



Select Committee on the European Union

External Affairs Sub-Committee

Corrected oral evidence: Brexit: customs arrangements

Thursday 5 July 2018

10.05 am

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Members present: Baroness Verma (Chairman); Baroness Armstrong of Hill Top; Baroness Chalker of Wallasey; Lord Dubs; Lord Horam; Lord Risby; Lord Stirrup; Baroness Suttie.

Evidence Session No. 5

Heard in Public

Questions 65 - 80

Witnesses

I: Susan Morley, Director, Morley Consulting Training Limited; Joseph Owen, Associate Director, Institute for Government; Sam Lowe, Research Fellow, Centre for European Reform.

Examination of witnesses

Susan Morley, Joseph Owen and Sam Lowe.

- Q65 **The Chairman:** Good morning and thank you very much for coming in this morning, Mr Owen, Ms Morley and Mr Lowe. This is going to be broadcast; it is a public session. We all have your biographies, but if you wish to make any opening remarks, the Committee is always very happy to hear from you. The session is part of the Committee's Brexit customs arrangements inquiry. We will send you a transcript after the session, and if you wish to see any corrections made, we will be happy to make those for you.

You have had sight of the questions. I think they were given to you late last night, with things moving as they are. As I always say to people who come here to give evidence, I cannot always guarantee that the Committee will stick to the questions on the paper, so please be prepared. I will start by asking if you would like to make any opening remarks.

Joseph Owen: No.

Susan Morley: No, I am fine.

Sam Lowe: No.

- Q66 **The Chairman:** Thank you very much. If we may, we will go into our first question. In the last few days, it has emerged that the Prime Minister is proposing a third option to the Cabinet at Chequers tomorrow, which we now know is going to be called the facilitated customs arrangement. It appears to be a combination of the customs partnership and the max-fac option, offering the best of both worlds. Would you be able to share your initial thoughts on this, in particular on the technological element and the overall feasibility? Do you think the UK would be able to set up its own tariffs on goods and use technology to determine where goods would end up?

Joseph Owen: Given the level of information that is available, it is very difficult to work out exactly how this would work in practice, but when a proposal emerges, assuming it emerges in the White Paper next week, there are certainly some big tests that it will need to answer. There is obviously Ireland, which was one of the big challenges that the EU had with the maximum-facilitation proposal when it was put forward.

Then there is the challenge of how the UK intends to collect tariffs and the relationship with the EU in a dual tariff regime operating at the UK's border. The EU will be concerned to understand how a third party that is potentially outside its institutions will be able to collect its revenue. What will be the process for auditing that and ensuring that the UK is giving the correct money and collecting the right tariffs? What will be the relationship between the Commission and HMRC, and the role of EU auditors and OLAF, the organisation that they use for assessing borders?

There is a set of challenges that we will need to answer before we can test its negotiability, before we even get to the technical delivery of it.

On the technology that is required, in the very limited accurate information that is in the public realm, the word “technology” seems to be doing a lot of the work without any real sense of what that would be, so there need to be some concrete proposals backing this up, if and when it comes into the public realm.

The Chairman: I sense some slight pessimism from you that things will be in place.

Joseph Owen: It is hard to be optimistic on the basis of a few sentences that have made their way into the public realm. I would not necessarily say that I was pessimistic, but I am reserving judgment until there is more detail.

Susan Morley: The difficulty will be tracking the goods. You do not pay any duty now on goods imported to the UK under many different customs procedures, and you do not decide what to do with the goods until you have finished processing them, repairing them or whatever you brought them here for in the first place. Therefore, you do not know, when you bring them to the UK, where they will end up. That is one bonus from using those schemes.

You gain a duty liability at the border even under those special procedures, so which duty would you be liable for and how would it all be tracked? Under end use, for example, the goods come in and the trader systems track the use of the goods. That is audited by Customs and there is no duty or tax to pay at all. However, once in free circulation and in use, they can go anywhere.

Sam Lowe: I have been trying to think it through, because, as Joe said, the information is quite limited. I have tried to work out how I would do it. I agree completely with the tracking issue and the possibilities for fraud, essentially, that are built into it, but I have some other questions that go along with it.

From what I have heard, it will function like a rebate scheme, so it is cost neutral for business, because upon entry the EU tariff level is the one that applies. If the UK tariff post Brexit is lower, the business could choose to reclaim the duty paid. If it were to do so, it would have to take into account whether it was worth the admin time. As it stands, relative to now, it makes no difference to the cost.

I have questions about payment allocation and how you decide how much goes to the UK and how much goes to the EU. For that to work effectively, you would have to trace all the way through to see where it was finally sold. As we have heard, that is quite difficult. My assumption is that, at least to begin with—I assume that this technological solution would take quite a long time to come to fruition—the UK may just say, “We’ll continue to pay 80% of the tariff revenues collected to the EU in

the interim while keeping the 20% for admin costs”, if and until we can effectively trace to final sale all the goods imported. That is just a theory.

I then have questions about quota management. Assuming that we are in this customs partnership, we will still be a distinct entity and we will still have taken on our obligations at the WTO as to existing quota shares. There are also quotas in different trade agreements, so we would have to work with the EU to manage those quotas. Otherwise, you could have a situation where the EU has hit its limit on a tariff rate quota for, say, lamb coming in at a preferential rate, but the UK has not. If you were the exporter from, say, New Zealand, it could just be funnelled through the UK, and once it was in free circulation it could go into the EU. So there is a problem there.

I also see a bit of an issue when it comes to anti-dumping or trade defence instruments. As the UK, we would have to do our own investigations and determine whether harm had been caused to our industry. We could have to levy different rates on, say, imported Chinese steel, or no tariffs at all. How do you control for that if, once the UK has imported this steel and it is in free circulation, and there are no checks at the border, it could then funnel into the EU? I ask these questions, because if I were the EU these are questions I would ask about a customs partnership arrangement prior to agreeing it.

The Chairman: I am not sure I agree with you that it would be cost neutral to business, because ultimately there will be a cost somewhere, whether that is when it is returned or otherwise. The cash flows for smaller businesses in particular will be where there is a cost to business.

Sam Lowe: The argument is that it is cost neutral relative to now, because in the worst-case scenario your imports would just be levied with the EU tariff. That is the argument. I am not saying that I buy into it fully, because there are costs somewhere, but that is the argument, so the benefit of a lower UK tariff would function as a bonus. If you worked out that the admin cost was worth the rebate, you might want to take advantage of it.

The Chairman: Yes, in those particular scenarios.

Sam Lowe: In those particular scenarios, yes.

Q67 **Lord Horam:** There are a lot of questions, as you say. One further question is how long this might take to get into place. We are talking about a wholly new, untried scheme. As we know, the implementation/transitional period is thought to be likely to end in 2020. That is what we have negotiated so far, although other reports in the press have suggested that it might take longer than that to implement this kind of scheme. Do you have any thoughts about how long it might take to get this in place?

Joseph Owen: Again, I would make the point that it is very difficult to put a timeframe on a technology system with unspecified requirements, but if you take the precedent of customs systems in the UK, the current

system that is in the middle of being implemented, the customs declaration service, which we were doing before Brexit and will still need post Brexit, started in 2013. It was originally planned for introduction in 2020, so there is a seven-year cycle. I think it is fair to say that it seems less complex—it is certainly less unprecedented—than some of the technology that the Government are alluding to.

Even before 2013 when the CDS programme started, the UK Government had been trying to upgrade the CHIEF system, which is the legacy system that they are building on. That had been in place since 1989. Towards the back end of the noughties, they started to look at how they would upgrade this system. They set up a programme, I think in 2009, and by 2013 they decided it was difficult—

Lord Horam: Are the Government therefore trying to do two things at once: to introduce a new digital system and this new arrangement?

Joseph Owen: The current plan is for the CDS system to be live by March next year, so by the time we have an internal agreement on our preferred customs system and then a negotiated outcome it will be some time beyond when the CDS system is implemented. Jon Thompson has said about timelines that he felt that the new customs partnership would take about five years, but that is five years from the point at which the requirements are set.

