HOUSE OF LORDS

Select Committee on the European Union

External Affairs Sub-Committee

Corrected oral evidence: Brexit: customs arrangements

Thursday 19 July 2018

11.15 am

Watch the meeting

Members present: Baroness Verma (Chairman); Baroness Armstrong of Hill Top; Baroness Brown of Cambridge; Baroness Chalker of Wallasey; Lord Dubs; Lord Horam; Earl of Oxford and Asquith; Lord Risby; Lord Stirrup; Baroness Suttie; Lord Triesman.

Evidence Session No. 7 Heard in Public Questions 100 - 118

Witnesses

I: Robin Walker MP, Parliamentary Under-Secretary of State, Department for Exiting the European Union; Mel Stride MP, Financial Secretary to the Treasury and Paymaster-General, HM Treasury.

Examination of witnesses

Robin Walker MP and Mel Stride MP.

Q100 **The Chairman:** Good morning, Mr Stride and Mr Walker. Welcome to our evidence session this morning. It is part of the inquiry that we are holding on the Brexit customs arrangements. We are being broadcast live. You will be given copies of the transcript of the session afterwards, so if there are any corrections to be made you can make them and send them back to us.

You have seen the intended questions. I cannot promise that colleagues will always stick to them, but we ask people giving evidence to try to be short, pithy and to the point so that we can get as much out of the session as possible. Do you want to make any opening remarks?

Mel Stride MP: Thank you for rescheduling my appearance before the Committee, given that the customs Bill, which I took through on Monday, was quite a lot of work. I appreciate that, and I am happy to be here now. My thanks to you for that.

Q101 **The Chairman:** In the White Paper published last week, the Government outlined a facilitated customs arrangement, which we will now refer to as the FCA for convenience. Could you explain to us how this arrangement would remove the need for any physical customs infrastructure at the border?

Mel Stride MP: I see this conceptually in two parts: an inner part and an outer part. The inner part is what happens across the borders between us and the EU 27, as they will then be. We will have frictionless trade without customs arrangements in place. That springs principally from the fact that in the White Paper and the Chequers proposal we adhere to a common rulebook. That covers the regulatory alignment issues, on goods and agricultural products and on having a free trade area: in other words, there would be no tariffs between us and the EU 27.

To move to the outer part of my way of looking at it, we are still left with the question of what happens to rest of the world goods coming into the UK or via the UK and destined for the EU 27, or indeed coming through the EU 27 and destined for the United Kingdom. That is where we have the proposal in effect to act as the customs agent for the EU 27 at our border, and we would apply the EU’s tariff at that point. For goods that we can be confident are indeed going through the UK and will be substantially processed or consumed within the EU 27, we would take the EU’s tariff at that point, at the border. In the same way, if we could be confident that goods were destined for the UK, we would apply the UK tariff.

The question then is what happens if you cannot be certain about the ultimate destination of goods coming in. In that circumstance, goods coming into the UK where the UK tariff was lower than the EU tariff would pay the higher EU tariff, but they would be able to reclaim the difference once they had proved to us that those goods did indeed have their final destination as the United Kingdom.

The Chairman: Do you think this particular model will ensure that there are no hard borders between Ireland and Northern Ireland?

Mel Stride MP: Yes.

The Chairman: In your mind, it addresses that issue.

Mel Stride MP: Yes. There are two significant advantages of this model over, say, the max-fac model that we considered before, which would see, albeit facilitated, borders between us and the EU 27. The first of those advantages are substantial cost savings in the operation of this model compared with that model. The second is that, naturally, the Northern Ireland-Ireland border issue falls away under this model.

Robin Walker MP: It is important to reiterate, as Mel said at the beginning of his comments, that it is the combination of the facilitated customs arrangement and the common rulebook that allows for that. We understand, of course, that customs arrangements in and of themselves would not resolve the issue and would not allow you to avoid barriers at the border. That is why the common rulebook is so important, covering agri-foods and industrial products, and ensuring that there are arrangements that allow for no friction.

It is also important to reflect that it needs to be focused on the areas that are required to avoid friction at the border. Some people suggest that it involves maintaining dynamic alignment with the whole of the acquis. That is a wrong interpretation. It is specifically things related to checks at the border and under the headings of goods and agri-food.

