HOUSE OF LORDS

Select Committee on the European Union

External Affairs Sub-Committee

Corrected oral evidence: Brexit: customs arrangements

Thursday 17 May 2018

10.05 am

Watch the meeting

Members present: Baroness Verma (Chairman); Lord Dubs; Lord Horam; Earl of Oxford and Asquith; Baroness Suttie; Lord Triesman.

Evidence Session No. 2 | Heard in Public | Questions 15 – 33

Witnesses

I: Chris Walker, Policy Chair for Trade, Federation of Small Businesses; Neil Warwick, Brexit Policy Chair, Federation of Small Businesses.

Examination of witnesses

Chris Walker and Neil Warwick.

Q15 **The Chairman:** Good morning. Thank you very much for coming in this morning. This evidence session is part of the Committee's Brexit customs arrangements inquiry. The evidence session is in public and is being broadcast. It will be transcribed and we will send you the transcripts so that you may make any corrections that you wish to after the session. We often ask witnesses for a few opening remarks about themselves. Then we shall go into questions, which you have seen beforehand. I always say to witnesses that we cannot guarantee that members of the Committee will follow the questions—they may have come up with their own—but we will see how we go. Mr Walker, would you like to open up with a few remarks?

Chris Walker: I will give some background on myself. I am policy chair for the Department of International Trade policy unit at the Federation of Small Businesses. I have had that role for around 18 months. As a policy chair I also run my own business, which coats things with diamond to make them hard and wear-resistant. We export to 22 different countries worldwide. We are a start-up business with a technology that we have patented and applied to various different sectors, including oil and gas, aerospace and the chemical processing industries.

Neil Warwick: I am a partner at a law firm called Square One Law. We set up seven years ago. Our main office is in Newcastle. We have a secondary office in Teesside and an associated office in Brussels. I am the national portfolio policy chair for Brexit for the FSB and my day job is specialising in EU competition law.

Q16 **The Chairman:** I may ask you to speak just a little louder; it would be useful for us to be able to hear all your words. Mr Walker, could you provide us with an overview of the importance of trade, including supply chains, with the EU for small businesses in the UK? How many of your members trade with non-EU countries?

Chris Walker: We have recently done two surveys, one specifically on export destinations and the second survey on Brexit. According to our surveys, 20% of our members are currently exporters. That fluctuates; probably about 5% are lost every year and 5% begin to be exporters. Of that 20% of exporters, 20% export exclusively to the EU and approximately 90% of those also import from the EU.

Neil Warwick: As Chris said, we carried out extensive research last year and are about to refresh that research, particularly on customs, this year. The surveys last year indicated that the EU is the largest trading partner for the small firms. Nine out of 10 exporting small businesses trade with the EU: the actual statistics were 92% of exporters and 85% of importers. As Chris said, one in five exporting small firms trades exclusively with the EU. The figures indicate that only about 16% of businesses are in a supply chain but, anecdotally from my own business practice, that is because some of the smaller and micro businesses do not recognise that they are in a supply chain. When they are in the fourth or fifth year of supply, they do not realise that their goods could be exported.

Q17 **The Chairman:** From your surveys, you have concluded that a reasonably good percentage of small businesses are trading with the EU. Have you been able to collate their concerns about the sort of issues that they are forecasting? The questions later on will draw that out a little more but I am talking about an overview of the survey, where the questions that you are asking will be pinpointing those issues.

Chris Walker: I can answer that in general terms. The main concerns are uncertainty and the burden of any administrative changes that will be necessary to continue to work with the EU.

Neil Warwick: The statistics in the survey—I caveat this with the fact that the survey was carried out last September, which is why we are doing the refresh this year—were almost 50:50 between tariff barriers and non-tariff barriers. As time has progressed, certainly from what I have seen from working with companies, they may not express their bigger concern as non-tariff barriers; as Chris said, it is the lack of certainty and the administrative burden. In many cases, exporting to the EU has been very easy. Basically, they do not know what they do not know.