Lord Horam: Is that five years from March next year?

Joseph Owen: That is assuming that we have negotiated the detail of our future customs arrangement by March next year, and we know that the EU's anticipation is that future relationship negotiations do not begin until March next year, so the details could not be agreed until the back end—

Lord Horam: We are talking about possibly seven or eight years.

Joseph Owen: From this point now, possibly, yes. Some work can be done up front, where the UK can say, "We know we'll need to do this regardless of the detail that is agreed with the EU". It is not as if everything has to wait, but there are some things to do with customs systems where the details of what is agreed will really matter, such as interfaces with EU systems and the level of data sharing. It is very difficult to say that it will be five years from this point when we have yet to agree the preferred option, let alone having agreement with the EU on how it will work and starting to spec up the systems.

Susan Morley: I do not disagree that there are system and technological issues, but whether it is CHIEF or CDS, if you decide that there will be a new custom procedure, such as goods coming to the UK that are going to get a different tariff because they are going to the EU, if that is the supposition, that simply has a new code. Codes are invented and changed all the time, for both CDS and CHIEF. You could say, "We're going to call this new process 'the EU process', and you'll use a customs

procedure code of X when you're doing this". That is all you need to do: switch a code. Then you can import through the CDS system or the CHIEF system.

As for how you would track the goods after that, you might leave it to the traders' systems, as you do with many of the special procedures now, whereby traders are supposed to know what they are doing with the goods they have and to keep records thereof, and they can be audited afterwards, which is how it works today.

While new technology might be wanted for some things, if you are asking whether we could decide to apply a different tariff for a different process, it involves not much more than changing a code or two. There is plenty of scope for lots and lots of codes in the new CDS system. They are already trialling it and it should go live for some imports in August. So, it will run up to Christmas for imports as a live system, and all you would need is more code.

Sam Lowe: That is entirely true, but to go back to the first question on fraud, the problem is that tariff duties and import tariffs are not necessarily levied because we want to collect revenue. If you are a developing country they might be, but if you are a developed country, that is not usually the main reason for levying those tariffs; it is to protect domestic industry from outside competition.

Say someone imports a car part into the UK on the basis that after Brexit the UK has a lower tariff than the EU. They import it into a warehouse and claim back the lower tariff, because it is then sold on to a UK manufacturer who puts it into a car, and it is then sold around the rest of the EU. The EU's problem, if you do not have a process that can effectively trace through to end sale, is that the UK car industry then has a competitive advantage over the EU car industry. The whole idea of being in a customs union and essentially forgoing rules of origin is to ensure that that does not happen.

While I completely agree that you could do it at the border just by asking traders to be honest, even if they are being honest they are saying, "We imported it and we sold it to a UK manufacturer, so we can claim back that rebate", but the lower cost is passed through to the manufacturer, who then benefits from that and is selling across Europe. Without an effective tracking mechanism, it is difficult to see how the EU could go with it. At the moment, it is difficult to see what that effective tracking mechanism would look like.

Q68 Lord Stirrup: I would like to understand the scale of the problem. I see the problem, but how big a problem is it? Presumably, there would be various audit mechanisms set up to check these things—to check that people were applying them properly and all the rest of it. Even assuming that some people are trying to pull a fast one, is this a mammoth defrauding of the EU or is it much more of a peripheral problem? One of the dangers of this is that we argue about what is clearly a technical risk, but we do not know the impact of that risk and therefore quite how much

attention and resource should be allocated to it.

Susan Morley: If you do not change the UK duties significantly from the EU ones today, there is less incentive, whereas if you change particular ones—perhaps you feel that food or clothing, which are high tariffs from outside the EU, might benefit from a reduction—you are creating a situation that could lead to fraud. It just depends on how many current tariffs you decide to alter.

Lord Stirrup: I am just trying to understand this. If the system that is implemented requires people to apply for a rebate, the onus is on them to say, "I sold these things on to somebody else within the UK, so I should get 5% of this back". They are providing an evidentiary trail that can be audited.

Susan Morley: Yes.

Lord Stirrup: Presumably some resource will be allocated to auditing that. There will be a risk associated with people who are trying to take advantage of the system, and I am not clear in my own mind whether we are making a mountain out of a molehill or whether it really is a mountain.

Susan Morley: Trade flows will adapt, because if the duty here were higher than in the EU, they would ship directly to the EU. They would change their supply chain. Why would they not do that? If the duty here is lower, you are drawing more cargo here, but a lot of the cargo that is currently imported to the UK, probably most of it in fact, is used in the UK. You are in a way penalising those importers in a drawback situation where you get a rebate, because they could pay the right duty, which would be the lower UK duty, at the border, but you are asking them to pay more and then claim it back, which has a cash-flow implication and an administrative cost.

Lord Stirrup: That is the situation they are in now.

Susan Morley: Now you would pay the duty into the UK, which is the same as the EU, and that is the end of it.

Lord Stirrup: As Mr Lowe said, they are getting a bonus, because they are paying that duty now. In future, they would pay the same duty, but they would be able to claim some of it back.

Susan Morley: Possibly, but there is an administrative cost to doing that. The current rebate systems for reclaiming duty if you have overpaid by accident, for example, are slow and not exactly difficult, but they are cumbersome.

Q69 **The Chairman:** Do you therefore think that we have enough resource? Are the Government looking at what will be required in human resourcing, as well as the training and skilling up that will be required to implement all the extra burdens that there will be?

Susan Morley: I do not think that has been thought of yet. It has been suggested, but people have not actually done anything about it yet, because we do not know which way we are going. We also have to remember that big car manufacturers probably have a department of customs specialists who can be on top of it. They have an ERP system, which will probably help them. Small and medium companies, which are all importing and exporting, and have done since the internet came into being, have no idea. They have no one who actually understands customs now. They rely entirely on agents and freight agents, rightly or wrongly, and may or may not get it right by doing so, but they are relying on others. They do not even really know that they are doing customs work.

Sam Lowe: To go back to the first question, which is whether we are making a mountain out of a molehill, my assumption would be that, in the medium term, tariff levels post Brexit will remain the same as the EU's. We know that they certainly will throughout the transition. My assumption is that the transition will be extended, either via an extension of the transition or an implementation phase, simply because, if we are using the entirety of the transition to negotiate a future relationship, we are going to need some time to implement it. While everything remains the same, there is not that much scope for fraud, because there is no differential to take advantage of.

Afterwards, it is dependent on what the UK decides to do. Do we negotiate lots of trade agreements? Are we successful in doing so? Do we unilaterally decide to reduce tariffs in certain areas? Once you have the answer to that question, you can start to judge how valuable trying to defraud the EU in this case would be.

Joseph Owen: On the scale of the risk, my understanding is that it would affect supply chains that involve goods coming from international trade into the UK and then on to the EU. It would not affect SMEs trading with the EU that trade with Berlin as if it is Birmingham. Those are not necessarily the issues. It affects largely the bigger, more global supply chains.

I am not sure what the value or volume of that trade would be if you tried to isolate it. It is true that a considerable percentage would probably have authorised economic operator status, just because, as part of those global value chains, there is probably more benefit to them than to other organisations in doing that. That is your risky subsection. As I said, I do not know the value of that or the volume of trade.

The other element of the risk relates to the pure negotiability and whether the EU is willing to accept that level of risk. There is one question about practicality and cost of the risk operating, but there is another question: whether you can get the EU to swallow that risk. We might be prepared to, but they might not.

On the resourcing question, if you are looking specifically at HMRC and its capacity to carry these things out, my understanding is that HMRC is looking to have hired around 5,000 additional staff by the autumn of this

year, but those plans are largely predicated on no deal. A lot of that staffing is about managing preparations for additional customs declarations being required. They are not looking at the specialised auditing that could be necessary in a new customs partnership or facilitated customs arrangement scenario. There is definitely a resourcing question when it comes to deciding the new model for the Government.

As Susan said, the resource necessary in business to allow these things to operate is another question that I am sure we will get on to.