Q102 **Baroness Armstrong of Hill Top:** Given that the White Paper and the Chequers agreement do not cover services, but many manufacturers have a service element in their work and their product, how will that be sorted?

Robin Walker MP: The White Paper does cover services. It sets out a number of arrangements relating to services.

Baroness Armstrong of Hill Top: Yes, but not under the FCA.

Robin Walker MP: No, because services of course do not face customs barriers or rules of origin in the same sense, so it is not related to the FCA, but there are proposals in the White Paper in relation to labour mobility to provide services, the ability to send people to provide a service, and short-term business visits, which will be very important to businesses that provide a service alongside goods. We have always recognised that there is a join between services and goods in this respect.

Crucially, the difference is that you do not need a common rulebook for services to enable travel to provide a service; you need arrangements to allow for that to continue. That is what we are setting out in the White Paper in the mutual recognition of qualifications and in the labour mobility framework. It puts those specific arrangements in place rather than talking about alignment of a whole rulebook, because services do not pose the threat of creating friction at the border.

The Chairman: Thank you. Your opening remarks will probably generate a lot more questions, but questions that will come up in relation to other questions.

Q103 **Lord Horam:** The White Paper speaks about a "phased implementation". What does that mean?

Mel Stride MP: The FCA model clearly has various component parts, and some will be deliverable relatively quickly—for example, negotiations with the EU about how the payment mechanism works between us and the EU 27 in the operation of the model. The netting out of the various tariff collections that are occurring will by definition have to be bottomed out very early for there to be an agreement.

However, other elements of the model, such as the repayment element, will take longer to deliver. In that sense—

Lord Horam: If I can interrupt you, we had evidence from HMRC officials just before you came in that that is a bespoke arrangement that exists nowhere else in the world. They were unsure as to whether it will be ready for the end of 2020. Does that not mean that there is a bit of a loose end to the arrangements?

Mel Stride MP: We would have to negotiate around that potential situation. One point I would make is that, whereas under the NCP model—

Lord Horam: The NCP?

Mel Stride MP: The new customs partnership model, which preceded—

Lord Horam: That is the old one, which we do not have. It was rejected.

Mel Stride MP: It was one of the two that we considered before we took the best of all worlds, as it were, and ended up where we are now, as you would expect us to do. Under that model, there would be a much higher reliance on the rebating system. It was not envisaged under that model that we would be doing stuff at the border using trusted traders and so on to make sure that we could actually deliver on the payment of the correct tariff as the goods came across the border.

Lord Horam: Your new system reduces the need for repayment. None the less it may not be ready in time.

Mel Stride MP: Exactly what it looks like will depend on the negotiations. In the event that it might go beyond 1 January 2021, the end of the implementation period, we would clearly need to negotiate on it at the time. Clearly, our intention would be to have the model up and running by the end of 2020.

Q104 **Lord Horam:** The repayment model is necessary where UK tariffs differ from EU 27 tariffs. Is that right?

Mel Stride MP: Yes.

Lord Horam: Where do they differ? Surely they are the same now.

Mel Stride MP: They would be on day one, but of course as we go out into the world and conclude FTAs—free trade agreements—with other countries, that may change. But you are right: to the extent that the tariffs are aligned, of course there is no need for repayment. It is one of the reasons—only one of them—why there would not necessarily be a huge reliance on a repayment element in this model.

Robin Walker MP: You make a very good point, Lord Horam. When the implementation period comes to an end, we will be in a situation where we start from the perspective of having the same tariff arrangements as we leave with. It is only after that point that the UK can bring new trade agreements into force. At that point, we might have lower tariffs with specific countries, which would—

Lord Horam: But only then. Not now.

Robin Walker MP: Only then. Under the terms of the implementation agreement, we would not be putting lower tariffs in place before then anyway. The point is that the repayment mechanism is the element of the scheme that might take longest to implement, but it will not be needed until at least the time when we leave the implementation period. No business will face a higher tariff than it faces today in that respect. If businesses are trading with countries outside the European Union, they will already be paying the European Union's tariff. At that point, they would continue to pay it.

If the UK then brought in a lower tariff in its trading arrangements with a third country, at that point businesses would need to determine whether it was worth their while to engage with the repayment mechanism in order to reclaim it. If they preferred, they could carry on trading as they did before on the basis of the EU's tariff. That is a point for the small proportion of businesses that this is likely to affect. They will have the choice as to how they engage. That is a crucial difference between this model and the original NCP, where businesses were worried about having a very high administrative burden in engaging in the repayment system. No business will have to engage with that repayment system; it will be a matter of choice for them.

