



Select Committee on the European Union

EU External Affairs Sub-Committee

Corrected oral evidence: Brexit: customs arrangements

Thursday 24 May 2018

10.05 am

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Members present: Baroness Verma (Chairman); Baroness Armstrong of Hill Top; Baroness Brown of Cambridge; Lord Horam; Lord Risby; Lord Triesman.

Evidence Session No. 3

Heard in Public

Questions 34 - 48

Witnesses

I: Andrew Meaney, Head of Transport Team, Oxera Consulting LLP; Stephen Adams, Senior Director, Global Counsel; Dr Lars Karlsson, President, KGH Border Services and Managing Director, KGH Global Consulting.

Examination of witnesses

Andrew Meaney, Stephen Adams and Lars Karlsson.

Lord Horam took the Chair.

Q34 The Chairman: Welcome to all three of you and thank you for coming in. As you know, this is a public session and it is on the record. We will send you a transcript, and if anything looks dodgy or wrong, or you want to correct anything, there is every opportunity of doing so.

Baroness Verma, the Chairman, is not here at the moment but she will be coming in shortly. In the meantime, I am chairing the meeting. After having welcomed you, we will go to our first question of which you have a record.

The so-called “max fac”—it is not a deodorant or a beauty product—is the maximum facilitation option, which is one of three government proposals, including the fallback option. It is a technologically oriented solution. Dr Karlsson, you have gone into this. You are not the only pebble on the beach, but this is one of the technological solutions.

Would this eliminate border customs arrangements and make it completely seamless, or not?

Dr Lars Karlsson: Thank you for the question and for the honour and privilege to be here addressing you and this Committee today. It could. It depends, of course, on different scenarios, where the security is and how you handle that border.

However, we are not only talking about technology here but about changing the operational model and how trade operates. I also made it clear in my report for the European Parliament that you need to have some trust-based system—a system base controlling play—to make that happen. It is not only technology at the border; it is how you engage the private sector together with government in a different type of set-up.

The Chairman: That is a cultural change for the private sector.

Dr Lars Karlsson: It is a change for the private sector.

The Chairman: With costs attached, no doubt.

Dr Lars Karlsson: There will be costs attached to any of these options, I am sure. The interesting thing is that, when you leave a customs territory, from an international customs law perspective three things need to happen. You need to know that you are exporting some kind of goods from the territory and what those goods are; you need to know when they are entering the next territory; and you need to know when that happens. That is where the customs physical border comes into play.

Of course, you do not have to do those formalities at the border. If you have a risk-based system where all the stakeholders are known and risk has already been handled, you can do that before and after. That is really the essence of my suggestion. You only need to identify that this is what

happens at the border. That can be done with full trust—that you trust the entire supply chain. Then there will be no more infrastructure at the border than already exists today.

If you need a little more trust between the two parties, you might have to have some kind of identifier at the border. That could be the type of technology that I have described in my report. That is a matter of negotiation between the two, but in principle you could have this system in place. I have to stress that it is not only technology; the private sector has to be engaged with the Government to do some of this work beforehand and afterwards.

Those systems are already in the international standards and international customs law for all economic operators. Here we are looking at a much wider and broader system for the UK and whether it could be a solution for the border issue.

The Chairman: Mr Adams, what is your comment on the Government's general proposition of maximum facilitation?

Stephen Adams: It is important to recognise that the maximum facilitation proposal presumes the existence of a relatively conventional customs frontier. The challenge is defining the technology that makes the existence of that frontier and the legal obligations that go along with it—the processing of trade and the obligation to seek clearance for goods moving in and out of the market—as simple, low cost and frictionless, in the jargon, for traders as possible.

The maximum facilitation proposals are fundamentally different from, say, the customs partnership proposals in assuming a relatively conventional model of a third-country border and then focusing on how you make that work as simply as possible. The big conceptual leap is in the customs partnership idea, which essentially tries to find a way to make that border—the legal line and the duties that go with it—disappear.

Andrew Meaney: I agree with Mr Adams. The challenge here on maximum facilitation, particularly when we are trying to understand the costs and benefits of the alternative models, certainly as HMRC said yesterday, is that it is expecting this to cost in the region of £17 billion to £20 billion per year. That is the cost for business and for government. Ultimately, we know that that either flows down to taxpayers, if it is a government scheme, or to consumers if it is a cost to the private sector.

The question of how you make that border work is fundamentally important. We have 2.5 million lorries a year going through the Port of Dover. That is over 300 an hour. Can you make these technological solutions work on the basis of that throughput, which we need to keep fluid in order to make the supply chains work?

Q35 **The Chairman:** We were in Felixstowe the other day, and they were rather rubbing their hands, as a matter of fact. They thought Dover

would be very congested as a result of all this, and that they, Southampton and other ports would get lots of extra business. Would that make sense? There is a congestion problem at Dover, but if you look around other ports there is not.