Q70 Baroness Suttie: I would want a little more detail on the two previous options. What elements of those two previous options, as we understand them, should be included in the third option of a customs arrangement?

Susan Morley: I tend to take a view on what has happened to customs over the years and what will happen in the future. It is a certainty, never mind Brexit or anything else, that in five or 10 years' time what we think of today as a customs declaration and the need for a customs declaration will be gone, because it will be all about technology, data flow and risk management. It will almost be untouched by human hand, because it is data flow. Imagine how the internet has changed things in such a short space of time. Customs systems are going that way, and there is no reason to think that they would not go that way.

If the end result, be it five or 10 years from now, is that we are looking at data, data flow and risk analysis of data as the way we do things, quite naturally and normally, we do not want to be building in processes and procedures that take us backwards. It is about the use of technology for assessing a customs risk, collecting the data needed to make that assessment and, as importantly, the data for all the other things that go on at the border, because customs is just a tiny part of what happens at the border. The delaying factors are the other issues, with inspections for food and things like that.

As for joining all that together, I know that the Government have now set up a committee, the border delivery group, which is doing great things with joining up what we have today. Take that all forward five to 10 years. We are going to have systems in place. It will probably be an app on somebody's phone, which is all you have to do. We do not really want to put clunky, difficult mechanisms in. We want to go forward with what technology we have in the short term, use what we have, use what we can have quickly in the short term and progress it to the end result, not seeing Brexit as the only thing that is happening.

Sam Lowe: Maximum facilitation, if you understood it properly and acknowledged that it just does not deal with Northern Ireland, got a slightly unfair representative when it was announced, because essentially it accepts that there is going to be friction and [the UK] will try to mitigate it, via technology and new programmes. That is what every country in the world does. If we have a standard free trade agreement with the EU, that is what both parties will try to do.

Then you get to Susan's point that over time there will be new technology and new schemes, and you can agree things that really reduce that friction, but they do not necessarily erase that friction. In fact, they are very unlikely to erase friction at the border, because customs is such a small part of what causes the additional friction. Max fac is fine so long as you accept that, if you have a whole-UK approach, you will have physical infrastructure in Northern Ireland.

Baroness Suttie: By that, you mean CCTV cameras, et cetera.

Sam Lowe: You would need something like that. If we were not part of the EU's SPS regime, we would have to have veterinary border inspection posts on the border, a scheme behind the border or an all-Ireland scheme. I am not sure. You could try to work it out. It is when you talk about food safety that you really start to hit some of the big issues at the border.

Max fac is fine so long as your working assumption is that you are going to have a free trade agreement, because you have accepted that there is going to be friction. A customs partnership is essentially a customs union with the option to diverge, as a clever means of still being able to have a fully independent trade policy. In and of itself, a customs union would be great in that it would remove the need for rules of origin requirements, so essentially it makes tariff-free trade with the rest of the EU unconditional. In a free trade agreement, it is conditional on meeting the origin thresholds, or demonstrating that you have substantially changed the product, or that it is wholly originating. That is all it really does at a border.

A customs union in and of itself does next to nothing. It reduces the admin cost on businesses and makes it easier for them to take advantage of zero tariffs, but beyond that you would still have to be talking about a lot of the max-fac type stuff to deal with the friction. You would have to be talking about regulatory alignment to get rid of, say, the need for veterinary border inspection posts and the like. There are things to be gained from looking at these different options, but I am not sure they are as distinct as is often made out.

Joseph Owen: I disagree with Sam on the distinction between the two. With max fac, the focus is the UK-EU border and facilitations to try to remove the administrative burden and the need for checks at the UK-EU border. The Irish border is obviously sensitive. If you take Dover and Calais, it is about trying to limit the need for checks either side of that. The customs partnership is about looking at what you can do at the other border, the border with international trade, to avoid the need to have anything at that UK-EU border.

If you look at the facilitation and co-operation that is part of any customs arrangement, it happens at the UK-EU border under max fac, whereas on a customs partnership they are looking to co-operate at, say, Southampton rather than Dover for goods coming in from the rest of the

world, so that there is no need for any checks at Dover, if that makes sense.

Sam Lowe: I completely agree with that. My point is simply that a customs partnership would not be enough to remove the need for checks at Dover. If, from a regulatory perspective, you were not to remain in the single market for goods, say, you would still have to have some of the max-fac elements to reduce that friction further.

Q71 **Lord Stirrup:** How would all this impact for example on car manufacturers' supply chains that are simply going backwards and forwards across the border between the UK and what will be the EU after we leave it?

Sam Lowe: To take the customs partnership as a baseline, which I am going to assume just means "customs union" for now, so assuming we have not diverged yet, it removes the need to demonstrate origin. Origin comes with two issues.

One is the cost of demonstrating origin. The documentation itself is not necessarily that expensive, but the administrative cost, if you are a car manufacturer meeting a 55% threshold of local content in a free trade agreement with the EU, is put at between 2% and 6% of the value of your export. It varies product by product; there is a range. You have that additional cost, so the first thing you have to decide is whether that additional cost is worth gaining the tariff preference. In the case of the car industry, on final products it is about 10%. With a cost of 2% to 6% of compliance with rules of origin, maybe it is still worth doing it, because you have saved your buyer 4% on the value.

The second issue is demonstrating that you can meet any requirement, and this is where the British car industry has quite a big problem, in so far as, if we were in a trade agreement scenario with the EU, even with max fac, we would have to meet a local value-added threshold of, say, 55%. That is what it is with EU-Korea. It is sometimes 60%, but let us assume that it is on the lower end.

The problem for the UK car industry is that 42% of the value of a UK car is produced in the UK. It is actually lower than that, because I think that percentage was estimated on the basis of parts sourced within the UK, but they could have come from elsewhere. The car industry's problem is then that it will not qualify for the zero tariff preference on the basis of a free trade agreement. If you are in a customs partnership/customs union, that is not a problem, so you can just continue to take advantage of the zero rate back and forth without ever having to qualify. That is the benefit of a customs union/customs partnership.

Lord Stirrup: It obviously does not work with max fac.

Sam Lowe: No. Max fac absent customs union is a free trade agreement with measures in place to reduce friction, but none of those measures could reduce the need to demonstrate origin. What could reduce the need to demonstrate origin is an agreement to lower the threshold between

the EU and the UK, or something to that effect. It is very unlikely that the EU is going to do so. It has already a set of thresholds agreed beyond the European Union, and that is really the only game in town.

Joseph Owen: On the supply chain impact in relation to costs, let us look at max fac, because there is more information on it. There are still only five paragraphs in the public realm on the customs partnership. The first is context and the last is a caveat, so it is quite difficult to say exactly what the impact would be, although I will come on to what Jon Thompson has been saying about it from an HMRC perspective.

For max fac, there are two potential cost impacts for supply chains. The first is frictional cost, by which I mean not friction at the border but just the cost of transactions. The other is the potential transformational cost. Under frictional cost, you just have the cost of a customs declaration, which can be £30 a pop. Then there is the cost of submitting things such as rules of origin paperwork and, if you choose to go to the AEO, complying and getting the necessary status through the AEO. Those are some of the frictional costs.

On the transformational cost, you might need to think about the staff and the capability you need in your organisation. If you do not already have them, you will need people who understand customs compliance, or at least you will need to pay for people who understand customs compliance on a consultancy basis. You might need someone on hand who can pick up the phone if, at 2 am, someone says, "I am stuck at Dover, I cannot get this thing through and it is just-in-time manufacturing". There is a staff element for organisations.

The other potential transformational cost is just changing the way the supply chain operates and moving away from just-in-time, because you might think it is no longer reliable to assume that you are not going to get stuck at a border. It might not be because you have done anything wrong, but there could be a few lorries in front that have not done the necessary paperwork, so things back up. You might look to take in more warehousing and stop relying on just-in-time manufacturing. It is very hard to quantify what those last two costs could be until you know how the solution will work and how different businesses will react. Max fac could have a greater impact on supply chains as they currently operate than a customs partnership, although it is very difficult to tell exactly how a new customs partnership would work.

