does". She gave an example:

> "There is quite a lot of interdependency between some of the industrial sectors and the financial sector. To take motor manufacturing as an example, the German motor manufacturers have very large finance companies attached to them, so these issues will inevitably come together."[26]

Services can account for a significant amount of the value of goods. For example, the Office for National Statistics (ONS) noted that in 2011, 37.1% of the total value of UK manufactured goods exports "reflected services sector value-added".[27] Services can also play an important role in driving demand for the physical goods to which they relate. Similarly, the services industry benefits from bundling with goods. Mr James Selka, Chief Executive Officer, Manufacturing Technologies Association, told us: "We are very much a services-based industry which is wrapped around hardware … we have UK-based importers that re-export after adding value through a service-based offering."[28]

It is not easy to quantify the value of add-on services provided by manufacturers, as not all manufacturing firms report service revenue separately, and there is no requirement for them to do so.[29]

14. In discussion of the domestic economy, goods are divided into manufactured products and primary commodities. The term 'manufacturing' is used to encompass the production of goods in a wide range of sectors including food and beverages, aerospace, machinery, automotive, chemicals, pharmaceuticals, and metals.[30] Primary commodities include raw materials, such as oil and metals, and unprocessed food (agriculture and fish). The production of manufactured goods is often closely interlinked with primary commodities, for example in the refining of crude oil into petroleum products or agricultural goods into processed food.

Manufacturing in the UK

15. A 2013 report by the Government Office for Science, *Future of manufacturing: a new era of opportunity and challenge for the UK—summary report*, noted that "in recent years, the relative share of manufacturing in the UK economy has declined more rapidly than in other developed economies … while the

26 Oral evidence taken before the EU Financial Affairs Sub-Committee, 9 October 2016 (Session 2016–17), Q 61

27 Written evidence submitted to the EU Internal Market Sub-Committee, 5 December 2016 (Session 2016–17) TAS0064 (Office for National Statistics)

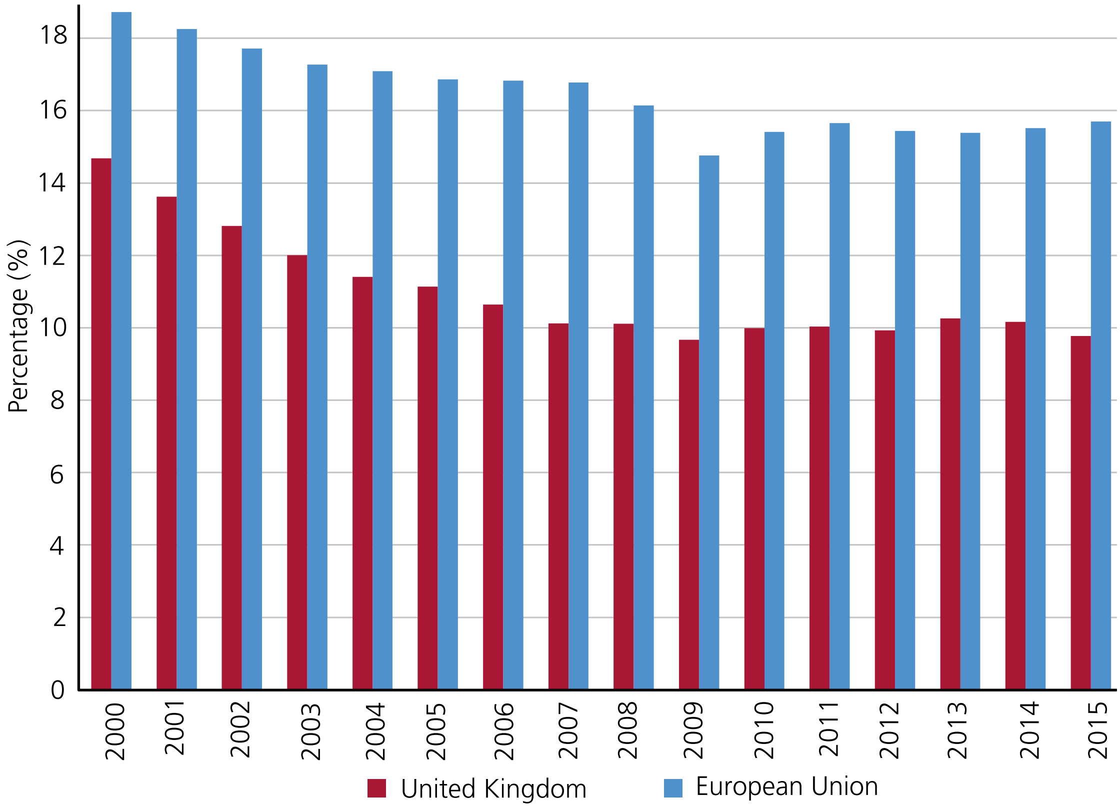
28 Q 18

29 Government Office for Science, *Future of manufacturing: a new era of opportunity and challenge for the UK—summary report* (October 2013), p 16: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/255923/13-810-future-manufacturing-summary-report.pdf [accessed 9 February 2017]

30 EEF—The Manufacturers' Organisation (EEF), *UK manufacturing 2016/17, the facts*: https://www.eef.org.uk/campaigning/campaigns-and-issues/manufacturing-facts-and-figures [accessed 9 February 2017] and Government Office for Science, *Future of manufacturing: a new era of opportunity and challenge for the UK—summary report* (October 2013): https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/255923/13-810-future-manufacturing-summary-report.pdf [accessed 9 February 2017]

service sector has grown at a faster rate".[31] The gross value added (GVA)[32] of manufacturing to the UK economy was 9.77% in 2015.[33] This compared to 22.81% for Germany,[34] 15.79% for Italy,[35] 11.23% for France,[36] 12.33% for the US,[37] and an EU average of 15.7%.[38] Figure 1 below shows the GVA of manufacturing in the UK and EU from 2000–2015.

Figure 1: GVA of manufacturing to the UK and EU economy as percentage of GDP 2000–2015



Source: World Bank, 'Manufacturing, value added (% of GDP)': http://data.worldbank.org/indicator/NV.IND.MANF.ZS?end=2015&locations=EU-GB&start=2000&view=chart [accessed 23 February 2017]

31 Government Office for Science, *Future of manufacturing: a new era of opportunity and challenge for the UK—summary report* (October 2013), p 14: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/255923/13-810-future-manufacturing-summary-report.pdf [accessed 9 February 2017]

32 Gross value added (GVA) measures the contribution to an economy of an individual producer, industry, sector or region. It is used in the calculation of gross domestic product (GDP). GDP is commonly estimated using one of three theoretical approaches: production, income or expenditure. When using production or income approaches, the contribution to an economy of a particular industry or sector is measured using GVA. Financial Times, 'Definition of gross value added GVA': http://lexicon.ft.com/Term?term=gross%20value%20added%20GVA%C2%A0 [accessed 9 February 2017] and World Bank, 'Manufacturing, value added (% of GDP)': http://data.worldbank.org/indicator/NV.IND.MANF.ZS?end=2015&locations=EU-GB&start=2015&view=bar [accessed 9 February 2017]

33 World Bank, 'Manufacturing, value added (% of GDP)': http://data.worldbank.org/indicator/NV.IND.MANF.ZS?end=2015&locations=EU-GB&start=2015&view=bar [9 February 2017]

34 World Bank, 'Manufacturing, value added (% of GDP)': http://data.worldbank.org/indicator/NV.IND.MANF.ZS?end=2015&locations=EU-DE&start=2015&view=bar [accessed 9 February 2017]

35 World Bank, 'Manufacturing, value added (% of GDP)': http://data.worldbank.org/indicator/NV.IND.MANF.ZS?end=2015&locations=EU-IT&start=2015&view=bar [accessed 9 February 2017]

36 World Bank, 'Manufacturing, value added (% of GDP)': http://data.worldbank.org/indicator/NV.IND.MANF.ZS?end=2015&locations=EU-FR&start=2015&view=bar [accessed 9 February 2017]

37 World Bank, 'Manufacturing, value added (% of GDP)': http://data.worldbank.org/indicator/NV.IND.MANF.ZS?end=2014&locations=US&start=2014&view=bar [accessed 9 February 2017] Data for the US is from 2014.

38 World Bank, 'Manufacturing, value added (% of GDP)': http://data.worldbank.org/indicator/NV.IND.MANF.ZS?end=2015&locations=EU-GB&start=2015&view=bar [9 February 2017]

16. Although manufacturing has declined relative to the services sector, and has been slow to recover from the 2008–09 downturn,[39] the Government Office for Science noted that "there are … many outstanding individual firms, and some important areas of relatively strong performance for manufacturing as a whole".[40] There has been a long term shift towards higher value-added and finished goods production in UK manufacturing, and an increase in export intensity (manufacturing exports as a proportion of manufacturing output).[41] For example, the UK's manufacturing export intensity rose from around 30% in 1991 to around 47% in 2011.[42]

17. The Government Office for Science report found that "'deindustrialisation' has also applied to UK manufacturing employment".[43] From the 1840s until the 1960s, manufacturing employed over a third of the UK's working population.[44] Between June 1978 and June 2016, jobs accounted for by the manufacturing, mining and quarrying sectors fell from 26.3% to 8.0%, while the services sector's share increased from 63.2% to 83.2%.[45]

18. Nonetheless, manufacturing continues to be an important employer. EEF estimated that there were 2.7 million people employed in manufacturing in the UK.[46] These jobs are often in regions where there are few alternative sources of employment. Mr Steve Elliott, Chief Executive Officer, Chemical Industries Association (CIA), noted that the chemicals and pharmaceuticals sectors, for example, "provide high-quality jobs in parts of the country that, frankly, need those jobs: for example, north of the M62".[47] The UK Trade Policy Observatory also highlighted regional variety in the areas where goods (both primary commodities and manufacturing) are produced: for example the upstream oil industry is highly significant to jobs and the economy in Scotland (and to Government revenue), while the Midlands depends more on engineering.[48]

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39 ONS, 'Economic Review: February 2016': https://www.ons.gov.uk/economy/nationalaccounts/uksectoraccounts/articles/economicreview/february2016 [accessed 9 February 2017]

40 Government Office for Science, *Future of manufacturing: a new era of opportunity and challenge for the UK—summary report* (October 2013), p 15: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/255923/13-810-future-manufacturing-summary-report.pdf [accessed 9 February 2017]

41 ONS, 'Economic Review: February 2016': https://www.ons.gov.uk/economy/nationalaccounts/uksectoraccounts/articles/economicreview/february2016 [accessed 9 February 2017]

42 Government Office for Science, *Future of manufacturing: a new era of opportunity and challenge for the UK—summary report* (October 2013), p 15: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/255923/13-810-future-manufacturing-summary-report.pdf [accessed 9 February 2017]

43 Government Office for Science, *Future of manufacturing: a new era of opportunity and challenge for the UK—summary report* (October 2013), p 14: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/255923/13-810-future-manufacturing-summary-report.pdf [accessed 9 February 2017]

44 Andrew Walker, 'UK manufacturing: Whatever happened to the 'march of the makers'?' *BBC News* (28 January 2016): http://www.bbc.co.uk/news/business-35414075 [accessed 9 February 2017]

45 ONS, 'Statistical bulletin—UK labour market: Nov 2016': https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/bulletins/uklabourmarket/november2016 [accessed 9 February 2017] The remaining 8.8 % is accounted for by: agriculture, forestry and fishing; electricity, gas, steam and air conditioning supply; water supply, sewerage, waste and remediation activities; and construction.

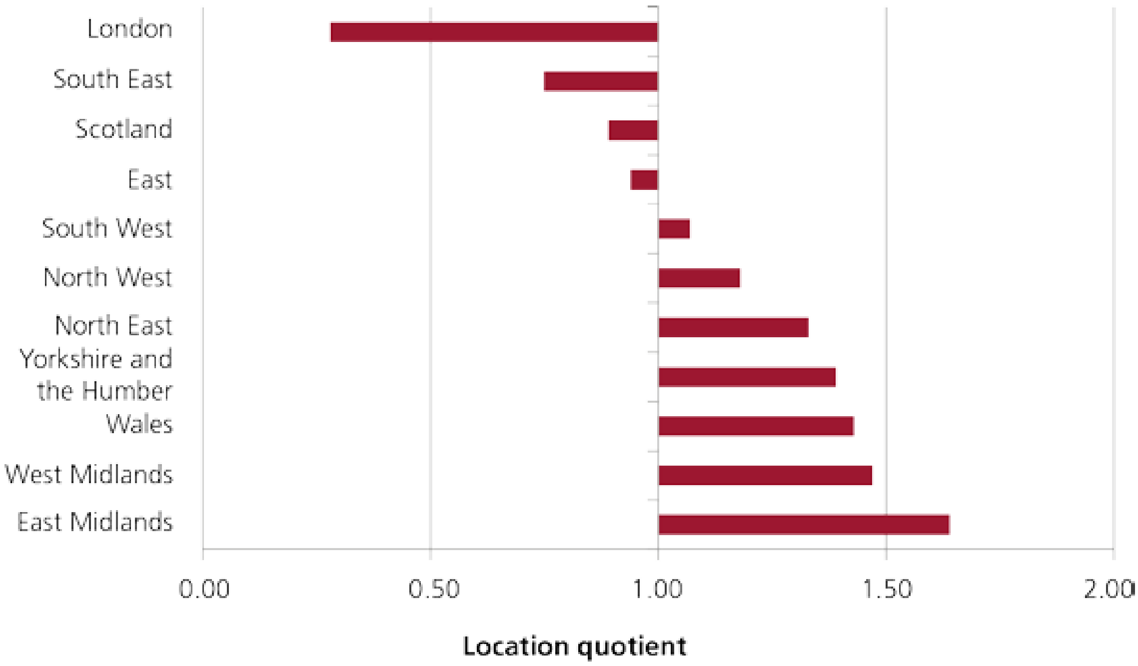
46 EEF, *UK manufacturing 2016/17, the facts* (no date): https://www.eef.org.uk/campaigning/campaigns-and-issues/manufacturing-facts-and-figures [accessed 9 February 2017]

47 Q 14

48 Written evidence submitted to the EU Internal Market Sub-Committee, 30 November 2016 (Session 2016–17) TAS0085 (UK Trade Policy Observatory, University of Sussex)

19. Figure 2 shows the share of employment in manufacturing by region, calculated by location quotients.[49] Location quotients compare each region's share of employees in a specific industry with its local share of total employees.[50] A location quotient greater than 1.0 indicates a relative concentration of the manufacturing industry in the geographic area.[51]

Figure 2: Manufacturing location quotients



Source: ONS, 'Manufacturing location quotients': unpublished data. Data drawn from ONS, 'Business Register and Employment Survey/Annual Business Inquiry': https://www.nomisweb.co.uk/query/select/getdatasetbytheme.asp?theme=27 [accessed 1 March 2017]

20. Manufacturing activity in the UK also supports jobs in the services sector, reflecting the close connection between the manufacturing of goods and the provision of services. Professor Peter Wells, Professor of Business and Sustainability, Cardiff Business School, told us that "there are many more jobs in automotive retailing, service, maintenance and support than there are in manufacturing".[52] The Society of Motor Manufacturers and Traders (SMMT) provided us with figures: the automotive sector accounted for "814,000 jobs across industry", of which 169,000 were employed directly in manufacturing.[53]

49 Location quotients show the concentration of an industry by location, and not the absolute employment figures.

50 The number of employees is derived from the Business Register and Employment Survey (BRES). This is the total number of employees in a specific day in September. The definition of employee in BRES is anyone aged 16 years or over that an organisation directly pays from its payroll(s), in return for carrying out a full-time or part-time job or being on a training scheme. It excludes voluntary workers, self-employed, and working owners who are not paid via PAYE. ONS, 'UK business register and employment survey (BRES)—Statistical bulletins': https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/bulletins/businessregisterandemploymentsurveybresprovisionalresults/previousReleases [accessed 9 February 2017]

51 ONS, *The Spatial Distribution of Industries* (8 November 2012) p 3: http://webarchive.nationalarchives.gov.uk/20160105160709/http:/www.ons.gov.uk/ons/dcp171766_285278.pdf [accessed 9 February 2017]

52 Written evidence from Prof Peter Wells (FTG0013)

53 Written evidence from SMMT (FTG0009); We note that these figures include the supply chain. Supply chain companies serve more than one sector, and so there may be some double counting, for example with the aerospace sector.

21. EEF noted that manufacturing was also an important source of investment in the UK. Manufacturers accounted for 14% of all business investment in the UK, and 68% of all business expenditure on research and development.[54] For example, we were told that the pharmaceuticals and chemicals sector contributed "around £5 billion a year on R&D".[55] The sectors also contributed to "investments in collaborations with our key universities and investment in significant programmes of [scientific] exploration".[56]

Sectors considered in this report

22. Lord Bridges of Headley MBE, Parliamentary Under-Secretary of State, Department for Exiting the EU, and Lord Price CVO, Minister of State, Department for International Trade, told us that the Government was analysing 58 sectors of the economy.[57] Within the scope of our inquiry, it was not possible to take evidence from such a wide range of economic sectors. We focused instead on six large and varied sectors:

- Pharmaceuticals and chemicals;
- Capital goods and machinery;
- Food and beverages;
- Oil and petroleum;
- Automotive; and
- Aerospace and defence.

We used these sectors to illustrate the potential impact of changes to the UK's trading relationship with the EU on trade in goods. We also drew on our report, *Brexit: the options for trade*, which analysed the possible frameworks for UK-EU trade in both goods and services—namely membership of the European Economic Area (EEA), a customs union with the EU, a free trade agreement with the EU, and trade under World Trade Organisation rules.[58] But given that the Prime Minister has now ruled out membership of the EEA or the customs union, our focus has been on the last two frameworks.[59]

23. Mr Luis González García, Associate Member, Matrix Chambers, told us that there was "a lot of creativity in the negotiation of an FTA."[60] FTAs typically set lower tariffs than the most favoured nation (MFN)[61] rate agreed at the WTO, and most agreements include provisions relating to "agricultural and industrial goods, rules of origin, customs procedures, customs facilitation

54 EEF, *UK manufacturing 2016/17, the facts*: https://www.eef.org.uk/campaigning/campaigns-and-issues/manufacturing-facts-and-figures [accessed 9 February 2017]
55 Q 14 (Steve Elliott)
56 Q 14 (Dr Virginia Acha)
57 Written evidence from Lord Bridges of Headley MBE and Lord Price CVO (FTG0027)
58 European Union Committee, *Brexit: the options for trade* (5th Report, Session 2016–17, HL Paper 72)
59 Theresa May MP, Speech on the government's negotiating objectives for exiting the EU, 17 January 2017: https://www.gov.uk/government/speeches/the-governments-negotiating-objectives-for-exiting-the-eu-pm-speech [accessed 13 February 2017]
60 Oral evidence taken before the EU External Affairs and Internal Market Sub-Committees, 8 September 2016 (Session 2016–17), Q 14
61 'Most favoured nation' (MFN) in the WTO refers to the principle that members cannot discriminate between WTO members. If they grant a lower duty on the import of a certain product, they have to do that for all other members too. WTO, 'Understanding the WTO: basics—Principles of the trading system': https://www.wto.org/English/thewto_e/whatis_e/tif_e/fact2_e.htm#seebox [accessed 10 February 2017]

and co-operation".[62] Traditionally they are more significant to trade in goods than trade in services. FTAs have become increasingly complex, however, tackling a variety of issues from quotas on imported goods to intellectual property, investment protection, cross-border services, labour conditions and mobility.[63] The most advanced agreements also include elements of regulatory co-operation.[64]

24. The six sectors were selected to provide an insight into the principal issues relating to goods trade that the Government must address in its Brexit negotiations. As the figures below demonstrate, the six sectors are significant exporters and importers, and represent both manufactured products and primary commodities.

25. The scope of each sector for the purposes of our inquiry is outlined below. We note that the available statistics in some cases cover either a broader or narrower industry segment, or incorporate a slightly different set of data points. Our inquiry did not seek to gather new data relating to the sectors investigated; rather, figures for each sector were provided by our witnesses and by the Office for National Statistics and other publicly available sources. For this reason, the figures used in this report are only indicative, and we acknowledge that some double counting or overlap is possible.

Pharmaceuticals and chemicals

26. The pharmaceuticals and chemicals sector comprises companies which produce medicines and conduct clinical research, the manufacturing base for active pharmaceutical ingredients, and chemicals manufacturing.[65]

27. In 2015, the UK's total exports of the sector were worth £51.2 billion (£26.1 billion for chemicals and £25.1 billion for pharmaceuticals). In the same year, the UK's total imports in the sector were worth £50.6 billion (£24.2 billion for chemicals and £26.4 billion for pharmaceuticals).[66]

62 Oral evidence taken before the EU External Affairs and Internal Market Sub-Committees, 8 September 2016 (Session 2016–17), Q 14 (Luis González García)

63 Oral evidence taken before the EU External Affairs and Internal Market Sub-Committees, 8 September 2016 (Session 2016–17), Q 14 (Luis González García) For more information about FTAs see our previous report, European Union Committee, *Brexit: the options for trade* (5th Report, Session 2016–17, HL Paper 72)

64 Written evidence submitted to the EU Internal Market Sub-Committee, 30 November 2016 (Session 2016–17) TAS0085 (UK Trade Policy Observatory, University of Sussex)

65 Q 1

66 Written evidence submitted to the EU Internal Market Sub-Committee, 5 December 2016 (Session 2016–17) TAS0064 (Office for National Statistics). The turnover of the sector in 2015 was £43.9 billion (£29.9 billion for chemicals, and £14 billion for pharmaceuticals). ONS, 'UK Non-Financial Business Economy (Annual Business Survey): Sections A-S (Section C)': https://www.ons.gov.uk/businessindustryandtrade/business/businessservices/datasets/uknonfinancialbusinesseconomyannualbusinesssurveysectionsas [accessed 13 February 2017] We note that the ONS balance of payments data (from which the data on exports is drawn) measures pharmaceutical products, while the ONS annual business survey (from which the turnover figure of £43.9 billion is drawn) considers pharmaceutical companies. Any discrepancy between the data may be accounted for by this difference in methodology.

28. The yearly average of employment in chemicals was 102,000 in 2015.[67] The Association of the British Pharmaceutical Industry's new *Biopharma R&D Sourcebook* 2016 cited 62,000 jobs as its "best approximation of employment in the pharmaceutical industry" in 2015.[68]

Capital goods and machinery

29. Capital goods are durable goods that are used in producing other goods and services.[69] The capital goods and machinery sector includes a wide range of industries working in manufacturing. Capital goods include machinery, tools and other equipment used to produce goods for consumption—for example excavators, forklift trucks, generators, metal-forming and metal-working machines.[70]

30. A number of sectors, notably automotive, include their supply chains in sector statistics. There is considerable potential for overlap between the supply chains of capital goods and machinery sector and other industry sectors in this report.

31. The UK exported capital goods worth £36.7 billion in 2015. Imports of capital goods were worth £57.2 billion in the same period.[71]

Food and beverages

32. The 'food and beverages' sector for the purposes of this report includes manufactured food, agricultural goods, and non-alcoholic beverages. The broader issues affecting the UK agricultural sector after Brexit are the subject of an inquiry by our Energy and Environment Sub-Committee, and we published a report, *Brexit: fisheries,* which considered the UK fishing industry—including trade aspects—on 17 December 2016.[72]

67 ONS, 'UK Non-Financial Business Economy (Annual Business Survey): Sections A-S (Section C)': https://www.ons.gov.uk/businessindustryandtrade/business/businessservices/datasets/uknonfinancialbusinesseconomyannualbusinesssurveysectionsas [accessed 13 February 2017]

68 Association of the British Pharmaceutical Industry, *Open for Innovation—UK Biopharma R&D Sourcebook 2016*, p 15: http://www.abpi.org.uk/our-work/library/industry/Documents/Open_for_innovation_ABPI_Sourcebook_2016.pdf [accessed 9 February 2017]

69 The Balance, 'Capital goods: examples, effect on economy': https://www.thebalance.com/capital-goods-examples-effect-on-economy-3306224 [accessed 9 February 2017]; We note that whether an item is a consumer good or a capital good depends on how it is used. For example, a computer is a capital good if used by a business, but a consumer good if used by a family.

70 Clifford Chance, 'Capital goods': https://www.cliffordchance.com/expertise/sectors/industrials/capital_goods.html [accessed 9 February 2017] and Business Dictionary, 'Capital goods': http://www.businessdictionary.com/definition/capital-goods.html [accessed 9 February 2017] Commercial buildings, such as factories, offices, and warehouses are also capital goods, although not relevant to trade as they have a fixed location. The Balance, 'Capital goods: examples, effect on economy': https://www.thebalance.com/capital-goods-examples-effect-on-economy-3306224 [accessed 9 February 2017]

71 ONS, *The Pink Book—2016, Chapter 2—2.1 Trade in goods summary table* (29 July 2016): https://www.ons.gov.uk/economy/nationalaccounts/balanceofpayments/datasets/2tradeingoodsthepinkbook2016 [accessed 9 February 2017]

72 European Union Committee, *Brexit: fisheries* (8th Report, Session 2016–17, HL Paper 78)

33. Annual exports of food and non-alcoholic drinks (including manufactured goods and processed and unprocessed ingredients) were worth £12.3 billion in 2015. Imports of food and non-alcoholic drinks amounted to £35.1 billion in the same period.[73]

34. Food and drink manufacturing employs around 400,000 people,[74] and agriculture employs 476,000 people (this figure comprises 115,000 regular employees, 67,000 seasonal, casual and gang workers, and 294,000 farmers, business partners, directors and their spouses).[75]

Oil and petroleum

35. The oil and petroleum industry comprises the upstream and downstream sectors. The upstream sector identifies oil deposits and extracts these resources from underground, and the downstream sector refines crude oil (producing gasoline, fuel oils and petroleum-based products) and markets it to retailers and other end users.[76]

36. Oil exports were worth £21 billion in 2015 and imports were worth £29.3 billion.[77]

37. Just over 330,000 jobs in the UK are delivered through or supported by oil and gas production (the upstream sector),[78] and the downstream sector supports the employment of 88,100 people, directly and indirectly.[79]

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73 Food and Drink Federation (FDF), 'UK-EU food and drink statistics': https://www.fdf.org.uk/eu-referendum-food-drink-statistics.aspx [accessed 23 February 2017] Food and drink manufacturing has a total turnover of around £83.7 billion per annum. Food and Drink Federation, *A new UK-EU relationship—priorities for the food and drink manufacturing industry* (July 2016), p 2: https://www.fdf.org.uk/corporate_pubs/FDF-Manifesto-A-New-UK-EU-Relationship.pdf [accessed 9 February 2017] Food and drink manufacturing adds £21.9 billion of gross value to the UK economy annually, and UK farmers contribute around £10 billion. FDF, 'Statistics at a glance': https://www.fdf.org.uk/statsataglance.aspx [accessed 7 March 2017] and National Farmers Union, 'The economy': https://www.nfuonline.com/back-british-farming/why-should-i-back-british-farming/the-economy/ [accessed 9 February 2017] The statistics and terms are provided in the documents cited. The House of Lords did not have the opportunity to verify the methodology used or the precise definition of the term 'contribution'.

74 FDF, *A new UK-EU relationship* (July 2016) p 2: https://www.fdf.org.uk/corporate_pubs/FDF-Manifesto-A-New-UK-EU-Relationship.pdf [accessed 9 February 2017]

75 Written evidence from the Agriculture and Horticulture Development Board (AHDB) (FTG0007)

76 The figures for the downstream sector used in this report only represent the membership of the UK Petroleum Industry Association (UKPIA). UKPIA represents the eight refining and marketing companies which own and operate the six major crude oil processing refineries in the UK.

77 ONS, *The Pink Book—2016, Chapter 2—2.1 Trade in goods summary table (29 July 2016):* https://www.ons.gov.uk/economy/nationalaccounts/balanceofpayments/datasets/2tradeingoodsthepinkbook2016 [accessed 9 February 2017]; The activities of the upstream and downstream sectors combined make an estimated annual contribution to the UK economy of £11.3 billion. UKPIA, *Fuelling the UK's economic engine* (21 October 2016), p 3: http://www.ukpia.com/docs/default-source/default-document-library/fuelling-the-uk's-economic-engine39b55c889f1367d7a07bff0000a71495.pdf?sfvrsn=0 [accessed 9 February 2017]; £11.3 billion is derived from £2.3 billion from UKPIA members and £9 billion from the upstream industry. We note that the figure for the contribution to the economy of the oil and petroleum sector was provided by UKPIA, while the export figure was collated by the ONS. The contribution to the economy (gross value added) of a sector can be significantly less than its exports, in particular in sectors with a high proportion of imports and if the cost of inputs is high. Any discrepancy between the data may be accounted for by a difference in methodology.

78 Oil & Gas UK, 'Oil & Gas UK figures show impact of oil price downturn on jobs': http://oilandgasuk.co.uk/oil-gas-uk-figures-show-impact-of-oil-price-downturn-on-jobs/ [accessed 10 February 2017]; The figure is a forecast for 2016.

79 Figures for UKPIA members only: UKPIA, *Fuelling the UK's economic engine* (21 October 2016) p 3: http://www.ukpia.com/docs/default-source/default-document-library/fuelling-the-uk's-economic-engine39b55c889f1367d7a07bff0000a71495.pdf?sfvrsn=0 [accessed 10 February 2017]

Automotive

38. The UK automotive sector comprises manufacturers of mainstream cars,[80] buses and coaches, premium and sports cars, and commercial vehicles, as well as design centres and R&D centres.

39. In 2015, the sector exported products worth £34.3 billion, and imports were worth £52.1 billion.[81] 169,000 people are employed directly in automotive manufacturing, and another 645,000 work across the wider automotive industry.[82]

Aerospace and defence

40. For the purposes of this report, 'aerospace and defence' covers the interrelated sectors of aerospace, defence, and space. This includes the production of complex aerospace parts—such as aeroengines, fuselages and landing gear—defence equipment, and the space industry.

41. The industries' combined exports were worth an estimated £33.1billion in 2015.[83] Import figures are not available for the defence sector, but imports of air, spacecraft and related machinery were worth £19.8 billion in 2015.[84] The sector directly employs 264,000 people in the UK.[85]

The competitiveness of the UK economy after Brexit

42. While the focus of our inquiry was the trade in goods between the UK and the EU, two non-trade issues with a direct impact on the competitiveness of the UK economy were highlighted by our witnesses: the availability of workers and research co-operation and funding.

43. The issue of UK-EU movement of people was the subject of our report *Brexit: UK-EU movement of people*, which considered the possible arrangements for migration of EU citizens to the UK, and their potential implications for UK citizens moving to the EU, after Brexit.[86] The issue of research and science funding was considered in the reports of the Science and Technology

80 'Mainstream cars' excludes Formula 1 and racing cars.

81 SMMT, *Motor industry facts 2016*, p 9: https://www.smmt.co.uk/wp-content/uploads/sites/2/SMMT-Motor-Industry-Facts-2016_v2-1.pdf [accessed 21 February 2017] and written evidence from SMMT (FTG0009); The industry has an annual turnover of £71.6 billion and added £18.9 billion in value to the UK economy. Written evidence from SMMT (FTG0009)

82 Written evidence from SMMT (FTG0009); We note that these figures include the supply chain. Supply chain companies serve more than one sector, and so there may be some double counting, for example with the aerospace sector.

83 Written evidence from ADS Group (FTG0028); Turnover of the combined sector in the UK in 2015 was £56 billion (the total figure for turnover including the security sector was £65 billion in 2015, and £56 billion is this sum minus £9 billion for the security sector). The total figure for exports including the security sector was £35 billion in 2015; £32.1 billion is this sum minus £2.9 billion for the security sector (average exports 2010–2014). ADS Group, 'Facts & figures 2016': https://www.adsgroup.org.uk/facts2016/ [accessed 10 February 2017]

84 ONS, *Publication Tables, UK Trade, CPA (08) (21 December 2016)*: https://www.ons.gov.uk/economy/nationalaccounts/balanceofpayments/datasets/publicationtablesuktradecpa08 [accessed 1 March 2017]

85 ADS Group, 'Facts & figures 2016': https://www.adsgroup.org.uk/facts2016/ [accessed 10 February 2017]; The total figure for employment including the security sector was 304, 000 in 2015; 264, 000 is this sum minus 76, 000 for the security sector.