Mel Stride MP: An important subsidiary point is that, given that it is a voluntary engagement with the repayment element—

Lord Horam: It is up to the business.

Mel Stride MP: Yes. Clearly the business would not bother to engage with the system if the costs of administration outweighed the benefit of receiving the lower tariff. In that sense, there would logically be no additional cost to the businesses that fell within the scope of that part of the arrangement.

Q105 **The Chairman:** When do you see the repayment mechanism up and working? On what date?

Mel Stride MP: That is an impossible question to pin a precise date on, because it is contingent on a number of different factors, not least the negotiation, what it looks like and what the requirements are. First, it will certainly require to be negotiated. Secondly, for it to be fully functioning, businesses will need to engage with it. In order for them to engage with it, we will have to have tariff differentials and therefore free trade agreements in place. The whole thing up and running and functioning will be a little way off, but I could not pin a precise date on it, I am afraid.

Q106 **Baroness Brown of Cambridge:** Presumably the higher EU tariff gets paid by us to the EU. We have collected it on their behalf.

Mel Stride MP: Yes.

Baroness Brown of Cambridge: If companies have chosen not to reclaim that higher tariff, the EU is getting more money than it would otherwise be getting, or are we keeping the extra bit?

Mel Stride MP: We envisage the actual mechanics not so much counting up exactly what is happening at our border and what we are collecting on each good or set of goods coming through, but using a formula based on the trade flows that we know are occurring between ourselves and the EU 27 and the different tariffs that might apply to those different flows. That is how you would back into the kind of amounts that would then be transferred between us and the EU 27 or vice versa, rather than looking at the individual movements themselves.

Q107 **Lord Stirrup:** Could I explore the logic of that? I am not quite sure that I understand it. Presumably we would have lower tariffs than the EU tariffs on some goods because we had come to some free trade arrangement with a third party. They would want those lower tariffs because they believed it would make it easier for them to sell their goods in our market. If the cost of reclaiming is such that businesses do not do it, those goods will not be cheaper in our market, so why would they enter into that trade agreement with us in the first place?

Robin Walker MP: That is exactly why we want to ensure that the repayment mechanism is designed in a way that fits the needs of business and actually engages with their key concerns. It will be a question for the individual trade negotiations to ensure that the savings in tariffs are substantial in that respect. We will absolutely want to work with business.

There are a variety of businesses selling at different tariff rates, some of which are quite substantial and would make a repayment mechanism very much more attractive, and some of which are very small. Indeed, in some cases of very low tariffs currently, some businesses choose to pay a tariff rather than go through the processes of reclaiming it or avoiding it under existing mechanisms. That will continue to be part of the thinking, but you are right in saying that we need to ensure that the design of the repayment mechanism makes it worth the while of third countries to engage in tariff negotiations with the UK.

Lord Stirrup: That is exactly the point. It is not just a question about businesses in the UK; it is about persuading others outside.

Robin Walker MP: Absolutely.

Q108 **Baroness Brown of Cambridge:** My question follows on from all that and the issue about having our own free trade agreements. Let us say that we have a free trade agreement with the country that appears in Dilbert cartoons as Elbonia, so that nobody gets offended by me picking on them. Suppose that Jaguar Land Rover is buying wheels from Elbonia as we do not make wheels in this country, and that some of the Jaguar Land Rover cars will arrive in the EU but some will be exported to China and some will stay in the UK. Will those wheels cost more if the car goes to Germany than if the car stays in the UK or gets exported to China, for example? Will there be an EU tariff on those parts of the car that might go to the EU, but a zero tariff on the ones that stay in the UK or that we export elsewhere?

Mel Stride MP: The tariff would fall due at the UK's border with Elbonia, or wherever it is coming in from. On day one, there would be no tariff differential whether it then goes on to the EU or to us. There would be no tariffs due on the completed vehicle going from the UK to the EU, because we would have a free trade arrangement with the European Union.

Baroness Brown of Cambridge: Germany would not mind that these wheels have come through somewhere that the EU has—

Mel Stride MP: We would have to comply with the rules of origin requirements of the EU's trade policy at our border, so to the extent that there were rules of origin issues and therefore tariff consequences, we would apply that at our border. In effect, that element of it would be captured at the UK border as the product went through.