The Chairman: We may come back to some of these questions later.

Q18 **Lord Dubs:** You mentioned administrative work. How much of the administrative work when trading with non-EU countries is handled by small businesses themselves and how much is outsourced to, for example, freight forwarders, customs brokers or whoever?

Chris Walker: Let us take an example. Currently when we are exporting something to the EU we do not have to send any commercial documents to the EU, but if we are exporting to the USA we have to send six copies of the commercial invoice. All the information on the commercial invoice—the certificate of origin, the information about the goods, the tariff code classification—has to come from the small business. While small businesses tend to use other people to support them in non-core activities, nevertheless most of this information would have to be supplied by the small business itself. That means work for the small business, and any queries are directed back to that business.

Lord Dubs: And the outsourcing of that work? Does it not happen very much?

Chris Walker: You cannot outsource it. The only outsourcing that you can do is to use a freight forwarder, and the freight forwarder relies on information supplied by the small business. A freight forwarder is just an intermediary who collects information from one side and collates it with information from the other.

Q19 **Lord Horam:** What is your definition of a small business?

Neil Warwick: There is a distinction between small and micro businesses and SMEs such as Chris's business. Our work survey indicates that small businesses, so five employees or fewer—

Lord Horam: Five?

Neil Warwick: Five employees or fewer is legally classed as a micro business. At that scale, exporting for those businesses could mean DHL or Amazon. It is a simple process.

Lord Horam: But in your organisation you have companies that have more employees than five.

Chris Walker: The FSB has 160,000 members, around 20% of which turn over more than £5 million. The rest of them are below that.

Lord Horam: Right. Would they have 10 or 15 employees or 20?

Chris Walker: Yes.

Lord Horam: That sort of number.

Chris Walker: Yes.

Lord Horam: But once they get, say, over 50 or 100, they become a medium-sized company and therefore outside your remit.

Chris Walker: We do not have a definition of an SME. We rely on the EU definition of a small business.

Lord Horam: Which is what? How does the EU define a small business?

Neil Warwick: It is 249 employees or fewer with a balance sheet of €50 million or less.

Q20 **Lord Horam:** That is useful to know. You are aware of the debate going on inside the Government about the various sorts of customs union and so forth. Apart from certainty, which I understand is a big issue—getting a clear view quickly—what are you really looking for from the Government? What would be your preferred solution?

Chris Walker: We are looking for a solution that provides a small business with the minimum amount of administrative burden and ensures that it has the maximum possibility of developing export sales.

Lord Horam: Yes. At the moment, clearly most of your members do not export very much. Only a tiny proportion export and, when they do so, they export only to the EU.

Chris Walker: No, that is not exactly true: 20% of our members export.

Lord Horam: That is a small proportion, yes.

Chris Walker: Well, government figures show 10%. So a larger proportion of the FSB membership export than according to the government figures from DIT. It is a small proportion of businesses, but there are aspirations to grow exports. We should not only consider protecting the existing export situation; we should also look at growing exports in future.

Q21 **Lord Horam:** Do you think there is a capacity and a desire to grow exports in the small business world?

Chris Walker: Yes.

Lord Horam: Do you have any evidence of how much they have grown over the last few years? Is that something that you could let us have?

Chris Walker: There is a demographic of small businesses. Some small businesses are local businesses that have local customers and perhaps do not have the aspiration to grow rapidly or internationally, but there is an underswell of ambitious small businesses that are looking to grow their business and a part of that is export. We are looking to encourage that.

Q22 **Lord Horam:** How much of a role does government play—the Department for International Trade, for example—in helping those small businesses to export? Does it play a big role or is there no connection between the two?

Neil Warwick: There is a connection but the services and support that DIT offers are better tailored to larger-scale businesses, to be perfectly honest.

Lord Horam: So when the Government talk about new trade agreements, which they are very keen to have, they do not really interest your members because that is largely for medium-sized or large companies.