86 European Union Committee, *Brexit: UK-EU movement of people* (14th Report, Session 2016–17, HL Paper 121)

Committee *EU Membership and UK Science* and *A time for boldness: EU membership and UK science after the referendum*.[87]

44. Provisions relating to the movement of people and research co-operation and funding are regularly included in FTAs. We briefly discuss these two issues below, before considering issues specifically pertaining to trade.

Availability of workers

45. Our witnesses emphasised that, for every sector, the ability to recruit the appropriate staff is critical to that industry's success. They highlighted two issues: the ability to recruit staff to roles in the UK, and to move workers between EU countries.

Recruit staff to roles in the UK

46. We heard that it was not possible to fill all vacancies with UK workers. Mr Mike Hawes, Chief Executive Officer, SMMT, said that "all the companies will invariably try to recruit locally; it makes eminent sense to do so, and that will continue. However, you cannot always recruit locally."[88]

47. The first challenge identified by witnesses was the skills shortage in science, technology, engineering, maths and design in the UK.[89] This shortage was currently addressed by recruitment from overseas,[90] and freedom of movement rules allowed companies to employ EU workers more easily than those from countries outside the EU.[91] Norton Rose Fulbright LLP, a law firm with a large oil and gas practice, expressed concern that ending UK-EU free movement of people could result in a "complex, time consuming and expensive visa process with caps on numbers".[92]

48. The Chemical Industries Association noted that, were restrictions to be placed on hiring EU nationals, UK capabilities could not be increased in the short term: "It is not possible to substitute 20 years of specialist knowledge in an obscure chemical discipline with a local training scheme."[93]

49. Witnesses also highlighted the disproportionate impact of restrictions on the movement of people on smaller companies. Norton Rose Fulbright LLP told us that, in the oil sector, maintaining a licence to sponsor work visas would be too expensive for start-ups and SMEs, which have only small personnel departments. This meant that "a proportionately heavier burden would fall on them".[94] Mr Hawes noted that small companies within the automotive supply chain "have as much need" for specialist skills as large firms such as Nissan, but already find it "much harder to recruit". Such companies were seeking "assurances that the non-UK nationals they currently have can remain and that they can continue to attract talent from abroad".[95]

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87 Science and Technology Committee, *EU Membership and UK Science* (2nd Report, Session 2015–16, HL Paper 127) and Science and Technology Committee, *A time for boldness: EU membership and UK science after the referendum* (1st Report, Session 2016–17, HL Paper 85)
88 Q 80
89 Written evidence from CIA (FTG0003), The Association of Manufacturers of Domestic Appliance (AMDEA) (FTG0002), Meggitt PLC (FTG0017) and Prof Peter Wells (FTG0013)
90 Q 74 (Mike Hawes), written evidence from AMDEA (FTG0002), CIA (FTG0003) and Meggitt PLC (FTG0017)
91 Written evidence from AMDEA (FTG0002)
92 Written evidence from Norton Rose Fulbright LLP (FTG0018)
93 Written evidence from CIA (FTG0003)
94 Written evidence from Norton Rose Fulbright LLP (FTG0018)
95 Q 73

50. A second challenge was access to "relatively lower-skilled labour" in the form of "both permanent and seasonal migrant workers".[96] Professor Tim Lang, Founder, Centre for Food Policy, City, University of London, told us that "you would not get any fresh British vegetables or fruit if it were not for migrant labour", and "there would be no food manufacturing".[97] The Agriculture and Horticulture Development Board (AHDB) informed us that "it is not unreasonable to view … EU nationals as accounting for around 20% of the 115,000 regular employees in the [agricultural] sector".[98] In addition, it was "clear that EU migrants are likely to be filling the majority" of seasonal migrant labour roles for that sector, although accurate data were not captured.[99] The Food and Drink Federation (FDF) estimated a higher rate still for the food and drink manufacturing workforce: 29% were non-UK EU nationals—almost 116,000 workers.[100]

51. The AHDB said that EU workers would be "an important factor influencing the competitiveness of the agricultural industry … post-Brexit".[101] While restrictions on free movement of people would "push up wages to attract UK workers", this would "increase costs of production resulting in product being uncompetitive on domestic and export markets".[102]

52. While access to lower skilled labour is a particular issue for the food and beverages sector, Professor John Manners-Bell, Chief Executive, Transport Intelligence Ltd, told us that the challenge was not limited to that sector: "At the moment, the logistics and supply chain sector is powered by employees who are largely migrants who come in from eastern Europe." These included van drivers and staff at warehouses and distribution centres supporting a range of sectors including e-commerce: "If that huge supply were to dry up it could really push up costs, and that would make UK manufacturing and retailing uncompetitive."[103]

Intra-group transfers of staff between EU countries

53. Many firms routinely move employees across the EU between the different locations in which they operate.[104] The reasons for such movement include project work (such as installing a product, or providing a related service) and seconding or transferring staff to different company locations.

54. Given that manufacturers increasingly provide add-on services, wrapped around their products, Mr McReynolds told us that "the free movement of individuals into the EU [27] to carry out those service activities" was important.[105] The Manufacturing Technologies Association emphasised the importance of "the movement of people and expertise to facilitate working on international contracts and projects,"[106] a point also made by Mr Simon Whalley, Head of External Affairs, Royal Aeronautical Society, and the SMMT.[107]

96 Written evidence from AHDB (FTG0007)
97 Q 39
98 Written evidence from AHDB (FTG0007)
99 *Ibid.*
100 Written evidence from FDF (FTG0021)
101 Written evidence from AHDB (FTG0007)
102 *Ibid.*
103 Oral evidence taken before the EU External Affairs and Internal Market Sub-Committees, 15 September 2016 (Session 2016–17), Q 38 (Prof John Manners-Bell)
104 We use intra-group and intra-company transfers interchangeably.
105 Q 34
106 Written evidence from The Manufacturing Technologies Association (MTA) (FTG0015)
107 Q 85 (Simon Whalley) and written evidence from SMMT (FTG0009)

55. Mr Chris Hunt, Director General and Company Secretary, UK Petroleum Industry Association (UKPIA), gave us an example of the importance of moving staff between the UK and other EU Member States in the downstream sector:

> "We move between 1,000 and 1,500 people from the UK into Europe and back again each year. There are around 82 locations throughout Europe which are affiliated to UKPIA members and where they have offices and plants. We move highly skilled people around through the processing we do, which is highly technical, so that is key to us."[108]

56. Our witnesses also emphasised the importance of moving staff to the development and retention of skilled employees. The CIA told us that larger companies needed to move staff between locations "for career progression and ensuring the best people are in the right jobs".[109]

Research collaboration and funding

57. Engagement between universities and businesses, in many cases facilitated by EU funding, is also important to the success of the UK's manufacturing industry. Meggitt PLC, which provides components and sub-systems for the aerospace, defence and energy markets, told us that the EU was "an important source of funding for research and development" within the aerospace and defence sector.[110] Mr Whalley agreed: given the "limited amount of funding available from national government compared with what is available from the European Union", such funding resulted in a "higher quality of outcome than necessarily achievable within only national programmes".[111] In the automotive sector too, "significant levels of EU funding" had the effect of "boosting UK automotive innovation".[112] Mr Whalley told us that while the Government's guarantee of funding for EU-funded projects until 2020 had been welcome, concerns remained in industry and academia about the longer term outlook.[113]

58. Dr Virginia Acha, Executive Director of Research, Medical and Innovation, Association of the British Pharmaceutical Industry, said that while "having predictable funding" mattered, collaboration was just as important: "It is not just about the money; it is about the networks in which these researchers are able to participate."[114] The Association of Manufacturers of Domestic Appliances (AMDEA) similarly told us that the collaboration between UK and other EU universities through EU funding created "competence centres that are beneficial for both EU and UK industries".[115] Such collaboration on research and development was also highlighted by the automotive industry.[116]

108 Q 48
109 Written evidence from CIA (FTG0003)
110 Written evidence from Meggitt PLC (FTG0017)
111 Q 85
112 Written evidence from SMMT (FTG0009)
113 Q 86 On 13 August 2016, the Rt Hon Philip Hammond MP, Chancellor of the Exchequer, confirmed that research funding from the EU's Horizon 2020 programme (which awards funding for research and innovation in EU Member States) granted before the UK leaves the EU will be guaranteed by HM Treasury, even when these projects continue beyond the UK's departure from the EU. If UK organisations bid directly to the European Commission on a competitive basis for EU funding projects while the UK is still a member of the EU, for example universities participating in Horizon 2020, the Treasury will underwrite the payments of such awards, even when specific projects continue beyond the UK's departure from the EU. HM Treasury, 'Chancellor Philip Hammond guarantees EU funding beyond date UK leaves the EU' (13 August 2016): https://www.gov.uk/government/news/chancellor-philip-hammond-guarantees-eu-funding-beyond-date-uk-leaves-the-eu [accessed 5 January 2017]
114 Q 1
115 Written evidence from AMDEA (FTG0002)
116 Written evidence from SMMT (FTG0009)

The Government's industrial strategy

59. The Government's Green Paper, *Building our industrial strategy,*[117] went some way to addressing the concerns we have outlined. It included "science, research and innovation" and "skills" as two of its 10 priorities. "Trade and investment" was a third heading, including the commitment to "pursue, as a priority, a bold and ambitious free trade agreement with the European Union". We note, however, that there was no mention of a new immigration policy or measures to enable the movement of staff overseas post-Brexit.

Conclusions and recommendations

60. **International businesses are not structured neatly along sectoral lines or national boundaries. The Government must be mindful of the complex structure of businesses, particularly multi-national companies, in its analysis of the impact of Brexit.**

61. **The manufacturing and primary commodities sectors are important employers, particularly in regions outside the South East of England. Ensuring that these industries do not face additional barriers to trade with the EU and beyond will be essential to drive growth across the whole country, as envisaged in the Government's Green Paper, Building our Industrial Strategy.**

62. **Although concentrated in different regions, the production of goods and services is often intertwined. A worsening of trade conditions for goods could therefore have a negative impact on employment in supporting services industries across the country. The Government must seek a trade agreement with the EU which recognises this interlinkage, and secures the best possible terms for both.**

63. **A new UK approach to immigration must take account of the needs of businesses in the UK. The ability to recruit staff from the EU-27, and move staff to and from the EU-27 through intra-group transfers, is essential to the primary commodities and manufacturing industries. The Government must ensure that its post-Brexit immigration policy allows this.**

64. **We call on the Government also to clarify that the UK's existing level of research funding and collaboration with the EU-27 will continue, or that equivalent domestic arrangements will be established, after the UK's withdrawal from the EU.**

117 HM Government, *Building our industrial strategy—Green Paper* (January 2017): https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/585273/building-our-industrial-strategy-green-paper.pdf [accessed 10 February 2017]

CHAPTER 3: GOODS—UK EXPORTS AND IMPORTS

Trade in goods

65. The UK economy as a whole is dominated by services (which account for 80% of the economy),[118] but goods continue to represent the largest share of UK trade.[119] Although the proportion of the UK's trade accounted for by goods has fallen significantly from a peak of 75% in 1986, goods still represented 56% of all trade in 2015.[120]

66. The UK imports more goods than it exports.[121] The UK's trade in services is in surplus, but this does not make up for the goods deficit, resulting in an overall trade deficit.[122] Increasing goods exports in order to address this trade deficit has been advocated by successive Governments. For example, in September 2016 the Rt Hon Liam Fox MP, Secretary of State for International Trade, said the UK "cannot leave our current account deficit, which currently stands at a record level of 5.4% of GDP, to be dealt with at some point in the future".[123]

67. It is a mistake to regard imports as bad for the economy, and exports as good: imports also generate economic activity. We also note that—as discussed below and in Chapter 4 (in relation to the six sectors)—imports are often essential to the production of goods which are then exported. The UK Trade Policy Observatory, University of Sussex, told our Internal Market Sub-Committee that while exports generated foreign exchange, the purpose of this was, in turn, "to purchase goods and services for us to consume". It added that "the output from sectors in deficit requires labour and so generates jobs just as much as that from sectors in surplus".[124]

68. The UK Trade Policy Observatory also told the Internal Market Sub-Committee that while the import of goods which might have been produced domestically could result in job losses, "very often domestic output could not readily (or sometimes even at all) substitute for imported goods, and so a simple 'jobs lost' calculation will be very misleading".[125]

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118 Full Fact, 'Everything you might want to know about the UK's trade with the EU': https://fullfact.org/europe/uk-eu-trade/ [accessed 10 February 2017]

119 ONS, 'Statistical bulletin—UK Balance of Payments, The Pink Book: 2016': https://www.ons.gov.uk/economy/nationalaccounts/balanceofpayments/bulletins/unitedkingdombalanceofpaymentsthepinkbook/2016#trade [accessed 10 February 2017]; The ONS noted that the rising share of services—44% of total trade in 2015—is "indicative of the UK's relative strength in services activities".

120 ONS 'Statistical bulletin—UK Balance of Payments, The Pink Book: 2016': https://www.ons.gov.uk/economy/nationalaccounts/balanceofpayments/bulletins/unitedkingdombalanceofpaymentsthepinkbook/2016#trade [accessed 10 February 2017]

121 ONS, 'UK Perspectives 2016: Trade with the EU and beyond': http://visual.ons.gov.uk/uk-perspectives-2016-trade-with-the-eu-and-beyond/ [accessed 10 February 2017]

122 *Ibid.*

123 Liam Fox MP, Speech on free trade, 29 September 2016: https://www.gov.uk/government/speeches/liam-foxs-free-trade-speech [accessed 3 February 2017]; The Rt Hon George Osborne MP, former Chancellor of the Exchequer, in 2011 announced a "march of the makers" to rebalance the UK economy towards manufacturing exports. *The Economist*, 'The other deficit' (15 October 2015): http://www.economist.com/news/britain/21674792-how-worrying-britains-large-current-account-deficit-other-deficit [accessed 23 February 2017]

124 Written evidence submitted to the EU Internal Market Sub-Committee, 30 November 2016 (Session 2016–17) TAS0085 (UK Trade Policy Observatory, University of Sussex)

125 Written evidence submitted to the EU Internal Market Sub-Committee, 30 November 2016 (Session 2016–17) TAS0085 (UK Trade Policy Observatory, University of Sussex)

Exports

69. Table 1 details the UK's exports to the EU in goods and services, and their share of the UK's total exports in 2015.

Table 1: UK exports to the EU and percentages of total UK exports 2015 (£ million)

Exports of goods to the EU	133,524
Percentage of total UK goods exports	46.9%
Exports of services to the EU	88,909
Percentage of total UK services exports	39.4%
Total exports of goods and services to the EU	222,433
Percentage of total UK exports	43.6%

Source: ONS, 'Statistical bulletin—UK trade: May 2016, Table 2': https://www.ons.gov.uk/economy/nationalaccounts/balanceofpayments/bulletins/uktrade/may2016 [accessed 9 February 2017]

70. The EU countries combined were the UK's single largest export market for goods in 2015, accounting for 47% (£134 billion). UK goods exports to non-EU countries were valued at £151 billion in 2015 (53%).[126] The major EU export destinations for UK goods in 2015 were Germany, France, The Netherlands and Ireland.[127] The largest export destinations for UK goods (after the EU countries combined) in 2015 were the US, China, and Switzerland.[128] We note that the UK's trade with Switzerland is covered by the conditions of the EU-Switzerland FTA and associated bilateral agreements, and these preferential terms would not apply to the UK after Brexit.[129] The destinations and figures for the UK's goods exports are given in Table 2.

126 ONS, 'Statistical bulletin—UK Balance of Payments, The Pink Book 2016': https://www.ons.gov.uk/economy/nationalaccounts/balanceofpayments/bulletins/unitedkingdombalanceofpaymentsthepinkbook/2016#trade [accessed 10 February 2017] and ONS, 'UK Perspectives 2016: Trade with the EU and beyond': http://visual.ons.gov.uk/uk-perspectives-2016-trade-with-the-eu-and-beyond/ [accessed 10 February 2017]

127 ONS, *The Pink Book—2016, Chapter 9—9.4 Trade in goods* (29 July 2016): https://www.ons.gov.uk/file?uri=/economy/nationalaccounts/balanceofpayments/datasets/9geographicalbreakdownofthecurrentaccountthepinkbook2016/thepinkbook/pinkbook2016chapter9.xls [accessed 12 January 2017] We note that statistics on trade with the Netherlands may be affected by the 'Rotterdam effect': the situation where goods which are initially exported to one country (with a large international port) are then re-exported elsewhere.

128 ONS, *The Pink Book—2016, Chapter 9—9.4 Trade in goods* (29 July 2016): https://www.ons.gov.uk/file?uri=/economy/nationalaccounts/balanceofpayments/datasets/9geographicalbreakdownofthecurrentaccountthepinkbook2016/thepinkbook/pinkbook2016chapter9.xls [accessed 10 February 2017]; These are the largest single-country destinations. The Residual Gulf and Arabian Countries combined (Bahrain, Iraq, Kuwait, Oman, Qatar, United Arab Emirates and Yemen) together account for £10,058 million or 4% of UK exports.

129 We considered Switzerland's trade arrangements with the EU in the report *Brexit the options for trade*. European Union Committee, *Brexit: the options for trade* (5th Report, Session 2016–17, HL Paper 72)

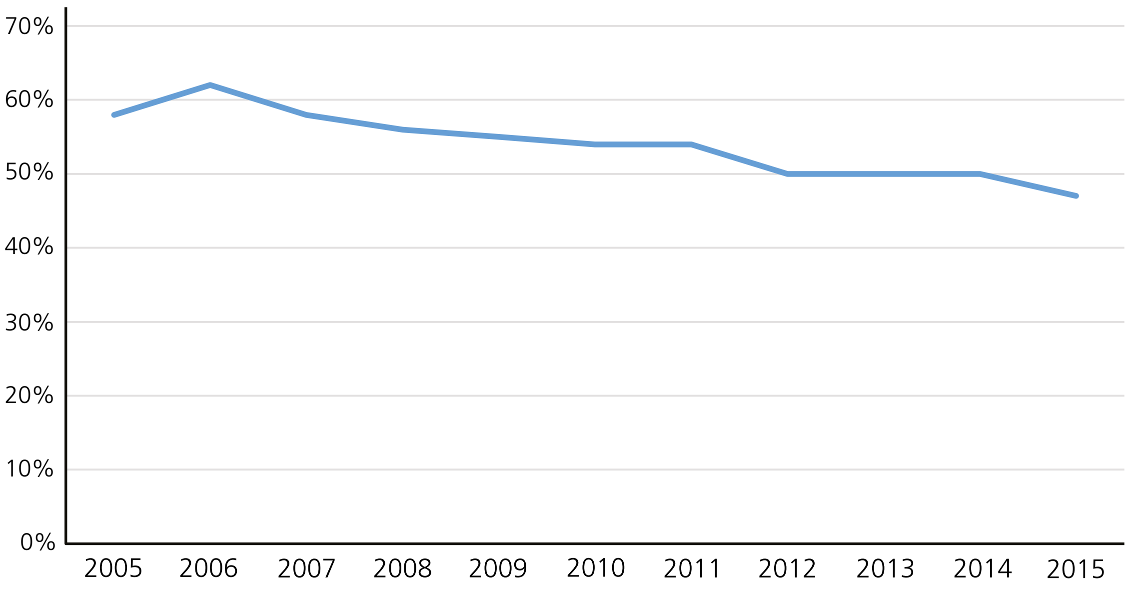
Table 2: Destination of UK goods exports 2015

		£ million	Percentage of total UK exports (rounded)
EU total		133,524	47
	Germany	*30,480*	*11*
	France	*17,920*	*6*
	The Netherlands	*16,870*	*6*
	Ireland	*16,764*	*6*
United States		47,229	17
China		12,721	4
Switzerland		8,143	3
Rest of the world		83,238	29
Total		284,855	100

Source: ONS, The Pink Book—2016, Chapter 9—9.4 Trade in goods (29 July 2016): https://www.ons.gov.uk/file?uri=/economy/nationalaccounts/balanceofpayments/datasets/9geographicalbreakdownofthecurrentaccountthepinkbook2016/thepinkbook/pinkbook2016chapter9.xls [accessed 7 March 2017]

71. The percentage of UK goods exports accounted for by the EU in 2015 was slightly lower than in the period 2012–2014, when on average just over 50% of the UK's goods were exported to EU countries.[130] The Office for National Statistics noted that this was a trend for both goods and services: "The UK has increasingly been trading with emerging and advanced economies from outside the EU, with the proportion of trade with EU countries falling since 1999".[131] Figure 3 shows this trend for goods exports.

Figure 3: Percentage of goods exports accounted for by the EU 2005–15



Source: ONS, 'Statistical bulletin—UK Balance of Payments, The Pink Book 2016': https://www.ons.gov.uk/economy/nationalaccounts/balanceofpayments/bulletins/unitedkingdombalanceofpaymentsthepinkbook/2016 [accessed 9 January 2017]

130 ONS, 'UK Perspectives 2016: Trade with the EU and beyond': http://visual.ons.gov.uk/uk-perspectives-2016-trade-with-the-eu-and-beyond/ [accessed 6 March 2017]

131 *Ibid.*

72. Although the UK's overall share of global goods exports is lower than that of key competitors, according to a 2012 report by the then Department for Business, Innovation and Skills, the UK's "export performance is relatively strong in many innovative, high growth goods sectors, such as pharmaceuticals and high tech machinery".[132]

73. The UK tends to export more components, fuels, food and beverages, and basic materials to the EU than to non-EU countries, but exports more finished goods and services to non-EU countries than to the EU.[133] The Office for National Statistics explained that this was in part because the UK is "an important part of the EU supply chain", and so "a relatively high proportion of our exports of goods are components manufactured in the UK for onward assembly elsewhere in the EU".[134]

Imports

74. Table 3 details the UK's imports from the EU in goods and services, and their share of the UK's total imports in 2015.

Table 3: UK imports from the EU and percentages of total UK imports 2015 (£ million)

Imports of goods from the EU	222,992
Percentage of total UK goods imports	54.2%
Imports of services from the EU	67,977
Percentage of total UK services imports	49.4%
Total imports of goods and services from the EU	290,969
Percentage of total UK imports	53%

Source: UKEA, 'Office for National Statistics: Statistical bulletin—UK trade: May 2016, Table 2': https://www.ons.gov.uk/economy/nationalaccounts/balanceofpayments/bulletins/uktrade/may2016 [accessed 9 February 2017]

75. The EU accounted for 54% (£223 billion) of the UK's imports of goods in 2015.[135] The principal EU countries supplying the UK's goods imports in 2015 were Germany, The Netherlands, France and Belgium.[136] The largest non-EU sources of the UK's imports in 2015 were China, the US, Norway and Switzerland.[137] We note that the UK's trade with Norway is covered by the conditions of the European Economic Area, and that with Switzerland is covered by the conditions of the EU-Switzerland FTA and associated bilateral agreements, and these preferential terms would not apply to the UK after Brexit.[138] The sources of and figures for the UK's goods imports are given in Table 4.

132 Department for Business Innovation and Skills, BIS economics paper no. 17 (February 2012), p 6: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/32475/12-579-uk-trade-performance-markets-and-sectors.pdf [accessed 7 March 2017]
133 ONS, 'UK Perspectives 2016: Trade with the EU and beyond': http://visual.ons.gov.uk/uk-perspectives-2016-trade-with-the-eu-and-beyond/ [accessed 6 March 2017]
134 *Ibid.*
135 ONS, *The Pink Book—2016, Chapter 9—9.4 Trade in goods,* (29 July 2016): https://www.ons.gov.uk/file?uri=/economy/nationalaccounts/balanceofpayments/datasets/9geographicalbreakdownofthecurrentaccountthepinkbook2016/thepinkbook/pinkbook2016chapter9.xls [accessed 12 January 2017]
136 *Ibid.*
137 *Ibid.*
138 We considered Norway and Switzerland's trade arrangements with the EU in the report *Brexit the options for trade*. European Union Committee, *Brexit: the options for trade* (5th report, Session 2016–17, HL Paper 72)

Table 4: Source countries of UK goods imports 2015

		£ million	Percentage of total UK imports (rounded)
EU total		222,992	54
	Germany	*61,789*	*15*
	The Netherlands	*31,690*	*8*
	France	*24,412*	*6*
	Belgium	*20,936*	*5*
China		37,968	9
United States		34,715	8
Norway		13,263	3
Switzerland		8,470	2
Rest of the world		93,778	23
Total		411,186	99 Percentage does not total 100 due to rounding

Source: ONS, The Pink Book—2016, Chapter 9—9.4 Trade in goods (29 July 2016): https://www.ons.gov.uk/file?uri=/economy/nationalaccounts/balanceofpayments/datasets/9geographicalbreakdownofthecurrentaccountthepinkbook2016/thepinkbook/pinkbook2016chapter9.xls [accessed 10 February 2017]

76. We note that many of the UK's strongest manufacturing industries in terms of trade—including machinery, pharmaceuticals, electrical goods and vehicles—are "quite import-intensive, but nevertheless … add significant value to the UK economy in terms of output and employment".[139] This is discussed further in relation to the sectors considered in Chapters 4 and 5.

Conclusions and recommendations

77. **The EU is, by a significant margin, the UK's biggest trading partner in goods. Both imports from and exports to the EU are essential to the UK's manufacturing industry and primary commodities sectors. Safeguarding UK-EU trade in goods will be a critical factor in ensuring the UK's long-term prosperity post-Brexit.**

78. **Norway and Switzerland are two of the UK's largest trading partners outside the EU. They are highly integrated into the EU's Single Market, and so Brexit will change the UK's trading relationship with them. The Government should seek a comprehensive trade agreement with these countries after Brexit, to avoid a worsening of trade conditions.**

139 Department for Business Innovation and Skills, *BIS economics paper no. 17* (February 2012), p 7: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/32475/12-579-uk-trade-performance-markets-and-sectors.pdf [accessed 10 February 2017]

CHAPTER 4: TARIFF BARRIERS

79. Tariffs are the most visible barriers to trade. All our witnesses said that the imposition of tariffs on trade with the EU would be deleterious to businesses in their sectors. More information on tariffs can be found in Box 2.

Box 2: What are tariffs?

Tariffs or customs duties are a state levy imposed on goods crossing from one customs territory to another. Tariffs can be imposed on both exports (usually commodities) and imports, but import tariffs are more common.[140] This report focuses on import tariffs only.

Tariffs impose a charge on the import of a product, usually expressed as a percentage of the value of the product,[141] with the percentage varying from product to product.[142] In so doing, a tariff raises the price of the imported product for the consumer and so both gives a price advantage to locally-produced goods, and raises revenue for governments.[143]

Tariffs therefore can have a dual impact: both imports and exports are made more expensive.

A customs territory—the territory in which a defined and autonomously-set customs law applies[144]—is usually a country, but it can also be a customs union between a number of countries, or another separate customs territory with full autonomy in the conduct of its external commercial relations (such as Hong Kong).[145]

WTO members commit not to raise tariffs beyond a certain maximum level (referred to as 'bound tariff rates').[146] These commitments vary from member to member, and between product categories. They are contained in each member's schedules of concessions. According to the most favoured nation (MFN) obligation contained in Article I of the GATT, members cannot normally discriminate between their trading partners. Members have to apply the same tariff to like products imported from different members. If a WTO member grants a concession (such as a lower tariff) to one member, then it must also do the same for all other WTO members.[147]

140 Michael J. Hahn, 'Article II GATT' in *WTO—Trade in Goods* by Rüdiger Wolfrum, Peter-Tobias Stoll & Holger P. Hestermeyer (eds), paras 5, 17 (Leiden: Brill, 2011)

141 Known as an ad valorem tariff. World Bank, 'Forms of Import Tariffs': http://wits.worldbank.org/WITS/WITS/WITSHELP/Content/Data_Retrieval/P/Intro/C2.Forms_of_Import_Tariffs.htm [accessed 10 February 2017]

142 Most countries use a nomenclature comprising about 5000 commodity groups to list the different products. The nomenclature is referred to as the Harmonised System and is maintained by the World Customs Organization.

143 WTO, 'Tariffs': https://www.wto.org/english/tratop_e/tariffs_e/tariffs_e.htm [accessed 10 February 2017]

144 World Customs Organization, *Chapter 2 E.12 of the Revised Kyoto Convention on the Simplification and Harmonisation of Customs Procedures (17 April 2008)*: http://www.wcoomd.org/en/topics/facilitation/instrument-and-tools/conventions/pf_revised_kyoto_conv/kyoto_new/gach2.aspx [accessed 23 January 2017]

145 Art. XII:1 of the Agreement Establishing the World Trade Organization permits such entities to become members of the WTO. Under this provision Chinese Taipei, Macao, China, and Hong Kong, China, are WTO members, separate to China. WTO, 'Members and observers': https://www.wto.org/english/thewto_e/whatis_e/tif_e/org6_e.htm [accessed 10 February 2017]

146 Members of the WTO provide information regarding their 'bound tariffs' in their goods schedules. However, they are able to provide more favourable 'applied tariffs' if this is done on an MFN basis to all other WTO members. WTO, *A Handbook on Reading WTO Goods and Services Schedules*, p 15: https://www.wto.org/english/res_e/booksp_e/handbook_sched_e.pdf [accessed 20 February 2017]

147 WTO, 'Understanding the WTO: basics—Principles of the trading system': https://www.wto.org/English/thewto_e/whatis_e/tif_e/fact2_e.htm#seebox [accessed 20 February 2017]

There are limited exceptions to this obligation not to discriminate between WTO members, including:

- WTO members can form a customs union. The EU is an example of this. There are no tariffs on products traded between the EU Member States and its Common Customs Tariff applies to all goods imported from third countries.[148]
- WTO members can negotiate a FTA. In the case of the EU, this includes third country FTAs (such as that between the EU and South Korea), Switzerland's bilateral agreements with the EU, and the European Economic Area (which brings together the EU Member States, Norway, Iceland and Liechtenstein).[149]
- WTO members may give preferential treatment to developing countries in accordance with the Generalised System of Preferences (GSP). This is discussed in Chapter 7.

The UK will no longer apply the Common External Tariff when it leaves the EU. The Government could decide either to adopt as its own the current tariff levels applied by the EU, or to review them.[150]

Tariff rate quotas

Another type of tariff, particularly common for agricultural products, is tariff rate quotas (TRQs).[151] A TRQ allows a customs territory to impose a lower tariff rate up to a quantitative limit, and then a higher tariff for imports after that limit has been reached.[152] TRQs were introduced to provide some market access, in the context of very high tariffs on some agricultural products. Scheduled TRQs constitute binding tariff limits. The EU's TRQs include dairy, beef, lamb, poultry meat, sugar, fruit and vegetables.[153]

148 WTO, *General Agreement on Tariffs and Trade 1994, Article XXIV: 8*: https://www.wto.org/english/res_e/booksp_e/analytic_index_e/gatt1994_09_e.htm [accessed 10 February 2017]; We note that the European Economic Area is treated as a free trade agreement under WTO rules.

149 The WTO rules regarding derogation from the MFN principle, and the detail of the EU's arrangements with third parties, including the EEA and Switzerland, are discussed in our previous report. European Union Committee, *Brexit: the options for trade* (5th Report, Session 2016–17, HL Paper 72)

150 The process for the UK to establish new tariffs at the WTO is discussed in our previous report. European Union Committee, *Brexit: the options for trade* (5th Report, Session 2016–17, HL Paper 72)

151 European Union Committee, *Brexit: the options for trade* (5th Report, Session 2016–17, HL Paper 72)

152 Holger P. Hestermeyer & Edith Brown Weiss, 'Article XIII GATT' in *WTO—Trade in Goods* by Rüdiger Wolfrum, Peter-Tobias Stoll & Holger P. Hestermeyer (eds), para 52 (Leiden: Brill, 2011)

153 Written evidence from Peter Ungphakorn (ETG0005)

Impact of tariff barriers on UK-EU trade

80. We note that the Government's White Paper, *The United Kingdom's exit from and partnership with the EU*, stated that "the Government will prioritise securing the freest and most frictionless trade possible in goods and services between the UK and the EU … including an ambitious and comprehensive free trade agreement and a new customs agreement".[154] In any free trade agreement tariff levels are subject to negotiation, but are generally lower than those provided for by the MFN principle under WTO rules. For example, the FTA between the EU and South Korea liberalises 98.7% of tariffs and commits to preventing a rise in tariffs on either side in the future.[155]

81. But though the Government envisages that the UK and EU will conclude a FTA within the two-year period set out in Article 50 TEU for the completion of withdrawal negotiations, we have previously concluded that this is unlikely to be possible.[156] In the absence of such a FTA, or a transitional arrangement, UK-EU trade would, from the point of withdrawal, have to proceed according to the MFN principle. This would mean the UK would be legally obliged to treat the EU the same as any other WTO member, and *vice versa*. Accordingly, both UK exports to the EU, and EU exports to the UK, would be subject to tariff barriers. Figure 4 shows a range of EU tariff levels.