Robin Walker MP: Another element is important. One of the positive evolutions of the facilitated customs arrangement from the earlier NCP suggestion is that it deals with substantial transformation of a good as well as the consumption. Instead of having to follow a good all the way through to a point of consumption, you could say that when the wheel was attached to a car it counted as the substantial transformation.

If that process took place in the UK, a UK tariff would be eligible. When we have a free trade agreement with Elbonia that removes tariffs, Elbonia would be able to say that the destination of that good for substantial transformation was the UK. Subject to negotiations with the EU, we would also like to reach agreement on that to ensure that the facilitated customs arrangement actually generates the maximum trade benefits to both parties.

Mel Stride MP: Robin raises an important point about substantial transformation. The point at which we would trigger the ability to reclaim a tariff difference, if there was one, would be at the earliest stage of the supply chain. By using substantial transformation, you could argue that when a gearbox that might have been imported gets attached to an engine, that is the moment at which substantial transformation has occurred, as opposed to perhaps waiting until it is in the car and the car is assembled, et cetera. We are very aware of the timing issue in making sure that reclaims can be made at the earliest possible moment to help the industries concerned.

Baroness Brown of Cambridge: If they are completed wheels and you are simply bolting them on, that is substantial transformation; you do not have to machine them or add value to them in other ways.

Mel Stride MP: I could not opine on a particular example such as that, but the principle would be that there would be definitions of what constituted substantial transformation, and that would be the trigger for the ability to reclaim any tariff differential.

Baroness Brown of Cambridge: But it will be very complex for some industries where you are putting together things that have many thousands of parts.

Mel Stride MP: All customs systems are inevitably fairly complex. There are 17,000 duties in the UCC tariff, for example—17,000 codes and different ways in which tariffs operate, and quotas and things. It would not be absolutely straightforward, but it is manageable.

The Chairman: There could also therefore be legal challenge on which bit you thought was major transformation.

Robin Walker MP: Which is why it would need to be agreed between the UK and the EU. This is something that we obviously want to agree. Given that the EU has in its negotiating guidelines that it wants a situation for goods that is tariff free and quota free, that will mean having conversations about rules of origin as well. We propose a detailed negotiation on how that arrangement will work and how it will recognise, on an agreed basis, substantial transformation, so that we can then have differential tariff collection.

The Chairman: How are those negotiations going? It is quite a major issue.

Mel Stride MP: The proposal is just out there really, and the EU has initially said that it is minded to have a serious look at it, but it is very early stages.

Robin Walker MP: My Secretary of State left the House of Commons Chamber about an hour ago to go straight to Brussels to meet Mr Barnier. This is something that we want to discuss with them, but recognising that it is an arrangement that meets our objectives both for tariff-free and quota-free trade between the UK and the EU and for no hard border in the island of Ireland, which of course both sides of the negotiation are committed to. We think this proposal makes that much more practicable.

Q109 **Lord Stirrup:** The White Paper talks about the new trusted trader scheme, which seems to be key to enabling companies to pay the right tariffs at the border rather than having to reclaim, other than in a minority of cases. What estimates have the Government made of the cost and timescale of implementing this new scheme? Clearly we already have a trusted trader scheme, but I assume the intention would be for there to be a much higher uptake of the new scheme, so that you could minimise the repayment claims and all their associated difficulties. Have you made any assessment of the additional burden on new businesses coming into the scheme?

Mel Stride MP: You are right to identify the importance of AEOs. A substantial amount of our trade with the rest of the world, whether it is import or export, is covered by trusted traders. It is about 60% for imports and a little more than 70% for exports. This is a concept and an approach that is very well understood by us. It is very much in operation and understood out there in the marketplace. We have to end up with mutual recognition between ourselves and the EU 27 on AEOs, so it follows that the negotiation itself will determine exactly what we are putting together, which partly drives the answer to your question.

We are looking closely at what the costs might entail. We are cognisant of the fact that we want to make this as simple as possible. We will constantly be balancing making sure on the one hand that it is robust and an integral part of assuring the European Union that we will respect and uphold the integrity of its customs union and its single market, with the importance on the other hand of making sure that people can sign up to it, engage with it and benefit from it as quickly as possible. It is ongoing work in that sense, but it will be central to what we are doing.