Andrew Meaney: It depends on how supply chains and logistics companies respond to pressure on the ro-ro ports. One option is to put things into containers, in which case Felixstowe and Southampton might benefit. Another option is if you can start to move logistics on to an unaccompanied instead of an accompanied basis. You drive the lorry up to the port, the driver gets out, the container is taken across the water, and then it is picked up by a logistics company on the other side. That is another way of doing this.

All this requires the logistics chains to change. It requires the assets and the infrastructure to be changed. It requires people to know what is required of them in order to make those investment decisions and those changes.

It is also worth bearing in mind that, with about a third of our trading goods going through Eurotunnel and the Port of Dover, it is very difficult to see all that suddenly shifting to Felixstowe and Southampton except at the margins.

Q36 **Baroness Brown of Cambridge:** My question is initially directed to Dr Karlsson, but I am very happy if others also have comments on it. There are several parts to it, but I will give you them all at once.

The first question, Dr Karlsson, is this. We have heard from the Swiss and Norwegian border authorities. They certainly do not seem to be implementing something that looks like the maximum facilitation option. Indeed, the Norwegians said that they thought they were probably at least five years away from having that kind of technology solution.

I would be interested in your specific comments on why they are not doing this or moving towards this, and your estimate of how long you think it would take to get to the stage where we were able to implement those technological solutions with the infrastructure and the software.

Given that there are things like enhanced drivers' licences, these are potentially not just things that we would have to change in the UK. Presumably, we need global standards for these things. Are those in place, or is negotiation also needed to move that forward?

I am sorry the question was rather long, but the floor is yours now.

Dr Lars Karlsson: I will try not to be too long in answering, because I could be. The first question is a very good one. I addressed it a little in my report. Where are the best examples in the world, and how could they contribute to the environment that we are looking at here?

There are two things you need to keep in mind. One is that it is a legacy border that is there. It was not created out of a situation where a border actually occurred. Of course, there are IT legacy systems involved that

have been there for 20 or 25 years, and there are a number of other things.

However, there was a clear ambition at these two borders, as examples, to do the maximum that you could do within the international framework and laws available there. There were tests going way further than what is there right now. For three or four years, with European Union support, we operated something that was very close to what we are looking at for this situation here with maximum facilitation.

On the other hand, when it was discussed whether that should be rolled out or not, there was a business case for that. That border managed the situation very well at that time. I was asked by my Minister of Finance at the time, when I was leading this work, whether we could do it faster. We said, "Yes, of course". We tested it so that we could do it frictionless. "We will go down from three minutes' release time to zero, 15 seconds or five seconds". He said, "What will it cost?", and I gave him the number. He said, "Why would I do that?" Was anybody from the private sector asking for this at the time? No, they were not.

It is all about the situation you are in, what it costs to do it and what the alternative is. Of course, in the future I am absolutely convinced that they will go further, and that will be based on the business case in those specific cases.

Having said that, there are lessons to be learned. The model behind technology that is not fully updated is the one that could be used in basically all these options on the table here right now. That means moving away from the border. Doing the formalities in international trade agreements, customs agreements or government agreements with other countries is demanding.

The answer to your first question is that there was a legacy there, which also makes it more difficult to move to a perfect situation or as close to a perfect situation as possible. That has not been fulfilled for those borders yet.

How long does it take to do that in a situation like this? It depends on how you design these two options on the table right now. That also comes down to the cost. You are asking what the cost would be and how you can do that. Again, as I heard in the testimony of Jon Thompson from HMRC yesterday, if you have the maximum facilitation alternative there will be customs declarations, but you can negotiate what those customs declarations would be. Would they be the traditional ones, or could they be simplified? Simplified ones will be cheaper and faster to implement than the original ones.

The same goes for the new customs partnership. Depending on how rigid or how complicated it is for business to do a drawback on money, that will have an impact on how fast you can get it into business and what the costs would be.

Both these alternatives need a more rigorous and wider type of registration system for businesses. Risk management can be done before, again moving away from the border issues.

I am sorry to take time here, but I also need to say that there has been a lot of focus on duties, duty collection and all that. That goes to the customs union and free trade agreements. We should not underestimate the issues with non-tariff barriers—the customs procedures that are there for other reasons. That needs to be solved for all these models as well. That is why there needs to be this broader trusted-trader programme that I am talking about, which would also include logistics companies and traders, which we heard my colleagues talking about, so that you can move away and do pre-checks on that, which is not so costly.

We know for a fact that you can operate programmes such as those in other countries that have modern programmes—not the AEO programme that the European Union and the UK have today, but the ones we see in Australia, Brazil and other countries that have done it recently—both for the private sector and the Government, with 25% of today's costs. There are gains from that. That can probably be done in two to three years. That is my estimation for having a system such as that up and running.