82. In our report, *Brexit: the options for trade*, we concluded that the UK was also unlikely to be able to retain access to the EU's FTAs with third countries following Brexit.[157] This would include non-EU EEA states (Norway, Liechtenstein, and Iceland) and Switzerland (which has a series of bilateral agreements with the EU), which are some of the UK's largest trading partners in goods. MFN tariff schedules would be the baseline for UK trade negotiations with all these countries.

83. This report accordingly considers the impact of tariffs in the various sectors according to the EU's MFN schedules. We also assume that the UK will retain, at least in the short term, the EU's tariff schedules. In this regard, Lord Price CVO, Minister of State for Trade Policy, Department for International Trade, said: "We are looking to replicate as far as possible the current UK agreements within a new WTO schedule. In that sense, we are not looking to deviate from what we do today. Our working principle is that whatever the UK does today within its schedules we will look to do in a post-Brexit world."[158] Lord Bridges and Lord Price added:

> "In order to minimise disruption to global trade as we leave the EU, over the coming period the Government will prepare the necessary draft schedules which replicate as far as possible our current obligations. The Government will undertake this process in dialogue with the WTO membership. These schedules will provide the baseline against which future liberalisation can be judged." [159]

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154 HM Government, *The United Kingdom's exit from and new partnership with the European Union*, Cm 9417, February 2017, p 35: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/589191/The_United_Kingdoms_exit_from_and_partnership_with_the_EU_Web.pdf [accessed 13 February 2017]

155 Written evidence from the Department for International Trade (FTG0025)

156 European Union Committee, *Brexit: the options for trade* (5th Report, Session 2016–17, HL Paper 72); European Union Committee, *Brexit: parliamentary scrutiny* (4th Report, Session 2016–17, HL Paper 50)

157 European Union Committee, *Brexit: the options for trade* (5th Report, Session 2016–17, HL Paper 72)

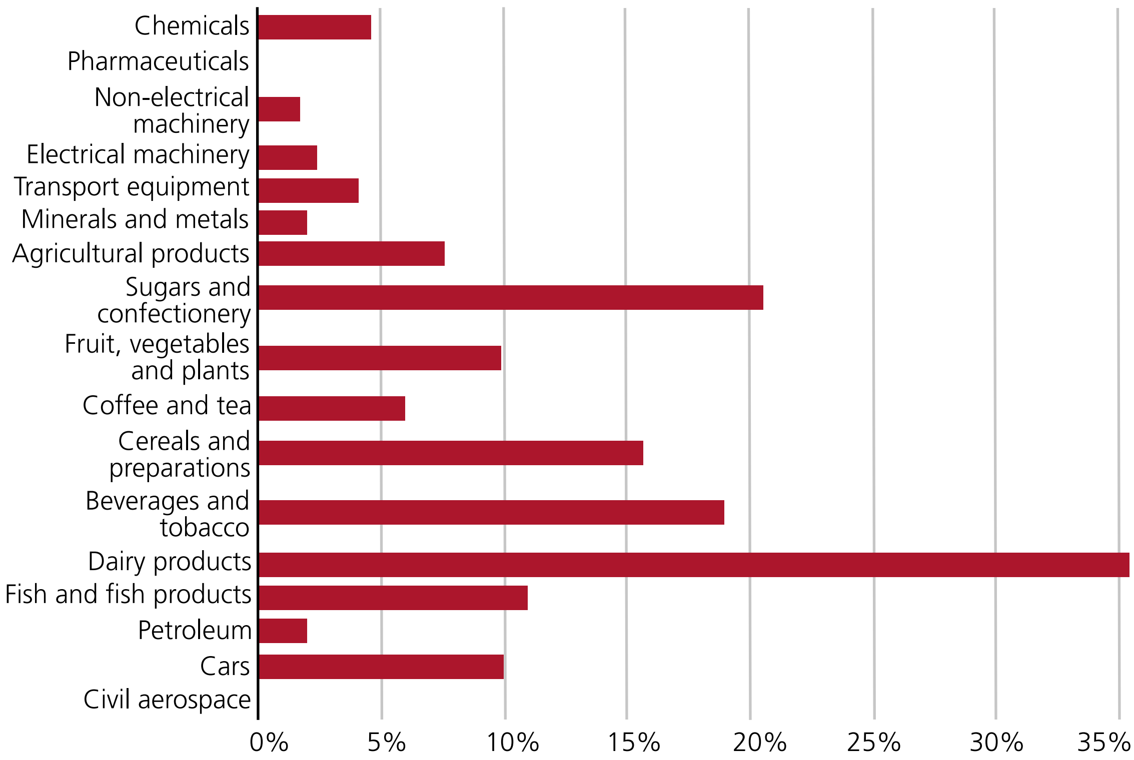
158 Q 122

159 Written evidence from Lord Bridges of Headley MBE and Lord Price CVO (FTG0027)

84. As noted in our previous report, the UK will have to negotiate with the EU to separate out its TRQs and levels of subsidies from those currently shared between the EU's 28 Member States, before presenting its schedules to WTO members.[160] We were told by Mr Richard Eglin, Senior Trade Policy Adviser, White and Case LLP, that it might take "many years" for consensus to be reached on the UK's proposed schedules. Nonetheless, in the intervening period, trade with the UK "would continue … on the terms in which [the UK] proposed", provided that these "were reasonable".[161]

85. While the average MFN tariff on goods levied by the EU is 5.3%,[162] the individual tariffs vary significantly between different sectors and products. For example, the import tariff on cars into the EU is 10% and the *ad valorem* equivalent tariff (a tariff based on the determined value of the item being taxed) on certain kinds of poultry is over 200%.[163] Figure 4 below shows tariffs relating to the sectors considered in this inquiry.

Figure 4: Average final bound tariff rates applied by the EU relating to the sectors considered in this report



Source: WTO, World Tariff Profiles 2016: applied MFN tariffs (2016): http://unctad.org/en/PublicationsLibrary/wto2016_en.pdf [accessed 31 January 2017]; Q 4 (Dr Virginia Acha); written evidence from SMMT (FTG0009) and Q 88 (Paul Everitt)

86. The industry representatives who provided evidence to this inquiry agreed that tariffs could have negative consequences for trade with the EU, the UK's biggest trading partner. As tariffs vary between different sectors, this chapter considers the possible impacts of tariffs on UK-EU trade for each sector in

160 European Union Committee, *Brexit: the options for trade* (5th Report, Session 2016–17, HL Paper 72)

161 Oral evidence taken before the EU External Affairs and Internal Market Sub-Committees, 8 September 2016 (Session 2016–17), Q 3 For more information about the process of establishing UK schedules at the WTO, see our previous report, European Union Committee, *Brexit: the options for trade* (5th Report, Session 2016–17, HL Paper 72)

162 Written evidence submitted to the EU Internal Market Sub-Committee, 30 November 2016 (Session 2016–17) TAS0085 (UK Trade Policy Observatory, University of Sussex)

163 Written evidence from Prof Peter Wells (FTG0013) and oral evidence taken before the EU External Affairs and Internal Market Sub-Committees, 8 September 2016 (Session 2016–17), Q 8 (Richard Eglin)

turn. We make the caveat, though, that it is not always straightforward to separate an industry from its supply chain, which can be highly integrated.

Pharmaceuticals and chemicals

87. Mr Steve Elliott, Chief Executive Officer, Chemical Industries Association (CIA), said that tariff-free access to the Single Market was "the key priority".[164] The chemicals sector "faces essentially three tariff levels: 0%,[165] 5.5% or 6.5%." The volume of cross-border trade made these potentially significant: "some 75% of our chemical imports come from the European Union", and 60% of the UK's exports went to the EU.[166] This meant that tariffs would apply to "both the import … of a raw material … and the export, so there is a potential double whammy if you sit at the 6.5% end."[167] The CIA concluded that the imposition of tariffs "would have a significant impact on the competitiveness of the UK to continue to deliver into EU markets."[168]

88. For pharmaceutical products, most Organisation for Economic Co-operation and Development members have imposed zero tariffs since the signature of the WTO Pharmaceutical Agreement during the Uruguay Round. This 'zero-for-zero'[169] rule, Dr Virginia Acha, Executive Director of Research, Medical and Innovation, Association of the British Pharmaceutical Industry, explained, covered many pharmaceutical products, so that "the first thing" for the sector to do was to "confirm that zero-for-zero will continue,"[170] through the re-establishment of the UK's independent schedules at the WTO.[171] Lord Bridges and Lord Price clarified that the WTO Pharmaceutical Agreement is extended on a MFN basis: "All WTO members enjoy the benefits of tariff free trade to signatory countries irrespective of whether or not they themselves are members. The UK will therefore continue to benefit from the tariff eliminations of negotiating parties". They stated that, "in line with our technical rectification approach" to the UK's schedules at the WTO, "the UK will continue to place zero tariffs on pharmaceutical goods covered by the Agreement".[172] In our previous report, we noted the risk that other WTO members may consider the UK's actions to be a 'modification' rather than simply a 'rectification' of the EU's schedules.[173]

164 Q 3
165 For items covered by the WTO Pharmaceutical Agreement (see below).
166 Q 1
167 Q 3
168 Written evidence from the Chemical Industries Association (FTG0003)
169 During the WTO Uruguay Round, the WTO Pharmaceutical Agreement was signed between Canada, the European Union and its Member States, Japan, Norway, Switzerland, the United States, and Macao (China). The agreement came into force in 1995 and eliminated tariffs on pharmaceutical products and chemical intermediates used in the production of pharmaceuticals in signatory countries for all WTO members on a MFN basis. Office of the United States Trade Representative, 'Pharmaceuticals': https://ustr.gov/issue-areas/industry-manufacturing/industry-initiatives/pharmaceuticals [accessed 10 February 2017]
170 Q 4
171 The UK is a member of the WTO, but is represented by the EU. For a discussion of the re-establishment of the UK's independent terms at the WTO, see our report: European Union Committee, *Brexit: the options for trade* (5th Report, Session 2016–17, HL Paper 72)
172 Written evidence from Lord Bridges of Headley MBE and Lord Price CVO (FTG0027)
173 European Union Committee, *Brexit: the options for trade* (5th Report, Session 2016–17, HL Paper 72) Rectification is possible for "rearrangements which do not alter the scope of a concession … and other rectifications of a purely formal character". Modification of schedules implies a substantive change of a concession. GATT, *L/4962—Decision on Procedures for Modification and Rectification of Tariff Concessions* (28 March 1980): https://www.wto.org/gatt_docs/English/SULPDF/90970413.pdf [accessed 2 March 2017]

89. Dr Acha also noted that "zero-for-zero is for a named list of medicines and some of the manufacturing components", which had "not been updated for seven years."[174] The list would need to be updated,[175] which would require the agreement of all signatories.

90. The impact of tariffs would also be deleterious to the pharmaceutical and chemicals sector's supply chain. Dr Acha told the Committee that "after 40 years of being part of the Single Market and the customs union, our supply chains are highly integrated within the EU". The sector and its supply chain were exchanging medicines, raw and clinical materials, active pharmaceutical ingredients (APIs) and "even trading and sharing samples" across the borders of EU Member States.[176] The CIA told us that the UK chemicals industry was reliant on an EU supply chain for some products, and would not be able to substitute domestic products, because the UK "no longer produces a number of its own feedstocks".[177]

Capital goods and machinery

91. Mr Fergus McReynolds, Director of EU Affairs, EEF—The Manufacturers' Organisation (EEF), said that the EEF "would like to see tariff-free access" to the EU after Brexit.[178] The Manufacturing Technologies Association (MTA) gave an example underlining the significance of trade with the EU for its members: around 45% of machine tools exports from the UK went to other EU countries, and 25–30% of the cost of a UK-manufactured machine tool consisted of materials and components imported from within the EU.[179] It added that "the manufacturing technology sector is a major supplier to UK industries such as automotive and aerospace which export a very substantial proportion of their output to the EU, therefore the exposure to EU markets is even greater that the figures suggest."[180] It cautioned that "special care should be taken to prevent their double imposition i.e. the levying of a tariff on an imported subsystem and then … again on an exported finished assembly which would leave the manufacturer paying twice—or even more times."[181]

92. A range of tariffs apply to capital goods and machinery, given the breadth of the sector. The EU's final bound duty on electrical machinery is on average 2.4% and on transport equipment 4.1%. The maximum bound duty can be as high as 22% on transport equipment or up to 14% on electrical machinery.[182]

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174 Q 4 The original list of 7,000 items has been updated periodically: in 1996, 1998, and 2006. The most recent update began in 2010. Geneva Network, *Pharmaceutical tariffs, trade flows and emerging economies (September 2015)*: http://geneva-network.com/wp-content/uploads/2015/09/GN-Tariffs-on-medicines.pdf [accessed 14 February 2017]

175 Q 4

176 Q 1

177 Written evidence from CIA (FTG0003) Feedstocks are raw materials used in the manufacture of chemicals. US Energy Information Administration, 'Today in energy': http://www.eia.gov/todayinenergy/detail.php?id=21432 [accessed 23 January 2017]; The feedstocks mentioned by the CIA were Iodine, Monoethylene Glycol (MEG) and Purified Terephthalic Acid (PTA).

178 Q 20

179 MTA, *Brexit priorities*, p 2: https://www.mta.org.uk/sites/default/files/page/downloads/Brexit%20and%20the%20MTA.pdf [accessed 10 February 2017]

180 *Ibid.*

181 *Ibid.*

182 WTO, 'Tariff profile—European Union': http://stat.wto.org/TariffProfiles/E28_e.htm [accessed 10 February 2017]

93. The effect of tariffs would be particularly significant for the supply chain: Mr McReynolds said that components of goods "may cross borders a number of times". Each time such a component "crosses any potential barrier, there is an implication for cost, time and additional administrative burden".[183]

Food and beverages

94. The imposition of tariffs on UK-EU trade would be particularly significant for the food and beverages sector. The Food and Drink Federation (FDF) highlighted the scale of cross-border trade: "The overwhelming majority of UK trade in food and non-alcoholic drink is with the EU—more than 70 per cent of both exports and imports".[184] For this reason, the FDF said the Government "must … prioritise tariff-free market access via a comprehensive UK-EU trade deal".[185] The Agriculture and Horticulture Development Board (AHDB) similarly stressed the importance of tariff-free access, "if remaining in the Single Market is not an option".[186]

95. The FDF has also highlighted, in a published paper, the difficulty of replacing the EU as an export destination: "Many manufacturers will struggle to substitute EU customers for ones in other parts of the world, including emerging markets, because of differing consumer tastes and limited product shelf-lives."[187] Mr Peter Hardwick, Head of Exports, AHDB, agreed the EU was "extremely important to our exports", not least because of its geographical proximity: "We are talking about fresh, perishable products, and moving them long distances is challenging."[188] We note that while increasing exports to non-EU markets might be a challenge, the ready availability in the UK of imported fresh and perishable products from geographically distant countries suggests that distance may not be a prohibitive obstacle throughout the sector. On the other hand, Professor John Manners Bell, Chief Executive, Transport Intelligence Ltd, noted that an increase in freight transport would exacerbate already high CO_2 emissions.[189]

96. The AHDB told the Committee that EU tariffs in the agricultural sector "differ significantly by product, being as high as 87% for frozen beef down to 3.8% on whole, fresh sweet potatoes".[190] Dairy products are subject to an average bound tariff of 35.5%, whereas coffee and tea only have an average bound tariff of 6.0%.[191] Tariffs would therefore be "significant for some sectors".[192] Turning to processed food, the FDF cited confectionery and cereals as being subject to significant tariffs, at 25% and 15% respectively.[193]

183 Q 27 (Fergus McReynolds)
184 Written evidence from FDF (FTG0021)
185 FDF, *A New UK-EU Relationship Priorities for the food and drink manufacturing industry (July 2016) p 4:* https://www.fdf.org.uk/corporate_pubs/FDF-Manifesto-A-New-UK-EU-Relationship.pdf [accessed 10 February 2017]
186 Written evidence from AHDB (FTG0007)
187 FDF, *A New UK-EU Relationship Priorities for the Food and Drink Manufacturing Industry (July 2016) p 4:* https://www.fdf.org.uk/corporate_pubs/FDF-Manifesto-A-New-UK-EU-Relationship.pdf [accessed 10 February 2017]
188 Q 35
189 Oral evidence taken before the EU External Affairs and Internal Market Sub-Committees, 15 September 2016 (Session 2016–17), Q 31 (Prof John Manners-Bell)
190 Written evidence from AHDB (FTG0007)
191 WTO, 'Tariff profile - European Union': http://stat.wto.org/TariffProfiles/E28_e.htm [accessed 10 February 2017]
192 Written evidence from AHDB (FTG0007)
193 Written evidence from FDF (FTG0021)

97. Mr Hardwick highlighted the pork sector as particularly vulnerable. Almost all UK sow exports went to Germany, so the imposition of tariffs (as currently set out in the EU's schedules) "would almost double the price and make us uncompetitive. That would be terminal for the pig sector—and there are plenty of other examples."[194]

98. The Agricultural Industries Confederation (AIC) gave the example of wheat. It told us that, if WTO tariff levels were to be applied, the UK would "find it difficult to compete with other third country wheat producers such as Russia and Ukraine and would become less competitive against other EU wheat producers such as France and Germany". Tariffs on imports would "lead to an increase in the costs of production and therefore [to] a negative impact on competitiveness".[195]

99. Mr Hardwick concluded that "I do not think that any arrangement that involves tariffs—this is the most important thing—will work because it will put up the price of goods to consumers".[196] Professor Tim Lang, Founder, Centre for Food Policy, City, University of London, was also concerned about the impact on consumers: "A WTO Brexit … would mean Britain trying to flog more saturated fats, alcohol and biscuits—those are our leading sources of food exports—to pay for the good things for public health, such as fruit and vegetables, which is what we bring in". This was a "public health" issue: "It would be folly in the extreme from a food policy perspective not to negotiate a customs union".[197]

100. Turning to the supply chain, we were told that tariffs would again have a significant negative impact. The AHDB told us that tariffs would "affect the whole supply chain as they would cover both [the] imported product ready for retail consumption through to input costs such as machinery, feed and fertilisers."[198] There was, as in other sectors, a danger of the double imposition of tariffs. Mr Hardwick gave an example:

> "Carcass meat is exported to The Netherlands or Ireland, where it is processed and sent back here or to another Member State … If I take sheep meat, for example, we represent something like 38% of the French market and a lot of that product is processed and moved on; it does not necessarily stay in France … Clearly, anything that obstructs that would be problematic."[199]

101. We note that the impact of tariffs on trade with Ireland would be particularly significant, due to a highly integrated supply chain. The FDF told us that 23.8% of the UK's food and non-alcoholic drink exports went to Ireland in 2015 and 10.9% of imports came from there.[200] In some agricultural sectors this percentage could be much higher: in 2015, 68% of the UK's beef imports came from Ireland.[201] The importance of trade with Ireland was discussed in our report *Brexit: UK-Irish relations*, published on 12 December 2016, in

194 Q 36
195 Written evidence from AIC (FTG0006)
196 Q 39
197 Q 35
198 Written evidence from AHDB (FTG0007)
199 Q 35 (Peter Hardwick)
200 Written evidence from FDF (FTG0021)
201 AHDB, *Horizon market intelligence—What might Brexit mean for UK trade in agricultural products?* (12 October 2016), p 14: http://www.ahdb.org.uk/documents/Horizon_Brexit_Analysis_Report-Oct2016.pdf [accessed 10 February 2017]

which we concluded: "It is extremely important for both Northern Ireland and the Republic of Ireland that an agreement is reached which takes into account the all-island nature of their economies."[202]

102. The FDF also highlighted that substituting EU imports with locally-produced inputs was not always an option. While its members were "partners of our domestic agriculture industry … they also often need to import ingredients that are not produced in the UK or are not produced in sufficient quantity to supplement their use of UK ingredients".[203]

103. We do not consider the impact of TRQs (for which see Box 2) on the UK agricultural sector in this report. Our previous report, *Brexit: the options for trade,* considered the division of the EU's existing WTO schedules between the UK and the EU-27, including TRQs.[204]

Oil and petroleum

104. Mr Chris Hunt, Director General and Company Secretary, UK Petroleum Industry Association, told us that the "barrier-free movement of goods … is very important to us".[205] In the oil and petroleum sector, tariffs are relatively low: the currently applied average MFN tariff on petroleum imports to the EU is 2.5%.[206] Nevertheless, Norton Rose Fulbright LLP said the UK oil and petroleum sector relied on crude oil imports, so a tariff-free regime between the UK and the EU "must be maintained" to protect the UK oil and petroleum industry's market share, and "for their businesses to survive".[207] We note that this is a rather strong statement, given the relatively low average MFN tariff.

105. Mr Hunt noted that the downstream industry's UK-EU imports and exports were relatively balanced—"around 15 million tonnes each way". Were tariffs to be imposed, "One would hope … they would be reciprocal, so that would affect exports as well as imports." In that case, "in theory you could say … so be it".[208]

106. Mr Hunt was, though, concerned by potential tariffs on equipment and spares for the refining industry.[209] He said that "typically, and very indicatively, the UK's six oil refineries could spend around £150–300 million per annum in trade with other EU countries" on such items. He added that some of this was "specialist equipment, catalyst and chemicals which are not manufactured in the UK". This was often required at short notice.[210] Norton Rose Fulbright LLP also recommended "maintaining a zero tariff on replacement parts".[211]

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202 European Union Committee, *Brexit: UK-Irish relations* (6th Report, Session 2016–17, HL Paper 76)
203 Written evidence from FDF (FTG0021)
204 European Union Committee, *Brexit: the options for trade* (5th Report, Session 2016–17, HL Paper 72)
205 Q 50
206 WTO, *World Tariff Profiles 2016, Applied MFN tariffs* (2016), p 81: https://www.wto.org/english/res_e/booksp_e/tariff_profiles16_e.pdf [accessed 16 February 2017]
207 Written evidence from Norton Rose Fulbright LLP (FTG0018)
208 Q 50
209 Written evidence from Chris Hunt (FTG0020) Such equipment includes pipework, valves, compressors, pumps, electricals and instrumentation, maintenance equipment and cranes, refinery catalysts and chemicals, and technical expertise and services.
210 Written evidence from Chris Hunt (FTG0020)
211 Written evidence from Norton Rose Fulbright LLP (FTG0018)

Automotive

107. The Society of Motor Manufacturers and Traders (SMMT) told us that continued membership of the Single Market was one of UK automotive industry's five key priorities for relations with the EU post-Brexit, in order to "ensure no tariff or non-tariff barriers to trade with the EU". The UK should also maintain membership of the EU's customs union, "with common customs procedures".[212] Both these objectives were ruled out in the Prime Minister's speech of 17 January 2017 and in the Government's White Paper. We discuss the Prime Minister's expectations of a customs arrangement with the EU in Chapter 6.

108. In the automotive sector, the EU's external tariff on cars is 10% (6.5% for developing countries).[213] Tariffs also apply to car components, ranging from 2.5–4.5%.[214] According to the SMMT, the introduction of UK-EU tariffs "would be hugely damaging to UK automotive. Tariffs on vehicles and parts would put the UK at an immediate competitive disadvantage."[215]

109. Professor Peter Wells, Professor of Business and Sustainability, Cardiff Business School, agreed that tariffs would potentially make "all aspects of UK automotive production more expensive".[216] According to the National Franchised Dealers Association, the increase in production costs would "have an impact on the end cost of vehicles supplied to both consumers and businesses", with the additional costs being passed on to retailers and customers.[217]

110. In the automotive sector, most companies rely on a highly integrated supply chain, magnifying the impact of tariffs, and making the separation of the impact of tariffs on the sector from that on the supply chain difficult. Mr Hawes told the Committee that "the average UK-built car has about 41% UK components. In other words, 59–60% come from abroad". Of these, "the majority come from the EU … Any tariff will add cost."[218]

111. The SMMT provided the following summary of the automotive supply chain:

> "One part can, as part of an integrated supply-chain, travel across the Channel multiple times before the final vehicle is completed. If a tariff is applied to parts, whole vehicles and furthermore customs duties and significant compliance costs for inward and outward processing, this could ultimately make UK automotive companies, and their operations unviable."[219]

112. Mr Koji Tsuruoka, Ambassador of Japan to the UK, also commented on supply chains, in the context of Japanese companies, such as Nissan or Honda: "If you have tariffs on both sides the company suffers very severely, in terms of prices but also procedures."[220]

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212 Written evidence from SMMT (FTG0009)
213 Written evidence from Prof Peter Wells (FTG0013)
214 Written evidence from SMMT (FTG0009)
215 *Ibid.*
216 Written evidence from Prof Peter Wells (FTG0013)
217 Written evidence from the National Franchised Dealers Association (FTG0012)
218 Q 67
219 Written evidence from SMMT (FTG0009)
220 Q 97

113. Imported parts could not easily be replaced with UK-sourced goods, according to Mr Mike Hawes, Chief Executive Officer, SMMT: "We have identified that about 80% of the parts that go into a car are not actually made here and there is no UK supplier".[221] Conversely, an increase in the cost of importing the necessary parts into the UK could result in the UK losing its competitiveness as a centre for car manufacturing. According to Mr Hawes, competitors included Slovakia, Hungary, and other eastern European countries.[222]

Aerospace and defence

114. Mr Paul Everitt, Chief Executive Officer, ADS Group, the trade organisation for companies in the UK aerospace, defence, security and space sectors, said that "Our strong preference would be for the UK to remain in the Single Market and customs union to ensure tariff-free trade".[223]

115. Mr Everitt acknowledged, though, that there was a WTO arrangement that would mitigate the effect of tariffs between the UK and the EU: "For the aerospace sector there is a pre-existing WTO plurilateral agreement on the trade in civil aircraft [the Agreement on Trade in Civil Aircraft (TCA)],[224] which means that both aircraft and complete parts are tariff free."[225] Plurilateral agreements are WTO agreements that—unlike most WTO agreements which all WTO members have to sign (so-called 'multilateral agreements')—are not and do not have to be signed and ratified by all WTO members. Mr Everitt was "reasonably comfortable that systems and sub-systems" were included in the TCA. Therefore, he thought that "with some care and attention", the tariff barrier challenge was "doable".[226]

116. The UK was an original signatory to the TCA agreement.[227] Mr Everitt thought that "the EU's signature to the agreement has subsequently superseded" the UK's.[228] However, Lord Bridges and Lord Price confirmed that "The UK is a member of the Agreement on Trade in Civil Aircraft in its own right and no action is necessary for the UK to remain a member."[229]

117. Mr Everitt also cautioned that the TCA agreement "does not cover some of the raw materials and part-finished goods that we import and export as part of the development of our larger products."[230] He told us that this was currently addressed by the EU Customs Code: "UK companies are … able to

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221 Q 76; In March 2017 Mr Carlos Tavares, CEO of Peugeot SA, said that tariffs between the UK and the EU would be an 'opportunity' to source more components from the UK. Peter Campbell, 'Peugeot SA chief pledges to step up UK presence in 'hard Brexit'', *Financial Times* (6 March 2017): https://www.ft.com/content/59be8994-0266-11e7-ace0-1ce02ef0def9 [accessed 8 March 2017]

222 Q 76

223 Written evidence from Paul Everitt (FTG0016)

224 The plurilateral Agreement on Trade in Civil Aircraft has 32 signatories, including the EU, several of its Member States including the UK, as well as Australia, Canada, Japan, Switzerland, and the US. This is contained in Article II (3) of the Marrakech Agreement establishing the World Trade Organisation. WTO, *Marrakesh Agreement Establishing the World Trade Organisation*: https://www.wto.org/english/docs_e/legal_e/04-wto_e.htm [accessed 10 February 2017] and WTO, 'Plurilateral agreement on trade in civil aircraft': www.wto.org/english/tratop_e/civair_e/civair_e.htm [accessed 10 February 2017]

225 Q 88 (Paul Everitt)

226 Q 88

227 WTO, 'Plurilateral agreement on trade in civil aircraft': www.wto.org/english/tratop_e/civair_e/civair_e.htm [accessed 10 February 2017]

228 Written evidence from Paul Everitt (FTG0016)

229 Written evidence from Lord Bridges of Headley MBE and Lord Price CVO (FTG0027)

230 Q 88 (Paul Everitt)

apply for Inward Processing Relief on the import of raw materials used in the manufacture of an aircraft component that are to be ultimately exported".[231] We note that this is currently part of EU law, and that the Government may need to consider establishing a similar UK scheme after Brexit. Box 3 explains Inward Processing Relief.

Box 3: Inward Processing Relief

Inward Processing Relief is an EU scheme that improves export competitiveness, similar to schemes that in other countries may be termed 'duty drawback'. It permits relief from the payment of import duties and other charges for certain goods brought into the EU, in order to enable those goods to be used for manufacturing, processing or repair before they are then exported from that territory.[232]

Inward processing or duty drawback is permitted under WTO law, as long as the relief is granted on a MFN basis, and the relief is not larger than the tariff due on the imported goods (if it were larger it would constitute an illegal export subsidy).[233]

The World Customs Organisation has noted that the rules of origin (see Chapter 5) within many FTAs prohibit the use of such duty drawback systems (so-called 'no-drawback' provisions).[234] 'No-drawback' ('no-inward-processing') provisions are routinely included within EU FTAs. For example, the EU-Canada Economic and Trade Agreement (CETA) limits the use of duty drawback.[235] However, we note that the EU-Korea FTA does not limit duty drawback to the same extent.[236] Whether the FTA between the UK and the EU will contain a no-drawback provision will be subject to negotiation.

118. Lord Bridges of Headley MBE, Parliamentary Under-Secretary of State, Department for Exiting the EU, told us that the Government was considering the issue of Inward Processing Relief. Such a scheme was another way to "mitigate tariffs", and was "something that is there or will be there".[237]

119. With regard to the defence industry, Mr Everitt told us that the EU was "a relatively small part of our overall defence market", with exports of around £700 million. For this reason, and because "there are already export licensing, export controls, a whole range of other procedures", he was "less alarmed about the impacts from a European perspective around defence".[238]

231 Written evidence from Paul Everitt (FTG0016)

232 Laurence Gormley, *EU Law of Free Movement of Goods and Customs Union* (Oxford: Oxford University Press, 2009), p 239

233 World Bank, *Duty and tax relief and suspension schemes* (2009), p 1: http://siteresources.worldbank.org/INTEXPCOMNET/Resources/duty_and_tax_toolkit_pub_screen_2009.pdf [accessed 10 February 2017] and WTO, 'Agreement on Subsidies and Countervailing Measures' (1994): https://www.wto.org/english/res_e/booksp_e/analytic_index_e/subsidies_e.htm [accessed 16 February 2017]

234 World Customs Organisation, 'Drawback': http://www.wcoomd.org/en/topics/origin/instrument-and-tools/comparative-study-on-preferential-rules-of-origin/specific-topics/study-topics/dwb.aspx [accessed 10 February 2017]

235 Article 2.5, *Comprehensive Economic and Trade Agreement (CETA) between Canada, of the one part, and the European Union and its Member States*: http://trade.ec.europa.eu/doclib/docs/2014/september/tradoc_152806.pdf [accessed 16 February 2017]

236 Article 14, *Protocol concerning the definition of 'originating products' and methods of administrative co-operation*: http://trade.ec.europa.eu/doclib/docs/2009/october/tradoc_145192.pdf [accessed 16 February 2017]

237 Q 113

238 Q 88

120. For the aerospace and defence sector, costs associated with tariffs could potentially have a more significant impact on smaller companies producing parts for export, which could be more easily replaced as part of a supply chain. Mr Everitt told the Committee: "Dealing with smaller businesses further down the supply chain, is a much more mobile situation … there is a downward push to find competitive places to manufacture."[239]

Establishing a UK tariff regime

121. As discussed in our previous report, *Brexit: the options for trade,* the UK is currently part of the EU's combined WTO schedules of concessions. As the UK will leave the EU's customs union (and so the Common External Tariff), it will have to establish its own schedules in the WTO, which will need to be certified according to WTO rules.[240] It is not yet clear how far this will require negotiations with other WTO members.