Robin Walker MP: I do not want to sound critical in any way of another part of government, but I have heard anecdotally from a number of businesses that there are states in the EU where it is easier to become a trusted trader and there is more uptake of the trusted trader schemes.

That is balanced by the fact that we have one of the most effective customs systems in the world, so perhaps there have been fewer incentives for some businesses to sign up behind a trusted trader scheme. Part of the process will be to look at how we can expand the capacity of the trusted trader system and make it easier and quicker for businesses to sign up.

Mel Stride MP: There is a higher level of uptake in Germany for its equivalent to AEOs than there is here, but ours is a very comprehensive scheme. I think it allows 21 different facilitations, and each one of them is significant. Ours may do more than others do, so what we mutually agree between us could be a simplified version of that, or it could be an expanded version. That, in turn, will determine how onerous or otherwise it is to get involved and what the costs would be.

As regards the entire model, the figure that HMRC has estimated that the additional cost for rest-of-the-world trade engaging in the model is about £700 million per year. That pales in comparison to the max-fac and the hard border model between us and the EU 27, where the estimated costs for the additional number of pre-declarations rising from 50 million to 250 million would be up to about £20 billion per year. There are some significant cost advantages of this model over the max-fac alternative.

Q110 **Baroness Chalker of Wallasey:** I am all for building as much automation into the scheme as you can, but whenever you do this there is the danger of some rather evil but clever brains finding ways round it. What consideration of potential additional fraud have you made, particularly with goods coming in from less well-developed EU partners, who frequently find ways round the rulebook that even Brussels comes up with?

Mel Stride MP: HMRC and Border Force are already engaged at our borders on just those kinds of issues. Goods coming in from the rest of the world, irrespective of whether they are destined for the UK or beyond, are subject to the approaches that we take, which are typically intelligence-led, ad-hoc interceptions, sometimes away from the border. In 2016-17, HMRC was able to recover around £30 billion in total from non-compliance across the tax base generally. That is across the broad tax base, not solely customs duty.

We have one of the lowest tax gaps in the world, so we have a pretty good record on getting tax and duties in. That is not to say that there are not circumvention risks and smuggling risks, and people bringing stuff into the UK, reclaiming and then taking it on. We will have mutually agreed systems and compliance approaches to deal with that.

Baroness Chalker of Wallasey: Thank you, but it is not just what we agree with Brussels; it is also what Brussels enforces with some of the member states. I do not want to blacken any country's name, but there are some problems. If we do not think about it in advance, I am sure we are going to get caught out on it from time to time.

Mel Stride MP: Yes. This is where co-operation and having access to each other's systems and processes will be really important. One of the issues that might be a challenge is where we have imposed trade remedies—for example, higher tariffs on particular goods such as steel—and the EU 27 have not. There would therefore be a fiscal incentive to bring steel in through Europe and straight across to us. In most of those examples, you end up with a discrete set of goods where, as a consequence, the relative ease of tracking and intercepting is important.

Secondly, you would, of course, have the option of making the end importer in the United Kingdom liable and responsible for ensuring that those goods have paid the appropriate duty. So there are tools that we would have, but I recognise the problem that you have identified.

Q111 **The Chairman:** Do you know what proportion of the membership of trusted trader schemes is in the SME sector, and do you want to increase that proportion? The forms are very complex, and traders are expected to put up a high level of financial security to access them. That will take a lot of small traders out completely. It is really important that the financial and administrative burdens that will be placed on traders are taken into account, because it is all a cost. We have not heard enough from the Government on how that is going to be allayed.

Mel Stride MP: That is a very pertinent point. I do not know offhand what proportion of current AEOs would be classified as SMEs. I would speculate that those companies would in the main be larger, for the obvious reason of the cost of entering into the arrangements. There are various things that you have to do to maintain your status as an AEO, including security measures at your locations in the UK for example, which would of course be a cost. These are certainly elements that we are closely looking at, among all the other things, as we look at the ideal form and shape of the AEO regime going forward.

The Chairman: We have been told that you can sign up with people who do it as a living, and get it done through them, but, inevitably, if the volume goes up, those guys are going to increase their costs too.

Mel Stride MP: Yes.