As to your final question, there are standards there to do basically all the things I set out in my report.

Baroness Brown of Cambridge: I feel that you have given me a technologist's answer.

Dr Lars Karlsson: Yes. That is why I am here.

Baroness Brown of Cambridge: From a technologist's point of view it could be done in two or three years, but you mentioned all sorts of things, such as negotiation, agreements and behaviours, which technologists are usually not very good at controlling or predicting. Do you not think that they would add to the timescale?

Dr Lars Karlsson: Throughout the time since I did my presentation for the European Parliament and all these environments here, I am glad to be answering questions about technology. So many others have viewpoints on the policies and the politics of it.

Of course, our experience is that things that are in line with international standards are faster to negotiate than those that are not. Technical agreements between customs administrations go faster than political agreements on trade, for instance. Free trade agreements take longer than technical agreements between AEO programmes for customs, for instance. There are ways of cutting the timeframe for negotiation if you bring a system into place that the other side knows about, although it may not utilise it to the same degree as the UK would have to, but then it would be easier for them to recognise it and negotiate it. However, I have tried to stay out of the political dimension.

Q37 **Baroness Armstrong of Hill Top:** You have been answering my

question as we are going on. I wondered whether there was anything else you wanted to say about the feasibility, taking Baroness Brown's question into account. The UK has not yet started to model or develop what it wants to do. Would it not also take the EU to change some of their processes and so on in order to facilitate the "max fac"?

Stephen Adams: The simple answer to all those questions is yes. Elaborating on what Lars has just said in answer to your question about why we seem to hit a point at which optimisation tails off, there is an important lesson in there for essentially the way optimisation works in supply chains.

The reality is that supply chains optimise around time, physical infrastructure and the facts on the ground. Once those facts on the ground get down to half an hour, 10 minutes or five minutes, and once they get down to an established piece of physical infrastructure such as a toll plaza or a customs plaza, businesses are generally relatively happy to work with that. The marginal costs of removing those final frictional barriers start to fall off in the mind of a policymaker.

Of course, the problem for the UK is that we are not dealing with frictional costs that are already in the price. The latency at the Northern Ireland crossing is zero. Anything new now is an additional frictional cost on the price. That will innately challenge us to go further than the Swiss, the Norwegians and the Swedes have had to go to this point.

A big problem we have at the moment with coming to meaningful conclusions about the technology is that the political exam question has not been properly set. We have terms such as hard border and physical infrastructure in the December agreement. We have ambiguous definitions of those, but not ones that a technologist such as Lars can use to tell us what is feasible or not. Lars's report in November was excellent, but it was immediately overtaken essentially by a moving of the political goalposts, which said that a hard border can mean no physical infrastructure—no cameras. No cameras? Unless we really understand what that means, it is very difficult for the technologists to get to work on the problem.

You quite rightly make the point that this is not something that the UK can do autonomously. A border is like a tango—it takes two. The reality is that, while we will be negotiating elements of that with the EU, the EU does not negotiate process efficiency at its borders except at the highest levels of generally "best endeavours" commitments. Where there is efficiency at the EU's borders, it is because customs authorities on both sides of those borders have worked well together.

This is of course the key insight into what is special about the Swedish-Norwegian border. I will be corrected if I am wrong, but it has a long-standing tradition of interoperability, co-operation between officials and optimisations of the systems to work together. That is what we are going to need to create in Ireland, but we cannot do that until Dublin and London agree on the question. We cannot do that until Dublin and London

have essentially been given a mandate to go away and work on the technical solutions.

I agree with Lars that, when we reach that point, that will move a lot faster than a negotiation. That is not a negotiation; it is a collaboration on technological solutions. But you cannot do that until a political mandate is there to go away, agree on the problem and solve it together.

Andrew Meaney: Following on from both my co-contributors, I would say that there is going to be a cost of change. We have to put in physical or non-physical software-based infrastructure at the various UK borders, including the one with the Republic of Ireland under this particular model, whatever that looks like.

Remember that at the moment the supply chains are across the UK's borders with other EU member states. All of that supply chain has to learn the new rules. They have to hire and train people. The people manning the borders, whether physical or not, have to be trained. Yesterday HMRC was talking about hiring 5,000 people under either of the models. There is going to be that cost of change.

When you have that border in place, I do not think you can guarantee that that border will always flow seamlessly. Stuff will happen for whatever reason. When you start putting that friction in place and uncertainty—"Will I be able to transit this border in two minutes or two hours?"—you start to think about changing logistics chains and adding time into those chains, or even thinking, "Why would we put this facility in the UK and not put it somewhere else?" It is these indirect costs that we need to consider as well as the direct cost of change.