122. We note that there may be a particular interest within the agricultural sector, both in the UK and in third countries, in changing the level of the UK's tariffs and quotas. Mr Hardwick said there was "probably scope for the UK to say in time that it will vary some of these tariffs a bit".[241] The AIC recommended the Government take into account "the ability of the UK to produce the product in question, its ability to meet the volume requirements and the market demands for the product" when considering the level of its import tariffs.[242] The AIC further told us that in sectors where the UK could not produce the quantity or quality of products needed, "a relaxation of import tariffs would be advantageous".[243] We note that lower tariffs could have a positive impact for UK consumers in the form of lower prices.

123. On the other hand, if the UK Government were to decide to lower tariffs, this could have two negative consequences. First, it could reduce the UK's leverage in future FTA negotiations with third countries, as WTO schedules are the baseline for negotiations to further liberalise trade. Second—and of particular interest to the agricultural sector—a lowering of tariffs could threaten the UK's agricultural industry by exposing it to global competition without the protection offered by tariffs. As Mr Hardwick explained, "tariffs reflect a difference in the costs of production in non-EU countries and in those within the European Union".[244] Without tariff protection, imports from countries with lower production costs could flood the UK market.

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239 Q 86
240 European Union Committee, *Brexit: the options for trade* (5th Report, Session 2016–17, HL Paper 72); The report also considers whether this would be a rectification or a modification of the schedules.
241 Q 42
242 Written evidence from AIC (FTG0006)
243 *Ibid.*
244 Q 42

Conclusions and recommendations

124. **In the event that the UK leaves the EU without first either agreeing a comprehensive UK-EU FTA or—pending completion of such a FTA—agreeing a transitional arrangement, UK-EU trade would have to proceed according to WTO rules, and may incur significant tariff costs for UK businesses.**

125. **All the sectors from which we took evidence expressed concerns about the imposition of tariffs in their sectors, although we note that the level of duties varies considerably between them.**

126. **Many of these sectors are integrated into efficient EU-wide supply chains. They are both significant importers of goods from the EU and exporters to the Single Market. It is imperative that a trade deal with the EU seeks to avoid the imposition of tariffs on trade in both directions.**

127. **Many UK businesses cannot easily substitute their imports from the EU with UK products. For example, the UK no longer produces three of the major feedstocks required for the chemicals industry. It may also be difficult for exporters to find new markets for goods. For example, perishable products from the UK food and beverages sector may have a short shelf-life, and customer demand for such products may not exist in non-EU markets.**

128. **When establishing its own schedules at the WTO, the UK Government must give particular consideration to the implications of tariffs on the UK agricultural sector. High tariffs on imports would raise the cost to UK consumers, whereas lower tariffs could reduce the cost of food to consumers, but might undermine the domestic agricultural sector's competitiveness.**

CHAPTER 5: NON-TARIFF BARRIERS

129. Non-tariff barriers can also pose significant obstacles to trade in goods. Box 5 provides an overview of different measures that can act as non-tariff barriers.

Box 4: Non-tariff barriers

Non-tariff barriers include all government-imposed and sponsored actions or omissions that act as prohibitions or restrictions on trade, other than ordinary customs duties, and other duties and charges on imports and exports.[245] Examples include sanitary measures, labelling requirements, pre-shipment inspection and other formalities, countervailing and anti-dumping duties, subsidies, and rules of origin.[246]

Non-tariff barriers can and often do serve legitimate purposes such as the protection of the environment and of public health. However, they can also be misused.[247]

EU law addresses non-tariff barriers in various ways, including harmonisation, mutual recognition, and by prohibiting not just internal customs duties and quantitative restrictions such as quotas on imports and exports between Member States, but also national measures, which may have an equivalent effect.[248]

In a survey of European businesses by the International Trade Centre and the European Commission, the most burdensome non-tariff barriers faced in international business were identified as technical requirements, conformity assessment and export-related measures, followed by rules of origin and pre-shipment inspections and other entry formalities.[249]

130. All the sectors from which we took evidence were concerned about the possible increase of non-tariff barriers to trade after Brexit,[250] which, according to Mr Mike Hawes, Chief Executive Officer, The Society of Motor Manufacturers and Traders (SMMT), "could be as punitive in cost as the tariff barriers."[251]

Rules of origin

131. 'Rules of origin' would apply to the UK both were it to agree a FTA with the EU, and if it were to trade under WTO rules, although the applicable rules of origin would differ in each case. Box 6 describes their nature and purpose.

245 Peter Van den Bossche & Werner Zdouc, *The Law and Policy of the World Trade Organization*, 3rd edition (Cambridge: Cambridge University Press, 2013), p 480

246 A taxonomy of non-tariff measures was developed under the leadership of UNCTAD. UNCTAD, *International Classification of Non-Tariff Measures* (2012), p 3: http://unctad.org/en/PublicationsLibrary/ditctab20122_en.pdf [accessed 10 February 2017]

247 Peter Van den Bossche & Werner Zdouc, *The Law and Policy of the World Trade Organization*, 3rd edition (Cambridge: Cambridge University Press, 2013), p 480

248 HM Government, *Review of the Balance of Competences between the United Kingdom and the European Union: the Single Market* (July 2013), p 22: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/227069/2901084_SingleMarket_acc.pdf [accessed 7 March 2017]

249 International Trade Centre and the European Commission, *Navigating non-tariff measures—insights from a business survey in the European Union* (2016), p 5: http://trade.ec.europa.eu/doclib/docs/2016/december/tradoc_155181.pdf [accessed 10 February 2017]

250 For example, Q 67 (Mike Hawes); Q 20, Q 23 (Fergus McReynolds); Q 3 (Steve Elliott); Q 43 (Peter Hardwick); Q 88 (Paul Everitt)

251 Q 67

Box 5: 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. The origin is also needed to compile trade statistics, assess anti-dumping and safeguard measures, and to fulfil labelling requirements.[252] 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.[253]

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.[254] 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.

There are two types of rules of origin:

- 'Non-preferential rules or origin', which apply to trade under WTO rules in the absence of a preferential trade arrangement, for example to trade between the EU and the US.[255]
- 'Preferential rules of origin', which apply to countries that have concluded a preferential trade arrangement. These apply to trade with countries with which the EU has a FTA, such as South Korea and Switzerland, and to non-EU members of the EEA, such as Norway. Under such agreements, only 'originating products' (products that contain the percentage of local content specified in the FTA) are given preferential tariff treatment. Each preferential agreement specifies a set of rules of origin.[256] For example, in the EU-Korea FTA, there are two principal scenarios for originating products: that the product has been 'wholly obtained' in the EU or Korea (for example fish or plants); or the product has been 'sufficiently processed' in the EU or Korea. The criteria (and level) for 'sufficient processing' are described for each product in the product-specific rules of the FTA.[257]

When importing goods, the importer has to present a proof of origin to the importing customs authority. This can either be an original movement certificate (such as a GSP Form A, EUR1, or EURMED form), which must be stamped and authorised by the exporting national authority, or an invoice declaration (made on a commercial document issued by the exporter that identifies the goods).[258]

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252 WTO, 'Technical Information on Rules of Origin': https://www.wto.org/english/tratop_e/roi_e/roi_info_e.htm [accessed 17 February 2017]

253 European Commission, 'Non-Preferential Origin—Introduction': http://ec.europa.eu/taxation_customs/business/calculation-customs-duties/rules-origin/nonpreferential-origin/introduction_en [accessed 17 February 2017]

254 World Customs Organisation, *Rules of Origin—Handbook*: http://www.wcoomd.org/en/topics/origin/overview/~/media/D6C8E98EE67B472FA02B06BD2209DC99.ashx [accessed 17 February 2017]

255 *Ibid.*

256 European Commission Export Helpdesk, 'Rules of origin': http://exporthelp.europa.eu/thdapp/display.htm?page=cd%2Fcd_RulesOfOrigin.html&docType=main&languageId=en [accessed 10 February 2017]

257 European Commission, *The EU-Korea Free Trade Agreement in practice* (2011), p 6: http://trade.ec.europa.eu/doclib/docs/2011/october/tradoc_148303.pdf [accessed 10 February 2017]

258 Written evidence from HMRC (FTG0010)

Cumulation

The concept of accumulation/cumulation, or 'cumulative rules of origin', allows originating products of one country within a free trade area to be further processed or added to products in another country of that free trade area, as if they had originated in the latter country. In this way, input materials from 'Country A' within a FTA can be included in domestic production within 'Country B' within the same FTA. This widens the definition of 'originating products', and provides flexibility to develop economic relations between countries within a free trade area.[259] This is referred to as bilateral cumulation and is the basic type of cumulation which is applied in all origin arrangements.[260]

There are two other forms of cumulation: diagonal and full:

- Diagonal cumulation increases the number of countries to which cumulation can be applied: it operates between more than two countries that have free trade agreements containing identical origin rules and provisions for cumulation between them. The EU applies diagonal cumulation within the Pan-European Mediterranean (PEM) zone (including European Free Trade Association (EFTA) states, Turkey, and a number of Mediterranean countries).[261] For example, materials originating in Turkey (which are covered by the EU-Turkey customs union) can be incorporated as originating materials between the EU and Albania (a participant in the EU's Stabilisation and Association Process).[262]
- Full cumulation allows the parties to an agreement to carry out work or to process non-originating products in the area formed by them (in contrast, bilateral and diagonal cumulation only apply to originating products or materials). Within the EEA Agreement, full cumulation is maintained. This means that manufacturing steps within EEA countries can be aggregated, which helps products acquire originating status from the EEA.[263] Full cumulation is also applied in the North American Free Trade Agreement (NAFTA),[264] which was highlighted by the consultancy Open Europe as an example of an integrated, cross-border car industry which is not within a customs union.[265]

259 World Customs Organisation, 'Accumulation / Cumulation': http://www.wcoomd.org/en/topics/origin/instrument-and-tools/comparative-study-on-preferential-rules-of-origin/specific-topics/study-topics/cum.aspx [accessed 10 February 2017]

260 European Commission, 'Taxation and Customs Union—common provisions': http://ec.europa.eu/taxation_customs/business/calculation-customs-duties/rules-origin/general-aspects-preferential-origin/common-provisions_en#cumulation [accessed 22 February 2017]

261 There are 23 contracting parties to the PEM Convention. European Commission. 'Taxation and Customs Union—The pan-Euro-Mediterranean cumulation and the PEM convention': http://ec.europa.eu/taxation_customs/business/calculation-customs-duties/rules-origin/general-aspects-preferential-origin/arrangements-list/paneuromediterranean-cumulation-pem-convention_en [accessed 22 February 2017]

262 Commission notice concerning the date of application of the Regional Convention on pan-Euro-Mediterranean preferential rules of origin or the protocols on rules of origin providing for diagonal cumulation between the Contracting Parties to this Convention, OJ C 214/5 (30 June 2015); The Stabilisation and Association Process is the EU's policy towards the Western Balkans.

263 World Customs Organisation, 'Cumulation in European Origin Models': http://www.wcoomd.org/en/topics/origin/instrument-and-tools/comparative-study-on-preferential-rules-of-origin/specific-agreements/agreement-topics/cum-eur.aspx [accessed 10 February 2017]

264 World Customs Organisation, 'Accumulation / Cumulation': http://www.wcoomd.org/en/topics/origin/instrument-and-tools/comparative-study-on-preferential-rules-of-origin/specific-topics/study-topics/cum.aspx [accessed 22 February 2017]

265 Open Europe, *The impact of Brexit on the UK's key export sectors (March 2015):* http://openeurope.org.uk/wp-content/uploads/2015/03/150309_Open_Europe_Briefing.pdf; Further information is in Canadian Council of Chief Executives, *Made in the world—defragmenting rules of origin for more efficient global trade* (June 2014): http://www.ceocouncil.ca/wp-content/uploads/2014/06/Made-in-the-world-Dawson-and-Staples-June-2014.pdf [accessed 7 March 2017]

Impact of rules of origin on UK businesses

132. Dr Virginia Acha, Executive Director of Research, Medical and Innovation, Association of the British Pharmaceutical Industry (ABPI), said the introduction of rules of origin would generate "a considerable amount of work" for the pharmaceutical industry. There was a "phenomenal number of changes", relating to thousands of products sold overseas, which "would be a burden to all the world's regulatory systems". This was "not an inconsequential piece of work". [266]

133. Mr Steve Elliott, Chief Executive Officer, Chemical Industries Association, agreed. Rules of origin added "a substantial level of bureaucracy, especially in the chemical sector". Were the UK to agree a FTA with the EU after Brexit, "the cost of providing the technical proof that a chemical or any other manufactured product originates from the EU or the UK, bearing in mind that in our case there could be several stages of synthesis involved … would clearly outweigh the benefit of duty-free sales".[267]

134. In the capital goods sector, Mr Fergus McReynolds, Director of EU Affairs, EEF—The Manufacturers' Organisation (EEF), confirmed that members of the EEF were concerned about rules of origin.[268] The Association of Manufacturers of Domestic Appliances (AMDEA) wrote: "Rules that differentiate market access based on country of origin are counter-productive and should be avoided".[269] We note that, outside the EU's customs union, this is unavoidable.

135. Witnesses from the food and beverages sector did not provide detail on the impact of rules of origin, but the Agriculture and Horticulture Development Board (AHDB) included the UK establishing its own rules of origin as part of the "principal risk" of Brexit (alongside "labelling and other criteria"). It explained that divergence from EU standards as a result of establishing separate UK rules of origin would lead to "additional technical barriers and paperwork when exporting to the EU".[270]

136. Mr Hawes said that the current absence of rules of origin in the EU was "part and parcel of why we have such an integrated automotive industry … the UK qualifies as Europe".[271] Professor Peter Wells, Professor of Business and Sustainability, Cardiff Business School, referred to a study, which found that the local value content of UK-produced cars was around 40% in 2015. This level of imported materials "would be contrary to EU rules of origin if the UK was outside the EU … as the EU requires at least 60% of the ex-works value of the car to be of local (i.e. EU) origin".[272] Mr Hawes said he would "struggle to see any scenario" in which the introduction of rules of origin would benefit the UK; rather, this prospect was "a threat" to future investment in the sector.[273] The impact of Brexit on investment is discussed in Chapter 9.

266 Q 5
267 Q 5
268 Q 23
269 Written evidence from AMDEA (FTG0002)
270 Written evidence from AHDB (FTG0007)
271 Q 67
272 Written evidence from Peter Wells (FTG0013); Automotive Council UK, *Growing the Automotive Supply Chain, Local Vehicle Content Analysis (September 2015):* http://www.automotivecouncil.co.uk/wp-content/uploads/2015/09/UK-local-sourcing-content-research-September-20151.pdf [accessed 16 February 2017]
273 Q 67

137. In the aerospace and defence sector, Mr Paul Everitt, Chief Executive Officer, ADS Group, said that, because the UK had long been a member of the EU, rules of origin would be "a particular challenge; it is not something that we, as a sector, have had to track".[274] At present, "shipping a wing from Broughton to Toulouse for final assembly" was "no different" to moving a part across the UK. Introducing rules of origin would "add significantly to the administrative burden of shipping goods". He added that this would be a particular burden for smaller businesses: "This would be a wholly new activity, certainly of a scale that they would not have had to deal with before, and both acquiring the expertise as well as the cost itself would be significant burdens for them".[275]

138. A further impact of rules of origin was explained by Dr Ulf Sverdrup, Director, Norwegian Institute of International Affairs, who gave evidence to our previous inquiry, *Brexit: the options for trade*. He told us that rules of origin, besides increasing transaction costs for businesses, would also increase barriers for consumers, for instance in e-trading, where customs would have to be declared for ordering goods from within the EU.[276]

139. Asked about the frictions that the application of rules of origin between the UK and the EU might cause, Lord Bridges of Headley MBE, Parliamentary Under-Secretary of State, Department for Exiting the EU, said that "not every import needs to be inspected at its point of entry into the UK". He also pointed out that "the EU's Common External Tariff is already zero for about a quarter of tariff lines, so preferential origin requirements do not apply on those goods". However, we note that while preferential rules of origin may be avoided, non-preferential rules of origin would still apply to UK trade with any trading partner (as discussed in Box 6).

140. Lord Price CVO, Minister of State for Trade Policy, Department for International Trade, gave the example of CETA, under which goods "will be tariff-free in accordance with the CETA tariff elimination schedule if they were wholly obtained there and produced exclusively from materials that originate there or have undergone sufficient production there".[277]

141. Lord Bridges cited, as an example of the simplification of rules of origin procedures, the "Australian and the New Zealand Productivity Commissions' 2012 report into strengthening trans-Tasman economic relations", which, he told us, "waived rules of origin requirements on goods that would attract a tariff below a *de minimis* level of 5% in that case".[278] This recommendation has not, however, been implemented by either government. The report, by two independent research bodies, recommended that the countries "waive … Rules of Origin for all items for which Australia's and New Zealand's most favoured nation tariffs are at 5 percent or less", and that they "consider reducing any tariffs that exceed 5 percent to that level".[279] In their reply, the Australian and New Zealand governments pointed to two previous

274 Q 88
275 *Ibid.*
276 Oral evidence taken before the EU External Affairs and Internal Market Sub-Committees, 15 September 2016 (Session 2016–17), Q 20 (Dr Ulf Sverdrup)
277 Q 109
278 *Ibid.*
279 Australian Government Productivity Commission and New Zealand Productivity Commission, *Strengthening trans-Tasman economic relations (November 2012):* http://www.pc.gov.au/inquiries/completed/australia-new-zealand/report/trans-tasman.pdf [accessed 10 February 2017]

simplifications of rules of origin, and agreed "that no action will be taken at this time".[280]

142. Lord Price told us that DIT had talked to Switzerland, Norway, the US, and Canada about the application of rules of origin. In current FTAs "we have rules of origin that we have to apply outside. So there are already processes in the UK" to manage these. However, it was "very hard to answer" the question of UK-EU rules of origin, "until the full shape of a comprehensive FTA and the extent to which you want free and easy movement of goods on both sides are known".[281] Lord Price concluded:

> "It is an issue that we do not have today on goods that go through Europe … It is a hurdle that would be there in the future, as not full members of the customs union, that is not there today. Our research, as the Prime Minister has said, is trying to guide us on how we make that as frictionless as possible. The more comprehensive and closer the FTA, the lower the hurdle will be."[282]

143. Further costs relating to the administration of non-tariff barriers (as well as tariff barriers) are discussed in Chapter 6.

Laws and regulations, standards and EU agencies

144. The regulatory environment is itself an important factor in trade and can act as a non-tariff barrier. There are three ways to address this barrier. First, harmonisation of standards. For example, the UK and French authorities may apply precisely the same regulatory standards. Mr Koji Tsuruoka, Ambassador of Japan to the UK, explained that the current harmonised EU system for drug approvals was helpful—in the case of Japanese companies operating in the UK—because it reduced the procedural requirements for firms.[283]

145. Second is mutual recognition. For example, the UK authorities may apply one set of standards, and the French another; the standards are not identical, but each admits a product once it has been approved in the other country.[284] Lord Price acknowledged that: "mutual recognition of standards" was one of the elements that "help business perform better" and that "reduce the costs of doing business … to the benefit of consumers and businesses".[285] Mr McReynolds agreed that "membership of a single regulatory and legal environment reduces the cost of doing business".[286] Third is equivalence. Equivalence means that it is determined that different standards suffienctly address a regulatory objective—such as sanitary or phytosanitary protection—through different means.[287]

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280 Government of Australia, *Australia and New Zealand government response to the joint productivity commissions' report on economic integration (2014):* http://jbh.ministers.treasury.gov.au/files/2014/05/Aus-NZ-Joint-Response-Productivity-Report.pdf [accessed 13 February 2017]

281 Q 109

282 *Ibid.*

283 Q 98

284 European Commission, 'Mutual recognition': http://ec.europa.eu/growth/single-market/goods/free-movement-sectors/mutual-recognition_en) [accessed 16 February 2017]

285 Oral evidence taken before the EU External Affairs and Internal Market Sub-Committees, 13 October 2016 (Session 2016–17), Q 52 (Lord Price)

286 Q 20

287 Trans Atlantic Consumer Dialogue, *TACD Briefing Paper on Mutual Recognition Agreements* (March 2001) p 1: http://test.tacd.org/wp-content/uploads/2013/09/TACD-TRADE-2001-Briefing-Paper-on-Mutual-Recognition-Agreements.pdf [accessed 8 March 2017]

146. The sectors of UK industry represented by our witnesses have benefited from many EU-wide regulations, and in most cases have influenced their shape. Witnesses also said that it would be important for the UK to seek to retain membership of standard-setting bodies after Brexit. As we noted in our previous report *Brexit: the options for trade*, the EU plays an important role in setting global standards and has convinced third countries to accept its standards.[288]

147. The Prime Minister's speech on 17 January sets out the Government's intention to negotiate a FTA with the EU. As we noted in our report, *Brexit: the options for trade*, "modern FTAs involve extensive regulatory harmonisation in order to eliminate non-tariff barriers". This entails a trade-off between the liberalisation of trade and the exercise of regulatory sovereignty—a high degree of liberalisation requires a high level of common regulation, which entails a loss of regulatory sovereignty on each side.[289]

Laws and Regulations

148. Currently, EU laws are automatically part of the UK domestic legal framework. The Government has stated its intention to introduce a Great Repeal Bill (see Box 7), maintaining this existing body of law in place. But Brexit means that the UK will have the opportunity to diverge from EU regulatory standards.[290]

Box 6: The Great Repeal Bill

In October 2016, the Prime Minister announced the Government's intention to introduce a Great Repeal Bill. It will repeal the European Communities Act 1972, which makes EU law part of the UK legal system, and will convert existing EU law into domestic law, wherever practical. The aim of the Bill is to ensure a "calm and orderly" exit from the EU. It will be open to Parliament in the future to keep or change these laws.

Source: HM Government, The United Kingdom's exit from and new partnership with the European Union, Cm 9417, February 2017: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/589191/The_United_Kingdoms_exit_from_and_partnership_with_the_EU_Web.pdf [accessed 7 March 2017]

149. Reflecting on the pharmaceutical industry, professional services firm Deloitte LLP told us:

> "The harmonisation of regulations applicable to the industry [is] probably the most important element of UK-EU relations. This is irrespective of whether one takes a narrow view of 'trade' (i.e. limiting the definition to the marketing and sale of medical products), or a broader definition of trade (i.e. one that includes all of the activities that a life sciences company undertakes, such as R&D)."[291]

150. Deloitte noted that while "the UK could create its own" rules and standards, the UK market for pharmaceuticals was "relatively insignificant". Thus UK standards "would need to be recognised as equivalent by the EU as a pre-requisite for ongoing EU trade". Moreover, changes to the rules on mutual recognition and regulatory harmonisation, and to common labelling

288 European Union Committee, *Brexit: the options for trade* (5th Report, Session 2016–17, HL Paper 72)
289 *Ibid.*
290 This is also considered in our report *Brexit: environment and climate change* (12th Report, Session 2016–17, HL Paper 109)
291 Written evidence from Deloitte LLP (FTG0004)

requirements, "would increase the costs of production" for pharmaceuticals. Qualifying this point, it added that this would be "inflationary rather than being significant in changing buying decisions".[292]

151. Mr Elliott highlighted the importance of the Control of Major Accident Hazards (COMAH) Regulations for the chemicals industry.[293] The purpose of the 2015 COMAH Regulations is to prevent major accidents involving dangerous substances and to limit the consequences to people and the environment of any accidents which do occur.[294]

152. He also highlighted the importance for the chemicals sector of the EU's Registration, Evaluation, Authorisation and Restriction of Chemicals (REACH) Regulation. The REACH Regulation requires industry to manage the risks from chemicals and to provide safety information on the substances used. The information has to be registered in a central database in the European Chemicals Agency (ECHA). While leaving the EU might be a "potential opportunity" to look at a "more risk-based, more proportionate, and more pragmatic" system, for instance US legislation on chemicals,[295] the level of UK-EU trade was such that he expected that "we would need to continue" to comply with REACH.[296]

153. For the food and beverages sector, Mr Peter Hardwick, Head of Exports, AHDB, said that there was a possibility for the UK to "create two-tier markets".[297] This would enable UK exporters to produce goods to different standards, depending on the eventual destination of the goods. This could involve adhering to more stringent regulations for one set of countries than for another: "We do not necessarily need the same type of factories supplying [West African] markets as we have to supply the European Union."[298]

154. Mr Hardwick acknowledged, though, that there were difficulties with such an approach. First, he stressed that, for trade to continue, it was important for the food and drink sector to "maintain the same or similar standards to those in the European Union" after Brexit.[299] Agra Europe agreed: in areas such as food labelling and pesticide residues, "any significant divergence from EU standards in these areas could make UK goods illegal on EU markets".[300]

155. A second problem was that in a meat plant, for example, "parts of that animal will probably go to one system and other parts will go to another … If you want to sell your carcass meat to the European Union and your offals to West Africa, you cannot have two plants—you can have only one for the European Union."[301] In addition, Professor Tim Lang, Founder, Centre for Food

292 *Ibid.*
293 Q 7
294 The COMAH Regulations 2015 implement the majority of the Seveso III Directive (2012/18/EU) in Great Britain (Northern Ireland produces its own regulations). The Seveso III Directive aims at the prevention and control of large-scale accidents involving dangerous chemicals. The land-use planning requirements from the Directive are implemented through planning legislation.
295 Q 9
296 Q 7
297 Q 40
298 *Ibid.*
299 *Ibid.*
300 Written evidence from Agra Europe (FTG0005) Agra Europe added that regulation which is unrelated to trade, "(for example, those related to habitats, or rules on how to claim for subsidies) could, on the other hand, be changed in the UK without any trade impact". This issue is further discussed in our report, *Brexit: environment and climate change* (12th Report, Session 2016–17, HL Paper 109)
301 Q 41 (Peter Hardwick)

Policy, City, University of London, said that creating different standards for different export zones would be "catastrophic for Brand Britain", the promotion of which was "Defra's current top-line thinking".[302] For all these reasons, a 'two-tier' approach to regulation of the food and beverages sector post-Brexit appears undesirable and unlikely.

156. So far as the downstream petroleum sector is concerned, Mr Hunt told us that it would "be very keen to ensure that we stick with the Control of Major Accident Hazards (COMAH) Regulations".[303]

157. For the upstream sector, Mr Michael Tholen, Director of Upstream Policy, Oil and Gas UK, told us that the EU had "no direct remit over the precise activities of oil and gas extraction offshore". The EU did, however, influence the upstream industry through environmental standards and energy market standards.[304]

158. Norton Rose Fulbright LLP also highlighted the EU's influence over product quality. There were "a number of European laws and standards which relate to the quality of downstream products, which are important for trading". These included Directive 2015/1513 (relating to the quality of petrol and diesel fuels) and Directive 2009/30 (on the specification of petrol, diesel and gas-oil to be used by cars and ships). Norton Rose Fulbright LLP commented:

> "At present, EU customers have certainty that when they purchase UK-produced products they will not be in breach of the obligations imposed on them to use a certain specification of fuel. However, if existing EU customers were to lose faith that UK-produced fuels were compliant with these rules, the EU export market might be in danger of disappearing."[305]

159. Mr Tholen therefore argued that "the ability to influence [EU] standards in a positive way post-Brexit for a very interrelated and complicated energy market will be vital". The UK's potential to influence EU standards from outside was, though, mixed at best. Norway had "a great degree of soft influence", but also "a large measure of frustration about the ability to influence specifics". The UK's influence would depend on "the nature of the separation of the upstream market post-Brexit from the European market", and "on how energy policy and the UK's own energy policy will emerge in that new world".[306]

160. Regarding common standards, Lord Bridges reiterated that "the Great Repeal Bill will take EU law and regulation and import it into UK law", and argued that "we are starting from a good base in terms of conformity".[307] He pointed to mutual recognition provisions for conformity assessment of standards in the EU-Swiss FTA as a precedent. Similar provisions could be found in CETA, and the EU and Canada had a regulatory co-operation forum.[308]

302 *Ibid.*
303 Q 51
304 *Ibid.*
305 Written evidence from Norton Rose Fulbright (FTG0018)
306 Q 51
307 Q 112
308 *Ibid.*

EU agencies and standards

161. Witnesses highlighted the UK's role in a number of different standardisation bodies, some of which are EU agencies, and other bodies in which the EU plays a major role. While the Prime Minister's speech on 17 January made no mention at all of EU agencies, the Government's White Paper stated: "As part of exit negotiations the Government will discuss with the EU and Member States our future status and arrangements with regard to these [EU] agencies."[309] While little detail has been provided by the Government on its objectives in this regard, it is clear that this will be a key part of the negotiations under Article 50 on a withdrawal agreement.

162. For the pharmaceuticals industry, the European Medicines Agency (EMA), based in London, is a major EU regulatory agency. The EMA is responsible for the scientific evaluation, supervision and safety monitoring of medicines developed by pharmaceutical companies for use in the EU and in the countries of the EEA.[310]

163. Dr Acha and Deloitte LLP told us the UK Medicines and Healthcare Products Regulatory Agency (MHRA) had contributed heavily to the development of standards through the EMA.[311] Deloitte LLP explained that for the pharmaceuticals sector, standards were "very significant and are a pre-requisite for the licencing of drugs and devices across the EU, as well as being a requirement in many operational areas of the business".[312] Moreover, standards were converging globally.[313]

164. Dr Acha said that there would be the opportunity for the UK to continue participating in the EMA after Brexit, if it chose to remain part of the EEA. Non-EU EEA countries "can participate under the EEA arrangements, but they do not have voting rights and they do not lead on policy".[314] The Prime Minister's speech on 17 January, ruling out membership of the Single Market or joining the EEA after Brexit, means that ongoing participation in the EMA would require a bespoke, and unprecedented, agreement between all sides to the forthcoming negotiations.

165. We note that EU agencies are subject to EU law. If the UK were to retain membership of the EMA, it would probably have to comply with EU law in the areas covered by the EMA. The Court of Justice of the European Union (CJEU) has jurisdiction over proceedings against any EU agency.[315] It is unclear how the UK could co-operate with the EMA after Brexit,[316] and whether the UK would be able to influence decisions taken by the EMA. It is

309 HM Government, *The United Kingdom's exit from and new partnership with the European Union*, Cm 9417, February 2017, p 46: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/589191/The_United_Kingdoms_exit_from_and_partnership_with_the_EU_Web.pdf [accessed 13 February 2017]

310 The EEA includes all EU Member States and Norway, Iceland, and Liechtenstein.

311 Q 6 and written evidence from Deloitte LLP (FTG0004)

312 Written evidence from Deloitte LLP (FTG0004)

313 Q 6 (Dr Virginia Acha) and written evidence from Deloitte LLP (FTG0004)

314 Q 11

315 The Court of Justice of the European Union, 'Jurisdiction': http://curia.europa.eu/jcms/jcms/Jo2_7024/en/#competences [accessed 23 February 2017]

316 We are confident that agreement on co-operation in general can be reached: the EMA co-operates with regulators outside the EU, and has agreements in place with regulators in the US, Canada, Japan, Switzerland, Australia, New Zealand and Israel. However, these countries do not participate in the management of the EMA. EMA, 'Regulators outside the European Union': http://www.ema.europa.eu/ema/index.jsp?curl=pages/partners_and_networks/general/general_content_000214.jsp&mid=WC0b01ac058003176d [accessed 2 March 2017]

also unclear whether a different oversight or dispute settlement mechanism could apply to the UK's co-operation with the EMA.