Q112 **Lord Risby:** One of the key points about the Brexit process is to enable us to have direct trade relationships. I happen to be a trade envoy, so I am reflecting what I hear in that context. Obviously many people have a view of the openness of the European Union that is rather different from the European Union view of its own openness.

Given that we are potentially going to sign up to a common rulebook on EU goods, to what extent will we be able to divert or change somewhat standards and regulations in establishing relationships with other countries? Are there any particular areas in your minds where that will be more possible?

Robin Walker MP: It is a very good question. One of the myths being discussed at the moment is the idea that a common rulebook and common standards on the agricultural and industrial products related to avoiding a frictionless border would prevent us doing trade deals with third countries. I certainly do not think that is the case. You need to look at the volume of trade that we have with a number of significant third countries that are able to trade with us on the basis of current standards but that potentially face tariff barriers in trading with the UK as a result of our application of the common external tariff. There is no reason why we could not remove those tariff barriers and significantly increase the volume of trade by doing that.

We have touched on services. We will have the capability to set our own rules on services; the UK is already a significantly more open economy to international trade, investment and services than many other EU economies. As you appreciate, the single market on services has never been completed. It is an area where the combination of divergence on tariffs in potential individual agreements and a more open approach to services can give us a lot to negotiate with.

The other point is an important political one. I was on the BIS Select Committee when we scrutinised the TTIP negotiations. Of course we were doing that at one remove, because it was an EU negotiation on our behalf, but we all remember the political furore at the suggestion that standards would in any way be lowered by those negotiations. We have heard all the rows about chlorine-washed chicken and so on.

I do not think there is the political appetite in this country to do trade deals that would lower standards of food or product safety. We have to be honest about that in our trade negotiations. We are going to be negotiating on volumes of trade, on removing tariffs and being a champion of free trade in the world, but we are not going to win trade by lowering standards, because that would not be in the interests of the public we represent.

Lord Risby: Absolutely, but the point needs to be made to people who are being told by our embassies, trade commissions and representatives that we are going to have a different regime open to them. The message needs to be clearly indicated to them, if I may make that observation. You certainly know, for example, that the protection of some parts of agriculture in the European Union is devastatingly bad for some people who wish to have a direct trade relationship with us.

Robin Walker MP: That is why it is important that we are leaving the common agricultural policy. We need to make the distinction between food standards and the type of standards that will be covered by the common rulebook, which are those that would lead to inspections at the border, and the whole argument about subsidies and tariffs, where we will have much more freedom to set our own approach.

Q113 **Baroness Armstrong of Hill Top:** The proposed arrangements include the UK collecting customs duties on behalf of the EU. How is that going to be audited? What will be the arrangements for differences, for disagreement?

Mel Stride MP: As I said earlier, it is really important to say right up front that we recognise the critical importance of making this work, and that it is robust and that we respect the integrity of the EU's customs union and single market. We would look to negotiate a mutually agreeable and very robust compliance system to cover issues with the common rulebook, the way the model works at the border for tariffs and the way the repayment mechanism would work.

We would seek continued access to the various systems that are already in place for exchanging information with the EU, and to keep those going. I have already mentioned that there may be duties imposed on those who are doing the importing to ensure that they satisfy us that they are indeed operating the system in the appropriate way.

Baroness Armstrong of Hill Top: What if there is disagreement?

Mel Stride MP: If there is disagreement, we recognise that we need some kind of institutional arrangement in place to handle it. In the broader context of disagreements, as set out in the White Paper, we have put forward the suggestion of a body or committee that would have equal representation from us and the EU in dealing with disputes. It would, with the agreement of both parties, be able to refer something to the ECJ, but it would have to be with the agreement of both parties and not just the EU. In the absence of that, and if disagreement continued, we envisage going to independent binding arbitration as a way of finally resolving any particular disagreement.

Q114 **Lord Dubs:** Presumably the Government are making all sorts of preparations or contingency plans for a variety of outcomes that may eventually happen. What about the possible outcome of a no-deal Brexit? What sort of plans are you making for that?

Mel Stride MP: A substantial number of plans have been ongoing for some time and continue across government. We have 146 ports of entry to the United Kingdom: airports, Eurotunnel and about 140 ports. Dover is the most obvious example of a ro-ro port where the impact of no deal would be most keenly felt.