Q38 Lord Risby: Have you noticed a slight change in language in the last day or two from frictionless trade to minimising friction? I think we know where we are going now, and it is not perhaps where some people thought we were going to be going, if I can put it like that.

I want to touch on this issue of differential tariffs. In a way, you have already gone into this. It is the idea of having a differential tariff on imports, depending on whether it is the EU and UK. It is very difficult to discern that in the absence of more substance, which is effectively what you have been saying. From the point of view of the Government and businesses, this would obviously involve substantial administrative tasks and burdens. As we have just heard, we have no clarity, but can you make some observations about this for the benefit of the Committee?

Andrew Meaney: This new customs partnership that you are effectively talking about here is the idea that you would have an EU tariff and then maybe a UK tariff with the country of origin for a particular good. Traders would claim back the difference in some way between the two.

There is an awful lot of effort potentially in saying, "I know that this good means that I can claim back this amount of money". It is clear that people will only bother to do that effectively if there is a really big difference between the UK tariff and the EU tariff.

The model takes away the need for a hard border, potentially, or indeed any border.

The other point to note is that you need to make sure that you have really strong relationships with the other EU member states, so that, when goods come in that then transit into the UK and then go out somewhere else, you know exactly what is coming into the UK and what is going out again. Of course, businesses need to adapt, particularly ones that are part of complex supply chains, where at the moment things are whizzing across the Channel in both directions. That potentially imposes an awful lot of cost on business in understanding the thing that has come from overseas, the thing that they are changing and sending back, and potentially getting back again. There is a set of things there that we need to bear in mind under this approach.

Stephen Adams: I would make two observations, if I may. There is a fiscal leakage problem. I do not see the EU agreeing to any version that did not essentially set the de facto assumption at all tariffs being remitted to Brussels and levied at the EU MFN or preferential level. The burden would essentially be on the UK to prove that a good had been placed on the UK single market. It would have to be placed on the UK retail single market. You would have to prove the point of consumption, otherwise the prospect of the good being moved into the single market remains a fraud risk for the EU.

Of course, you would assume that the EU would essentially refuse to co-operate with this system at its own ports. In relation to a good coming into Rotterdam and being moved into the UK, the EU would levy the tariff and keep it for itself. At the moment the UK remits its tariff revenue to the centre, and essentially this proposal would continue to do that. This is a lost new potential revenue, not a lost actual revenue in that sense.

I think we need to bear in mind that you would have to make a very delicate judgment about whether the fiscal loss was outweighed by the benefits of not imposing frictional costs on the supply chain.

The other point, which is related to this, relates essentially to the value of trade policy autonomy. If you accept that one of the advantages of leaving the customs union is the ability for the UK to set its own MFN tariff, and for the UK to negotiate preferential tariffs with third countries, a model such as the customs partnership potentially hobbles both those things. It makes it much harder, because traders would have to claim back the lower MFN tariff, and they are less likely to do that if it is burdensome on them. UK trading partners would have to accept that the benefits that we were proposing to give them in an FTA were contingent on UK importers seeking to claim back the margins they were negotiating. Inevitably, a UK trading partner is going to say "Well, that's a contingent benefit that you're offering me, and I'm offering you a real tariff cut at the border. You're trying to sell me a rebate system".

It is very hard to see that not turning into a big drop-off in the utilisation of UK preferential tariffs and probably a hindrance for the UK in negotiating free trade agreements on goods with third countries.

Q39 The Chairman: I see your point. The complexity arises from the fact that the UK may want to put its own tariffs on particular goods. If it decided not to do that but to accept the totality of the European Union tariff arrangements—

Stephen Adams: You are absolutely right. The complexity derives from the desire to leave the common external tariff. The customs partnership is an attempt to square the circle of an autonomous UK tariff policy and a frictionless, non-existent internal border with the EU.

The Chairman: But if it did accept total European Union tariffs and the single market regulations, et cetera, this would literally be a frictionless border.

Stephen Adams: And it would resemble being in the single market for goods.

The Chairman: To put the opposite argument, that is what the hard-line Brexiteers, if I may call them that, would call a vassal state, whereby you have no say what the tariff or regulation may be, but you have to accept them because you decided to do so and because you want a frictionless border.

Stephen Adams: It is very difficult to see how you can have a frictionless border while not being an EU member state without accepting that you are a regulatory satellite of the European Union.

Dr Lars Karlsson: I will make a few comments. I will keep it brief, because a lot has been said already. I think it is an innovative model. It is interesting to put an innovative model on the table. It has not been tested anywhere else.

There are issues that need to be solved, as my colleagues have said, to make it work. It is probably a lower cost overall than the alternative at the moment.

The Chairman: The figure of £700 million has been mentioned in the *Times* this morning.