Chris Walker: No, no. The trade agreements affect all businesses that are doing international trade, so it is in our interests to have as open barriers as possible with as many countries as possible. Non-tariff trade barriers and other barriers inhibit the ability for small and indeed all businesses to do business with other countries. Free trade agreements are of interest nationally across the whole business portfolio.

Q23 **The Earl of Oxford and Asquith:** I have a supplementary question. You will be well aware of the two options that the Government have proposed for future partnership on customs with the EU. From what I understand, you say that 20% of your members are exporters, of which 20% are exclusively to the EU—that is, let us say, 4%. What kind of demands, requests or proposals are they putting to you on the Government's two options? What do they prefer? This will be a small proportion of your membership but an important one.

Chris Walker: The two options have only surfaced relatively recently so we had not had an opportunity to survey our members specifically on them. As I mentioned, though, a lot of small businesses are looking to streamline export and import as much as possible by reducing administration.

The Chairman: I think our difficulty with what you are saying is that you have known for a long time that these events were coming. The dates are there. If your surveys are not being carried out at least to gauge some sort of feedback from your members, whether they are small, medium-sized or micro businesses, are you not running out of time to be able to influence the Government?

Neil Warwick: We are about to refresh the survey, particularly in relation to customs. As Chris said, the two options have just come out very recently. The problem for some of our members is not necessarily about the options between the UK and the EU. The EU has 56 free trade agreements around the world that remove a lot of the administrative burden for small exporters. For example, one of our members is an engineering firm that imports and exports goods from within and outside the EU quite seamlessly because of those free trade arrangements. When they drop away, every time an import or export crosses a border our member will have to swear a customs declaration. That does not sound like too much of a burden until you realise that it costs a minimum of £20 to swear the declaration. If the good is worth £5, what is the point in our member doing that?

The Chairman: Exactly. I think the Committee is keen to draw from you how the membership feels. The dates and the workarounds for the customs arrangements have been out in the public domain since August last year. We are now approaching June. It has been some time.

Q24 **Lord Triesman:** May I supplement the question being asked? I can see that the two options that have been floated are relatively recent. Have you put any options to the Government that you think would meet your needs, aside from those two options?

Neil Warwick: No, we have not put any options to the Government. Throughout the whole debate the FSB's policy has been to remain neutral and not comment on what we would see as political issues. We use the surveys and the information to inform the Government, but we are thorough and rigorous about the surveys so it takes quite a lot of time to gather this information from such a large membership and put the information forward to the Government.

Lord Triesman: I think we might be at cross-purposes, probably because I did not ask the question accurately enough. I am not asking whether you wanted to make a political point at all but whether you have a model that you might have said, as an organisation in the sense of advocacy, would be the best way for you to conduct your business, as business practice.

Chris Walker: I was a speaker at a conference recently. I was the SME representative. There were 10 other speakers from large companies representing people from ports, pharmaceutical companies and so on. Each presented 10 or 15 slides showing that they had maybe 10 people on a committee or reference group from their company looking at scenario planning for their business. Small businesses with up to 50 people cannot dedicate the resources to spend a lot of time looking at and planning for different scenarios over which they have no influence.

Neil Warwick: I have done work outside the FSB, particularly in relation to the north-east of England, which is the only net exporting region of the country. We were touching on supply chains, particularly just-in-time supply chains for engineering and manufacturing. We contacted over 150 companies, from the brand manufacturers right through the supply chain. The idea was to find out how many had a Brexit contingency plan and how far forward they were. The result was that not one single company has a plan because the uncertainty is too great for them to do anything other than scenario-plan or add risk registers together.

Q25 **Baroness Suttie:** Obviously you have said that you have not looked into or resurveyed based on the two options that the Government are putting forward. In terms of the FSB's own analysis, have you looked at what the cost implications for UK small businesses will be under the two options currently on the table?