The point that Jon Thompson made in giving evidence was that, in their view, as Sam has mentioned, it would be relatively cost neutral, because the big new administrative burden will be tracking goods, and their assumption is that businesses will not bother tracking goods unless they know it is in their interest and the money they will get back from proving they qualify for the lower tariff outweighs the cost of having done the tracking in the first place. His estimate was that, in the worst-case scenario that they modelled, a customs partnership could cost businesses £3.4 billion a year, and he compared that to max fac, where they had

said £17 billion to £20 billion potentially. These are the Government's estimations.

Susan Morley: We have to be slightly cautious with what we say about the two different schemes, because you can play around with detail in them to mitigate some of the worst sides of either. For the max-fac side, for instance, people talk about all the other checks on food and goods, and it is very true that these are the ones that stop the border up. Well, if they are goods coming in to us from Europe that are going to get stuck because we now have to do some border checks, let us decide not to do them. After all, if you brought in a lorry-load of oranges last week, and then you bring them in post Brexit, what risk factor changed such that you need to do checks now that you did not do before? None, because they were already in Europe, so why change it? You do not necessarily need to. That has been discussed in some committees that I sit on, and the Government have been saying, "We can decide not to do those extra checks. If it is coming to us from Europe, we will not do them. We do not need to do them. We do not do them today". That is a choice we can make.

However, we cannot influence it where we export to the EU 27. They have been quite clear on this and have said they will instigate checks. That is what they are saying at the moment, because their law demands it. Therefore, under the UCC, they will do the checks and things could get difficult on the other side of the border. They have the law in place. It would be more difficult for them to change it at that point, whereas here we are currently putting our law through Parliament and we are waiting for statutory instruments. They could very well propose a change and we could make that change at the Brexit point if we so selected.

We can facilitate things, and there are a great many options for facilitation that can be taken on our side to prevent delays, remove the need for paperwork and remove the problems with max fac. We can also do things with the partnership model, because I do not see the partnership model being as free and easy as it sometimes sounds. It would have its own difficulties inherent in it. You only have to look at other models, such as the Swiss model and the Turkish model. They are not the easiest ones. The queues at the Turkish border are legendary, and it is in the customs union with the EU and maintains the same tariffs as the EU. That is not the fix that it is sometimes said to be.

We can do a great deal to facilitate within our own purview, and we would then have to persuade the EU 27 to join in if they wished to, or their own traders might apply some pressure because it is causing difficulties their side. It is not very black and white. There are a lot of things that you can bolt together, if you wish to, to make it work.

The Chairman: That must be in the context that, if you are going to have free trade agreements with other countries, they will see that as a disadvantage, because you are suddenly letting traffic flow in without the usual checks and balances. If we are trying to do free trade agreements with other countries on the same level, they will see that as a preference.

Susan Morley: There is a balancing act with everything. There are things that you can do. Very few companies take up origin preference now because it is too hard. In the modern world, it is not just too hard to run; it is too hard to know where the components or elements of your product come from, because they swap so often.

Sam Lowe: To build on that point slightly, we have just been talking about the customs side, but if we are talking about what would impact pan-European supply chains, the Airbus example is interesting, because it was reported as largely being a tariff problem. If you read their impact assessment, it has nothing to do with tariffs. For civil aviation, as long as they can prove that it is going into a civil aircraft, they can pretty much zero rate the entire thing, so the rules of origin are no issue whatsoever. It was to do with authorisation and disruption to just-in-time.

On the question of authorisation, there was a fear that the UK-notified body would no longer be able to authorise their product for sale on the European market. They were worried about it because, given the sheer number of suppliers they have, if one person does not have the correct authorisation, the whole wing is useless, so there is an issue there.

On the point about just-in-time at the border, theirs is a big company and they can do all that, but they are still going to get stuck behind someone else. That was the disruption fear there.

On the point about the UK being able to decide unilaterally how it treats Europe and the rest of the world, that is entirely true, but I should say that it cannot just be on a whim. There would have to be a framework setting out that, if you meet certain criteria, these are the checks that we would apply to your product upon import. It could not discriminate in favour of the EU absent a preferential trade agreement.

You could do it in the context of an agreement where you discriminated in favour of the EU, but absent that the regime would have to be fair. It could theoretically allow for products from elsewhere, if they met the same risk criteria, to come in with the same degree of checks. I completely agree with that point. I just wanted to expand on it slightly.

Q72 **Baroness Armstrong of Hill Top:** We have a lot to do in a fairly short time, but it is all extremely complex. We looked at the Institute for Government report, *Implementing Brexit: Customs*. You mentioned four different ways of decreasing the number of customs checks at the border. Are any of these ways reflected in what the Government are proposing in any of the options, or what we know of in any of the options?

Joseph Owen: If you take max fac and the new customs partnership, the first point to make is that our paper looked at the border more broadly, whereas what we have seen in these proposals from the Government is purely customs. In that respect, we outlined four areas: reducing or eliminating tariffs; minimising non-tariff barriers; trying to limit administration for importers, exporters or customs authorities; and

consistency, co-operation and working between customs authorities. In that respect, the customs element is specific to the last two of those.

On eliminating tariffs, both sides have said it is their ambition to have zero tariffs in a future relationship.

On the non-tariff barriers, we have seen through the Mansion House speech an outline of what the Government are thinking, and if you believe the press reports it will be a subject for discussion tomorrow at Chequers. The two proposals, max fac and a customs partnership, focus mostly on how you eliminate or limit the administrative burden and how the two customs authorities can work together to reduce the need for checks.

I will come back to that point I made earlier. Max fac looks to use those things in the context of the UK-EU border—what it can do to limit administration or work with EU customs officials at, say, Dover and Calais—whereas the new customs partnership looks at the level of co-operation there can be at other ports for international trade coming in, to obviate the need for checks at the EU-UK border. I guess that max fac looks in a bit more detail at trying to negotiate waivers for entry summary and exit summary declarations. It looks at trying to agree mutual recognition of authorised economic operator.

On the point about co-operation, it talks about the UK remaining part of the common transit convention. It looks at bilateral technology implementations that would allow roll-on roll-off ports such as Dover and Calais to work more closely together to limit the need for checks, so it has quite a lot in there on that.

As for the new customs partnership, there is the usual caveat of not having a huge amount of detail on it. The idea of running a dual tariff regime is probably the height of co-operation that you could seek to get outside a customs union, so there is a real emphasis on co-operation.

On limiting the administrative burden, it will be a question of what the proposed tracking mechanism is.

I guess, in summary, those two points are addressed by both of them, but with a different focus.

Q73 Lord Stirrup: I want to come back to the technology, which this question sort of relates to, picking up a few strands that have come out so far.

A couple of you have said, "You can do everything perfectly, but you might be stuck behind a couple of lorries that have not". I am sure it is because I simply do not understand the problem, but it does not seem to me beyond the wit of man to have a system whereby, if somebody's electronic whatever does not go through immediately, you say, "Go over there. We'll sort you out later". I come back to the question of understanding the scale of the risks as well as the nature of the risks, because sometimes we risk getting ourselves caught on these hooks unnecessarily.

On the technology front, I would like to understand the degree to which improved technology can address the non-tariff issues, the non-customs issues, which clearly are a significant part of the friction at the border. I would like to understand whether there is already technology existing anywhere in the world that would help us to do this. Do we have to develop something new? I was very interested in the point about just changing code in some existing systems.

I would also like to understand the two sides of the border. You have mentioned it in respect of stopping oranges coming in, for example, but the checks will have to be carried out in both directions and on both sides. We might have the slickest system in the world, but if it is not on the other side of the border it is not going to matter, is it?

I was interested in Ms Morley's point that everyone is moving in this direction because it is the direction of travel. Can we have confidence that if we are doing this on our side of the border, it is going to be replicated on the other side? There are multiple points wound up in there, but I wonder if you can help me on those.