Dr Lars Karlsson: There are a couple of other challenges. You need to solve the non-tariff barrier issue as well together with the European Union one way or another. There are a number of reasons why you have customs declarations; it is not only for customs duties and tariffs. So you need to solve that as well. Again, there will be some kind of system in place for that, if this would work or not. You should not underestimate that type of issue.

We know for a fact that non-tariff barriers, often for the private sector, are more difficult than tariff barriers. Tariffs are going down all around

the world when it comes to that. There is, however, still the complex issue of showing how this system would work. It becomes very complex very early, as was said, with the global value change we see today. Also, goods are coming in and they are split into different types of things. Some are exported again, and some are put into other types of products; they are manufactured again and so forth. Keeping track of that is a complex activity.

However, if HMRC or the Government could find a solution to that, there is an option to find a model that is new and innovative, and the European Union will have to accept that that has happened.

Q40 Lord Risby: You have made one point that I want to completely understand, because, if I understood what you said, it is absolutely crucial. It related to the impact on our ability to form trading relationships with other countries. Did you say something about that? That is at the heart of what this process is meant to be all about. I would just like some clarity on that.

Stephen Adams: I make a purely tactical point. If I was a trade negotiator, and the UK was seeking to negotiate a preferential trade agreement with me and was offering a tariff cut but was only able to offer that tariff cut in the form of a rebate system, and the third country in question was expected to table a tariff cut at the border that is easy to claim, those two things are not the same. One implies harder work for the importer than the other. I would say it is quite difficult to see those things being traded off in a trade negotiation without the UK essentially having to compensate for the fact that it is basing its preferential trade policy on a rebate system.

Lord Risby: This is absolutely key, so I am very glad that you have explained this, because it is at the heart of the whole debate about our capacity to have relationships with other countries that involve freer trade than exists under the umbrella of the European Union.

Stephen Adams: You would anticipate that what would happen would be a low level of what is called preference utilisation, which is essentially the scale of usage of the preferential tariffs that you negotiate. You would expect it to be lower than usual. Generally, it would become more difficult, problematic or burdensome for a UK importer to claim the negotiated preferential tariff rate. Therefore, they would not. They would simply absorb it and pay the EU tariff as they do now.

Andrew Meaney: It is not just the tariffs. It is the non-tariff barriers. It is the regulations. I think my fellow panellists would agree that under this model you are effectively also tied by EU regulations. It is quite difficult for you to imagine the famous chlorine-washed chicken coming in from the US, somehow us being able to track this, and for the EU to accept that there is a risk that this type of food product ends up somehow in the EU supply chain because of the way in which this model is working.

Baroness Verma resumed the Chair.

Q41 The Chairman: Listening to you, those two options are quite difficult for business. If businesses had to go for an option, in your consideration which option do you think UK businesses would choose, and why? If not those two options, in your view what do you think would be a proposed third option?

Lord Horam: We are asking for your judgment.

Stephen Adams: One of the challenges with thinking through these problems is that they basically force us to try to price against each other the immediate costs of disruption and the restructuring of current supply chains that are concrete against hypothetical benefits in the future. Businesses think generally about concrete costs now, quite understandably and quite rightly.

I would be very surprised if you found a British business trading with the single market that did not say that if you could make the customs partnership model work you should do it. Essentially, it sustains the status quo for moving goods across the frontier with the EU. A thoughtful business might think into the future and say, "That's going to make it harder for me to benefit from future UK FTAs, and it is going to make it harder for the UK to liberalise its MFN tariff in the inputs that I bring in from China. I bring in textiles from China at 15%, and it's going to make it harder for me to benefit from a possible cut in that".

As I say, generally speaking, it is the problem of trying to weigh up concrete, disruptive costs now against hypothetical future benefits. I think the answer in most cases would be skewed towards the concrete costs now, for understandable reasons.

Dr Lars Karlsson: Of course, it is right that we are in a situation where there are no borders. If new procedures are put in place, that is a cost, as Stephen said. We should look at what the best customs procedure in the world could bring to the country. If you put it in place to solve the issue with the European Union, you get a benefit from all the data, to which you referred.

As I said before, free trade agreements are great, and I am sure you will have many of those post Brexit, but they take time. Technical agreements are faster. There are a number of them that you can do very quickly. A very advanced process would give trade facilitation for all the goods going in and out of the UK, regardless of the tariffs and the situation on the duty side.

Looking at it as an opportunity has to be in the discussion, at least for me as a technician. At the end of the day, if I was asked to choose between those models and estimate which is best for the private sector, it would be very difficult to say, as my colleague said, but there is also a hybrid between them. Some companies would be able to adjust to a model such as the new customs partnership model as part of the benefit of a more traditional but very advanced border model.