Chris Walker: We are speculating, aren't we? It is terribly uncertain. One option is supposed to be streamlined, electronic and very sophisticated, and the other is another route forward. The only thing we can say is that both options presently appear to increase the administrative burden on business.

Baroness Suttie: So you think preparedness is quite difficult for small and medium-sized businesses because they do not have enough details about the two options.

Neil Warwick: It is also quite difficult because supply chains in particular are very dependent on their purchasers. A lot of our members will be third-tier and fourth-tier suppliers in a supply chain. They cannot do very much until the first-tier or second-tier suppliers tell them what they are doing, and they are waiting for the brands. There is anecdotal evidence in one or two industry sectors that the kneejerk reaction from the brands is to tell the first-tier suppliers to increase stockholding by 25%, which causes problems of cash flow, logistics and storage. However, the fear factor within the supply chain is an interruption or delay. Some of these supply chains are dependent on eight hours. There can be plant closure if there is any delay within that chain.

Chris Walker: I can underline that. At the conference that I attended and presented at, the largest first-tier suppliers were planning for the immediate changeover, whatever the scenario might be, that they build up a stock of material in order to cover the intermediate situation. That will have a knock-on effect for people lower down the supply chain.

Q26 **Baroness Suttie:** When you speak to your members, what is their take on the technological option? How do they feel about that option?

Chris Walker: What is the technological option? Tell me about it. Tell me the details.

Baroness Suttie: Is that the view that you are getting from them? Other people that we have spoken to, including colleagues who are in business, believe that it is possible that things are moving and that within the next five or seven years the technological option would be possible.

Chris Walker: We want a technological option that reduces the administrative burden. You have on your question list the AEO, for example, which I will talk about later on, or I can talk about it now if you want. The internet offers a host of technological options, but if your technological option is to download the questionnaire with 17 pages that you have to fill in, it does not really help, does it?

Q27 **The Chairman:** What we are getting from you is that there is a big vacuum of information. In the meantime, your membership will be asking how they are going to manage those exposure risks. There must be something within your organisation or at least some preparedness on how to manage these exposures and the forecasted risk of what you see at this moment in time, given that there is not a lot of information for you to draw from.

Chris Walker: Are you talking about how the FSB as an organisation is advising its members to manage risk?

Neil Warwick: It is very complicated and very difficult. Take the example of Chris and me: I am service sector, he is manufacturing. The answers, risk mitigation and contingencies that we would take are completely different. You could make some generic suggestions to both of our areas of business that would be utterly useless to food and drink or agriculture. It really is about the uncertainty, the vacuum and, to be honest, from a business organisation perspective, the risk factor. As a responsible organisation, we cannot put out generic advice that would work for a manufacturing firm but would be pretty bad for someone who was in a supermarket supply chain.

Chris Walker: The only thing we are saying is that they have to think about the situation and factor it into their risk analysis. Unfortunately, though, in lots of small businesses people spend more time working in the business than on the business—that is, on the risk factors, risk mitigation and business factors. If businesses have ISO 9000, which is a quality standard, they are encouraged to do risk management, but if they are struggling with their cash flow they are not going to spending time planning for Brexit, with two scenarios that are completely undetailed, versus getting their customers or their suppliers to pay them so that they can pay their employees and suppliers at the end of the month.

Q28 **Lord Triesman:** I completely get those points. Is there any other source that your members tell you they are drawing on for advice? Are there bankers trying to identify and price risk? Are the accountants trying to do it? You will all have bankers and accountants.

Neil Warwick: The big four accountancy firms all have big policy teams that are completely focused on large-scale businesses.

Lord Triesman: And charge you a fortune for doing that.

Neil Warwick: Yes, and they get consultancy fees for that. The banks are not coming up with any solutions or products because the obvious solution for a number of businesses is to move their treasury function to mainland Europe. It would be a risk factor for the banks to try to come up with anything other than standard advice, so at the minute the consultants—I would probably put myself in that category—are making fees out of advising companies on a case-by-case basis. However, that is very much being kept under the radar because no one wants to appear to be profiteering from Brexit.