Susan Morley: When we speak of the EU 27 and the border with them, we have to differentiate quite greatly between air freight, sea freight and road freight, because the air freight and sea freight are not perceived as being any difficulty at all, whichever way we end up operating, because they have the capacity and they have the systems. They have moved on. All the tracking within the port is already electronic. It is all done in advance electronically. There really is no issue.

Road freight has lagged behind. I guess that if it did not need to change, it did not change. It is still quite paper-based, which is part of the problem. You also factor in the fact that the border crossing is quite quick, because it is only the channel. People would say that there is less time for registering the detail and data of a cargo on a vehicle coming from Calais to the UK, perhaps to Dover. The way I see it is that we are talking data again, and it is about the information you need in order to assess whether you should stop that vehicle, and what papers or data he needs to present in order to move without stopping.

That vehicle did not, in general, load at Calais. That vehicle was loaded somewhere else; it began its journey a little earlier than that somewhere. You can start to capture that, because after all that is a removal from the EU. At the moment, between EU countries, you capture all the data, but you do it retrospectively and it is called an Intrastat report, which is an equivalent customs entry in truth but under VAT law, because there is no duty, so there is no customs law between us at the moment. It is all VAT rules. That Intrastat is already being done. If you are a VAT-registered company over a certain threshold of goods movements, you have to report an Intrastat. You have to report your sale through an ESL report, and you have to put amended information on your VAT return.

This is how Europe works now. It is not entirely frictionless. It is just done in arrears electronically. Someone, somewhere, is collecting that

information. Could it be collected a little earlier? I would suggest that the people who put the goods on the truck or were responsible for sending the goods to be put on the truck have most of the data already. If there is the will, there is no reason why cannot be passed. It is already going to be put on a piece of paper, so there is no reason it cannot be electronically, even at base level, emailed ahead. Then the export or the dispatch can be dealt with, and you are ready by then, because how long does it take to do the receipt this end? You could do it in arrears or you could do it in advance. Choices would need to be made. At the moment it is in arrears. That is a way that can lead you to gathering the data and the frictionless side of things.

The border delivery group within government is doing great things to join together the 30-odd agencies that could be involved in an import or an export. It is mostly food and some technology items that need checking. Those people have some sort of system. Each different agency has a different system. They do not talk to each other very well, if at all. Some are connected by pieces of paper. We have the ability, because they are our agencies, to improve that. Even if your base answer is, "Instead of handing over a piece of paper by fax, please let us email it", this would join things together quite a lot and, I hope, would move us forward, because you would not have to keep rekeying everything.

The CDS system is much more than a replacement for CHIEF, as I understand it. CHIEF was very transactional. It gathered what it needed to know to get you over the border. CDS is gathering more of the information for those other agencies, as well as customs, in the data that it wants to collect. If that is used sensibly, you can begin to pass data around, input it once and pass it around, and have those automatic checks dealt with.

There is potential there, and the border delivery group is working with trade, through the JCCC, to make that better and make it happen. It will not be state of the art immediately, but it can be a great deal better and a great deal slicker than it is today just by somebody sitting down, getting everyone together and joining the dots, to be perfectly honest.

Sam Lowe: To focus slightly differently on the non-tariff barrier element, this is probably one of the more extreme examples, just to give you an idea of the issue. Every product of animal origin imported from outside the EU has to enter the EU via a veterinary border inspection post. The problem that UK exports to the EU have post Brexit is that Calais is not a veterinary border inspection post. The Eurotunnel is not a veterinary border inspection post. The closest is Dunkirk, which has low capacity for physical inspections. After that, we are thinking about Rotterdam and the like. You also have some issues on the UK side at Anglesey.

What are the solutions? As it stands, if you are sending live fish through a veterinary border inspection post, they are subject to documentary checks. About 50% is subject to physical inspections if it is fresh. If it is frozen, it is around 20%. You can have an agreement. The EU has some agreements, such as with New Zealand, on SPS, which reduces the

frequency of the physical inspections, almost to the point of something just being obviously a bit off. Those products still have to enter via a veterinary border inspection post.

This is the issue on the UK side for exports: what is your route to market now? You cannot use the Eurotunnel or Calais, unless and until they are upgraded, so it may be Rotterdam, but that is a different sort of thing. You are talking about a different type of shipment and you have to think about whether you are doing it in bulk or in frequency, so refilling the supermarkets becomes a bit of an issue.

The other option to avoid the need for veterinary border inspection posts entirely is what the EEA countries and the Swiss have done. We do not know if the Swiss arrangement is on the table—just to be clear about that—as they have a unique scenario. The option is to apply the EU's sanitary and phytosanitary regime domestically in its entirety and to apply it to imports. Written into their agreements are their own veterinary border inspection posts, through which products of animal origin from third countries enter.

Lord Stirrup: This is what we do now.

Sam Lowe: This is what we do now. We have essentially extended the SPS firewall. If that were available outside a single market option for the Government—we do not know if it is yet—the trade-off there is that it has an implication for the sort of agreements that you can do with the rest of the world, particularly with the US. Chlorinated chicken has become a joke, but it is actually an aggressive ask of the US. They would like to be able to sell their chicken here, which they cannot do currently. They would like to be able to sell their beef, which has been reared using hormones. Under the EU's SPS regime, you cannot do that. That is one of the trade-offs that the Government have to work through.

This is also a big issue in Northern Ireland, because the EU's regime on this is very strict, and it makes sense when you think it through. It all sounds a bit binary, but these are products that could cause damage to human health. They are quite high risk. If there was some contamination and it spilled over on to the side somewhere, it could cause disease to break out. There is a reason why these inspections happen at the border.

Joseph Owen: I would like to answer a couple more of the questions you set out. Can you just tell people to "go and wait over there" if they do not have the right documentation? Yes, absolutely, and I understand that Eurotunnel has a piece of software or is trialling a piece of software that would allow it to do that quite quickly. But the limitation at both Eurotunnel and Dover is just space. What is "over there"? If you are at Dover, "over there" is the sea or the cliff, basically: "In you go". That is the big challenge there. You can hive stuff off.

Susan's point about roll-on roll-off ports being the big issue is absolutely right. Part of it is the technology story. The other point is dwell time. If you are a container, you will come off a ship and you will sit there until

someone comes to pick you up, which is time in which authorities can do the necessary checks if they need to. Dover and Eurotunnel market themselves by saying, "We are basically a continuous motorway that will take you all the way over to France, non-stop", so where do you put that dwell time? I cannot remember the exact facts, but I think it was Dover that came out and said that if you delayed every consignment by three minutes, it would not take long until the queue hit the M25. You have the challenge there of how the trade flow works now, where there is space to insert checks and what the implications are.

In terms of systems for removing the need for checks at the border and technology that already exists, if you assume that the non-tariff issues go away, that the UK is going to propose a goods-only alignment and that that disappears, you are left with some of the customs issues. One of those that I am aware of is the registered exporter system for rules of origin, which means that a business can do a self-assessment to ensure that the inventory matches what it is saying it will. Exporters will have an audit by authorities at some point. Once you do that, you can basically submit your rules of origin documentation well away from the border. There is no need for there to be a check at the border.

It does not remove the need for the costs and the concerns that businesses have about working out their rules of origin in the first place, but it means that there is no need for eyeballing a piece of paper at the border. You can do it through a system. It is a system that the EU uses with some of the poorer countries it trades with, but it was also written into CETA with Canada and it is seen as a system that will be used increasingly. Susan talked about the move to digitising all these systems. This will be a key one around rules of origin and removing the need for a physical check at the border. That is one example.

Q74 Lord Dubs: This is just a small point. Mr Lowe, you talked about Northern Ireland. Is there any difference between having a large volume and having a very small volume moving across the border?

Sam Lowe: Yes, in so far as if there are fewer things to be checked, you do not have the queues or the delays. With the specific issue of Northern Ireland, it is often pointed out that the value of trade is not so great over the Northern Irish border, and east-west is bigger. Looking at the north-south supply chains, if you are making Baileys, it does not become valuable until it is in a bottle, branded and sold off elsewhere. That goes north-south quite frequently.