166. Discussions have already begun about moving the EMA to one of the EU-27. As Deloitte LLP noted, this will be "a disadvantage for the UK life sciences industry, both in terms of status as host nation but also there is likely to be a reduction of research and other work contracted to the MHRA by the EMA".[317]

167. More broadly, Dr Acha noted that the Government would have to "think about how we are going to align with the standards that have been arranged after so many years of careful thought".[318] There was a "need to have continued alignment, as far as possible, with the global process, to which the European Medicines Agency has been a significant contributor".[319] Deloitte wrote that the UK had three options. It could either continue to align with the EMA (particularly given the "potential disadvantages of losing mutual recognition with the EU"), align with another regulatory framework (such as the US Food and Drug Administration (FDA), or "create a new/enhanced UK regulatory body". Aligning with another regulatory body such as the FDA might be "time-consuming and costly", while the "size and complexity" of the task of creating a new regulatory body and supporting a new regulatory framework meant that this was "unlikely to be feasible in the time available".[320]

168. Dr Acha told the Committee that the ABPI "would like the role the MHRA plays"—as an important voice in the EMA and in international groups on harmonisation—"in the future to be no smaller than in the past". She hoped that "the British voice" would "continue to weigh importantly in the scientific developments on standards", and she looked to the Government "to ensure that … we are directly represented at the ICH [International Council for Harmonisation of Technical Requirements for Pharmaceuticals for Human Use] and other relevant bodies".[321] The UK is currently represented at ICH only as a member of the EU, and the Government will need to establish itself as an independent member.[322]

169. In the food and beverages sector, the UK Food Standards Agency participates in the EU's Rapid Alert System for Food and Feed (RASFF). RASFF enables information to be shared efficiently between EU Member States and agencies and the EFTA countries when risks to public health are detected in the food chain.[323] Mr Hardwick told us that after Brexit, "there are options to remain in", though in so doing he was reflecting the fact that the EFTA states are members—an option now ruled out by the Government.[324] It is therefore not yet clear whether ongoing UK participation in RASFF will be

317 Written evidence from Deloitte LLP (FTG0004)
318 Q 6
319 Q 9 (Dr Virginia Acha)
320 Written evidence from Deloitte LLP (FTG0004); Deloitte cited the example of Australia and New Zealand, which had "tried to align on two previous occasions, ultimately deciding to cease efforts in favour of New Zealand introducing a new scheme".
321 Q 9 (Dr Virginia Acha) ICH brings together the regulatory authorities and pharmaceutical industry to achieve greater harmonisation worldwide to ensure the safety, effectiveness and quality of medicines. ICH, 'Current Members and Observers': http://www.ich.org/about/membership.html [accessed 17 January 2017]
322 ICH, 'Current Members and Observers': http://www.ich.org/about/membership.html [accessed 17 January 2017]
323 European Commission, 'RASFF—Food and Feed Safety Alerts': https://ec.europa.eu/food/safety/rasff_en [accessed 6 March 2017]
324 Q 41

possible after Brexit. Prof Lang presented the options in stark terms: "One is that you do not leave it, and the other is that you duplicate it."[325]

170. For the downstream petroleum sector, technical standards are determined by the European Committee for Standardisation (CEN). CEN brings together the national standardisation bodies of 34 European countries, including EU Member States, the Former Yugoslav Republic of Macedonia, Turkey, Iceland, Norway and Switzerland. CEN provides a platform for the development of European Standards and other technical documents in relation to various kinds of products, materials, services and processes.[326]

171. Mr Chris Hunt, Director General and Company Secretary, UK Petroleum Industry Association, said that CEN was open to non-EU members, and that Brexit "should make no difference" to the UK's membership and influence. He thought that the UK's standards body, the British Standards Institution (BSI) "will maintain its role in maintaining [international] standards, as now".[327]

172. The automotive sector raised the issue of vehicle approvals after Brexit. Through the Whole Vehicle Type Approval system, the EU sets standards for road vehicles.[328] The Automobile Association and the RAC noted that these allowed car manufacturers to obtain approval against a set of standards that permit cars to travel or be sold across the EU without further inspections.[329] The SMMT wrote that "the validity of existing type approvals issued by the Vehicle Certification Agency (VCA)[330] once the UK has left the EU" required "urgent legal clarification". It added that the UK had an "influential and respected voice", which "must continue to participate in [standard-setting] discussions".[331]

173. Turning to the aerospace industry, the European Aviation Safety Agency (EASA) is an EU agency and the main regulator of civil aviation in Europe. As well as, in the words of Mr Simon Whalley, Head of External Affairs, Royal Aeronautical Society, creating "common standards and common requirements" for its members,[332] Mr Everitt said it was "our route to market … it is through EASA that we gain access to all of our major markets, whether that is the US, China, Japan or elsewhere". For this reason, membership of EASA was "our number one ask of the UK Government".[333]

325 Q 41
326 CEN supports standardisation activities in relation to a wide range of fields and sectors including: air and space, chemicals, construction, consumer products, defence and security, energy, the environment, food and feed, health and safety, healthcare, ICT, machinery, materials, pressure equipment, services, smart living, transport and packaging. CEN, 'Who we are': https://www.cen.eu/about/Pages/default.aspx [accessed 17 January 2017]; CEN, 'Our role in Europe': https://www.cen.eu/about/RoleEurope/Pages/default.aspx [accessed 16 February 2017] and CEN, 'CEN Members': https://standards.cen.eu/dyn/www/f?p=CENWEB:5 [accessed 17 January 2017]
327 Q 51
328 House of Commons Library, Brexit: how will it affect transport?, CBP7633, 17 November 2016
329 *Ibid.*
330 The VCA is an Executive Agency of the United Kingdom Department for Transport and the United Kingdom's national approval authority for new road vehicles, agricultural tractors and off-road vehicles. It is also responsible for enforcement of vehicle safety and environmental standards.
331 Written evidence from SMMT (FTG0009)
332 Q 90
333 *Ibid.*

174. Mr Whalley told us that the UK had been "very positively influential within EASA", and that it "should try to maintain [its] position within EASA and retain as much influence as possible."[334] Mr Everitt noted that current membership of EASA cost the UK around £1 million per annum, whereas building these functions into the existing UK Civil Aviation Authority "would cost tens if not hundreds of millions".[335]

175. Mr Everitt noted "existing examples of countries outside the EU which are part of EASA",[336] namely the four EFTA states.[337] He also believed that the UK should retain membership of EASA post-Brexit,[338] though we note that, as for other agencies, the Government's decision to rule out EEA or EFTA membership means that it is not yet clear whether this will be possible.[339] As is the case with the European Medicines Agency, if the UK were to remain a member of EASA, it might have to comply with EU law (and possibly accept the oversight of the Court of Justice of the European Union) in the areas covered by it.[340] It is unclear in which ways the UK could co-operate with the EASA after Brexit, and whether the UK would be able to influence decisions taken by the EASA. It is also unclear whether an oversight or dispute settlement mechanism other than the CJEU could apply to the UK's co-operation with the EASA.

176. Mr Whalley told us that it would be important to maintain access to the European Space Agency's (ESA) flagship programmes, Galileo and Copernicus.[341] ESA is not a European Union agency, but an intergovernmental organisation with membership beyond the EU,[342] so continued membership appears feasible.[343] Nevertheless, as Mr Whalley said, it implements EU space programmes, and, thanks to the EU's role as a research funder, legislator and regulator, there are "overlaps with the EU".[344] Some 20% of the funds managed by ESA originate from the EU budget,[345] and Mr Whalley said

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334 Q 90
335 *Ibid.*
336 *Ibid.*
337 The EFTA states are Iceland, Liechtenstein, Norway, and Switzerland. EASA, 'EASA by Country': https://www.easa.europa.eu/easa-and-you/international-cooperation/easa-by-country?easa_relationship[0]=field_easa_country_mbmo_target_id [accessed 17 January 2017]
338 Q 90
339 We note that Switzerland participates in EASA, although it is not a member of the EEA. It is not clear whether the UK's participation would depend on its joining EFTA, signing a FTA with the EU, or on separate negotiations.
340 It should be noted that the four EFTA countries that are EASA member states are not subject to the CJEU, but to the EFTA Court (Iceland, Liechtenstein, and Norway) or no court system (Switzerland). It should further be noted, however, that the EU has stated that "a precondition for further developing the sectoral approach remains the establishment of a common institutional framework for existing and future agreements through which Switzerland participates in the EU's Single Market, in order to ensure homogeneity and legal certainty for citizens and businesses." Council of the European Union, Press release—*Council conclusions on EU relations with the Swiss Confederation* (28 February 2017): http://www.consilium.europa.eu/press-releases-pdf/2017/2/47244655317_en.pdf [accessed 3 March 2017]
341 Q 91; Galileo is Europe's own global navigation satellite system, providing an accurate and guaranteed global positioning service under civilian control. Copernicus is a European system for monitoring the earth by collecting data from satellites and *in situ* sensors such as ground stations, airborne and sea-borne sensors. It provides information on environmental and security issues.
342 ESA, 'ESA and the EU': http://www.esa.int/About_Us/Welcome_to_ESA/ESA_and_the_EU2 [accessed 23 January 2017]; 20 EU Member States are members, plus Norway and Switzerland. Canada takes part in some projects under a co-operation agreement.
343 Q 91 (Paul Everitt)
344 Q 91 (Simon Whalley)
345 ESA, 'ESA and the EU': http://www.esa.int/About_Us/Welcome_to_ESA/ESA_and_the_EU2 [accessed 23 January 2017]

that a key issue for the UK was "having the influence to direct where that money is spent".[346] After Brexit, the UK should "maintain, as other non EU countries are able, access to EU space programmes for UK firms to be able to tender for future space programmes". He was concerned, however, that non-EU countries "are not always able to tender for all projects because, even though there are WTO rules that say that all countries can tender for European Union space projects, there are exclusions for non-Member States due to certain research and security clauses."[347] This meant that companies in the UK that were "heavily involved in EU-funded space programmes would not necessarily be able to enjoy the same benefits in the future".[348]

177. Asked about participation in the EMA and EASA, Lord Bridges told us: "We are very much looking at all the agencies … in terms of what is in our national interest and therefore of what will be in the long-term interests of a partnership between this country and the European Union." While the UK might wish "to continue to play some sort of role" in some of the agencies, it might not wish to do so in others. The UK's approach to such bodies was "not going to be a one-size-fits-all rule, so the role that we play is not a binary choice that can be made right now".[349] We note that this statement did not provide a great deal of clarity or detail on the UK's potential participation in EU agencies after Brexit.

Conclusions and recommendations

178. **Non-tariff barriers can pose as significant or a greater barrier as tariffs to trade in goods.**

179. **Were the UK to agree a FTA with the EU, rules of origin (which determine where a product and its components were produced) would apply. They would also apply were the UK and EU to trade under WTO rules. Applying rules of origin will generate significant additional administration, and therefore costs and delays, to UK businesses.**

180. **If the UK and the EU were to agree a FTA, compliance with preferential rules of origin might be so administratively burdensome for some sectors, such as chemicals, as to outweigh the benefit of tariff reductions. It will be important for the Government fully to assess the benefit, sector by sector, of preferential rules of origin under a FTA as compared to non-preferential rules of origin under WTO terms.**

181. **Some industries with an integrated EU supply chain and high levels of both imports and exports, notably the automotive sector, might be unable to comply with the local content requirements contained in the EU's preferential rules of origin. In this scenario, WTO most favoured nation tariffs would be imposed, increasing costs and disrupting the UK's place within the EU supply chain.**

182. **Regulatory standards are a significant non-tariff barrier. If the current level of EU-UK trade is to be maintained, ongoing harmonisation or mutual recognition of regulatory standards may be required. We welcome the Government's decision—by means of the Great Repeal Bill—to preserve existing EU regulations in domestic law as a first step towards regulatory co-operation with the EU.**

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346 Q 91 (Paul Everitt)
347 Q 91 (Simon Whalley)
348 *Ibid.*
349 Q 111 (Lord Bridges of Headley)

183. **As we stated in our report Brexit: the options for trade, the Government will have to make a trade-off between its desire to determine UK laws and regulations, and how far-reaching a FTA it can agree with the EU (and other partners).**

184. **Operating to two separate regulatory standards—for the domestic and EU markets—would be costly for UK businesses.**

185. **We urge the Government to maintain close dialogue with the EU over the development of UK and EU standards post-Brexit, to avoid unnecessary divergence.**

186. **But a comprehensive FTA is likely to require more than just such dialogue: it is likely to require a legal commitment by the UK to maintain a high level of harmonisation or mutual recognition of regulations and standards with the EU. This would require the UK Government to limit its exercise of regulatory sovereignty, in order to secure liberal conditions for trade. It might also require the UK to agree with the EU a new arrangement for oversight and dispute resolution.**

187. **As part of this regulatory alignment, there may be significant benefits in the UK continuing to participate, where legally possible, in EU agencies. We regret the lack of information in the Government's White Paper regarding the UK's strong and abiding interest in continued membership of such agencies.**

188. **The UK has in particular benefited from hosting and participating fully in the European Medicines Agency (EMA). The Government's decision to rule out membership of the Single Market means that the UK may be unable to maintain its membership of this body. We regret this, and urge the Government to bring forward proposals for future collaboration with the EMA.**

189. **We call on the Government to confirm whether vehicle type approvals issued by the Vehicle Certification Agency will remain valid after Brexit.**

190. **The European Aviation Safety Agency is the civil aviation industry's 'route to market'. We urge the Government to confirm whether the Government intends to seek continuing membership of the EASA after Brexit, and if so on what terms.**

191. **The Prime Minister has stated the Government's intention to leave the jurisdiction of the Court of Justice of the European Union. Full UK participation in EU agencies after Brexit would be likely to require some form of oversight and dispute resolution, in the specific areas covered by these agencies. We urge the Government to clarify whether it would accept such conditions for co-operation with specific EU agencies, and if so on what terms.**

CHAPTER 6: COSTS OF ADMINISTERING TARIFF AND NON-TARIFF BARRIERS

Costs through increased administration

192. The imposition of both tariff and non-tariff barriers on trade between the UK and the EU would be likely to lead to an increase in costs to businesses, as a result of increased administration. Such costs would be additional to any tariff levied: they would result from administering tariffs, rules of origin and customs procedures, which could affect the competitiveness of UK industry.

193. These costs would be incurred for UK trade with the EU once the UK left the customs union, regardless of the new trading framework (unless a unique customs arrangement were to be agreed between the UK and the EU, an option that is discussed below). In the absence of such an arrangement, the nature and amount of the costs would depend on whether trade was conducted under WTO rules or under a FTA.

194. Box 7 outlines existing procedures and requirements related to customs controls.

Box 7: Administrative requirements and customs procedures

This box considers how the UK currently applies EU rules on customs controls and procedures.

Administrative requirements for intra-EU trade

EU businesses that trade within the EU do not usually need to obtain compliance certificates and are not subject to rules of origin.[350]

Imports from EU countries are not regarded as imports for customs purposes as they are 'goods in free circulation' within the customs union. Therefore no customs duty or import VAT is charged on these goods and there is no requirement for a formal customs declaration. There may still be some national restrictions in place, which may require risk-based and highly targeted border checks, for instance on firearms. These are not routine controls. If a firm's trade with the EU-27 exceeds £1.5 million imports, it must also provide additional information on a monthly Intrastat declaration.

For exports to the EU-27, UK businesses are required to declare the total of their sales or acquisitions of goods from other EU Member States on their VAT return. If a firm's trade with the EU exceeds £250,000 for goods exports, additional information must be provided on a monthly Intrastat declaration.[351]

UK legislation requires that businesses retain any information used to compile their Intrastat declarations for 6 years.

Animal products can be traded within the EU and in non-EU EEA states accompanied by a commercial document only and do not need to pass through a Border Inspection Post.

350 Rules of origin determine where a product and its components were produced, in order to ensure that the correct customs duty is levied.

351 Intrastat is the system for collecting information and producing statistics on the trade in goods between EU Member States.

Administrative requirements for trade with non-EU countries

EU businesses which trade with non-EU countries need to obtain an Economic Operator Registration and Identification (EORI) number. This enables the Economic Operator (EO) to uniquely identify itself in whatever customs activity it undertakes or plans to be involved in. The requirement is the same for importing and exporting businesses. In order to benefit from arrangements under mutual recognition agreements with third countries, businesses need to apply for Authorised Economic Operator status for security and safety (AEOS).[352]

HM Revenue and Customs (HMRC) runs an electronic declaration system, which handles customs declarations for exports to and imports from non-EU countries. This declaration system, also known as CHIEF (Customs Handling of Import and Export Freight), records all imports and exports into and out of the UK. The format of customs declarations is standardised across the EU and is also used by members of the EFTA and countries wishing to join the EU. Economic operators can be authorised to lodge a simplified declaration, with a reduced data set.

Customs declarations serve the purpose of controlling the movement of goods, ensuring compliance with customs regimes and protecting revenue, supporting the zero-rating of exports for VAT purposes, supplying data for risk assessment to assist with international requirements, and supplying data for trade statistics. UK exporters can use freight forwarders to make the export declaration on their behalf, which entails additional costs to their business. UK businesses are required to keep customs paperwork for four years.

UK exporters are required to obtain a license to export some goods to non-EU countries. Documentary checks may be required and the exporter will need to provide evidence to support its export declaration before the goods can leave the EU. This is the case, for instance, with art works and cultural goods that require a cultural licence, or certain hazardous chemicals, as specified in the Prior Informed Consent Regulation (PIC, Regulation (EU) 649/2012).

Imports from non-EU countries, as exports to non-EU countries, require an EORI number and an import declaration, to be made in CHIEF. Such an import declaration needs to enable customs authorities to identify the customs status of goods at any time (currently 'Union' or 'non-Union' goods), in order to determine whether the goods are subject to customs controls and/or customs charges (for example, customs duty, import VAT, anti-dumping or countervailing duties.

All products of animal origin imported from a third country into the EU are subjected to a documentary check—an assessment of the common veterinary entry document, public and/or animal health certificates, and accompanying commercial documentation. Rules of origin also apply to third country agricultural imports.

Source: Written evidence from HMRC (FTG0010)

352 HMRC, *Authorised Economic Operator* (21 September 2012): https://www.gov.uk/guidance/authorised-economic-operator-certification [accessed 14 February 2017]

Tariff-related administrative costs

195. The first issue raised by witnesses related to tariffs was the additional bureaucracy for companies. Dr Virginia Acha, Executive Director of Research, Medical and Innovation, Association of the British Pharmaceutical Industry, said there was "no doubt that the administrative burden and the cost is a challenge for the [pharmaceutical] industry".[353] The Association of Manufacturers of Domestic Appliances (AMDEA) wrote that the "administrative burden" of tariffs in the capital goods sector "should not be underestimated".[354] Mr Fergus McReynolds, Director of EU Affairs, EEF—The Manufacturers' Organisation (EEF) agreed, and said the challenge was "not just the tariff … we have to fully understand the implications of the customs controls that would potentially be introduced, and understand the time and any barrier that might introduce".[355]

196. From the automotive sector, the National Franchised Dealers Association was concerned that tariffs and customs procedures would result in "administrative and financial burdens on the import and export of vehicles".[356] From the perspective of the supply chain of the aerospace and defence sector, Meggitt PLC estimated that the administration of "tariff barriers would pose a significant amount of red tape costs (+200%)". This "would be counterproductive".[357]

197. HMRC highlighted that the administrative burden of export declarations was "affected by a number of factors, such as business size; type and volume of goods; country of origin/destination; and the timing and mode of transport selected". [358] Nevertheless, the advisory firm Global Counsel told us, "None of the established mechanisms of trading with, or integrating with the EU market short of full membership, eliminate these requirements entirely."[359]

198. The second issue brought up by witnesses was the likelihood that customs administration would lead to delays. Mr Chris Hunt, Director General and Company Secretary, UK Petroleum Industry Association, wrote that the downstream oil sector needed spares for refineries "to be delivered quickly to the UK when they are required, often at very short notice". There was a risk that a "lengthy customs import process could lead to refinery production issues should products not be delivered promptly".[360]

199. Mr Mike Hawes, Chief Executive Officer, The Society of Motor Manufacturers and Traders, told us one should "by no means be relaxed" about the impact of customs controls on trade. When products had to pass borders, "You need a customs validation, that creates some delay, and anything that delays creates cost." He agreed that products would either need to be stored in warehouses, which would "act as a buffer" for delays, or one would "have to increase the logistic capability". During the customs checks, "the truck may have to wait there for however long it is going to take before moving on, so you will potentially have to double up the transport costs, too".[361] Similarly, Mr Paul Everitt, Chief Executive Officer, ADS Group,

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353 Q 4
354 Written evidence from AMDEA (FTG0002)
355 Q 27 (Fergus McReynolds)
356 Written evidence from the National Franchised Dealers Association (FTG0012)
357 Written evidence from Meggitt PLC (FTG0017)
358 Written evidence from HMRC (FTG0024)
359 Written evidence from Global Counsel (FTG0023)
360 Written evidence from Chris Hunt (FTG0020)
361 Q 67

said that in the aerospace and defence sector, "The UK's industry benefits from being able to move components quickly and efficiently across Europe … Any customs or border controls could add significant administrative and processing costs, including the need to increase stock holding to avoid any potential delays."[362]

200. Meggitt PLC wrote that the administration of instructions to forwarders and declaration checks (both customs entry processes) would increase by "a further (approx.) 22,000 entries". It added that the "average time for an instruction issue is 10 minutes and [for] an entry check 5 minutes".[363] A study by Oxera in June 2016 found that around 8% of the cost of importing goods by sea arose from customs clearance. For a single freight container, customs clearance processes added around one day to the import process.[364]

201. Dr Acha noted that delays to the shipment of pharmaceuticals could also have a direct impact on patients in the UK. She was "very concerned" about introducing "delays into the process that may mean that medicines coming to a British patient are delayed in any way".[365]

202. Lord Bridges of Headley MBE, Parliamentary Under-Secretary of State, Department for Exiting the EU, acknowledged that for time-critical industries, avoiding processing delays "on both sides of the Channel" was "undoubtedly an issue". He said that, "having identified a problem we are now trying to simplify the solution to it as far as possible … we are really focused on it". He highlighted that "roll-on, roll-off traffic" across the channel might be problematic, but "containerised traffic" was already "highly digitised". This "may be able to help us as we move forward on this".[366]

203. A third issue is the administration of trade with the EU as a non-Member State, which would increase the work of HMRC. HMRC told the Committee that it was "currently assessing the potential impacts of leaving the European Union, including the number of declarations that may arise and the impact on resourcing".[367] Dr Acha estimated that as a consequence of the imposition of customs duties, "the need to go through declarations will jump to about 350 million declarations per annum. At the moment they are only geared up for about 100 million."[368] AMDEA agreed that administration was a concern.[369]

204. The UK Trade Policy Observatory, University of Sussex, also believed that introducing customs procedures between the UK and the EU would result in additional costs falling on the UK state. Collecting tariffs would "require customs posts and inspections, where currently there are none".[370] Mr Steve Elliott, Chief Executive Officer, Chemical Industries Association, said that leaving the customs union would mean the UK having to "rewrite … the customs code, and recruit and retrain customs officers". The Government would need to "look at the extent to which customs controls would need to be reintroduced", which would potentially result in additional administrative

362 Written evidence from Paul Everitt (FTG0016)
363 Written evidence from Meggitt PLC (FTG0017)
364 Oxera, *Agenda—Brexit: implications for the transport sector* (June 2016): http://www.oxera.com/Latest-Thinking/Agenda/2016/Brexit-implications-for-the-transport-sector.aspx [accessed 10 February 2017]
365 Q 4
366 Q 113
367 Written evidence from HMRC (FTG0023)
368 Q 4
369 Written evidence from AMDEA (FTG0002)
370 Written evidence submitted to the EU Internal Market Sub-Committee, 30 November 2016 (Session 2016–17) TAS0085 (UK Trade Policy Observatory, University of Sussex)

requirements. The UK Government would have to decide whether to create "a single administrative document with 54 questions and 8 sections: goods, movement of goods, commodity codes, customs procedures, rules of origin, duty administration, et cetera".[371]

205. Mr Peter Hardwick, Head of Exports, The Agriculture and Horticulture Development Board (AHDB), expressed particular concern about the UK system for agricultural declarations. New Zealand's electronic certification system, he said, enabled it to pre-clear goods and thus speed up the process. In contrast, the UK's system was "based on Crown watermarked paper", with changes being "handwritten" and sent around by "snail mail". He continued: "If there is an opportunity with Brexit, it will be to really address and modernise some of our processes so that we can minimise the impact on industry."[372] HMRC responded that while agricultural goods with licenses issued in other Member States required paper versions of these licenses in order to be cleared in the UK, "most CAP licences[373] are already issued electronically", and "the vast majority of customs declarations in the UK" were dealt with via CHIEF.[374]

206. Global Counsel wrote that any trade relationship with the EU post-Brexit would signify a "huge step change in the volume of goods moving through the UK's formal systems of trade processing". Such a change would raise a "simple capacity question with respect to the system's ability to essentially double its basic coverage". For a number of UK ports this might also have "infrastructure implications if new requirements physically slow the transit of goods through them".[375] Illustrating this point, Oxera wrote that, were the UK to leave the customs union, "a lorry would have to wait while each separate pallet is checked, requiring extensive investment in parking facilities at UK ports and/or extensive queues in France (if customs clearance were moved there) or UK port towns".[376]

207. Global Counsel acknowledged, though, that there was a possibility to agree "simplified procedures for EU-UK trade as part of an FTA". For example, "trusted trader status and self-assessment systems can be used to simplify procedures for recognised bulk or regular traders".[377] Such trade facilitation "should be seen as a clear area of mutual interest in practical solutions" between the UK and the EU, "and should be actively carved out from politicisation or wider trade-offs".[378]

371 Q 3
372 Q 37 (Peter Hardwick)
373 CAP licenses are licenses for products covered by the EU's Common Agricultural Policy (CAP).
374 Written evidence from HMRC (FTG0024)
375 Written evidence from Global Counsel (FTG0023)
376 Oxera, *Agenda—Brexit: implications for the transport sector* (June 2016): http://www.oxera.com/Latest-Thinking/Agenda/2016/Brexit-implications-for-the-transport-sector.aspx [accessed 10 February 2017]
377 Global Counsel detailed a number of possible options, including: "fully recognise each other's trusted trader designations and link them to simplified processes on both sides; allow for simultaneous export and import clearance based on a shared data template, or a single customs border; implement publicly-funded single window systems that would act as digital interfaces between traders and border authorities at no cost for economic operators (as opposed to the fees currently payed to private digital intermediaries in the UK)". Written evidence from Global Counsel (FTG0023)
378 Written evidence from Global Counsel (FTG0023)

Non-tariff barrier-related administrative costs

208. In addition to the costs discussed in Chapter 5 in relation to rules of origin, administration costs can also arise in the absence of a common regulatory system. This is because goods have to be checked at the border, imposing additional costs not only on businesses, but also on the state. The Government's decision that the UK should neither become a non-EU EEA country nor enter into a customs union with the EU means that the same administrative checks would apply to UK imports from and exports to the EU as currently apply to trade with non-EU countries. This is likely to be the case whether UK trade with the EU is conducted under a FTA or under WTO rules, as discussed in Chapter 4. Any additional costs will be incurred over and above tariff-related costs (as discussed above).

209. The regulatory issues raised by witnesses to this inquiry related primarily to the pharmaceutical and food and beverages sectors. First, there was the potential for disruption to UK trade with third countries if the UK were to diverge from the EU's regulatory framework. While a number of third countries have agreed with the EU the mutual recognition of their regulatory frameworks, such agreements would not apply to the UK post-Brexit. Thus Deloitte LLP wrote that introducing a new set of pharmaceutical standards specific to the UK would "potentially impact trade [with] countries outside of the EU where the UK would also need to seek mutual recognition".[379] Mr Hardwick told us that in order to trade in agricultural goods with China, "We went through an extremely long process to get approval … and the certification for that and 360 other export health certificates in the livestock sector alone make specific reference to the EU regulatory framework."[380] After Brexit, the UK would have to establish its own regulatory framework, and China might want to "carry out an audit of the regulatory system itself". The task of explaining the UK regulatory framework to trading partners would be "complicated" and "take resource and people".[381]

210. There would also be extra administrative costs in trading with the EU itself. We heard from HMRC that "all products of animal origin imported from a third country are subjected to a documentary check".[382] This included "an assessment of the common veterinary entry document, public and/or animal health certificates and accompanying commercial documentation, which may include bill of lading, invoice and packing list".[383] In contrast, imports or exports of animal products within the Single Market can simply be accompanied by a commercial document, with details of the contents of the consignment, sender and recipient.[384]

211. Mr Hardwick said that the "transactional costs alone would be significant" for such checks between the UK and the EU. AHDB estimated them to be "in the region of 8% to 10%, and perhaps a bit more than that."[385] The FDF

379 Written evidence from Deloitte LLP (FTG004)
380 Q 35 (Peter Hardwick)
381 *Ibid.*
382 Written evidence from HMRC (FTG0010)
383 *Ibid.*
384 Written evidence from HMRC (FTG0010) We note that "certain fish and agricultural products" are not part of the EEA Agreement. EFTA, *Free Movement of Goods (August 2014):* http://www.efta.int/media/publications/fact-sheets/EEA-factsheets/GoodsFactSheet.pdf
385 Q 38 (Peter Hardwick)

estimated this cost at "a further eight per cent", and added that the increase in transactional costs for "composite products" was "likely to be higher".[386]

212. Mr Hardwick gave the example of trade between Norway and Sweden. Even though Norway is part of the EEA, "it still takes hours for certain types of goods to cross the border", thanks to customs controls. This was in particular the case with meat, due to a highly regulated meat industry in Norway.[387]

A new arrangement on customs?

213. The Prime Minister, in her speech on 17 January 2017, said:

> "I want Britain to be able to negotiate its own trade agreements. But I also want tariff-free trade with Europe and cross-border trade there to be as frictionless as possible. That means I do not want Britain to be part of the Common Commercial Policy and I do not want us to be bound by the Common External Tariff. These are the elements of the Customs Union that prevent us from striking our own comprehensive trade agreements with other countries. But I do want us to have a customs agreement with the EU."[388]

214. On the content of such an agreement, the Prime Minister said that she had "an open mind" over whether it would entail "a completely new customs agreement", becoming an "associate member of the customs union in some way", or remaining "signatory to some elements of it".[389]

215. Dr Peter Holmes, Reader in Economics, University of Sussex, said: "There is currently no deal which exactly matches the aims which Mrs May appears to be seeking to achieve." The EU-Korea FTA had provisions which meant that "both parties accept cars and electronic goods certified to the other parties' norms without further inspection", and the EU-Switzerland agreements included "mutual recognition of testing and certification for conformity assessment, but there have to be border checks of documents for proof, even when there is exemption from tariffs or testing of goods themselves". He said that "no agreement, even the EEA, allows goods to move across EU borders with no checks at all".[390]

216. An alternative to a customs union, according to Dr Holmes, could be a FTA "under which there are zero tariffs on goods originating in partner countries but no Common External Tariff". Such a FTA would entail customs checks at borders within the FTA to avoid goods entering the UK at a lower tariff than the EU's Common External Tariff and then freely circulating within the EU. Therefore, the border check would "establish what tariffs are payable (which might be zero in the case of an FTA)"; conformity of UK goods with EU rules would also need to be inspected, "at minimum to insure they have paperwork which does confirm compliance".[391]

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386 Written evidence from FDF (FTG0021)

387 Q 38 (Peter Hardwick)

388 Theresa May MP, Speech on the government's negotiating objectives for exiting the EU, 17 January 2017: https://www.gov.uk/government/speeches/the-governments-negotiating-objectives-for-exiting-the-eu-pm-speech [accessed 10 February 2017] We note that the EU's customs union with non-Member State Turkey involves a common tariff.

389 Theresa May MP, Speech on the government's negotiating objectives for exiting the EU, 17 January 2017: https://www.gov.uk/government/speeches/the-governments-negotiating-objectives-for-exiting-the-eu-pm-speech [accessed 23 January 2017]

390 Written evidence from Peter Holmes (FTG0026)

391 *Ibid.*

217. Lord Price CVO, Minister of State for Trade Policy, Department for International Trade (DIT), told us that DIT was already involved in discussions on customs procedures: "Part of the role of DIT … was to talk to other countries about customs facilitation."[392] Lord Bridges said the "most important thing" was maintaining "free and frictionless trade".[393] In this regard, "we need to look at the entire supply chain from start to finish, as well as at its different component parts. If we focus simply on what happens at the border, although that is critical, we may miss other points."[394]

218. In particular, Lord Bridges said that a customs arrangement with the Republic of Ireland after Brexit was "obviously a significant challenge". The Government did "not want to return to the hard borders of the past":

> "[The Government is] looking closely at how digital technology data can help us and how working closely—I am choosing my words very carefully here—with our colleagues and counterparts in the Republic and in Northern Ireland can help address the flow of goods and make sure that it is as free and frictionless as possible … We are acutely aware that there, among all places, we need to make sure that the flow of goods remains frictionless."[395]

219. Lord Bridges gave some options that the Government was studying with regard to customs, but with the caveat that these were "examples that we might look at and which you may wish to look at"; they did not mean that "A, B or C is now going to be a Government position in the negotiations".