Lord Triesman: I can quite see why people would not want to do that. I suppose I am trying to see whether there are any broad discussions that your members are describing that they are having with people whose job it is to price risk.

Neil Warwick: I would say no. The membership organisations are working together. We work closely with the CBI, the British Chambers of Commerce and so on. Each one has a bit of a piecemeal solution. We have members that have Brexit assessment tools, while the chamber has hired a number of ex-HMRC people to help with authorised economic operator status. So there are little piecemeal solutions around but there is no one-stop shop for this.

Q29 **Baroness Suttie:** How do you think your members feel about the potential extended transition period, because a solution on the customs issue is not currently coming forward? On the news this morning they were talking about perhaps extending further the transition period. How do you think members of the FSB would feel about that?

Chris Walker: If it offered a further period of relative stability, I think they would be in favour of it.

Neil Warwick: But the unintended consequence might be that it looks as though the can is being kicked further down the road. My worry would be that, if we extended the transition period, I can see a number of clients saying, "Oh well, we don't have to do anything until next year or the year after", which is just delaying the risk.

Q30 **Lord Horam:** There has been a lot of complaint from medium-sized and even large companies about the Government's unwillingness to consult. As you were rightly saying, we have learnt about two alternatives quite late in the day. Have the Government at any stage consulted the FSB? Are you involved in any formal discussions with the Government? How have those gone, from your point of view?

Neil Warwick: I start with the caveat that Chris and I are not involved in every discussion. The Government have been very open. I would think that between the national portfolio chairs, particularly Mike Cherry and Martin McTague, we have probably had a consultation with the Government of some kind almost on a weekly basis.

Lord Horam: That is good. With senior Ministers or civil servants? How does it work?

Chris Walker: It works at all different levels. There is a sub-committee that we are involved with, with the main five membership organisations being consulted, I believe, every month. That is with the senior Minister.

Lord Horam: So from your point of view there has been a reasonable level of consultation and they are listening to you.

Chris Walker: Yes.

Neil Warwick: Yes.

Q31 **Lord Horam:** Mr Walker, you mentioned authorised economic operators and so forth. About 500 are currently registered. Presumably those are medium-sized or large companies rather than your own members. Is that right?

Neil Warwick: Yes, that is a fair statement. Chris has some good anecdotal evidence about trying to apply for this but it is also worth noting that, while 500 are registered in this country, 5,000 are registered in Germany.

Lord Horam: Right, but is this a feasible option for reducing your costs post Brexit?

Chris Walker: In our business, we receive parts from overseas. We have to import them temporarily, we coat them with diamond to make them hard and wear-resistant and then we send them back. All of that happens within a month at most because customers usually cannot wait for these parts to arrive. We are at the end of the supply chain. We are dealing with big blue-chip companies such as Baker Hughes. One instance last year was that the customer decided to send us some parts and declared them at the sale value of the parts because of an administrative error. That was $120,000 worth of parts coming to the UK. Fortunately, I intercepted the paperwork before it arrived with us and was able to advise them that they had declared it at the wrong value, but if I had not then my business would have been liable to tie up around $30,000—£20,000—of cash flow for three months or more while HMRC hung on to my VAT. We do that on a quite regular basis. You can suspend that temporarily, but you can do that only 10 times. We looked at the AEO. As part of the AEO you have to submit six pieces of evidence. The application form is two pages long and the self-assessment is 17 pages.

Lord Horam: To be accredited?

Chris Walker: Yes. When I got to the bit where it said that you had to put your house up for any liabilities for VAT, I just stopped applying. It is not a process that I believe is useful. There are only 500 in this country because it is such an administrative burden and a liability. We are not encouraging people by making it easy to do that. If we encouraged people by making it easier to do, more people might be exporting.