When you think of Northern Ireland, you have the customs, et cetera, but the big check is on agricultural products. This is the question: there is already a Northern Ireland regime for live animals. If you send a cow from Great Britain into Northern Ireland, it already has to go through a veterinary border inspection post, so there is already a whole system for that. Could you have a whole-Ireland regime on SPS that was distinct from the rest of the UK? That would do a lot to alleviate checks there, if possible, but you would then have the questions that we see at the moment as to different regulatory regimes in parts of the UK.

Susan Morley: Also part of the complication is where you can flex existing regulations to assist with achieving an overall facilitation. The AEO—authorised economic operator—scheme that you spoke of is for compliant traders. It can be for security and customs work currently. AEO schemes are global schemes for trusted traders. It is another name for “trusted trader”, really.

Let us say that your entire supply chain was trusted-trader certified. Wherever the goods are coming from, from within the EU or from outside the EU and the UK, so from anywhere, part of the benefits given to those traders could be no checks—you are a trusted trader; it is all done on audit. In order to get the gold standard, you have already passed all the checks that say, “You will self-police”. That is the point of those schemes. They are self-policing, and you are audited quite rigorously from time to time to make sure that you are still doing what you are supposed to do.

If you were to suggest expanding your current AEO scheme benefits to include agricultural produce, and not being checked and not needing a border inspection post because you are a trusted trader, that is entirely doable. The SAFE standard from the WCO, which is what it is all based on, is the bottom line. You can add to it if you so choose. You could choose to do that. If you do that, you are offering everyone the same benefit, so long as they reach a certain standard. It takes away the need to say, “You are being preferential to European countries and penalising others”, because you are simply saying, “If you all meet the standard, you will get the benefit”.

Sam Lowe: The problem, especially with Northern Ireland, is when you are talking about small traders. With authorised economic operator, there is a real cost-benefit issue, in that gaining the status is incredibly costly and arduous. You have to have three years’ worth of inspections; you have to have all your details up to date. In Northern Ireland, we are talking about farmers who have farms on both sides of the border. We are talking about small traders going back and forth. It is not worth their time to try to get AEO status, because they probably could not even qualify for it. There are reasons why the bar is set quite high—because so much trust is put in a company once they have it. AEO has a role to play and what Susan has said is right: that you could expand the scheme, although the scheme as expanded would need to be mutually recognised by the EU, to go the other way, and that is far from a given.

You have to be careful about overregging AEO. There are some people going round the country essentially telling loads of small businesses, “Just become an AEO”. It is entirely not in their interest to do so, and I do not think they could.

Joseph Owen: There is one point I would like to make about the Irish border. AEO is really important there, because there are opportunities, but there are also risks and serious caveats.

On the question of the Irish border, it seems to me that even if you take the assumption that non-tariff barriers are taken care of because the UK

wants to align to the single market for goods and it is a question of customs, or even if you do not assume that, there are some mechanisms where theoretically and technically you could get to the point where there was not the need for physical checks at the border potentially, but even in that scenario it seems to me that the definition between the EU and the UK of what “no border” means is different. The Irish-EU definition is no checks anywhere on the island of Ireland, which means that some of this stuff on AEO and audits et cetera is off the table. Until there is an agreement over what “no border” actually means, you cannot start to scope up the possible landing area for solutions.

On AEO, the context is that if customs is increasingly intelligence-led, AEO gives you intelligence that it is not just about a single consignment going from A to B; it is intelligence about who is doing that trade. Often an organisation is a far better indicator of whether something is going to be dodgy or dangerous than the list of what is included in that consignment. It is about taking a more system-wide approach to enforcement rather than a transactional one of goods moving between A and B.

You have options for improving that. Either you can get more of the system to engage with you or you can broadly increase the scope of the system. Getting more of the system to engage with you is about getting more people to use AEO. At the moment there is lots about how limited the number of authorised economic operators is in the UK, but actually about 60% of imports are made through AEOs—certified organisations—and about 75% of exporters, and there is this very long tail of SMEs.

What can you do to get more people to use it? There are newer trusted trader schemes, such as in Australia, that have different tiers. At the lowest tier you just have to complete a self-assessment and you can get a basic level with basic benefits. Then, the more you commit to auditing and sharing information, which, as Sam said, comes with a cost, the more benefits you can unlock. It is a tiered system. That is a possibility. Australia does that.

In terms of getting more of the system to engage and the regulatory element, as Susan said you can get AEO to unlock more for you. You can use what is called a single-window approach whereby you can engage with government but government is lined up internally so that “government” does not mean 30 different agencies; it just means a single point of contact.

Baroness Armstrong of Hill Top: Good luck with that one.

Joseph Owen: “Good luck with that one” indeed. You can do that. Some countries, such as Australia and Brazil, are starting to do this, or have done this, but are thinking about expanding. The big caveat is that for it to have any value for UK-EU trade it has to be mutually recognised by the EU. Otherwise, you just have a nice AEO scheme and it means nothing for UK-EU trade. If you look at the other countries that the EU has mutual recognition agreements with, they have some of the so-called legacy AEO

systems, more than any of these new and innovative ones. Australia and Brazil are not on that list. USA, Norway, Andorra, Japan and Switzerland are, so you do not have any of the newer and more innovative schemes.

There is a question about whether, even if we designed the most perfect trusted trader scheme, the EU would accept it. Would it ask, "Why are we giving your small businesses preferential treatment when the effort that we put on our big businesses means that only they can unlock these benefits?" As Sam said, you then need a history of trading that you can share. One of the challenges is how organisations that have traded with the EU are going to be able to prove that in the short term in order to benefit. Yes, there is potential in the trusted trader schemes and there are possible benefits that you can unlock, but there are big caveats. It is far from a silver bullet to the Brexit problem. It has long-term benefits, but you could not pin your hopes on it for 2020 or shortly afterwards.

Q75 The Chairman: There is also the fact that the schemes are complicated, and for small businesses they are incredibly complex. There are 17 or 18 pages' worth and you have to put up collateral. Where will those small businesses get the amount of collateral to put down?

Joseph Owen: You can have a sort of graded system whereby, for a low-entry trusted trader, you can just fill out a self-assessment online and the customs authorities will look at it and say, "Yes, okay. You can get a small amount of benefits from the AEO system". You are right that in order to get the full suite that means you can whistle through the border, you are likely to need to do some of those more intrusive and costly compliance activities.

Susan Morley: I agree with lots of what my colleagues have said, but in truth getting AEO is easy for many small companies.

Sam Lowe: For a freight-forwarder.

Susan Morley: No, not just a freight forwarder but a trader. What traders have to do with AEO is scaled to their involvement in the supply chain. There are many myths about AEO, but one of them is that it is very costly and very difficult if you are a small trader. I have worked, in my consultancy and in my CILT role, with many micro-businesses. Getting AEO is easy, because you have two or three people only who handle any of the work. A lot of it is given to third companies, because third companies are used to do customs things. They can certify their relationship with those companies, if you like, and those companies already have AEO for the most part—if you are talking about the fast parcels operators, which you often are for small businesses. They already have AEO, so in fact they do not have to do the security work to verify those third companies anyway.

It is true that you have to fill in an 18-page form, but that is not beyond the wit of a human being to do. You can do it and you can get AEO very quickly and very simply. You can get it with the spreadsheet. You can get it with paper index cards if that is what you work from. None of that is

important. AEO does not mandate at all what you have to have. It is actually very, very much harder for a large organisation, with many sites and ERP systems and all this good stuff, to get AEO, because of the control and the diversity aspects. We lose that in the translation sometimes. All you hear about is the big people who go through quite a lot of difficulty in pulling themselves together, because in the UK, despite what many of us think, we have had a facilitative customs regime for many, many years. That is why we have not had much uptake of AEO initially: because we have already had the benefits. Why do we want to do anything else?

Other countries in Europe very much did not have them, and that is where the uptake has been enormous. That is actually the differentiator: it is not the ease of getting it, or the benefits; it is whether you need it. It is a facilitator for Brexit. It is certainly not a silver bullet and it is not for everyone, but a great many more companies can get it, and we should ease back on the bad press that AEO can get because, if you really boil it down to what these companies need to do, it is nothing. It is really easy.