Again, it is the best of the two together. That does not solve all the issues either, because it means that you have to have both in place. On the other hand, I have to say, having led a customs administration myself, that it is very difficult for a customs administrator to operate different operational models towards different trading partners. It is also extremely difficult over time.

There are a number of issues that need to be taken into account. Maybe it is a good idea that could be linked together into a hybrid model that takes care of both these issues.

Q42 The Chairman: I am quite sensitive to the fact that we talk about tariffs all the time. As you said, Dr Karlsson, we do not really have the debate about the non-tariff issues. That is a real worry for me, because, while we are talking about these options, where does the non-tariff discussion fit into making either or none of these options actually workable, whether in the long term or the short term? The costs are going to be phenomenal if you do not have real alignment.

Andrew Meaney: It is a policy choice as to how much regulatory divergence you decide to select. You could decide to keep matching EU regulations as they change over time, but the minute you decide that a particular decision that has been taken and legislated for by the EU is not to your liking, you have regulatory divergence and you have to be able to manage that as goods are coming in and going out of the EU. It is likely that that it will happen, but it will be a policy choice that you take at some point in the future.

If I can just follow on with the discussion between the two models, what I see all the time is business saying, "We do not have sufficient certainty in order to jump one way or the other. Why would we hire people today to fulfil one set of customs standards if it's going to be the other one? Why should I invest in a particular facility here in order to cope with volumes of lorries going through the Dover Straits when that might not be necessary?"

Most people will adapt to whatever model is ultimately put in front of them. Let us hope it is the cheapest cost for people and provides the greatest benefits. It seems vital to me to have a degree of certainty about what the model is going to be and to be able to get on with it, and to have some clarity about which regulations people are going to have to meet. Otherwise we will see people thinking, "Shall I invest in the UK? Shall I put this plant in the UK from outside? Actually, I don't know what the environment is going to be, so although the UK is great on a number of different levels, at the moment it's just not looking that attractive and I'm going to make that investment somewhere else". The quicker we make these decisions, the less likely it is that those things will happen.

Lord Horam: Do you think the need for a decision is more important than the choice that is eventually made?

Andrew Meaney: As long as the choice we eventually make is not so outrageous that it is imposing large costs on business for the foreseeable future, taking the decision is really important today.

Q43 **Lord Triesman:** I am very struck by the complexity that is embedded in each of these models and, I guess, in other models as well. It has made me reflect on one of the great industries of the United Kingdom historically, which is smuggling.

If I were to ask you the question the other way round when looking at these systems, and were you to plan it in a criminal way, which I know you would not, which of them gives you the greatest opportunity for criminality?

Dr Lars Karlsson: You are looking at me.

Lord Horam: You are a former customs officer.

Dr Lars Karlsson: Of course, it is extremely difficult to say. We know that cross-border international crime today is extremely organised. It very much does not obey borders; it is international. Different types of crime syndicates work together. It does not matter if you are a terrorist or a drug smuggler. You work very efficiently together because there is business to do.

That means, of course, that the Government need to do the same. Systems need to be related more to getting access to what is going on with pattern recognition. Working together with the private sector in different ways to minimise the risks is the only way to fight this type of international cross-border crime. We have known that for a fact for many years now.

It is getting better and better. We see it in some of the areas where we collect information in a more structured way. Air traffic is a typical one with the movement of passengers. Immigration issues related to security issues are another one.

There is still some way to go with goods. I see it as an opportunity, in either of these two models, when you have to have some kind of more advanced risk management system in place. You will also get access to more information. Working together with the private sector in a more trust-based way makes it possible to collect information that we do not have for intra-EU traffic today. It also makes it possible to fight international crime hiding in these traffic flows in a better way. You will get more access today and intelligence information. By the way, that is an asset for the UK in relation to a discussion with the European Union and other countries.

To answer your question, there is no such thing as zero risk. The problem is always that risk itself is not dangerous; it is only if you do not know about it. There is an element here of having to develop more work on the intelligence side than has been done before.

Again, as I say, you will have some kind of data information on what is going on. It is better than the intra-state data that we have today from a customs perspective in this new scenario, which can be of benefit in fighting crime.

Crime has been here for a long time. I have also been asked this question: would there not be more bootlegging or more smuggling over the Irish border and Dutch border? First of all, unfortunately there is already organised crime in our society. Secondly, if the tariffs are the same, there will not be more smuggling of that specific product. If the tariffs are different, there will be smuggling. That is easy. That is how the whole trade works.

Of course, it goes back to policy. Do you want to have different policies on duties when it comes to high-excise goods, for instance? There will be a risk for increased international crime to utilise that.

Andrew Meaney: There is a genuine question about enforcement, whether it is about paying duty or regulation. There is a policy choice about how much more enforcement we would do under either of these models, or indeed any model, compared with today. At the moment, there is risk-based, fairly limited enforcement. It is zero around customs and regulation across the UK's external borders with other member states.