We will shortly be making a statement about the possibility of a no-deal situation, although it is unlikely in our view and certainly not our desired outcome. Over the summer, there will be some 70 technical notes covering a number of issues that would arise as a consequence of no deal. We will be rolling out a trader communication plan over the summer and beyond, to make sure for example that the 140,000 businesses that export only to the EU and do not export to the rest of the world and are therefore unfamiliar with customs arrangements are duly aware of what they will have to do in those particular circumstances.

The priority will be to keep the flow moving. There is a trade-off between keeping the flow moving, raising revenues, and security. We will not compromise on security, but particularly in a place such as Dover, where you have to keep flow moving very quickly or you end up with all sorts of problems, there may be a trade-off between keeping the flow going and revenue protection.

Not all of this is in our hands. In the case of Dover, the system involves vessels going over to Calais and back. If it gets gummed up at the French end, we have the problem at our end as well. In a sense, we are keen that our EU partners are as engaged in preparations as we are.

Lord Dubs: As a Committee, we went to Dover last week. There will be a difficulty for the Dover people if they do not have enough time to get everything sorted. In other words, if there is something approaching a no-deal Brexit, they would have to do some configuration of the traffic flows and so on, and that cannot be done overnight.

Mel Stride MP: There is an end-state model with no deal, which would be a very highly streamlined and very facilitated and efficient border. That end model could not be delivered by 29 March next year, and we recognise that. One component would be an inventory-based system at the port that allows you to match pre-declarations made en route to Calais, via vehicle number plate recognition technology, to the inventory system, which would tell you what is on the particular truck. That would help to control the whole process and keep it moving.

We will not be able to deliver that by 29 March next year, but that is not the same thing as saying that we cannot deliver something that works. That is where we come back to the essential trade-off between keeping the flow moving and perhaps losing some revenue as a consequence. I am confident that, subject to our European partners being in the right position, we will be able to keep the ports moving.

The public, the press and everybody tends to focus on what might happen to us in that situation. It is worth bearing in mind that, of course, supply chains extend from the EU into the UK as well as the other way around. If we ended up in the kind of really difficult territory that you could imagine if everything stopped for a lengthy period, it would not just be the UK that suffered. There is mutual interest in resolving this on both sides.

Lord Stirrup: You talked about the trade-offs you might have to make at Dover to keep the flow moving in the event of a no-deal exit. What would be the situation at the border with the Irish Republic, and what sort of compromises do you envisage having to make there?

Mel Stride MP: The first thing to say is that there will be no hard border. Nothing that we will do will introduce a hard border between the Republic of Ireland and Northern Ireland. The precise way in which it would work would be subject to the negotiations between now and if we came out with a no deal.

People assume that in Ireland there are no checks or interventions going on with goods going across, but of course there are. There is a substantial amount of trafficking, fuel laundering and tobacco smuggling. There are interceptions inland in Northern Ireland, so it is not the case that we would not have the ability to function in that particular environment, but there would clearly be some very significant restrictions.

I cannot answer now the question as to what exactly that border will look like after 29 March. That is subject to the Irish Government, the EU and us working out exactly what we do.

Lord Stirrup: But presumably we are in this situation because we have not been able to work things out with the EU.

Mel Stride MP: Well, it could be for a variety of—

Lord Stirrup: To say that it would depend on the outcome of negotiations, when the negotiations have essentially broken down—

Mel Stride MP: Our model actually resolves the Irish situation. The situation in which it broke down might be around the functioning of our collecting EU tariffs, or whether the EU feels that that is being proposed in a robust enough fashion or whether it is going to work. There could be a number of areas where we are going to have to look at this very carefully, but we are saying to the EU that one of the most important things is that this proposal resolves the Irish conundrum.

Robin Walker MP: It is important to remember that we are still in discussions on the withdrawal agreement as a whole, including the commitments under the joint report to have all the options addressed in that respect. We put forward a proposal for a temporary customs arrangement, and we always made it clear that regulatory areas would have to be covered in that arrangement. Clearly what is set out in the White Paper gives us a useful framework within which to discuss that.

When my Secretary of State goes to Brussels today, he will make the point that we now really want to push forward at pace to agree all elements of the withdrawal agreement, but we still believe, and have consistently believed, that the best way of addressing the issue at the border is through the future relationship between the UK and the EU. These proposals allow us to deliver that.