220. One example of simplified customs procedures was NAFTA,[396] which was a useful precedent for how "very complex supply chains, especially with the automotive industry" are managed within a FTA. This is done by applying diagonal cumulation of rules of origin between NAFTA countries (see Box 6); a Customs Sub-Group has also been created to harmonise customs procedures.[397]

221. Another example was the Authorised Economic Operator (AEO) scheme. This provided businesses with "simpler and faster customs procedures". AEO status indicated "that a trader's role in the international supply chain is secure and that their customs controls and procedures are efficient and compliant". According to HMRC estimates, "UK companies with AEO status account for around 60% of the UK's imports and 74% of the UK's exports."[398] Lord Bridges added that mutual recognition agreements on customs, which the EU had with China, Japan, Norway, Switzerland, and the US, allowed "firms with AEOs in one party to take advantage of quicker access to certain simplified procedures, and sometimes they give the ability to fast-track shipments while exporting to the other party".[399] We note that the UK is currently part of the EU's AEO concept, which has its basis in the

392 Q 107 (Lord Price)
393 Q 107 (Lord Bridges of Headley)
394 *Ibid.*
395 *Ibid.*
396 NAFTA is a trade agreement between Canada, Mexico, and the US. It entered into force in January 1994.
397 This Sub-Group was set up under the NAFTA Working Group on Rules of Origin, to which it reports. World Customs Organisation, 'Working Group and Customs Sub-Group in the NAFTA Model' (4 July 2012): http://www.wcoomd.org/en/topics/origin/instrument-and-tools/comparative-study-on-preferential-rules-of-origin/specific-agreements/agreement-topics/wor-nafta.aspx?p=1 [accessed 17 February 2017]
398 Q 107 (Lord Bridges of Headley)
399 *Ibid.*

Union Customs Code.[400] After Brexit, the UK would need either to adopt the provisions of the AEO scheme into UK law,[401] or develop its own AEO scheme. It is unclear whether recognition of the UK's AEO scheme by other countries after Brexit would be automatic, or would require prior agreement or negotiations.

222. Finally, he gave the example of "the Common Transit Convention, which the EU and other parties are party to". Under this scheme, "The trader responsible for the movemgent provides a guarantee to cover the potential duty and tax liability that will fall due in the destination country, assuming that the goods are not diverted en route". This "facilitates the smooth movement of goods across countries and ensures that, if things go wrong in a legitimate supply chain, there is no fiscal loss to the authority".[402] The Common Transit Convention applies to EU Member States, members of EFTA, Macedonia and Serbia.[403] Any third country may become a contracting party following unanimous agreement by current signatories to the Convention.[404]

223. Dr Holmes agreed that a UK-EU FTA could simplify some procedures: it could reduce the burdens of "paperwork needed to prove compliance with rules of origin … [and] ease the origin requirements" (we discuss rules of origin in Chapter 5). It could also reduce the "documentation needed to prove conformity with origin and technical requirements". He noted:

> "The kind of agreement that might be envisaged could not stop the creation of additional trade barriers but it would be seeking to minimize the extent of additional obstacles. There is, however, an inescapable trade-off between closer access to the EU market and freedom to set one's own national rules and regulations and external trade policy."[405]

224. In general, any UK-EU agreement would have to comply with WTO rules. Dr Holmes said: "This means that it would have to cover 'substantially all trade', and be officially notified to the WTO. We could not sign a customs union covering only cars, or informally agree not to apply tariffs on EU goods while applying them to others, without risk of challenge." Nevertheless, there was some leeway in the application of rules of origin.[406]

400 European Commission, 'Authorised Economic Operator (AEO)' http://ec.europa.eu/taxation_customs/general-information-customs/customs-security/authorised-economic-operator-aeo/authorised-economic-operator-aeo_en#what_is [accessed 21 February 2017]; The EU established its AEO concept based on internationally recognised standards, creating a legal basis for it in 2008 through the 'security amendments' to the Community Customs Code (Regulation (EC) 648/2005) and its implementing provisions.

401 BDO, 'Article: Brexit: What does 'taking control' mean from a customs duty perspective?': https://www.bdo.co.uk/en-gb/insights/tax/vat-and-customs-duty/brexit-what-does-%E2%80%98taking-control%E2%80%99-mean-from-a-customs-duty-perspective [accessed 21 February 2017]

402 Q 107 (Lord Bridges of Headley)

403 HMRC, 'Guidance—UK Trade Tariff: community and common transit outwards': https://www.gov.uk/government/publications/uk-trade-tariff-community-and-common-transit-outwards/uk-trade-tariff-community-and-common-transit-outwards [accessed 16 February 2017]

404 Recommendation No 1/93 the EEC-EFTA Joint Committee on Common transit of 23 September 1993 for the amendment of the Convention of 20 May 1987 on a common transit procedure, OJ L 036 (14 February 1996) and Council Decision of 22 November 1993, OJ L 036 (14 February 1996)

405 Written evidence from Peter Holmes (FTG0026)

406 Written evidence from Peter Holmes (FTG0026); The WTO rules on the coverage of FTAs are set out in Article XXIV:8, General Agreement on Tariffs and Trade 1994: https://www.wto.org/english/res_e/booksp_e/analytic_index_e/gatt1994_09_e.htm [accessed 13 February 2017] and Article V:1(a), General Agreement on Trade in Services: https://www.wto.org/english/docs_e/legal_e/26-gats_01_e.htm [accessed 13 February 2017]; Our previous report considered these issues. European Union Committee, *Brexit: the options for trade* (5th Report, Session 2016–17, HL Paper 72)

225. Overall, Dr Holmes assessed it to be "unlikely that such a [UK-EU] deal could be in place within 2 years, although a framework could be agreed leading to an 'implementation' phase over the next years (in reality this period would involve finalising negotiations)".[407]

Conclusions and recommendations

226. **Leaving the EU customs union would result in costly administrative requirements and customs procedures, whatever new framework for trade is established. This would result in a significant additional administrative burden for companies, and delays to consignments of goods, incurring additional costs.**

227. **Administering UK-EU tariffs and non-tariff barriers—in the absence of a common regulatory system—would also significantly increase the work of HMRC, a task for which it is not currently resourced. The UK would also have to establish new customs posts, develop a new customs code and consider improvements to the UK's systems for trade processing. We call on the Government to set out its plans for reviewing and if necessary increasing the resources available to HMRC and other agencies.**

228. **We welcome the Government's commitment to seeking simplified customs procedures for EU-UK goods trade. We note that the customs agreement proposed by the Prime Minister would be unprecedented, and we are unclear whether it will be possible outside a formal customs union (including the Common External Tariff).**

229. **If a comprehensive FTA between the UK and the EU can be achieved, there may be scope within it to simplify some customs procedures.**

230. **The Authorised Economic Operator scheme provides an opportunity for registered companies to streamline certain customs procedures, and we recommend that the UK Government adopt the provisions of the current AEO scheme into UK law after Brexit. The scheme would not, however, remove the requirement for customs checks to be implemented between the UK and the EU after Brexit, and would not prevent the additional burden of associated administration and costs from arising.**

407 Written evidence from Peter Holmes (FTG0026)

CHAPTER 7: THE EU AND PREFERENTIAL TRADE WITH THIRD COUNTRIES

Existing EU preferential trade arrangements

231. The EU currently has more than 36 preferential trade agreements covering 60 third countries,[408] which the UK benefits from as an EU Member State. Rather than providing completely free trade, FTAs provide preferential market access relative to a situation in which no such agreement exists.

232. Countries with which the EU has a FTA accounted for 17.2% of UK exports in goods on average in the period 2013–15.[409] The purpose and scope of the EU's FTAs vary considerably, so this report considers different examples in the context of Brexit: the EU-Korea FTA as a recent agreement with a developed country; and the EU's agreements with developing and the Least Developed Countries (LDCs) under the Generalised System of Preferences (GSP) and the relationship with African, Caribbean, and Pacific (ACP) countries.[410]

EU FTAs with developed countries

233. Recent FTAs between the EU and developed countries generally tackle not only tariff but also regulatory barriers. Box 8 outlines one example, the FTA between the EU and South Korea.

408 Q 123 (Lord Price) The EU has a large number of agreements that include an economic dimension with partner countries. When using the term 'FTA' in this context, it therefore also includes Economic Partnership Agreements (EPA), Association Agreements (AA), Partnership and Co-operation Agreements (PCA), and other EU agreements that include a free trade dimension. These agreements serve a mix of political and economic purposes. For the EU's FTAs, see European Commission, 'Agreements': http://ec.europa.eu/trade/policy/countries-and-regions/agreements/index_en.htm#_other-countries [accessed 13 January 2017] and European Commission, *Overview of FTA and other trade negotiations of the EU* (February 2017): http://trade.ec.europa.eu/doclib/docs/2006/december/tradoc_118238.pdf [accessed 17 February 2017]

409 Written evidence submitted to the EU Internal Market Sub-Committee, 30 November 2016 (Session 2016–17) TAS0085 (UK Trade Policy Observatory, University of Sussex)

410 This report uses the terms 'developed', 'developing', and 'least developed' on the basis of the UN's human development index (HDI) classification. The HDI consists of three indices: the life expectancy index, the education index, and the GNI index. It classifies countries into groups of 'very high human development', 'high human development', 'medium human development', and 'low human development'. We note that the criteria used by the UN to identify the group of 'least developed countries' (LDCs) are slightly different from the HDI grouping of 'least developed' countries and therefore the two groups do not overlap completely. However, with a few exceptions, they are the same.

Box 8: The EU-Korea FTA

Described by the European Commission as "the most ambitious FTA implemented by the EU so far",[411] the EU-Korea FTA was provisionally applied in 2011 and entered into force in December 2015.

The FTA liberalises 98.7% of tariffs between the EU and Korea and commits to preventing a rise in tariffs on either side in the future.[412] The Department for International Trade (DIT) told us that almost all tariffs on industrial goods have now been eliminated.[413] Tariff duties for products deemed sensitive, such as some agricultural and fisheries goods, will only be eliminated over longer staging periods of seven years and over.[414]

The FTA addresses non-tariff barriers in four sectors specifically: motor vehicles and parts, pharmaceutical products and medical devices, chemicals, and electronics. It also aims to increase market access in services and investments.[415]

Motor vehicles and parts

The EU and Korea have agreed to align their regulations with the World Forum for Harmonisation of Vehicle Regulations (WP.29). The WP.29 is in the framework of the United Nations Economic Commission for Europe (UN ECE). Both sides have also committed to providing full market access by eliminating tariff and non-tariff barriers.

Compliance with these commitments is being monitored by a working group established under the FTA. Korea has agreed to accept 'EURO VI' certificates for heavy duty commercial vehicles, as well as simplified electronic documentary procedures for imports of E-marked tyres in 2016.

Pharmaceutical products and chemicals

The EU and Korea have agreed to make immediately available to the other party any laws, regulations, procedures, administrative rulings and implementing guidelines related to pharmaceutical products. Such laws and regulations will take into account, as appropriate, international provisions, practices, and guidelines.

For chemicals, there are a number of initiatives including protection of public health and the environment, implementing appropriate regulatory mechanisms, and developing best practices on chemicals assessment and management.

For both pharmaceutical products and chemicals, working groups have been established to monitor areas of the agreement and to exchange updates on regulations.

411 European Commission, *Report from the Commission to the European Parliament and the Council: annual report on the implementation of the EU-Korea Free Trade Agreement (30 June 2016)*: http://trade.ec.europa.eu/doclib/docs/2016/june/tradoc_154699.pdf [accessed 4 January 2017]; We note that the Comprehensive Economic and Trade Agreement with Canada goes further than the Korea FTA, but has yet to be implemented.

412 Written evidence from the Department for International Trade (FTG0025)

413 *Ibid.*

414 *Ibid.*

415 European Commission, '*Countries and regions—South Korea*': http://ec.europa.eu/trade/policy/countries-and-regions/countries/south-korea/index_en.htm [accessed 4 January 2017]

Electronics (part of capital goods and machinery in this report)

For electronics, the EU and Korea agree to recognize three international standard-setting bodies, which are to be used as the basis for any standards, technical regulation or conformity assessment procedures: the Internationa l Standards Organisation (ISO), the International Electrotechnical Commission (IEC) and the International Telecommunication Union (ITU). To facilitate conformity assessments, a list of approved testing laboratories must be notified to the other party under the FTA. Unlike the sectors above, no working group has been established on electronics.

Source: Written evidence from the Department for International Trade (FTG0025)

234. Lord Price CVO, Minister of State for Trade Policy, Department for International Trade (DIT), told us that the EU-Korea FTA had boosted UK exports to Korea by 111% from 2010/11 to 2014/15, and imports by 74% in the same period.[416] Secretary of State for International Trade, the Rt Hon Liam Fox MP, said in a speech on 29 September 2016: "In the year before the FTA was agreed, the UK sold just over 2,000 cars to South Korea. In 2014 that number reached over 13,000."[417]

235. The removal of the oil tariff has led to an annual increase of UK oil exports of 47% between 2011 and 2015. In 2015 oil accounted for one third of total goods exports.[418]

236. Table 5 gives an overview of the changes of UK trade with Korea before (2010/11) and after (2015/16) the implementation of the EU-Korea FTA. It should be noted, however, that it cannot be said with certainty that these changes are the direct result of the EU-Korea FTA.

416 Department for Business, Innovation and Skills, *Explanatory Memorandum on European Union document—Report from the Commission to the European Parliament and the Council-Annual Report on the Implementation of the EU-Korea Free Trade Agreement* (14 July 2016): http://europeanmemoranda.cabinetoffice.gov.uk/files/2016/07/EM_10847–16.pdf [accessed 6 March 2017]

417 Liam Fox MP, Speech on free trade, 29 September 2016: https://www.gov.uk/government/speeches/liam-foxs-free-trade-speech [accessed 3 February 2017]

418 Written evidence from the Department for International Trade (FTG0025)

Table 5: UK Trade with Korea

	UK exports to Korea (£)			UK imports from Korea (£)		
	July 10 – June 11	July 15 – June 16	% increase	July 10 – June 11	July 15 – June 16	% increase
Food and beverages	179,545,522	173,392,166	-3%	11,142,601	27,969,245	151%
Chemicals and pharmaceuticals	353,768,784	378,251,309	7%	53,843,225	141,213,109	162%
Machinery and electrical	788,580,890	1,295,581,833	64%	1,247,817,413	1,338,707,030	7%
Automotive	141,016,439	649,566,957	361%	352,384,545	1,134,755,636	222%
Aerospace, arms and ammunition	45,907,274	224,998,690	390%	46,567,620	188,312,937	304%

Source: Written evidence from the Department for International Trade (FTG0025)

EU FTAs with developing countries

237. EU trade arrangements with developing countries and the LDCs mostly offer preferential EU market access to these countries. Market access for developing countries is usually not reciprocal and such agreements include a large political and development element. These arrangements include FTAs and the EU's GSP programme, which is described in Box 9.

Box 9: The EU's trade with developing countries

The Generalised System of Preferences[419]

The Generalised System of Preferences (GSP) is based on an exception to the MFN clause, referred to as the 'Enabling Clause'.[420] The GSP allows developed countries to offer non-reciprocal preferential treatment to products originating in developing countries. The preference-giving country (in this case the EU) decides unilaterally the countries and products included.[421]

The EU's GSP allows developing countries to pay less or no duties on their exports to the EU in the specified sectors. This gives them important access to EU markets, and contributes to their economic growth.[422]

There are three main variants of the EU's GSP Scheme:[423]

- The standard/general GSP arrangement offers tariff reductions to developing countries. This means partial or entire removal of tariffs on two thirds of all product categories.
- The 'GSP+' enhanced preferences arrangement involves the full removal of tariffs on essentially the same product categories as those covered by the general arrangement. These are granted to countries that ratify and implement core international conventions relating to human and labour rights, environment and good governance.
- The 'Everything but Arms' (EBA) arrangement for LDCs grants duty-free and quota-free access to the EU market for all products, except for arms and ammunitions. These 48 countries are classified by the United Nations' Committee for Development Policy, based on their gross national income per capita, the human asset index, and the economic vulnerability index.[424]

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419 The WTO agreement is called 'Generalised System of Preferences', whereas the EU calls its GSP 'Generalised Scheme of Preferences'.

420 This clause allows WTO members to grant "differential and more favourable treatment" to developing countries without granting it to all members. One of the cases in which this is possible is in the case of preferential tariff treatment by developed countries to developing countries in accordance with the GSP as described in a 1971 decision. Countries decide themselves if they adopt a GSP scheme and how it is structured. There are currently 13 national GSP schemes notified to the UNCTAD secretariat. UNCTAD, 'About GSP': http://unctad.org/en/Pages/DITC/GSP/About-GSP.aspx [accessed 6 March 2017]

421 WTO, 'Development: Trade and Development Committee—Special and differential treatment provisions': https://www.wto.org/english/tratop_e/devel_e/dev_special_differential_provisions_e.htm [accessed 6 March 2017]; We note that the unilateral granting of preferential treatment includes a non-discrimination obligation which was interpreted by the WTO Appellate Body in *EC—Tariff Preferences, WT/DS246/AB/R* (2015): https://www.wto.org/english/tratop_e/dispu_e/cases_e/1pagesum_e/ds246sum_e.pdf [accessed 24 February 2017]

422 European Commission, 'Generalised Scheme of Preferences (GSP)': http://ec.europa.eu/trade/policy/countries-and-regions/development/generalised-scheme-of-preferences/index_en.htm [accessed 3 February 2017]

423 A full list of the countries included in each scheme is available in the Official Journal of the European Union. Commission delegated regulation (EU) 2015/1979 of 28 August 2015, OJ L 289/3 (4 November 2015)

424 European Commission, 'Generalised Scheme of Preferences (GSP)': http://ec.europa.eu/trade/policy/countries-and-regions/development/generalised-scheme-of-preferences/index_en.htm [accessed 6 March 2017]; United Nations, 'Least developed countries (LDCS)': http://www.un.org/en/development/desa/policy/cdp/ldc_info.shtml [accessed 6 March 2017]

EU trade with ACP countries

Another framework is that between the EU and African, Caribbean, and Pacific (ACP) countries:

- Until 2007, EU trade with ACP countries took place on basis of the 2000 Cotonou Agreement. Following the expiry of the trade pillar, a number of African states have signed regional Economic Partnership Agreements (EPAs) with the EU.[425] The EU decided to remove trade preferences for 17 countries that had not ratified an EPA by 1 October 2014. Preferences were reinstated for eight of these countries after the ratification of the EPA.[426]
- As a result of overlap between ACP countries and those included in the LDC grouping, countries that are both LDCs and ACP countries continue to receive preferential access to the EU market for their exports under the 'Everything But Arms' agreement.

238. The UK's trade with developing countries is very small relative to total UK trade. UK exports to the LDCs accounted only for 0.6% of total goods exports on average between 2013 and 2015, and goods imports accounted for 1.1%.[427] UK trade with ACP countries is also limited. Among the sectors included in our inquiry, food and beverages and oil and petroleum are the largest trading sectors for the UK: in 2015 4.5% of the UK's food and beverages trade was with ACP countries, and 5.6% of its trade in oil and petroleum. In total, trade with ACP countries accounted for 2.1% of the UK's trade in the six sectors in 2015.[428]

239. Beyond the simple balance of trade, the EU's FTAs with developing countries serve as an important tool of the UK's foreign and development policy. The Rt Hon Lord Bates, Minister of State for International Development, wrote in February that the UK "remain[ed] committed to ensuring developing countries can reduce poverty through trading opportunities", and that the UK had "made clear [its] potential interest in future partnership, working under aspects of the new EU-ACP framework".[429]

425 European Parliament, *African, Caribbean and Pacific (ACP) countries' position on Economic Partnership Agreements (EPAs) (April 2014)*: http://www.europarl.europa.eu/RegData/etudes/etudes/join/2014/433843/EXPO-DEVE_ET(2014)433843_EN.pdf [accessed 17 February 2017]

426 European Commission 'The Countries of Africa, the Caribbean and the Pacific (ACP)': http://ec.europa.eu/taxation_customs/business/calculation-customs-duties/rules-origin/general-aspects-preferential-origin/arrangements-list/countries-africa-caribbean-pacific-acp_en [accessed 17 February 2017] and Regulation (EU) No 527/2013 of the European Parliament and of the Council of 21 May 2013 amending Council Regulation (EC) No 1528/2007 as regards the exclusion of a number of countries from the list of regions or states which have concluded negotiations, OJ L 165/59 (18 June 2013)

427 Written evidence submitted to the EU Internal Market Sub-Committee, 30 November 2016 (Session 2016–17) TAS0085 (UK Trade Policy Observatory, University of Sussex)

428 Written evidence from the Department for International Trade (FTG0025)

429 Letter from the Rt Hon Lord Bates to Lord Boswell of Aynho, 17 February 2017

Sectoral views on post-Brexit preferential terms with third countries

240. We asked witnesses how important it was to maintain access to the EU's preferential trade arrangements with third countries. For the pharmaceuticals industry, Dr Virginia Acha, Executive Director of Research, Medical and Innovation, Association of the British Pharmaceutical Industry, described the EU's FTAs with third countries as "very important". She said that losing access to them "would obviously potentially lead to higher duties on imports as well as in those destination countries".[430] Mr Steve Elliott, Chief Executive Officer, Chemical Industries Association (CIA), identified the FTAs with Switzerland and Korea.[431]

241. From the perspective of capital goods, Mr Fergus McReynolds, Director of EU Affairs, EEF—The Manufacturers' Organisation (EEF), said the EEF would like existing FTAs "to be rolled over".[432] Mr James Selka, Chief Executive Officer, Manufacturing Technologies Association, named Switzerland, Korea, Turkey, and Mexico as countries with which the EU had particularly important arrangements.[433]

242. With regard to food and beverages, Mr Peter Hardwick, Head of Exports, the Agriculture and Horticulture Development Board (AHDB), highlighted Canada[434] and Korea as important for UK food exports. The AHDB told us that North Africa, West Africa, and Vietnam[435] were most important to the UK's food and drink sector. The AHDB also noted that the UK "currently imports over £0.5 billion of food and drink imports from Sub-Saharan Africa",[436] and Mr Hardwick said that "most of our trade with ACP countries is with West Africa".[437]

243. Mr Hardwick highlighted the EU's association agreement with Egypt as important to certain parts of the food and beverages sector. The UK exports half of its total exports of seed potatoes to Egypt, and the association agreement included a "10-year degressive tariff arrangement", which reduced the tariff by gradual amounts, that was "certainly … of interest" to the UK food sector.[438] He also identified South Africa as an important market for AHDB members.[439]

430 Q 5
431 Q 15
432 Q 32
433 *Ibid.*
434 Q 45 We note that the FTA with Canada has not yet been applied.
435 The EU concluded negotiations with Vietnam on a FTA on 2 December 2015. The FTA is currently under legal review and will then be presented for ratification. European Commission, 'Countries and regions: Vietnam': http://ec.europa.eu/trade/policy/countries-and-regions/countries/vietnam/index_en.htm [accessed 4 January 2017]
436 Written evidence from AHDB (FTG0007)
437 Q 45
438 Q 45 The 2004 EU-Egypt Association Agreement commits to the establishment of a free trade area "over a transitional period not exceeding twelve years from the entry into force of this Agreement". It grants Egypt tariff-free access to the EU market for "products originating in Egypt" and phases out tariffs for EU exports to Egypt. In 2014, Egypt ceased to benefit from the EU's GSP due to its FTA with the EU. A dialogue on a deep and comprehensive FTA (DCFTA) between the EU and Egypt was launched in 2013. Euro-Mediterranean agreement establishing an association between the European communities and their Member States, of the one part and the Arab Republic of Eqypt, of the other part: http://trade.ec.europa.eu/doclib/docs/2004/june/tradoc_117680.pdf [accessed 9 January 2017] and European Commission, 'Countries and regions: Egypt': http://ec.europa.eu/trade/policy/countries-and-regions/countries/egypt/index_en.htm [accessed 9 January 2017]
439 Q 45 We note that the EU-South Africa Trade, Development and Co-operation Agreement covers 90% of bilateral trade between the EU and South Africa. European Commission, 'Countries and regions: South Africa': http://ec.europa.eu/trade/policy/countries-and-regions/countries/south-africa/index_en.htm [accessed 6 March 2017]

244. Mr Richard Eglin, Senior Trade Policy Adviser, White and Case LLP, noted that leaving the EU's ACP arrangements would have implications for the UK's ability to use trade as a tool of development policy. For example, the EU currently offered duty-free access to sugar imports from ACP countries. If the UK reverted to WTO terms for trade with ACP countries, it would have to grant the same tariffs on sugar on an MFN basis to all countries, unless it adopted a GSP scheme for developing and LDCs or signed FTAs with these countries. In the absence of such preferential agreements, the Government "would not be able to choose who we get it from".[440]

245. Considering the automotive sector, Mr Mike Hawes, Chief Executive Officer, The Society of Motor Manufacturers and Traders (SMMT), said that existing EU FTAs with third countries were "very important"; the SMMT "would like to see some sort of … continuation of those trade agreements." The SMMT called for "urgent clarity … on the UK's ability to access third country markets where an existing EU FTA is in place or currently being negotiated".[441]

246. Mr Hawes said that the Government "should explore every option for retaining the trading arrangements that currently apply to it as a result of free trade agreements signed by the EU with third countries."[442] Current EU FTAs provided "a £15 trillion market", which the UK would "clearly want to make sure we maintain access to". He identified the FTA with Korea as a "significant example".[443]

247. Lord Price told us that DIT was currently "trying to find the best way in which we can have a continued trading relationship on the same terms with the countries that we currently have access to through an EU FTA … In total, that includes 60 countries through 36 agreements."[444] By the time of Brexit, this number could rise to 64, as new agreements with countries including Singapore, Japan, Vietnam and Canada came into effect.[445] Lord Price said: "Our broad principle in the WTO and in existing FTAs is to carry on in the most straightforward way what we are doing today." We note that the withdrawal of the UK, a large Member State, could also have an impact on EU FTAs with third countries.

248. Acknowledging that the UK could only negotiate and sign FTAs after the two-year Article 50 period, the DIT's current engagement was "about promoting British business exporting to those countries today".[446] The EU's existing agreements and those under negotiation, particularly with Japan, may provide a useful template for bilateral agreements with the UK. Ambassador Tsuruoka told us that "having a Japan-EU EPA will be quite useful" for FTA discussions with the UK.[447]

440 Oral evidence taken before the EU External Affairs and Internal Market Sub-Committees, 8 September 2016 (Session 2016–17), Q 8 (Richard Eglin)
441 Q 81
442 Written evidence from SMMT (FTG0009)
443 Q 81
444 Q 123
445 *Ibid.*
446 *Ibid.*
447 Q 104

249. Reflecting on whether the UK could replicate, on a bilateral basis, the terms of existing EU FTAs with countries such as Korea, Lord Price said: "Some are very straightforward and others are more complicated. It is about the extent to which they are bound into EU legislation and regulation." DIT had "worked through every one of them to understand the level of complexity".[448] The UK also wanted "to continue … if not improve" access given to developing countries under economic partnership agreements signed by the EU. DIT and the Department for International Development were "working on what regime could be put in place".[449]

Priority countries for new FTAs

250. The Government's Green Paper, *Building our industrial strategy*, listed Canada, China, India, Mexico, Singapore and South Korea as countries interested in discussing future trade relations with the UK.[450] On 19 January 2017 the Rt Hon Liam Fox MP wrote in the *Daily Telegraph* that Britain was "conducting trade audits with a number of countries to see how we can remove barriers to trade and investment".[451] Lord Price explained that 'trade audits' were discussions about trade barriers, which could include customs arrangements, or access to particular sectors.[452] This was not new: "For the last 43 years we have been conducting trade audits".[453] Trade audits took place at "a more formal level", whereas working groups were "looking to explore how we can continue to trade with those countries in a post-Brexit world".[454] The Prime Minister had "announced a working group with China and high-level talks with the USA [on trade]".[455] In total, the UK was currently engaging with 15 countries on post-Brexit trade relations. Some of these countries "do not have EU FTAs, but a lot of them do".[456]

251. We note that such discussions with 15 countries in parallel, in addition to withdrawal negotiations with the EU, seem to be far beyond the Government's current staff resources.[457] We discuss resourcing further in Chapter 10.

252. Such trade discussions with third countries, though not formal negotiations and therefore not necessarily in breach of the Common Commercial Policy, might be politically sensitive during the Article 50 period. Lord Price said: "We feel that, within the context of what we can do today, having discussions with countries about continuity of trade with the UK is perfectly acceptable."[458]

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448 Q 124
449 *Ibid.*
450 HM Government, *Building our Industrial Strategy* (January 2017): https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/585273/building-our-industrial-strategy-green-paper.pdf [accessed 23 January 2017]
451 Liam Fox MP, 'Britain is embracing the brave new world of free trade', *The Telegraph* (19 January 2017): http://www.telegraph.co.uk/news/2017/01/18/britain-embracing-brave-new-world-free-trade/ http://www.telegraph.co.uk/news/2017/01/18/liam-fox-launches-brexit-trade-crusade-confirming-informal-talks/ [accessed 16 February 2017]
452 Q 120
453 *Ibid.*
454 *Ibid.*
455 Q 123 (Lord Price)
456 Q 123 (Lord Price); These countries are: Australia, China, Israel, India, New Zealand, Norway, Turkey, South Korea, the Gulf Cooperation Council (six countries) and the US. Written evidence from Lord Bridges of Headley MBE and Lord Price CVO (FTG0027)
457 Lord Price told us that the DIT currently had around 185 staff (Q 121). He previously acknowledged that Canada had "100 people working on the Canada-EU FTA" alone. In comparison, the UK was in "the early foothills of where we need to get to". Oral evidence taken before the EU External Affairs and Internal Market Sub-Committees, 13 October 2016 (Session 2016–17), Q 57 (Lord Price)
458 Q 123

During visits to Japan, Vietnam and Canada, the Government had conveyed that "we support the EU and we support the EU FTAs. We want those to succeed, as we always have done—that is our position". EU FTAs could then "become the base of the UK arrangement going forward".[459]

253. The witnesses to this inquiry also considered which non-EU countries would be most important for future UK trade agreements after Brexit. Mr Elliott said that for the chemicals industry, Canada,[460] Brazil, and the US "would be particularly significant";[461] Dr Acha said that China was also "very important" for pharmaceuticals.[462] For the capital goods and machinery sector, EEF members' priority countries were the US, China, India, and Canada.[463] For the food and beverages sector, the FDF said the US, alongside China and Japan, "could provide significant opportunities if ambitious deals can be secured that address both tariff and regulatory barriers".[464]

254. From the automotive sector, the SMMT took a more cautious approach: it recommended that the Government should "clarify the status" of current EU FTAs as well as "the rules under which companies can access these third markets before pursuing new bilateral trade negotiations".[465]

Substituting EU trade with non-EU trade

255. On 17 January 2017, the Prime Minister stated:

> "Many in Britain have always felt that the United Kingdom's place in the European Union came at the expense of our global ties, and of a bolder embrace of free trade with the wider world … it is time for Britain to get out into the world and rediscover its role as a great, global, trading nation".[466]

256. The UK Trade Policy Observatory (UKTPO), University of Sussex, noted that there was potential to increase trade in goods with non-EU markets. Countries with which the EU has launched, or agreed to open negotiations on, a FTA or investment agreement (the US, Japan, India, China,[467] Australia and New Zealand) accounted for 21.7% of UK goods exports in 2015, and 21.9% of the UK's imports.[468] This indicates that, if the UK were to negotiate agreements with these countries bilaterally, these deals could have a positive impact on more than 20% of the UK's trade in goods.