There is a genuine question as to how much more enforcement we would want to do under the new arrangements, whatever they are. That enforcement, albeit risk based, will impose costs on people doing legitimate business, because their van or their lorry may be the one that gets pulled over, torn to pieces and then put back together before it is allowed to move on. The uncertainty about those delays and the degree of enforcement will impose genuine costs on the supply chains. How we design that and the choices we take around that is an important factor here.

Q44 **Lord Risby:** The question that I was about to ask has essentially been touched on. I want to ask a very specific question. You talked about a trusted trader arrangement, for example. Presumably a part of that would be a minimal bureaucracy situation, but they are likely to be large companies. Do you have any observations on the pressure of staff for smaller businesses in this kind of situation? Perhaps you could answer very quickly. I do not want to delay you on this.

Dr Lars Karlsson: Yes. Your programme in the UK, the AEO programme with the European Union, is 10 years old. It is a legacy system. It does not take these types of things into account. In the newer type of trusted trader programmes today there are different tiers. There are different levels and maturity models within these types of programmes. That includes SMEs or other types of industries that you would want to support in different ways. It means that you will have the minimum registration at the lower levels, such as a VAT-type of registration, while at the higher levels there will be more demands.

For a bigger business or something like that, you would need to reach those levels to be able to enter into international agreements at that specific level. That is what we call AEO today. Those are basically models that already exist.

Stephen Adams: There is one decision that is worth flagging on AEO. There is an established audit process for achieving AEO, and it generally requires a company already to be an exporter and/or importer and to have an audited customs profile. It is worth bearing in mind that, if we are proposing to put UK firms into trusted trader schemes, where they have only traded or dispatched and received from the single market, and they have no audit trail of imports and exports, we will need some proxy for that import/export pattern to use in order to audit them for this status.

Q45 **Baroness Brown of Cambridge:** You will have heard that we have a third option emerging at the moment. It is the time-limited goods arrangement, whereby we stay inside the EU common external tariff until we can put the new arrangements in place.

Stephen Adams, would I be putting words in your mouth if I said that that might allow us to negotiate FTAs during that period, but it would not allow us to implement them?

Stephen Adams: We probably need to be slightly careful when we refer to this as an alternative model. It feels more to me like a stopgap solution at the moment. It might hypothetically transform itself into an alternative model.

If I understand the Government's position correctly, they seem to envisage this essentially as an extension in a slightly stripped-down form of the transition model that was agreed in March. So it is the prolongation of the application of the *acquis* for goods and linked areas to the UK for a period of time long enough to enable a technological solution to be developed that meets the terms agreed in the December agreement of no hard border and no physical infrastructure.

Baroness Brown of Cambridge: You would assume that that implied common phytosanitary and sanitary standards and so on.

Stephen Adams: If you wanted to maintain the status quo for goods trade, it would have to involve the extension of the *acquis* for goods standards, the *acquis* for competition and the *acquis* for state aid—all the elements that the EU tends to see as integral to the integrity of the single market for goods.

Q46 **Baroness Brown of Cambridge:** Picking up on what Baroness Verma was pressing you on, we have heard about a possible hybrid model, but are there other models that the Government should be looking at?

Stephen Adams: There are a range of other possible outcomes. The one we have not really discussed, although it was referred to, is customs union, some variance of a shared external tariff with the EU. That obviously has certain benefits for internal cross-border trade with the EU.

It eliminates the need for origin requirements, which is quite important. It potentially enables an element of streamlining at the border. Obviously it comes at a price in trade policy autonomy and regulatory autonomy. We can expect the EU to build an element of regulatory union into a customs union, as it did with Turkey. That strikes me as the one other model to consider here.

Baroness Brown of Cambridge: Are there any others?

Andrew Meaney: There are no other models for me, but certainly an agreement that this is effectively an extension to a transition period. You will have heard HMRC talking about three to five years of elapsed time from when we know which model we are going to adopt. That pushes us to, say, 2024. That is in the middle of the next multi-annual financial framework for the EU, so potentially you are talking about up to 2027. If you are agreeing UK ongoing contributions to the EU budget for 2021 onwards, you are potentially talking about up to that point, to go along with all these other things that you are maintaining your linkages to.

It is probably a necessary stopgap so that we can get business to a point at which it knows what the new rules are and business can trade on that basis with EU member states. It is not a new model; it is a continuation of largely the status quo.

Q47 **Lord Triesman:** We were told that there are approximately 600 UK AEOs. We were told last week that the registration process is complicated and not wholly welcomed as a process. What do you see as the future role for AEOs in these kinds of scenarios? Would they alleviate administrative burdens elsewhere?

Dr Lars Karlsson: Absolutely. The description is right. As I said before, there is a reason. This is a system of compliance management. We are moving from transaction control to system-based controls and really utilising what companies are already doing. It is a 15 or 20 year-old international standard that is in place.