Q76 **Baroness Armstrong of Hill Top:** Outside the system, the main Committee interviewed people from the Swiss border control and the Norwegian border control. At that stage our Government, in the paper on Northern Ireland, were talking about having a system for larger companies that is done away from the border and not bothering essentially for the smaller ones. The Swiss guy in particular was incredulous at this, because he said that would be a huge means of encouraging bad practice and the bad people.

Susan Morley: I would call that a risk assessment. If you look at what we do today, both with EU trade and the Intrastat, which is like the customs entry that VAT-registered traders have to submit over certain thresholds—that is different in every EU country, by the way—those on the ground who are dealing with it and doing it know that system to be rubbish, because the data that is being input is dreadful. I am not too sure whether Governments know that. It is viewed in terms of, “Who checks on it anyway?” and “Who cares?”, so nobody really bothers. You need to put down tariff codes, just as you do on a customs entry, to identify the product that is moving, for instance. It is known that a lot of the big players use one code. They should be using hundreds, but because nobody checks they just put one down.

I would not rely on one tiny piece of the data quality that comes out of that and which feeds government statistics, because I know what goes in. I have been on the putting-in end and it is just not reliable. It is very, very poor. If you make a risk assessment and say that you will let the little Northern Irish companies move about without checks and without too much bother, how much more risk are we putting in the system than we have today? We have no idea what is going across that border today, with Intrastat or with anything else. Why do we think that matters? If we do not care today, are we going to care tomorrow?

Baroness Armstrong of Hill Top: The EU might care, because it is an

entry point for their 27 countries.

Susan Morley: True, but today the information that they have on the entry point into the 27 countries is hopeless.

The Chairman: We are going to move on, because we are getting into a round debate here.

Q77 **Lord Risby:** I remember hearing before this whole process started that a free trade arrangement between us and the European Union would be the simplest thing imaginable. That certainly appears not to be the case, to say the least. If we get no deal, what impact do you think there would be on the business community in this country? The obvious thing would be WTO rules, but could you just give us a brief notion of what you think could happen in those circumstances? That would be very helpful for the Committee.

Susan Morley: No deal would mean that what we do for third countries today we do for all the European countries too, so that means that you translate the border checks for veterinary things or food. You translate having to do some sort of customs entry into having to do it for absolutely everybody. It has some advantages in that it is one system for everything, whereas today we operate two systems: the European and the non-European. There is an advantage to that. One system has to be cheaper and easier to do than two.

However, a lot of companies do not know how to do that. A lot do, because they already do both. Would it matter to them to swap staff and put more through one methodology? Probably not, in respect of actually doing it. For those who have never done anything but EU trade, particularly those below the VAT-threshold, it would be a new world altogether. Would it hurt them terribly? They would use someone else to do it, just as many small businesses do now, so they might have to pay a little more because they are paying for someone else to do some more administration. They might be looked to for legal liability a little more, so they might be audited, whereas they probably have never been now. There would be some more practical issues to that.

On the question of how much that would impact on cost, you start talking about tariffs and then about the admin cost—the extra bit that you are paying an agent, which Jon Thompson spoke of, although I think some of the figures were somewhat exaggerated. If you are sending multiple goods there is no single customs entry for each item. It is per consignment. We have to be careful with the numbers, but there would be a cost.

Lord Risby: The difference is that you have a complex of supply chain arrangements, which do not exist in the same way with outside countries. That would be the crunch point for so many businesses.

Sam Lowe: I would also emphasise that I am not quite as relaxed about it as Susan is in a broader sense. We need to define what we mean by “no deal”. I am going to assume that we have failed to sign under the

withdrawal agreement, so it is not that we have left under the withdrawal agreement and then failed to sign up to a future relationship. In March 2019, we are out without any measures in place. All goods authorised by UK authorising agents—think of the vehicles and authorisation people—are no longer authorised for sale on the EU market. Even if you self-certify certain goods, all of a sudden your importer will be the one who is liable if there is a problem with it. If you are a distribution hub in the UK that is selling to lots of little shops across the EU, they will no longer be able to import your good because they will not want to take on that liability. They are going to be confused. They are not going to want to have to deal with that.

At the beginning, we could not get fresh food into the European Union because we have no pre-existing routes of access. You would have some that already exist elsewhere that may go through veterinary border inspection posts, but Calais is not one and nor is the Eurotunnel. At least in the short term, in the very hard no-deal scenario, everything stops pretty much, at least while it is resolved.

On the EU side, we have seen—this is a caveat—that as part of their no-deal preparation they are putting plans in place to try to facilitate trade, at least in the short term. There will be friction and there will be queues, but they will at least keep trade moving while they put the infrastructure in place to police the border, as they would for any other third country.

Not all trade will stop from day 1, because emergency measures will be put in place on both sides, but after one, two or three months we will go to a new way of trading, and then we have all the issues that you alluded to. The supply chains that run through the European Union will no longer function as they did before. The UK companies will have to work out whether it is okay to have a component part of that supply chain within the UK, or whether it should go one way or even the reverse, and it completely changes the flow of trade.

Also, the route to market will alter quite considerably, so it would be incredibly disruptive. I cannot emphasise enough that leaving the European Union without a deal is one of the most ridiculous ideas that I have ever heard, and most people who work on this agree with that.

Joseph Owen: How do I follow that?

On the impact for business, various large businesses are making their voices heard. There are various leaks of colourful scenarios in the *Sunday Times* about Armageddon, et cetera. There is clearly a significant impact on trade.

There are things that the UK Government could do unilaterally to try to keep trade moving in that scenario, and there are things that they would need agreement with the EU on.

On the question of unilateral measures, there is the question of tariffs, customs paperwork and non-tariff barriers. If you wanted to avoid the

need for any kind of checks and to keep trade moving, you would need to drop tariffs for everyone, because you do not have a preferential trade agreement with the EU, so it would be discriminatory not to charge tariffs to them but to charge tariffs to, say, the US goods coming through. You would have to decide unilaterally to drop all tariffs.

On the customs and the non-tariff barriers, you could, as Susan said, just decide, "We are not going to check anything. No risk has changed overnight from goods coming over from France into the UK, so there is no reason why we should suddenly start checking 50% of live fish that come through. Those fish were fine yesterday, so why are they not fine today?" That logic stands, and it stands under the WTO and the World Customs Organization, but for a period of time, because it gets harder and harder to say that the risk has not changed. You can say, "The risk has not changed since yesterday", or, "The risk has not changed since last week", but when you start getting into months and definitely years, other countries have a rightful opportunity to try to take you to the WTO and say, "No, this is discrimination". There are some measures you could take in the short term, but just on goods coming in to the UK.

If we fall out, as Sam said, and the scenario is a withdrawal agreement, so we have not paid the money we have owed and the key EU priority in relation to the Irish border has not been met, is it likely that they will try to make things as easy as possible for UK goods coming into the EU? Possibly not. When there were pictures of lorries queuing on the M10 through Kent, that was a problem on the EU side of the border. It is a canyon, not a cliff edge.

In terms of the bilateral or negotiated measures that you could do, you could probably do a fair amount of what is in max fac by a standalone customs co-operation agreement. The EU has them with, say, the US in certain elements. You could therefore try to join the common transit convention. You could get mutual recognition of authorised economic operators.

However, if you have crashed out with no deal and we have not paid the withdrawal bill, or the money that has been agreed as part of the withdrawal agreement, it is unlikely that the EU will say, "Okay, yes, but we will sign up to all these customs measures instead".

Connected to that is the fact that customs is exclusive EU-competence. It sits in the Commission. It would be very difficult to do a specific deal with France that says, "Come on, let's keep Calais and Dover moving between us". There is potential to have co-ordination and co-operation just operationally between officials working on the ground between Dover and Calais to try to understand how each side are going to cope in that scenario so that they can work as best as possible. My understanding is that some of those conversations are happening already, but actually the Commission has been quite keen to prevent substantive dialogue on what would happen in some of these scenarios, because customs is a future-relationship issue. Some of that thinking is happening and there

are some levers that you could pull in a no-deal scenario, but they would far from mitigate it.