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459 *Ibid.*
460 We note that the EU and Canada have agreed the Comprehensive Economic and Trade Agreement, which will provisionally be applied in 2017.
461 Q 15
462 *Ibid.*
463 EEF, *Britain and the EU: manufacturing an orderly exit* (21 September 2016), p 3: https://www.eef.org.uk/resources-and-knowledge/research-and-intelligence/industry-reports/britain-and-the-eu-manufacturing-an-orderly-exit [accessed 20 January 2017]
464 Written evidence from FDF (FTG0021)
465 Written evidence from SMMT (FTG0009)
466 Theresa May MP, Speech on the government's negotiating objectives for exiting the EU, 17 January 2017: https://www.gov.uk/government/speeches/the-governments-negotiating-objectives-for-exiting-the-eu-pm-speech [accessed 19 January 2017]
467 The EU and China are negotiating a comprehensive investment agreement.
468 Written evidence submitted to the EU Internal Market Sub-Committee, 30 November 2016 (Session 2016–17) TAS0085 (UK Trade Policy Observatory, University of Sussex)

257. We have previously noted, however, that the conclusion of new FTAs would be likely to take a number of years, and would be contingent on the trade arrangements reached with the EU and the UK's WTO schedules. The Government should thus first focus on trade conditions with the EU and on the UK's WTO schedules.[469] Mr Hawes echoed this view: "The bottom line is that we have a massive market on our doorstep and we want to make sure we continue to be part of that."[470]

258. An important factor will be whether any shortfall in trade with the EU could easily be made up by trade with non-EU countries (including those currently covered by EU FTAs). We discussed sector-specific issues in this regard in Chapter 4. The UKTPO too thought this would be difficult, noting that the UK tended to export different products to countries with which the EU has FTAs, compared with the goods exported to the EU-27. This indicated that UK exports to the EU would not be easily substituted by other markets following Brexit. As for imports, those from the EU-27 and from EU FTA countries were "quite different". This would make "finding alternative sources of supply [for both EU and FTA originating products] harder / more expensive for the UK".[471] Mr Hawes added that there might be a risk in relying on emerging markets, such as China, Russia, and Brazil, to make up for any shortfall, because they could "be quite volatile".[472]

Conclusions and recommendations

259. **As we concluded in our report on *Brexit: the options for trade*, it is unlikely that the UK will be able to maintain access to the EU's FTAs with third countries after Brexit. The UK will also not be able to conclude new FTAs with third countries until after it has left the EU.**

260. **Thus Brexit is likely to result in a cessation of the preferential conditions of trade with non-EU countries currently enjoyed by UK businesses. This is likely to result in significant tariff costs and other reductions in market access for many of the sectors we considered, until new preferential arrangements can be put in place post-Brexit.**

261. **We welcome the Government's efforts to engage with non-EU countries to lay the groundwork for future FTAs. However, trade negotiations are time consuming and complex, and it is important that the Government focus its efforts where they can deliver maximum benefit. In particular, the Government should focus on countries where the EU already has FTAs in place, with a view to securing the current level of market access enjoyed by UK businesses. The terms of the EU's existing FTAs and those under negotiation are likely to form a useful starting point for future UK agreements with these countries.**

262. **The Government needs to demonstrate that it has the capacity to negotiate with the EU, and simultaneously open preliminary discussions on FTAs with third countries. We are concerned that there may be significant delays to the Secretary of State for International Trade's plan to agree new FTAs with 15 countries shortly after leaving the EU.**

469 European Union Committee, *Brexit: the options for trade* (5th Report, Session 2016–17, HL Paper 72)
470 Q 81
471 Written evidence submitted to the EU Internal Market Sub-Committee on 30 November 2016 (Session 2016–17) TAS0085 (UK Trade Policy Observatory, University of Sussex)
472 Q 81

263. **It is critical that the Government considers negotiating access to the EU's preferential trade arrangements with third countries for a transitional period.**

264. **The EU's frameworks for preferential trade are a valuable tool of the EU's foreign and development policies. When the UK leaves the EU, it is likely to lose access to such agreements, which cover a wide range of developing countries, such as the ACP and LDC groupings. We therefore welcome the Government's commitment to continue or improve access given to developing countries under economic partnership agreements signed with the EU.**

265. **We expect the Government to assess the full range of EU trade agreements, and their role in furthering the UK's foreign and development policy objectives. We recommend that the Government consider recreating such agreements on a bilateral basis, including a UK General System of Preferences.**

CHAPTER 8: SUMMARY OF SECTOR ISSUES

Pharmaceuticals and chemicals

Significance of trade	In 2015, the exports of the sector were worth £51.2 billion and imports amounted to £50.6 billion.[473]
Tariffs	Up to 6.5%.[474] There is a 'zero-for-zero' regime for pharmaceutical products and chemical intermediates used in the production of pharmaceuticals through the WTO Pharmaceutical Agreement.[475]
Supply chain	Highly integrated supply chain across Europe.[476] In some cases no domestic substitute is possible, for example basic chemical feedstocks.[477]
Rules of origin	The cost of providing the proof of origin for a chemical or other manufactured product could outweigh the value of tariff reductions under an FTA.[478]
Laws and regulations	Regulatory harmonisation, and mutual recognition and common labelling requirements are important for pharmaceuticals.[479] Compliance with COMAH and REACH are important for the chemicals industry if it is to trade with the EU.[480]
Agencies and standards	Active participation in the European Medicines Agency is important to the pharmaceutical industry, and ongoing collaboration would be welcomed.[481]
FTAs with non-EU countries	Current EU FTAs are very important.[482] The chemicals industry would like to preserve current preferential access to Korea and Switzerland.[483] The pharmaceuticals and chemicals sector would welcome new FTAs with Brazil, Canada the US and China.[484]

473 Written evidence submitted to the EU Internal Market Sub-Committee, 5 December 2016 (Session 2016–17) TAS0064 (Office for National Statistics)
474 Q 3 (Steve Elliott)
475 During the WTO Uruguay Round, the WTO Pharmaceutical Agreement was signed between Canada, the European Union and its Member States, Japan, Norway, Switzerland, the United States, and Macao, China. Office of the United States Trade Representative, 'Pharmaceuticals': https://ustr.gov/issue-areas/industry-manufacturing/industry-initiatives/pharmaceuticals [accessed 10 February 2017]
476 Q 1 (Dr Virginia Acha) and written evidence from CIA (FTG0003)
477 Written evidence from CIA (FTG0003)
478 Q 5 (Steve Elliott)
479 Written evidence from Deloitte LLP (FTG0004)
480 Q 7 (Steve Elliott)
481 Q 9 (Dr Virginia Acha)
482 Q 5 (Dr Virginia Acha)
483 Q 15 (Steve Elliott)
484 Q 15 (Steve Elliott and Dr Acha)

Capital goods and machinery

Significance of trade	The UK exported capital goods worth £36.7 billion and imported capital goods worth £57.2 billion in 2015.[485]
Tariffs	Vary widely, from 2.4% for electrical machinery, to 14% for electrical machinery and 22% on transport equipment.[486]
Supply chain	Highly integrated supply chain across Europe, and components may cross borders a number of times.[487]
Rules of origin	A concern to the sector.[488]
Laws and regulations	Membership of the Single Market, a single regulatory and legal environment, has reduced the cost of doing business.[489]
Agencies and standards	No evidence provided.
FTAs with non-EU countries	Would like to preserve current preferential access,[490] in particular to Switzerland, Korea, Turkey and Mexico.[491] Would welcome new FTAs with US, China, India, and Canada.[492]

485 ONS, *The Pink Book—2016, Chapter 2—2.1 Trade in goods summary table* (29 July 2016): https://www.ons.gov.uk/economy/nationalaccounts/balanceofpayments/datasets/2tradeingoodsthepinkbook2016 [accessed 9 February 2017]
486 WTO, 'Tariff profile—European Union': http://stat.wto.org/TariffProfiles/E28_e.htm [accessed 10 February 2017]
487 Q 27 (Fergus McReynolds) and MTA, *Brexit priorities*, p 2: https://www.mta.org.uk/sites/default/files/page/downloads/Brexit%20and%20the%20MTA.pdf [accessed 10 February 2017]
488 Q 23
489 Q 20 (Fergus McReynolds)
490 Q 32 (Fergus McReynolds)
491 Q 32 (James Selka)
492 EEF, *Britain and the EU: manufacturing an orderly exit* (21 September 2016), p 3: https://www.eef.org.uk/resources-and-knowledge/research-and-intelligence/industry-reports/britain-and-the-eu-manufacturing-an-orderly-exit [accessed 20 January 2017]

Food and beverages

Significance of trade	Exports of food and non-alcoholic drinks were worth £12.3 billion in 2015 and imports amounted to £35.1 billion.[493]
Tariffs	Vary widely for example from 3.8% on whole, fresh sweet potatoes to 25% for confectionery and 87% for frozen beef.[494]
Supply chain	Significant impact, including the possibility of double imposition for food manufacturing with particular significance for Northern Ireland.[495].
Rules of origin	Would result in additional technical barriers and paperwork.[496]
Laws and regulations	Any significant divergence from EU standards could prevent the sale of UK goods in the EU.[497] The UK could potentially apply different standards according to the export market, but this could be costly and have a deleterious impact on 'Brand Britain'.[498]
Agencies and standards	Ongoing participation in the EU's Rapid Alert System for Food and Feed (RASFF) would be welcomed.[499]
FTAs with non-EU countries	The FTA with Korea is important, and preferential access to West African countries via ACP arrangements, the South African EPA and the association agreement with Egypt.[500] Future preferential trade deals with Canada, Vietnam, North Africa, the US, China and Japan would be welcomed.[501]

493 FDF, 'UK-EU food and drink statistics': https://www.fdf.org.uk/eu-referendum-food-drink-statistics.aspx [accessed 23 February 2017]
494 Written evidence from AHDB (FTG0007); WTO, 'Tariff profile - European Union': http://stat.wto.org/TariffProfiles/E28_e.htm [accessed 10 February 2017] and written evidence from FDF (FTG0021)
495 Q 35 (Peter Hardwick) and written evidence from FDF (FTG0021)
496 Written evidence from AHDB (FTG0007)
497 Q 41 (Peter Hardwick)
498 Q 41 (Prof Tim Lang)
499 Q 41 (Peter Hardwick)
500 Q 45 (Peter Hardwick)
501 Written evidence from AHDB (FTG0007) and FDF (FTG0021)

Oil and petroleum

Significance of trade	Oil exports were worth £21 billion and imports were worth £29.3 billion in 2015.[502]
Tariffs	Tariffs are relatively low; the average MFN tariff on petroleum imports to the EU is 2.5%.[503] The downstream sector is concerned by potential tariffs on equipment and spares.[504]
Supply chain	No evidence provided.
Rules of origin	No evidence provided
Laws and regulations	The downstream industry is "very keen" to maintain COMAH.[505] A number of directives specify the quality of petrol, diesel fuels, and gas-oil, which are important for consumer confidence.[506] The upstream sector is not directly regulated by the EU, but is influenced by environmental standards and energy market standards and would like to continue to influence such standards.[507]
Agencies and standards	Technical standards for the downstream sector are determined by European Committee for Standardisation (CEN), and Brexit "should make no difference"[508].
Non-EU FTAs	No evidence provided.

502 ONS, *The Pink Book—2016, Chapter 2—2.1 Trade in goods summary table (29 July 2016)*: https://www.ons.gov.uk/economy/nationalaccounts/balanceofpayments/datasets/2tradeingoodsthepinkbook2016 [accessed 9 February 2017]
503 WTO, *World Tariff Profiles 2016, Applied MFN tariffs* (2016), p 81: https://www.wto.org/english/res_e/booksp_e/tariff_profiles16_e.pdf [accessed 16 February 2017]
504 Written evidence from Chris Hunt (FTG0020) and Norton Rose Fulbright LLP (FTG0018)
505 Q 51 (Chris Hunt)
506 Written evidence from Norton Rose Fulbright LLP (FTG0018)
507 Q 51 (Michael Tholen)
508 Q 51 (Chris Hunt)

Automotive

Significance of trade	Exports were worth £34.3 billion and imports were worth £52.1 billion in 2015.[509]
Tariffs	The EU's external tariff on cars is 10%. Tariffs also apply to car components, ranging from 2.5–4.5%.[510]
Supply chain	A highly integrated supply chain within the EU. 80% of the parts that go into a car are not made in the UK and there is no domestic supplier.[511]
Rules of origin	The current level of imported materials would be contrary to EU rules of origin if the UK were outside the EU.[512] This was "a threat" to future investment in the sector.[513]
Laws and regulations	No evidence provided.
Agencies and standards	Whether the Whole Vehicle Type Approval system will remain valid for UK-made vehicles required "urgent legal clarification". The UK should seek to maintain its influence on standard setting.[514]
Non-EU FTAs	The current access provided by EU FTAs is "very important" to the sector, for example the FTA with Korea.[515] Maintaining the current level of access should be the Government's focus, before pursuing new bilateral trade negotiations.[516]

509 SMMT, *Motor industry facts 2016*, p 9: https://www.smmt.co.uk/wp-content/uploads/sites/2/SMMT-Motor-Industry-Facts-2016_v2-1.pdf [accessed 21 February 2017] and written evidence from the Society of Motor Manufacturers and Traders (FTG0009)
510 Written evidence from Prof Peter Wells (FTG0013) and SMMT (FTG0009)
511 Written evidence from SMMT (FTG0009) and Q 76 (Mike Hawes)
512 Written evidence from Peter Wells (FTG0013); Automotive Council UK, *Growing the Automotive Supply Chain, Local Vehicle Content Analysis (September 2015)*: http://www.automotivecouncil.co.uk/wp-content/uploads/2015/09/UK-local-sourcing-content-research-September-20151.pdf [accessed 16 February 2017]
513 Q 67 (Mike Hawes)
514 Written evidence from SMMT (FTG0009)
515 Q 81 (Mike Hawes)
516 Written evidence from SMMT (FTG0009)

Aerospace and defence

Significance of trade	The industries' combined exports were worth an estimated £33.1billion in 2015.[517] Import figures are not available for the defence sector, but imports of air, spacecraft and related machinery were worth £19.8 billion in 2015.[518]
Tariffs	Trade in aircraft and complete parts is tariff free between signatories of the WTO Agreement on Trade in Civil Aircraft.[519]
Supply chain	Some raw materials and part-finished goods are not included in WTO Agreement on Trade in Civil Aircraft.[520] This is currently addressed by the EU's Inward Processing Relief regime[521], which the Government will need to consider when the UK leaves the EU.
Rules of origin	Would be "a particular challenge" as the sector does not currently monitor origin and can move parts freely across EU countries. This would be a significant burden in terms of cost and expertise.[522]
Laws and regulations	No evidence provided.
Agencies and standards	The European Aviation Safety Agency (EASA) is the industry's "route to market" and remaining a member was the industry's "number one ask of the UK Government".[523] The UK should seek full access to the European Space Agency's programmes, including the ability to tender for future EU space programmes.[524]
Non-EU FTAs	No evidence provided.

517 Written evidence from ADS Group (FTG0028)
518 ONS, *Publication Tables, UK Trade, CPA (08) (21 December 2016)*: https://www.ons.gov.uk/economy/nationalaccounts/balanceofpayments/datasets/publicationtablesuktradecpa08 [accessed 1 March 2017]
519 Q 88 (Paul Everitt)
520 *Ibid.*
521 Written evidence from Paul Everitt (FTG0016)
522 Q 88 (Paul Everitt)
523 *Ibid.*
524 Q 91 (Simon Whalley)

CHAPTER 9: INVESTMENT AND BUSINESS CLIMATE

The value of sterling

266. Since the EU referendum in June 2016, the value of sterling has fallen significantly. This is shown in Figure 5.

Figure 5: Value of sterling against the US dollar, February 2016 – February 2017

Source: XE, 'XE Currency Charts: GBP to USD': http://www.xe.com/currencycharts/?from=GBP&to=USD&view=1Y [accessed 22 February 2017]

Impact on exports and imports

267. A falling currency benefits exporters, as confirmed by our witnesses. For example, the Food and Drink Federation (FDF) told us that the weaker pound had made UK exports "increasingly competitive in recent months". It hoped "to see a further upswing in exports in the coming months as companies capitalise on these opportunities".[525] Mr Michael Tholen, Director of Upstream Policy, Oil and Gas UK, said that, for the upstream oil sector, because oil is priced in dollars, devaluation of sterling had had an "improving effect on the UK's competitiveness and has helped a little from a producer's point of view".[526]

268. Imports were, in turn, more expensive for both sectors,[527] and this has had a pervasive impact throughout UK manufacturing because, as shown in Chapters 3, 4 and 5, many UK industries are embedded within wider EU supply chains, with a significant reliance on imports.

525 Written evidence from FDF (FTG0021)
526 Q 59 (Michael Tholen)
527 Q 59 (Michael Tholen) and written evidence from FDF (FTG0021)

269. Thus the Society of Motor Manufacturers and Traders (SMMT) explained that "whilst the logic of a weak pound supporting exports is true, this is countered by the increased costs for supply-chains for raw materials, energy costs and imported semi-finished goods or components".[528] The FDF wrote that devaluation had "increased prices for raw ingredients such as butter or cocoa, or packaging materials and factory equipment". Its members had "reported increased input costs of up to 20%".[529] Mr Paul Everitt, Chief Executive Officer, ADS Group, agreed that "beyond the immediate few months", when a lower sterling might help exports, this would also be the case for aerospace and defence. He added: "Our big message is that long-term global competitiveness is not based on exchange-rate fluctuations."[530]

270. Mr Fergus McReynolds, Director of EU Affairs, EEF—The Manufacturers' Organisation, summed up the issue:

> "The nature of modern manufacturing today is not a simple model of one factory in the UK which makes something and then it is exported to one destination. As we add value in the sector, we bring in components from other countries, which would be affected by changes in the exchange rate, and they have to be managed."[531]

271. We note that this management challenge confronts companies of all sizes and that SMEs often find themselves particularly exposed. Larger companies are often able to hedge their risks through the currency markets more effectively.

Impact on sectors and prices

272. Our witnesses noted that a prolonged depreciation of sterling would be likely to have structural effects on UK industry, with positive overall benefits for the UK economy. The National Franchised Dealers Association noted that, were sterling to continue to fall in value, UK-made cars would be likely to obtain a larger share of the UK market (because imported models would be more expensive), but the overall UK market might shrink.[532]

273. We were told the impacts of currency devaluation would be felt by consumers, in the form of higher prices. The SMMT wrote that vehicle price increases for consumers were already being announced, in the form of "tightening … credit conditions", a point echoed by the National Franchised Dealers Association.[533] Norton Rose Fulbright noted that, for the downstream oil sector, "the fall of the pound and the resultant increase in the price of oil imports has meant that consumers are seeing a rise in prices at the pump, which is never going to be popular".[534] We note that the impact of sterling depreciation has also been felt on some food prices since the referendum.[535]

528 Written evidence from SMMT (FTG0009)
529 Written evidence from FDF (FTG0021)
530 Q 87 (Paul Everitt)
531 Q 19
532 Written evidence from the National Franchised Dealers Association (FTG0012)
533 Written evidence from SMMT (FTG0009) and the National Franchised Dealers Association (FTG0012)
534 Written evidence from Norton Rose Fulbright LLP (FTG0018)
535 Unilever has raised the price of Marmite, Mondelez has changed the shape of Toblerones to contain less chocolate for the same price, and Weetabix has indicated its intention to raise prices, decisions which the companies attributed to higher commodity prices and the weak sterling. Reuters, 'Cadbury owner Mondelez raises some prices on weak pound, higher cocoa cost' (12 January 2017): http://uk.reuters.com/article/uk-mondelez-freddo-price-idUKKBN14W2OT [accessed 13 February 2017] and 'Weetabix warns of price rises this year', *BBC News* (30 January 2017): http://www.bbc.co.uk/news/business-38794292 [accessed 13 February 2017]

As a result of this, in the longer term, there was concern that "a significant increase in wage inflation in the UK" would result.[536]

274. It is also worth noting that movements in sterling/euro exchange rate could well be more significant than any likely level of tariff that might be introduced between the UK and the EU (discussed in Chapter 4).

Certainty and investor confidence

275. As we concluded in our report, *Brexit the options for trade*, businesses are operating in conditions of considerable uncertainty about the terms of the future trading arrangement with the EU, notwithstanding the Prime Minister's speech on 17 January 2017 and the ensuing Government's White Paper. Uncertainty undermines investor confidence and so is, in itself, a significant threat to the UK economy.[537]

276. A number of the witnesses to this inquiry also highlighted this concern.[538] Commenting on the manufacturing technology industry, Mr James Selka, Chief Executive Officer, Manufacturing Technologies Association (MTA), stated that there was "enormous interest and alarm about [Brexit] among overseas-owned members [of the MTA], of which there are many".[539] He commented that "uncertainty is the enemy of investment, and that is what we are dealing in in manufacturing".[540]

277. Mr McReynolds agreed that long-term investment decisions for manufacturers would be made "harder" by this "uncertainty".[541] Mr Hawes explained that, in the automotive industry, "most volume models [such as the majority of Toyota and Nissan cars] operate on a four-year product cycle".[542] He continued:

> "Where a contract is coming up for a new model in the next three or four months, this is a challenge because you are trying to understand what your future costs will be, but you have to make that decision now in pitching. You are in competition with other suppliers around Europe, or indeed around the world."[543]

278. Mr Hawes described the impact of a decrease in investment in the car industry as "more like death from a thousand cuts than just shutting the gates overnight".[544] Mr Everitt said that this was also the case for the aerospace and defence industry. Investment in the long term "will depend on our ability to negotiate a successful new relationship with the EU … The danger is that we see a slow and steady erosion of our competitiveness if we do not address the challenges in front of us."[545]

536 Q 87 (Paul Everitt)
537 European Union Committee, *Brexit: the options for trade* (5th Report, Session 2016–17, HL Paper 72)
538 Q 53 (Michael Tholen) and Q 86 (Paul Everitt)
539 Q 22 (James Selka)
540 *Ibid.*
541 Q 22 (Fergus McReynolds)
542 Q 65
543 Q 64
544 Q 79
545 Q 86 (Paul Everitt)

279. Norton Rose Fulbright LLP wrote that "the additional uncertainty of Brexit" was exacerbating the already existing problem of attracting investment to North Sea production, in a period of low oil prices: "There is little investor confidence, and this is likely to remain until it becomes clear what the post-EU UK will look like".[546]

Japan

280. Japanese Foreign Direct Investment (FDI)[547] in the UK is a case in point. Japan is a major investor in the UK automotive and pharmaceuticals sectors, as well as in financial services.[548] It was the fourth largest source of FDI in the UK 2014 (after the EU countries combined, the US and Switzerland), worth £38.2 billion.[549] Mr Koji Tsuruoka, Ambassador of Japan to the UK, explained that "more than 1,000 Japanese companies [are] investing all over the UK … [which] directly generate employment for 140,000 people", with many more employed indirectly.[550]

281. The Ambassador told us that Japanese companies valued the UK as a "stable, predictable and friendly economy".[551] Japanese car manufacturers and pharmaceutical companies hoped to maintain existing trade conditions, such as the harmonised EU system for drug approvals (via the EMA), and current tariff rates and customs clearance procedures.[552]

282. Ambassador Tsuruoka told us that the large share of Japanese companies' investment in the EU accounted for by the UK—proportionately more than double that of the rest of the EU—was "linked to the understanding that the UK is the gateway to continental Europe as part of the Single Market".[553] The Japanese government's open letter of 4 September 2016, *Japan's Message to the United Kingdom and the European Union*, stated: "Japanese businesses with their European headquarters in the UK may decide to transfer their head-office function to Continental Europe if EU laws cease to be applicable in the UK after its withdrawal."[554]

546 Written evidence from Norton Rose Fulbright LLP (FTG0018)

547 FDI is defined as cross-border investment by a resident entity in one economy with the objective of obtaining a lasting interest in an enterprise resident in another economy. The lasting interest implies the existence of a long-term relationship between the direct investor and the enterprise, and a significant degree of influence by the direct investor on the management of the enterprise. Ownership of at least 10% of the voting power, representing the influence by the investor, is the basic criterion used. Organisation for Economic Co-operation and Development, 'OECD Factbook 2013: Economic, Environmental and Social Statistics': http://www.oecd-ilibrary.org/sites/factbook-2013-en/04/02/01/index.html;jsessionid=2owcbu8ik9bbs.x-oecd-live-02?itemId=/content/chapter/factbook-2013–34-en&_csp_=01ed25b0712bc3492f6d2d68d1f16a37 [accessed 13 February 2017]

548 Our report, *Brexit: financial services*, considers the implications of Brexit for financial services. European Union Committee, *Brexit: financial services* (9th Report, Session 2016–17, HL Paper 81)

549 ONS, 'Article: International perspective on UK foreign direct investment (FDI)— 2014': https://www.ons.gov.uk/economy/nationalaccounts/balanceofpayments/articles/internationalperspectiveonukforeigndirectinvestmentfdi/2014#foreign-direct-investment-positions-in-the-uk-by-geography [accessed 13 February 2017]; The top three sources of FDI in 2014 were the EU countries combined, (£495.8 billion), the USA (£253 billion) and Switzerland (39.9 billion).

550 Q 96

551 *Ibid.*

552 Q 98 and Government of Japan, *Japan's Message to the United Kingdom and the European Union* (4 September 2016): http://www.mofa.go.jp/files/000185466.pdf [accessed 13 February 2017]

553 Q 96

554 Government of Japan, *Japan's Message to the United Kingdom and the European Union* (4 September 2016), p 13: http://www.mofa.go.jp/files/000185466.pdf [accessed 13 February 2017]

283. Ambassador Tsuruoka accepted that "while the negotiation is under way … the UK's status as an EU member will not be affected".[555] But businesses needed information from the Government on what the long-term trade arrangements would be, to allow them to plan: "We need consultation with stakeholders and not to be led by the press in understanding what is really going on".[556] He was reassured that "the first message that the UK Government has put to the Japanese public is that the UK is mindful of Japanese interest in Brexit, especially the interest of Japanese industry, and therefore Japanese industry will be heard and there will be consultation".[557]

284. Ambassador Tsuruoka told us that there was "an ongoing process of consultation with the UK Government, from the very top to the level of officials". However, the two sides had "not yet set up an agreed, regular, periodic mechanism of consultation".[558]

285. The Japanese car manufacturer Nissan is a key investor in the UK economy, both nationally and, equally importantly, regionally, in the North East of England. Its announcement in October 2016 that it would continue to invest in the UK was a significant boost to the regional economy. The engagement between the Government and Nissan that led to this announcement is described in Box 10.

Box 10: Nissan's investment in the UK

Nissan's plant in Sunderland makes almost one in three cars built in Britain. In 2015 it produced 475,000 vehicles. 55% of Nissan's cars are exported to Europe.[559] It employs 7,000 people directly, and there are a further 28,000 employees in the plant and its supply chain.[560]

In September 2016 Mr Carlos Ghosn, the CEO of Nissan, warned that the company might not invest further in the Sunderland plant unless the Government provided a guarantee to compensate the company for the cost of tariffs on trade between the UK and the EU, should these be introduced.[561]

In October 2016 the company announced that it would produce both the next-generation Qashqai and the X-Trail at Sunderland.[562] Greg Clark MP, Secretary of State for Business, Energy and Industrial Strategy, told the House of Commons that the Sunderland plant would "be expanded through new investment to be a super-plant, manufacturing more than 600,000 cars a year".[563]

555 Q 102; The Government has stated its intention to trigger Article 50 of the TEU by the end of March 2017. Article 50 specifies a two year period, which can be extended by the unanimous agreement of the EU-27 and the UK.
556 Q 102
557 Q 102
558 Q 103
559 Chris Johnston, 'Nissan to build new models in Sunderland', *BBC News* (27 October 2016): http://www.bbc.co.uk/news/business-37787890 [accessed 13 February 2017]; Tom Bergin, UK support for Nissan may be costly, hard to calculate, Reuters (27 October 2016): http://uk.reuters.com/article/uk-britain-eu-nissan-support-idUKKCN12R2FI [accessed 8 March 2017]
560 HC Deb, 31 October 2016, Col 679
561 Chris Johnston, 'Nissan to build new models in Sunderland', *BBC News* (27 October 2016): http://www.bbc.co.uk/news/business-37787890 [accessed 13 February 2017]
562 Chris Johnston, 'Nissan to build new models in Sunderland', *BBC News* (27 October 2016): http://www.bbc.co.uk/news/business-37787890 [accessed 13 February 2017]
563 HC Deb, 31 October 2016, Col 679

Considerable uncertainty remains over the undertakings made to Nissan by the Government. Mr Clark told the House of Commons that one of four "reassurances" made to Nissan had been that "in our negotiations to leave the EU, we will emphasise the very strong common ground, especially in the automotive sector, that exists between ourselves and other EU Member States in ensuring that trade between us can be free and unencumbered by impediments".[564] He declined to publish the correspondence between the Government and Nissan, stating that this contained information confidential to Nissan.[565]

Ambassador Tsuruoka said he did not know "what conditions or assurances the UK Government might have presented Nissan". He noted:

> "Having the Prime Minister deal with the president of Nissan is in itself a remarkable engagement by the UK Government. Therefore, I interpret this as a strong commitment of good will on the part of the host Government for Nissan. You may have seen in the press that there are certain issues that they discussed, most of them, I believe, to the satisfaction of both sides."[566]

Mr Hawes told us that "all our members were surprised by the speed of that announcement, given some of the comments that were made in the previous few weeks".[567] He believed that the commitment from the Government was "not just Nissan, it is the sector as a whole", which was very welcome news to the automotive industry.[568]

We note that, as discussed in Chapter 4, the GATT stipulates that customs unions or free trade agreements must liberalise "substantially all the trade" in goods, or have "substantial sectoral coverage" for trade in services. This means that sectoral agreements (those covering just the automotive sector, for example) would not be legal under the rules of the WTO.

Some uncertainty over the company's future investment remains: on 20 January 2017 Mr Ghosn told the World Economic Forum in Davos that when the Brexit "package" was made available, Nissan would "have to re-evaluate the situation" and ask the question, "Is the competitiveness of your plant preserved or not?"[569]

564 HC Deb, 31 October 2016, Col 680
565 HC Deb, 31 October 2016, Col 682
566 Q 97
567 Q 77
568 *Ibid.*
569 Ben Chu, 'Nissan boss Carlos Ghosn says UK investment to be 're-evaluated' if Theresa May delivers poor Brexit deal', *The Independent* (20 January 2017): http://www.independent.co.uk/news/business/news/nissan-boss-carlos-ghosn-admits-uk-investment-will-be-reviewed-a7537586.html [accessed 13 February 2017]

Conclusions and recommendations

286. **Sterling has fallen substantially since the EU referendum. While devaluation has brought some benefits to exporters, it has also raised the cost of imports. Many UK export industries are embedded within wider EU supply chains, with a significant reliance on imports. The effect of sterling's fall upon UK exports is thus complex and mixed.**

287. **Larger companies may be able to hedge currency risk, but devaluation has a disproportionate impact upon smaller companies, which are less able to hedge.**

288. **Uncertainty is the enemy of investment. Lack of clarity on what Brexit will entail has caused concern in the business community, particularly in sectors reliant on international investment. While the Prime Minister's clarification that the UK will pursue a FTA with the EU is a start in providing greater certainty, the Government must do more to help businesses to plan for the future.**

289. **The Government's explicit support for Nissan to remain in the UK was welcome. We are not clear, however, what commitment was made by the Government, and whether any offers to the company apply more broadly to the automotive sector as a whole, or whether similar offers will be made to other sectors.**

290. **International investment is critical to the UK manufacturing and primary commodities sectors. We urge the Government to engage regularly with the governments of significant non-EU investors, as well as with individual businesses.**

291. **The Government has limited freedom to offer guarantees to any industry: the UK-EU conditions of trade will require negotiation with the 27 EU Member States, and the UK is obliged to comply with WTO rules on MFN status, subsidies and the coverage of FTAs**.