Today, we see much more modern programmes in other countries than the one that the European Union operates, which was one of the first ones, for the reason that we were early adopters when this type of system came into play.

There are benefits for the private sector in utilising a programme such as AEO. Today, many other countries around the world have programmes with bigger benefits for the private sector than exist even in the UK, which is one of the countries that has a lot of trade facilitation in place.

There is an opportunity here. What we are really talking about is a new type of trusted trader programme, which is much broader. There is an easier way to get in; there are lower cost thresholds to get into the programme. It is a maturity model. What is described as an AEO today may be at the highest level, but not the AEO highest level. It may be the highest level of those countries that have now implemented programmes

for the last two or three years. Again, that is totally different from the process that UK business sees today in the European Union programme.

If you meet the international standards requirements for that highest level in a two-year programme, you can still sign these international agreements getting benefits in other areas of the supply chain. That means that, if you are an AEO in the UK, you would also be one in China or Brazil and all the other markets, getting more benefits for the programme.

What I am really saying is that I believe it has to play a role in both these models, because that is the only way to get away from some of the non-tariff barriers that we talked about before. We have to move away from doing those formalities at the border, to doing them before and after in the natural process of the company itself, of course based on trust, which you have to prove. You can model a new AEO programme on top that is better than the European Union one based on best practices, doing things you know. It can have tiers under that for different types of companies, including SMEs, as we talked about before, with low thresholds and registration on the website.

Again, as Stephen said, we need to take into account in one way or another the 100,000-plus companies not in external trade today. For me, the big challenge is the capacity in both the Government and private sector to adopt either of these two new options, including a new trusted trader AEO programme.

Stephen Adams: It is worth reinforcing the point that Lars has just made about the shift conceptually from transaction-based controls to systems-based controls. It is absolutely crucial to reconceptualise the way this stuff is going to work around the idea that the best way to do it is essentially to use the credibility of the actors in the system to take the strain off the point of border crossing and transaction. You do that through pre-registration and using AEO essentially to allow self-certification and things like that.

We often see the low level of uptake of AEO in the UK as a failure, but you can see it from a slightly different perspective. People sign up for AEOs because of the margin of improvement from the baseline treatment. One of the reasons why you do not necessarily see the same levels in the UK as in, say, Germany is because the margin of improvement when you become an AEO is not necessarily that great.

My final point is about the long tail. The AEO system in the UK covers somewhere between 60% and 75% of goods imported and exported. That is great, and the Government will be inclined to see that as the key critical mass of trade that they want to protect, but we need to remember that in that 20% is a long tail of small traders and SMEs, firms that we want to encourage to sell cross-border and that need looking after. They do not necessarily have the capacity at the moment to get themselves into an AEO system, to maintain the audit trail or to go back every three years and do it again. We need to make sure that in focusing on the

critical mass of goods trade, which is understandable, we keep our eye on that long tail of smaller businesses as well and make sure they are getting the support they need.

Q48 Baroness Brown of Cambridge: I want to ask a very quick follow-up question. I thought I understood Dr Karlsson to say that we needed a different AEO programme, and one that would need to be agreed internationally and therefore for which companies might need to re-register. Is such an internationally agreed programme in place and we just need to sign up to it, or does that have to be agreed?

Dr Lars Karlsson: No, it is at the highest level where you can sign customs-to-customs agreements and where you will also have the same benefit as you have in the UK in other countries. That needs to be at that high level, meeting the standards. Under that, you could have different maturity levels that take care of that type of business.

Again, in relation to the Northern Ireland and Republic of Ireland situation or the EU, you can give benefits overall to the private sector, including SMEs. There are countries that have SME programmes in their AEO programmes as trusted traders, while only the ones that meet the higher requirement will have the international benefits as well.

Baroness Brown of Cambridge: But this would mean our companies transferring to a new system.

Dr Lars Karlsson: Yes. They would transfer in countries that have done it. Those that are already AEO will be placed on the highest level, because they have already met the criteria. Others could get a lower and less costly criteria to get in, depending on how you design the system. It could be designed to be very similar to VAT registration at the lowest levels to make SMEs a part of it. Then you can give them benefits to support export industries for SMEs.

Baroness Brown of Cambridge: But this needs a new system.

Dr Lars Karlsson: It is another type of programme that needs to be developed, where you embrace the AEO that already exists. Again, there are countries that are aiming for 90% of their traders to be in programmes such as that in other places. I think the UK could do that as well.

Lord Horam: Thank you very much. I am sorry, but we have to bring this session to a close. As you can see, it was very interesting from our point of view. Thank you for the clarity with which you helped us in this rather complicated area. It was really very helpful indeed. Thank you once again.