Lord Horam: So this is something that the Government should pay attention to. They should make it a lot easier.

Chris Walker: Yes. That is our general message regarding existing arrangements and any future arrangements as we leave the EU.

Lord Horam: Do you think the Government understand that point? A 17-page dossier is a lot to ask.

Neil Warwick: That is only one piece of the evidence. As Chris said, there are six pieces of evidence. The form, which is standard across Europe, is two pages long. The evidence base to get this status in the UK would probably run to about a lever arch file for a small business.

Lord Horam: Is this something that the Government should attend to?

Chris Walker: Yes.

Neil Warwick: Streamlining the process for applying in this country would be an easy fix.

Chris Walker: But you need to get the civil servants to tell the Government what is really going on.

Lord Horam: Yes. That is a good idea. Do you think it is different in Germany, and that is why they have 5,000?

Neil Warwick: We could not possibly comment but it is an interesting statistic.

Chris Walker: I suspect that in countries like Germany and the Netherlands exporting is a default. In other words, when you set up a business you automatically think about exporting and importing. In this country we have tended to rely on our own home market quite a lot for business.

Q32 **The Earl of Oxford and Asquith:** Your businesses must be quite well acquainted with the current customs systems of CHIEF. Do they have any comments or reactions to the proposed new customs declaration service, or CDS, systems that have been proposed?

Neil Warwick: A general comment that we have had back from all the businesses in the FSB that export is that CHIEF is okay and it works, but it is a little bit clunky. They are okay with that. There is a general nervousness about the new system. Anecdotally, there is always nervousness about bringing in new IT systems, whether in your own business or for the Government. Our members know that the system has been delayed twice, which sends a bit of a signal and makes people nervous. The general comment that we have had more recently is that there is a suspicion that the delay was down to capacity issues with the new system. When we exit the EU, that capacity will almost double overnight. So if we have capacity problems before it has been launched, what reassurances can we have that that will be addressed when we leave the EU?

The Earl of Oxford and Asquith: But since, as I understand it, most of your members are in fact geared towards non-EU markets in terms of exports, will this change affect them just as fundamentally for their non-EU export market?

Neil Warwick: Again, it is worth making the distinction that there are two non-EU export markets. There are those that are covered by free trade arrangements with the EU and those that are not. For the members who are sophisticated enough to know that, there is a real concern about customs declarations to countries that they have not previously had to do that with.

Chris Walker: Our concern is that the companies in our membership organisation that export only to the EU will cease exporting or perhaps be completely put off it because of the administrative burden, the additional work that they need to do and the lack of knowledge about and experience of having exported to non-EU countries before.

Q33 **The Chairman:** When you sit in your regular meetings with government civil servants and Ministers, obviously you are laying out these issues quite clearly. Do you feel that the response you are getting from the Government in preparing your members for Brexit is—I would not say "sophisticated enough"—easy enough for your members to be able to absorb in time for Brexit?

Neil Warwick: At the current pace, the blunt answer is no. The interface that I have had personally on behalf of the FSB with senior civil servants has been very good and useful, but I think they themselves would admit that they are still in information-gathering mode. Some of this is quite complicated. Some very good people have joined the main departments who are listening and want to find solutions. To be perfectly honest, I am not sure how connected the departments are between each other or how connected the civil servants are to the Ministers.

The Chairman: That has given us quite a lot to think about. Do colleagues have any other questions? After this session, we will probably have more questions to ask. I thank you both for coming in. I reiterate that if there are any errors in the transcript that you would like corrected, please let us know. You have given us an insight into how much more needs to be done and we look forward to any other pieces of information that you would like us to see. During the process, given that you are doing surveys on a regular basis, we would like to see what their outcomes are. It would be helpful to the Committee to be able to gauge progress on your behalf.

Chris Walker: To whom should those be addressed?

The Chairman: If you address them to our clerks, they will be able to distribute them to all of us. Thank you very much for coming in.