Lord Risby: I think what you are trying to say is that this is not a very good idea.

Joseph Owen: It is brave.

Q78 **Lord Dubs:** As part of the third option, the UK would be able to negotiate FTAs with third countries. We were told by a previous witness that in this case tariff cuts offered by trading partners would be in the form of a rebate system, which would be less attractive and make negotiating FTAs difficult for the UK. Is that the right assessment? What other concerns do you have relating to the negotiations of FTAs under this proposed arrangement?

Sam Lowe: He is right. He says that essentially it would be a contingent benefit, because you would have to claim the rebate in order to benefit from the terms of the free trade agreement whereby the actual third country, say Australia, that we negotiated an agreement with will just lower that tariff at the border.

The first thing to say is that all preferential access afforded by trade agreements is a contingent benefit. You still have to qualify for it, so there is already an admin cost that comes with utilising a preference. His point would be that this would be an additional burden for any UK importer hoping to bring something in from Australia under this regime. It does make it slightly less attractive if you are attempting to negotiate an agreement with a third country, because the uptake of this zero-tariff rate would potentially be lower, so there is an issue there.

With a customs partnership generally, there are issues as to what constraints it would place on a UK independent trade policy. The Government say that it would place none, because you would have this dual regime. There may be some issues on tariffs, as I have just discussed.

There is then the question as to what else comes with this customs partnership, because if we want to ensure that there are no checks at the border, we will at least need to be in the single market for goods, and probably have a VAT union, so you rule out goods if you take it to its end state. There are areas that the Government can still negotiate from within a customs union. We still have to negotiate access to other markets when the EU does, alongside it. We would also still be able to negotiate on services, intellectual property, procurement and movement of people in terms of professional visas and the like.

The customs union option still leaves open free trade agreements and the options. However, they would be quite limited, and there are no real examples of, say, a services-only bilateral free trade agreement. There is one being negotiated plurilaterally at the moment, parallel to the WTO, called the trade in services agreement, which the UK might be able to engage with.

Susan Morley: The problem with the free trade agreements is that every single one is different. That is the barrier for trade, because you need a certain amount of skill, knowledge and technical knowhow to figure out whether that particular free trade agreement is of any use to you in your commercial arrangement. That is why the take-up of existing free trade agreements is not very great. Although they are beneficial, on the inbound leg it is really quite difficult. It is easier on the outbound leg. When the EU signed the EU-South Korea free trade agreement, when it came to the balance of trade between the two they were exporting everything to South Korea and they have started to put in some trade defence mechanisms to try to rebalance things slightly.

These agreements are difficult for trade to understand on the inbound, and for traders to meet. In the modern global world, origin rules are not much help because we source things so frequently from different sources and flip-flop in terms of supply. That makes it very unstable, and you need stability to use a free trade agreement. It is the extra parts of a free trade agreement that often become very useful on exports again, because you get market access. It does not mean that imports get market access our side, quite often, but certainly going outwards we have some very good traders here who can make use of them. You can get a very quick and difficult imbalance of trade, but you will not get a huge take-up, because they are complicated and they do not really fit the modern world. The existing ones do not, anyway. They help, but they are not the answer to everything.

Q79 **Baroness Armstrong of Hill Top:** How far do the FTAs go in bridging the gap between no arrangement at all and the current customs arrangements with the EU?

Susan Morley: On the customs side, they do not make any difference at all. On the additional non-tariff barriers, they are designed to make a difference, but as part of a free trade agreement you would normally do customs entries. With all the EU's arrangements, for instance with Switzerland, Norway and other countries that have a variety of deals with the EU, there are customs entries at every border. For the actual customs part of it, they are neither here nor there. You get to add a few extra codes and they do not charge you duty. That is what a free trade agreement means for customs work.

Sam Lowe: On the extras side, one of the things that the EU can do, either as part of a free trade agreement or in and of itself, is mutual recognition of conformity assessment. We assume that most CE-marked products are self-certified but that there is a list of dangerous ones that you need a notified body to actually look at and say, "This is okay". A mutual recognition agreement of conformity assessment bodies would, for example, allow an Australian-based conformity assessment body to certify that a product produced in Australia to EU standards is safe for sale, so the importer on the EU side can be confident, when it has that certificate, that it meets the EU standards and they are not going to get into any trouble if they distribute it throughout the EU. That is one thing a free trade agreement can do.

You also have SPS equivalence. I mentioned one earlier with regard to New Zealand. Again, you can have this separately or as part of a free trade agreement whereby you deem that, say, New Zealand's regime produces an equivalent outcome, and it reduces the percentage of checks and the need for physical inspection. New Zealand pretty much brings it down to close to zero, but the EU also has one with Chile and the like, which has different levels.

Beyond that, yes, you have things like mutual recognition of authorised economic operator schemes. The one that Joe did not mention is a recent one with China. I am not sure how effective it has been yet, because it is so recent. Beyond that, when it comes to free trade agreements and say, regulatory aspects—the non-tariff barriers—they do not do very much. The EU, with its single market, has managed to go much further, largely because it has recreated the regulatory architecture that you find at a domestic level at the supranational level, with all the enforcement, oversight and harmonisation that comes with it.

I suppose the other benefit of a free trade agreement, from a risk basis, is that it is with a country you trust. It could help there. Obviously you have the tariff benefits, but on services they do very little. They might do more on intellectual property, which can be quite helpful.

On procurement, you can also sometimes get greater access to markets, so they do things.

It is just that at the border a free trade agreement is not necessarily enough, for the most part, to significantly decrease the friction.

Q80 Baroness Chalker of Wallasey: When we talk about the customs backstop, the proposed arrangement actually foresees the application of a common commercial policy, but only in areas that are required to enable a temporary customs arrangement to function. Do you have any sense of what these particular areas might be? What is your assessment of the feasibility of this highly selective application? I foresee it causing big longer-term problems.

Sam Lowe: It is essentially what I said before. The backstop proposal, as it exists, is essentially a customs union with VAT union added on, as well as waiving the need for import-export docks. There are a couple of other things, but it does not talk about the regulatory side. Assuming it is a customs union, it means that we would be unable to reduce our own tariffs unilaterally unless the EU had also reduced them in that area. That is where the constraint is on the common commercial policy. We would be bound to apply the EU's essentially external trade regime in regards to goods.

Theoretically we would still be able to negotiate and implement agreements that covered services and IP—the other bits of the trade agreement. Specifically it says, "We want to be able to negotiate on everything, but we would implement those bits only after the backstop ends". My issue with the proposed backstop is the amount that the UK

seems to want to be able to influence the EU side during this process. Let us be clear: Turkey still has to run its own independent trade policy, so if the EU negotiates an agreement with a third country and reduces its tariffs on goods entering from that country, Turkey still has to do that because it is bound to the EU's common external tariff, but it then still has to try in parallel to negotiate its own access to the other market.

The UK appears to be asking for the EU to continue to do that when new trade agreements are struck but we would still have some sort of say over it. It depends what we mean. Could we have a consultation mechanism? Could we arrange to negotiate in parallel? Yes, probably. Could we have any sort of veto over what the EU did? No, absolutely not. No EU member state has a veto over EU trade policy, at least in the competencies that are held by the Commission.

We seem to be asking for quite a lot while also wanting to be free to negotiate our own agreements. As I have said, perhaps we could do it if we did not implement it, but if I was the Commission I would have a lot of questions about this, ignoring the fact that we have actually proposed a whole-UK solution, which, as it stands, the EU is saying no to. That is maybe a slightly separate discussion.

The Chairman: Thank you very much. I am afraid that time has beaten us. It has been an incredibly interesting session. For all of us here it has been a very well-informed session for us, and we would like to take this opportunity to thank you again for coming in this morning. I remind you that the transcripts are there for you to read through to see if any corrections are needed. Thank you very much for coming in this morning.