CHAPTER 10: THE GOVERNMENT'S VIEW

Negotiating a FTA

292. Lord Price CVO, Minister of State for Trade Policy, Department for International Trade (DIT), told us that a UK-EU FTA would be unprecedented:

> "What makes the EU FTA so unique is that we start from a point of no tariffs and complete conformity, with tariffs or different conventions applied at some point in the future. I do not think anybody is quite sure how that will work, because nobody in the world has ever done this before. We are doing the complete reverse of every FTA that has ever been done."[570]

293. When asked about the feasibility of negotiating the UK's withdrawal and the new trading relationship within two years, Lord Bridges of Headley MBE, Parliamentary Under-Secretary of State, Department for Exiting the EU (DExEU), said the Government was seeking to negotiate "an agreement that covers both … within the two years". Thanks to the UK's "unique position because of the way in which our laws and regulations are so entwined with one another … we see it being technically possible to do this".[571] Lord Price agreed, arguing that there was "certainly no reason why an FTA could not be negotiated within that timeframe".[572]

A transitional agreement

294. In our report, *Brexit: the options for trade,* we concluded that a transitional arrangement would be essential. In her speech of 17 January the Prime Minister rejected a "form of unlimited transitional status, in which we find ourselves stuck forever in some kind of permanent political purgatory", and reiterated that the UK and the EU must reach an agreement on their future partnership "by the time the two-year Article 50 process has concluded". Rather than transition as such, she favoured "a phased process of implementation" of Brexit.[573] This was reiterated in the Government's White Paper in February 2017.[574]

295. On the distinction between a 'transitional arrangement' and 'a phased process of implementation', Lord Bridges told us: "An implementation phase is an implementation phase, and you could call a transition arrangement an implementation phase." In many FTAs there was "a phase after the agreement has been signed in which businesses, legislatures and regulators have time to put in place what has been agreed. It is pretty much that simple."[575]

570 Q 117 (Lord Price)
571 Q 118 (Lord Bridges of Headley)
572 Q 118 (Lord Price)
573 Theresa May MP, Speech on the government's negotiating objectives for exiting the EU, 17 January 2017: https://www.gov.uk/government/speeches/the-governments-negotiating-objectives-for-exiting-the-eu-pm-speech [accessed 13 February 2017]
574 HM Government, The United Kingdom's exit from and new partnership with the European Union, Cm 9417, February 2017, p 8: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/589191/The_United_Kingdoms_exit_from_and_partnership_with_the_EU_Web.pdf [accessed 10 February 2017]
575 Q 117 (Lord Bridges of Headley)

296. We note that this issue is also of concern to foreign investors in the UK. Mr Koji Tsuruoka, Ambassador of Japan to the UK, emphasised the need for a transitional arrangement following withdrawal, as articulated in the Government of Japan's open letter:[576]

> "If there are changes that need to be implemented it is our hope that there will be transparency and an indication as to what will be implemented at some future time, with a time schedule. Companies will therefore be able to adopt a road map that has been made public and known, and they could adjust step by step. If it happens overnight and you say, 'The world is now different. Unless you have satisfied A, B and C, your product will not be able to enter the market', that will not be possible for anyone to address."[577]

Resources and capacity

Staffing

297. In our report, *Brexit: the options for trade*, we expressed concern that Government would not be able to recruit the necessary additional skilled personnel and that the timetable decided by the Government was putting considerable strain on resources across government. Giving evidence to that inquiry in October 2016, Lord Price told us that DIT had around 110 staff working on trade policy. In February 2017, he said that number had risen to 185 staff.[578] This number included "policy and country specialists as well as expert economic analysts and lawyers".[579] Lord Price estimated that by the end of 2017, "we will probably be at around 240 or 250".[580] DIT had "a lot of good-calibre people with experience in international relations", and had advertised "for a government-appointed chief trade negotiator to advise on all trade deals. So we are now starting to beef up our capacity."[581]

298. Similarly, Lord Bridges told us that there were now "300 very good people in DExEU". He was "confident but never complacent".[582] DExEU was "also supported by 120 UKRep staff, based in Brussels, who report to FCO and DExEU Ministers".[583] Regarding the potential recruitment of UK staff currently working for EU institutions in Brussels, Lord Bridges said: "We have to be somewhat careful with our European partners so that we are not seen as trying to poach people, but we are making it clear that opportunities are available in the way that [Lord Price] explained. They are obviously a valuable resource."[584]

299. An increase in staff numbers was important not only to DExEU and DIT, but to HMRC, in order to deal with an increase in customs controls for goods crossing the UK border post-Brexit. A joint customs consultative committee, consisting of 20 associations representing core business sectors and Government departments, was "working together to look at exactly the issue" of managing the increased need of staff.[585] We noted in Chapter 6 that HMRC was considering its resourcing needs.

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576 Government of Japan, *Japan's Message to the United Kingdom and the European Union* (4 September 2016): http://www.mofa.go.jp/files/000185466.pdf [accessed 13 February 2017]
577 Q 102
578 Oral evidence taken on 13 October 2016 (Session 2016–17), Q 57 (Lord Price)
579 Written evidence from Lord Bridges of Headley MBE and Lord Price CVO (FTG0027)
580 Q 121 (Lord Price)
581 *Ibid.*
582 Q 118 (Lord Bridges of Headley)
583 UKRep is the UK Permanent Representation to the EU. Written evidence from Lord Bridges of Headley MBE and Lord Price CVO (FTG0027)
584 Q 121 (Lord Bridges of Headley)
585 Q 110 (Lord Bridges of Headley)

Processing

300. Lord Bridges told us that "if you look at our performance at customs internationally, you will see that actually HMRC does a good job". He also stated that, of goods imported from non-EU countries, "92% of all declarations … are cleared for UK customs purposes in less than five seconds, and … 8% of goods are identified for further control requiring examination of paper documents or physical inspection."[586]

301. Lord Bridges pointed out that a new IT system was being created—the Customs Declarations Services (CDS) system. This system was "planned before the referendum to increase the capacity of the current CHIEF system" (which we considered in Chapter 6), and should "make things quicker and easier to operate". HMRC was "making every possible effort to make [the CDS] ready for operation in 2019". The new CDS and the current CHIEF system "will be able to be run side by side, so we should be able to have the capacity".[587]

302. Lord Bridges and Lord Price added that CDS "is being developed with appropriate mechanisms in place to ensure high levels of performance and resilience continue to be provided to users as HMRC moves from CHIEF to CDS". In preparation for its launch, HMRC and the Home Office planned "a rolling programme of staff training in June 2017, with checks in place to make sure affected staff receive appropriate support in readiness for the operational use of the system".[588]

303. When asked about the cost of the additional capacity for customs controls, Lord Bridges told us: "When we can provide figures, we will, and I am sure that there will be further added scrutiny, quite rightly, on this point when we introduce primary legislation on customs, which we have said we will need to implement."[589]

Engagement with business and investors

304. Lord Bridges and Lord Price told us that the Government "will continue to build a national consensus around [the UK's] negotiating position by listening and talking to as many organisations, companies and institutions as possible". Their departments continued to have "open and honest conversations with businesses and trade associations to help limit uncertainty and ensure our future trading relationships work for them", and such dialogue would be maintained.[590]

305. Ministers and officials in DIT were "working in a range of markets to promote the UK as a great place to do business and with which to trade". Such discussions were undertaken informally through UK embassies abroad, with "embassies and High Commissions in London", and through "official-level dialogues, and ministerial discussions".[591]

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586 *Ibid.*
587 *Ibid.*
588 Written evidence from Lord Bridges of Headley MBE and Lord Price CVO (FTG0027)
589 Q 110 (Lord Bridges of Headley)
590 Written evidence from Lord Bridges of Headley MBE and Lord Price CVO (FTG0027); Details of ministerial meetings are published in the Department's Quarterly Transparency Returns, which are publicly available on GOV.UK.
591 Written evidence from Lord Bridges of Headley MBE and Lord Price CVO (FTG0027)

Conclusions and recommendations

306. **If the UK and EU are unable to agree a FTA within the two years provided for in Article 50 TEU, preferential terms for trade between the UK and the EU would cease, and WTO rules would apply. This can only be avoided by negotiating a transitional arrangement. Businesses, both domestic and foreign, would welcome such a period of adjustment.**

307. **We urge the Government to establish at the outset of negotiations a clear strategy for a future transitional agreement, with specific proposals as to what form it should take.**

308. **We welcome the Prime Minister's commitment to a phased implementation of Brexit. We note, however, that this commitment is conditional upon the UK and EU agreeing a FTA within the two years provided for in Article 50 TEU. This is inherently ambitious, and there has been no indication so far that the EU is willing to contemplate such a truncated negotiation.**

309. **We are concerned that the introduction of a new IT system for customs—planned for the year that the UK leaves the EU—may add to the complexity of the trading conditions facing businesses in the wake of Brexit. We urge HMRC to ensure that the system is robust and fully tested before it is rolled out, to prevent further disruption to businesses.**

310. **We welcome the Government's commitment to report to Parliament on the cost of new infrastructure and of additional staffing at customs posts.**

311. **We welcome the Government's efforts to increase the promotion of UK trade overseas. We ask the Government to confirm that it is confident it has sufficient commercial staff in UK embassies overseas to promote the UK's trade interests, in particular in comparison to the staffing of the embassies of other European countries.**

SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

UK production of goods

1. International businesses are not structured neatly along sectoral lines or national boundaries. The Government must be mindful of the complex structure of businesses, particularly multi-national companies, in its analysis of the impact of Brexit. (Paragraph 60)

2. The manufacturing and primary commodities sectors are important employers, particularly in regions outside the South East of England. Ensuring that these industries do not face additional barriers to trade with the EU and beyond will be essential to drive growth across the whole country, as envisaged in the Government's Green Paper, Building our Industrial Strategy. (Paragraph 61)

3. Although concentrated in different regions, the production of goods and services is often intertwined. A worsening of trade conditions for goods could therefore have a negative impact on employment in supporting services industries across the country. The Government must seek a trade agreement with the EU which recognises this interlinkage, and secures the best possible terms for both. (Paragraph 62)

4. A new UK approach to immigration must take account of the needs of businesses in the UK. The ability to recruit staff from the EU-27, and move staff to and from the EU-27 through intra-group transfers, is essential to the primary commodities and manufacturing industries. The Government must ensure that its post-Brexit immigration policy allows this. (Paragraph 63)

5. We call on the Government also to clarify that the UK's existing level of research funding and collaboration with the EU-27 will continue, or that equivalent domestic arrangements will be established, after the UK's withdrawal from the EU. (Paragraph 64)

Trade in goods

6. The EU is, by a significant margin, the UK's biggest trading partner in goods. Both imports from and exports to the EU are essential to the UK's manufacturing industry and primary commodities sectors. Safeguarding UK-EU trade in goods will be a critical factor in ensuring the UK's long-term prosperity post-Brexit. (Paragraph 77)

7. Norway and Switzerland are two of the UK's largest trading partners outside the EU. They are highly integrated into the EU's Single Market, and so Brexit will change the UK's trading relationship with them. The Government should seek a comprehensive trade agreement with these countries after Brexit, to avoid a worsening of trade conditions. (Paragraph 78)

Tariff barriers

8. In the event that the UK leaves the EU without first either agreeing a comprehensive UK-EU FTA or—pending completion of such a FTA—agreeing a transitional arrangement, UK-EU trade would have to proceed according to WTO rules, and may incur significant tariff costs for UK businesses. (Paragraph 124)

9. All the sectors from which we took evidence expressed concerns about the imposition of tariffs in their sectors, although we note that the level of duties varies considerably between them. (Paragraph 125)

10. Many of these sectors are integrated into efficient EU-wide supply chains. They are both significant importers of goods from the EU and exporters to the Single Market. It is imperative that a trade deal with the EU seeks to avoid the imposition of tariffs on trade in both directions. (Paragraph 126)

11. Many UK businesses cannot easily substitute their imports from the EU with UK products. For example, the UK no longer produces three of the major feedstocks required for the chemicals industry. It may also be difficult for exporters to find new markets for goods. For example, perishable products from the UK food and beverages sector may have a short shelf-life, and customer demand for such products may not exist in non-EU markets. (Paragraph 127)

12. When establishing its own schedules at the WTO, the UK Government must give particular consideration to the implications of tariffs on the UK agricultural sector. High tariffs on imports would raise the cost to UK consumers, whereas lower tariffs could reduce the cost of food to consumers, but might undermine the domestic agricultural sector's competitiveness. (Paragraph 128)

Non-tariff barriers

13. Non-tariff barriers can pose as significant or greater a barrier as tariffs to trade in goods. (Paragraph 178)

14. Were the UK to agree a FTA with the EU, rules of origin (which determine where a product and its components were produced) would apply. They would also apply were the UK and EU to trade under WTO rules. Applying rules of origin will generate significant additional administration, and therefore costs and delays, to UK businesses. (Paragraph 179)

15. If the UK and the EU were to agree a FTA, compliance with preferential rules of origin might be so administratively burdensome for some sectors, such as chemicals, as to outweigh the benefit of tariff reductions. It will be important for the Government fully to assess the benefit, sector by sector, of preferential rules of origin under a FTA as compared to non-preferential rules of origin under WTO terms. (Paragraph 180)

16. Some industries with an integrated EU supply chain and high levels of both imports and exports, notably the automotive sector, might be unable to comply with the local content requirements contained in the EU's preferential rules of origin. In this scenario, WTO most favoured nation tariffs would be imposed, increasing costs and disrupting the UK's place within the EU supply chain. (Paragraph 181)

17. Regulatory standards are a significant non-tariff barrier. If the current level of EU-UK trade is to be maintained, ongoing harmonisation or mutual recognition of regulatory standards may be required. We welcome the Government's decision—by means of the Great Repeal Bill—to preserve existing EU regulations in domestic law as a first step towards regulatory co-operation with the EU. (Paragraph 182)

18. As we stated in our report Brexit: the options for trade, the Government will have to make a trade-off between its desire to determine UK laws and regulations, and how far-reaching a FTA it can agree with the EU (and other partners). (Paragraph 183)

19. Operating to two separate regulatory standards—for the domestic and EU markets—would be costly for UK businesses. (Paragraph 184)

20. We urge the Government to maintain close dialogue with the EU over the development of UK and EU standards post-Brexit, to avoid unnecessary divergence. (Paragraph 185)

21. But a comprehensive FTA is likely to require more than just such dialogue: it is likely to require a legal commitment by the UK to maintain a high level of harmonisation or mutual recognition of regulations and standards with the EU. This would require the UK Government to limit its exercise of regulatory sovereignty, in order to secure liberal conditions for trade. It might also require the UK to agree with the EU anew arrangement for oversight and dispute resolution. (Paragraph 186)

22. As part of this regulatory alignment, there may be significant benefits in the UK continuing to participate, where legally possible, in EU agencies. We regret the lack of information in the Government's White Paper regarding the UK's strong and abiding interest in continued membership of such agencies. (Paragraph 187)

23. The UK has in particular benefited from hosting and participating fully in the European Medicines Agency (EMA). The Government's decision to rule out membership of the Single Market means that the UK may be unable to maintain its membership of this body. We regret this, and urge the Government to bring forward proposals for future collaboration with the EMA. (Paragraph 188)

24. We call on the Government to confirm whether vehicle type approvals issued by the Vehicle Certification Agency will remain valid after Brexit. (Paragraph 189)

25. The European Aviation Safety Agency is the civil aviation industry's 'route to market'. We urge the Government to confirm whether the Government intends to seek continuing membership of the EASA after Brexit, and if so on what terms. (Paragraph 190)

26. The Prime Minister has stated the Government's intention to leave the jurisdiction of the Court of Justice of the European Union. Full UK participation in EU agencies after Brexit would be likely to require some form of oversight and dispute resolution, in the specific areas covered by these agencies. We urge the Government to clarify whether it would accept such conditions for co-operation with specific EU agencies, and if so on what terms. (Paragraph 191)

Costs of administering tariff and non-tariff barriers

27. Leaving the EU customs union would result in costly administrative requirements and customs procedures, whatever new framework for trade is established. This would result in a significant additional administrative burden for companies, and delays to consignments of goods, incurring additional costs. (Paragraph 226)

28. Administering UK-EU tariffs and non-tariff barriers—in the absence of a common regulatory system—would also significantly increase the work of HMRC, a task for which it is not currently resourced. The UK would also have to establish new customs posts, develop a new customs code and consider improvements to the UK's systems for trade processing. We call on the Government to set out its plans for reviewing and if necessary increasing the resources available to HMRC and other agencies. (Paragraph 227)

29. We welcome the Government's commitment to seeking simplified customs procedures for EU-UK goods trade. We note that the customs agreement proposed by the Prime Minister would be unprecedented, and we are unclear whether it will be possible outside a formal customs union (including the Common External Tariff). (Paragraph 228)

30. If a comprehensive FTA between the UK and the EU can be achieved, there may be scope within it to simplify some customs procedures. (Paragraph 229)

31. The Authorised Economic Operator scheme provides an opportunity for registered companies to streamline certain customs procedures, and we recommend that the UK Government adopt the provisions of the current AEO scheme into UK law after Brexit. The scheme would not, however, remove the requirement for customs checks to be implemented between the UK and the EU after Brexit, and would not prevent the additional burden of associated administration and costs from arising. (Paragraph 230)

The EU and preferential trade with third countries

32. As we concluded in our report on *Brexit: the options for trade*, it is unlikely that the UK will be able to maintain access to the EU's FTAs with third countries after Brexit. The UK will also not be able to conclude new FTAs with third countries until after it has left the EU. (Paragraph 259)

33. Thus Brexit is likely to result in a cessation of the preferential conditions of trade with non-EU countries currently enjoyed by UK businesses. This is likely to result in significant tariff costs and other reductions in market access for many of the sectors we considered, until new preferential arrangements can be put in place post-Brexit. (Paragraph 260)

34. We welcome the Government's efforts to engage with non-EU countries to lay the groundwork for future FTAs. However, trade negotiations are time consuming and complex, and it is important that the Government focus its efforts where they can deliver maximum benefit. In particular, the Government should focus on countries where the EU already has FTAs in place, with a view to securing the current level of market access enjoyed by UK businesses. The terms of the EU's existing FTAs and those under negotiation are likely to form a useful starting point for future UK agreements with these countries. (Paragraph 261)

35. The Government needs to demonstrate that it has the capacity to negotiate with the EU, and simultaneously open preliminary discussions on FTAs with third countries. We are concerned that there may be significant delays to the Secretary of State for International Trade's plan to agree new FTAs with 15 countries shortly after leaving the EU. (Paragraph 262)

36. It is critical that the Government considers negotiating access to the EU's preferential trade arrangements with third countries for a transitional period. (Paragraph 263)

37. The EU's frameworks for preferential trade are a valuable tool of the EU's foreign and development policies. When the UK leaves the EU, it is likely to lose access to such agreements, which cover a wide range of developing countries, such as the ACP and LDC groupings. We therefore welcome the Government's commitment to continue or improve access given to developing countries under economic partnership agreements signed with the EU. (Paragraph 264)

38. We expect the Government to assess the full range of EU trade agreements, and their role in furthering the UK's foreign and development policy objectives. We recommend that the Government consider recreating such agreements on a bilateral basis, including a UK General System of Preferences. (Paragraph 265)

Investment and business climate

39. Sterling has fallen substantially since the EU referendum. While devaluation has brought some benefits to exporters, it has also raised the cost of imports. Many UK export industries are embedded within wider EU supply chains, with a significant reliance on imports. The effect of sterling's fall upon UK exports is thus complex and mixed. (Paragraph 286)

40. Larger companies may be able to hedge currency risk, but devaluation has a disproportionate impact upon smaller companies, which are less able to hedge. (Paragraph 287)

41. Uncertainty is the enemy of investment. Lack of clarity on what Brexit will entail has caused concern in the business community, particularly in sectors reliant on international investment. While the Prime Minister's clarification that the UK will pursue a FTA with the EU is a start in providing greater certainty, it is critical that the Government does more to help businesses to plan for the future. (Paragraph 288)

42. The Government's explicit support for Nissan to remain in the UK was welcome. We are not clear, however, what commitment was made by the Government, and whether any offers to the company apply more broadly to the automotive sector as a whole, or whether similar offers will be made to other sectors. (Paragraph 289)

43. International investment is critical to the UK manufacturing and primary commodities sectors. We urge the Government to engage regularly with the government of significant non-EU investors, as well as with individual businesses. (Paragraph 290)

44. The Government has limited freedom to offer guarantees to any industry: the UK-EU conditions of trade will require negotiation with the 27 EU Member States, and the UK is obliged to comply with WTO rules on MFN status, subsidies and the coverage of FTAs. (Paragraph 291)

The Government's view

45. If the UK and EU are unable to agree a FTA within the two years provided for in Article 50 TEU, preferential terms for trade between the UK and the EU would cease, and WTO rules would apply. This can only be avoided by negotiating a transitional arrangement. Businesses, both domestic and foreign, would welcome such a period of adjustment. (Paragraph 306)

46. We urge the Government to establish at the outset of negotiations a clear strategy for a future transitional agreement, with specific proposals to what form it should take. (Paragraph 307)

47. We welcome the Prime Minister's commitment to a phased implementation of Brexit. We note, however, that this commitment is conditional upon the UK and EU agreeing a FTA within the two years provided for in Article 50 TEU. This is inherently ambitious, and there has been no indication so far that the EU is willing to contemplate such a truncated negotiation. (Paragraph 308)

48. We are concerned that the introduction of a new IT system for customs—planned for the year that the UK leaves the EU—may add to the complexity of the trading conditions facing businesses in the wake of Brexit. We urge HMRC to ensure that the system is robust and fully tested before it is rolled out, to prevent further disruption to businesses. (Paragraph 309)

49. We welcome the Government's commitment to report to Parliament on the cost of new infrastructure and of additional staffing at customs posts. (Paragraph 310)

50. We welcome the Government's efforts to increase the promotion of UK trade overseas. We ask the Government to confirm that it is confident it has sufficient commercial staff in UK embassies overseas to promote the UK's trade interests, in particular in comparison to the staffing of the embassies of other European countries. (Paragraph 311)

APPENDIX 1: LIST OF MEMBERS AND DECLARATIONS OF INTEREST

Members

Baroness Armstrong of Hill Top
Lord Balfe
Baroness Brown of Cambridge
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

Part-owner of a property in Spain

Lord Balfe

Chairman, European Parliament Members Pension Fund

Vice President, European Parliament Former Members Association (FMA)

In receipt of a pension from the European Parliament

One of this Member's ISAs has a registrable investment in pharmaceuticals

Baroness Brown of Cambridge

Chair, The Sir Henry Royce Institute for Advance Materials (a national research institute centred at Manchester University)

Chair, STEM Learning Ltd (not for profit company delivering teacher CPD in maths and sciences)

Non-Executive Director, The Green Investment Bank

Non-Executive Director, The Offshore Renewable Energy Catapult

Shareholder in Rolls-Royce plc, BP plc and Lloyds Banking Group

Vice Chair, The UK Committee on Climate Change

Former employee of Rolls-Royce plc

Husband is Engineering Director of the Institution of Mechanical Engineers

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

Chairman, Arab British Chamber of Commerce (Trade and Investment in the Arab Middle East)

Non-Executive Director, Manchester Airport Group (Open Skies)

International Consultant, DLA Piper (Trade, investment and government affairs)

Chairman, Saudi British Joint Business Council (Trade and Investment in KSA)

Lord Triesman

Executive Director, Group Board, Salamanca Group Holdings Merchant Bank

Advisory Board Member, Joule Africa

Baroness Verma (Chairman)

No relevant interests declared

European Union Select Committee

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

Baroness Armstrong of Hill Top
Lord Boswell of Aynho (Chairman)
Baroness Browning
Baroness Falkner of Margravine
Lord Green of Hustierpoint
Lord Jay of Ewelme
Earl of Kinnoull
Lord Liddle
Baroness Prashar
Lord Selkirk of Douglas
Baroness Suttie
Lord Trees
Lord Teverson
Baroness Verma
Lord Whitty
Baroness Wilcox
Lord Woolmer of Leeds

During consideration of the report the following Members declared an interest:

Lord Boswell of Aynho

Family farming interests as declared in the Register of Member's Interests

Lord Green of Hustierpoint

President, Institute of Export (IoE); and member of informal advisory group on Brexit and trade, convened by the CEO of the Engineering Employers' Federation (EEF)

Earl of Kinnoull

In receipt of CAP payments both personally and as a trustee of the Blair Charitable Trust

Lord Selkirk of Douglas

Diversified investment portfolio in McInroy & Wood Income Fund managed by third party

Lord Teverson
Director, KCS Trade Print Limited

A full list of Members' interests can be found in the Register of Lords Interests: http://www.parliament.uk/mps-lords-and-offices/standards-and-interests/register-of-lords-interests/

Dr Holger Hestermeyer acted as a Specialist Adviser for this inquiry and declared no relevant interests.

APPENDIX 2: LIST OF WITNESSES

Evidence is published online at www.parliament.uk/brexit-trade-goods 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

*	Dr Virginia Acha, Executive Director of Research, Medical and Innovation, Association of the British Pharmaceutical Industry	QQ 1–17
*	Mr Steve Elliott, Chief Executive Officer, Chemical Industries Association	QQ 1–17
*	Mr Fergus McReynolds, Director of EU Affairs, EEF—The Manufacturers' Organisation	QQ 18–34
**	Mr James Selka, Chief Executive Officer, Manufacturing Technologies Association	QQ 18–34
*	Professor Tim Lang, Founder, Centre for Food Policy, City, University of London	QQ 35–47
*	Mr Peter Hardwick, Head of Exports, Agriculture and Horticulture Development Board	QQ 35–47
**	Mr Chris Hunt, Director General, UK Petroleum Industry Association	QQ 48–63
*	Mr Michael Tholen, Director of Upstream Policy, Oil and Gas UK	QQ 48–63
*	Mr Mike Hawes, Chief Executive Officer, Society of Motor Manufacturers and Traders	QQ 64–84
*	Mr Simon Whalley, Head of External Affairs, Royal Aeronautical Society	QQ 85–95
**	Mr Paul Everitt, Chief Executive Officer, ADS Group	QQ 85–95
*	Mr Koji Tsuruoka, Ambassador of Japan to the United Kingdom	QQ 96–105
*	Lord Price CVO, Minister of State for Trade Policy, Department for International Trade	QQ 106–128

*	Lord Bridges of Headley MBE, Parliamentary Under Secretary of State, Department for Exiting the European Union	QQ 106–128

Alphabetical list of all witnesses

*	Dr Virginia Acha, Executive Director of Research, Medical and Innovation, Association of the British Pharmaceutical Industry (QQ 1–17)	
	ADS Group	FTG0028
	Agra Europe	FTG0005
	Agricultural Industries Confederation	FTG0006
	Agriculture and Horticulture Development Board	FTG0007
	The Association of Manufacturers of Domestic Appliances	FTG0002
**	Lord Bridges of Headley MBE, Parliamentary Under Secretary of State, Department for Exiting the European Union (QQ 106–128)	FTG0027
	British Food Importers and Distributors Association	FTG0011
	Chemical Industries Association	FTG0003
	Deloitte LLP	FTG0004
	Department for International Trade	FTG0022
		FTG0025
*	Mr Steve Elliott, Chief Executive Officer, Chemical Industries Association (QQ 1–17)	
**	Mr Paul Everitt, Chief Executive Officer, ADS Group (QQ 85–95)	FTG0016
	Food and Drink Federation	FTG0021
	Global Counsel	FTG0023
*	Mr Peter Hardwick, Head of Exports, Agriculture and Horticulture Development Board (QQ 35–47)	
*	Mr Mike Hawes, Chief Executive Officer, Society of Motor Manufacturers and Traders (QQ 64–84)	
	Professor Raphael Heffron, Jean Monnet Professor in Energy and Natural Resources Law and Policy, Queen Mary, University of London	FTG0019
	HM Revenue and Customs	FTG0010
		FTG0024
	Dr Peter Holmes, Reader in Economics, University of Sussex	FTG0026
**	Mr Chris Hunt, Director General, UK Petroleum Industry Association (QQ 48–63)	FTG0020

*	Professor Tim Lang, Founder, Centre for Food Policy, City, University of London (QQ 35–47)	
*	Fergus McReynolds, Director of EU Affairs, EEF—The Manufacturers' Organisation (QQ 18–34)	
	Meggitt PLC	FTG0017
	National Franchised Dealers Association	FTG0012
	Norton Rose Fulbright LLP	FTG0018
**	Lord Price CVO, Minister of State for Trade Policy, Department for International Trade (QQ 106–128)	FTG0027
**	Mr James Selka, Chief Executive Officer, Manufacturing Technologies Association (QQ 18–34)	FTG0015
*	Society of Motor Manufacturers and Traders Limited	FTG0009
*	Mr Michael Tholen, Director of Upstream Policy, Oil and Gas UK (QQ 48–63)	
	Tobacco Manufacturers' Association	FTG0008
*	Mr Koji Tsuruoka, Ambassador of Japan to the United Kingdom (QQ 96–105)	
	Professor Peter Wells, Professor of Business and Sustainability, Cardiff Business School	FTG0013
*	Mr Simon Whalley, Head of External Affairs, Royal Aeronautical Society (QQ 85–95)	

APPENDIX 3: GLOSSARY

ACP countries	African, Caribbean and Pacific countries.
AEO	Authorised Economic Operator. The UK is part of the EU's AEO concept, based on internationally recognised standards, which aims to enhance international supply chain security and to facilitate legitimate trade.
CDS	Customs Declarations Services system. A new customs system being developed by the Government, to be introduced in 2019.
CETA	Comprehensive Economic and Trade Agreement between the EU and Canada.
CHIEF	Customs Handling of Import and Export Freight; this is the UK customs declaration system.
CJEU	Court of Justice of the European Union.
Common External Tariff	This refers to the tariffs imposed on all goods imported into the EU's customs union from third countries.
Customs union	The EU's customs union means that there are no customs duties at internal borders between EU Member States, the application of the Common External Tariff on imports from non-EU countries, and common rules of origin for products from non-EU countries.
DExEU	Department for Exiting the European Union.
DIT	Department for International Trade.
EEA	European Economic Area, covering all those party to the EEA agreement: all EU Member States and Norway, Liechtenstein and Iceland.
EFTA	European Free Trade Association This consists of a free trade area between the EFTA states (Norway, Liechtenstein, Iceland and Switzerland). EFTA conducts FTA negotiations on behalf of its members. For those members party to the EEA Agreement, it also provides the basis for the EFTA Surveillance Authority and the EFTA Court.
EU Directive	An EU Directive is a legal act of the EU that is binding as to the result to be achieved upon each Member State to which it is addressed, but needs to be transposed by the Member State into national law.

EU Regulation	An EU Regulation is binding in its entirety and directly applicable in all EU countries from the date of its entry into force. It can be invoked in Member States without the need to be transposed.
FTA	Free Trade Agreement.
GATS	The General Agreement on Trade in Services of the WTO.
GATT	The General Agreement on Tariffs and Trade of the WTO.
Great Repeal Bill	It will repeal the European Communities Act 1972, which makes EU law part of the UK legal system, and will convert existing EU law into domestic law, wherever practical.
GSP	Generalised System of Preferences. The GSP allows developed countries to offer non-reciprocal preferential treatment to products originating in developing countries.
GVA	Gross value added. GVA measures the contribution to an economy of an individual producer, industry, sector or region.
Harmonisation of standards	The process of creating common regulatory standards across countries.
Inward Processing Relief	An EU scheme that permits relief from the payment of import duties and other charges for certain goods brought into the EU, in order to enable those goods to be used for manufacturing, processing or repair before they are re-exported.
LDCs	Least Developed Countries.
MFN	Most favoured nation. At the WTO, members have to offer all other members the same level of market access (including tariffs) unless they have agreed a FTA, entered into a customs union or fall under another exemption.
Multilateral agreement	WTO agreements which all WTO members have to sign.
Mutual recognition	The principle according to which countries that have so agreed allow a product legally sold in one country to be sold in the other as well, recognising each other's approval of products even though the standards the countries use are not harmonised.
NAFTA	North American Free Trade Agreement (between Canada, the US and Mexico).

NTB	Non-tariff barriers. This refers to all barriers to trade other than tariffs including quotas, rules of origin, embargoes, sanctions and regulatory restrictions.
Plurilateral agreement	WTO agreements that are not, and do not have to be, signed and ratified by all WTO members.
Primary commodities	These include raw materials, such as oil and metals, and unprocessed food (agriculture and fish).
Rules of origin	The criteria used to determine the country of origin for a product, for example to identify what tariff should be imposed on an imported good.
Schedules of concessions	These detail a WTO member's specific commitments on tariffs and on some other restrictions to trade at the WTO.
Single Market	The Single Market refers to the market which exists between the EU's Member States. It consists of the free movement of goods, people, services and capital through harmonised rules interpreted by the Court of Justice of the European Union.
Tariffs	Levies imposed by a state on goods when they enter or leave a customs territory.
TEU	Treaty on European Union.
TRQs	Tariff Rate Quotas. Allow a customs territory to impose a lower tariff rate up to a quantitative limit, and then a higher tariff for imports after that limit has been reached.
WTO	The World Trade Organisation.