Lord Horam: Minister, you said that the important thing will be to keep things moving at Dover and elsewhere, in the sky and so forth. Is there a legal contractual problem, or, if you have the unsatisfactory situation of no deal very late in the day, will Governments on both sides keep things moving as best as possible, even if there is no legal basis for the situation?

Mel Stride MP: I do not think we would seek to do anything that was not compliant with WTO rules or our international obligations of any kind. It would depend on exactly what we were doing, and I would be confident that we were doing it in a way that was compliant legally. My understanding is that we can do that. We can keep the flow going while—

Lord Horam: That is your understanding.

Mel Stride MP: Yes, but I am afraid I am not an expert on WTO compliance requirements and all the other things that might be out there.

It has never been suggested to me that it would be anything other than compliant, in that sense.

Q115 **Baroness Suttie:** The proposals in the White Paper mean that the so-called backstop would not actually be used, but is it still the Government's intention to negotiate a backstop?

Robin Walker MP: Yes. We are committed to that through the joint report. As I say, my Secretary of State will be saying, "Let's bring these negotiations to a conclusion". When we originally set out the temporary customs arrangement, there was clearly a place holder for regulatory arrangements. The clarity that we set out in the White Paper on a common regulatory approach across issues that relate to friction at the border is helpful in resolving that, but of course I cannot pre-empt the detail of the negotiations.

Baroness Suttie: Do the Government feel confident that the European end of the negotiations will feel that the Government's proposals in the White Paper will prevent a hard border?

Robin Walker MP: I cannot comment yet, because we have not had the formal view. Obviously the EU has said that it will study the proposals carefully and it welcomes the detail that has been provided. What I can say is that we have had encouraging conversations with, among others, the Irish Government, who recognise that there is more detail on some of the key issues that they want addressed. We will want to engage actively with the EU and with member states to make the case that it provides resolution on that key issue. I think there is recognition that some of the key concerns they had about earlier proposals have been addressed in the White Paper.

Q116 **Baroness Chalker of Wallasey:** We heard earlier from Treasury officials about administrative implications and costs. Have the Government made a full assessment of the staff resources that will be needed for the facilitated customs arrangement, both for the Government and for UK businesses? Businesses will need some help, whatever solution we finally arrive at.

Mel Stride MP: We are tracking two things in HMRC. We have the FCA, which is one model, but we are gearing up for the no-deal scenario and we have to be ready for that. As you may know, the Chancellor announced £3 billion additional funding to cover Brexit preparations generally across all government departments in the last Budget. HMRC received £47 million last year and is receiving £260 million this year.

I believe that HMRC has recruited over 1,000 new personnel. Another 1,500 are imminent, which would take it to about 2,500 additional staff. The number that we believe we would need to handle a contingency scenario would be between 4,000 and 5,000. To put that into context, the organisation has a full-time equivalent staff of about 60,000 people. It recruits between 6,000 and 7,000 additional staff every year as a matter of course, so it is a proportionate number to be taking on. It is quite manageable.

We have been investing heavily in systems. The CHIEF system, which has handled our pre-declarations and customs declarations to date, will be replaced with the CDS system, which is on target for delivery next January. That will allow us to scale up from the 50 million to 250 million declarations that we would have to handle if we were in a no-deal situation. HMRC is broadly in a good place, not least because it has heavily re-prioritised what it was doing to focus on this.

Robin Walker MP: On the cost to business, the most important thing about the facilitated customs arrangement is that for the very large number of SMEs in particular who trade only with the EU it would mean no additional cost, because it would mean continuing to operate on the basis of a tariff-free and customs declaration-free arrangement. That is a very significant part of why this is the right way forward.

Mel Stride MP: We believe that there are 140,000 businesses trading only with the EU, as opposed to businesses that are also trading with the rest of the world, and that are above the VAT threshold, so are known to us. In the communication planning that I referred to earlier, it would be easy to interact with them, to write to them and get in touch with them.

We estimate that there are a further 100,000 businesses below the £85,000 turnover threshold for VAT. It will be more difficult to get through to them and we will need a broader campaign. About 250,000 businesses are just trading with the EU 27 rather than elsewhere. As Robin says, one of the strengths of this model is that they will see no change at all; they will carry on as before.

Baroness Chalker of Wallasey: They are the people, though, who have most loudly called for the changes, yet very often they do not seem able to cope with the paperwork that will be necessary for them to benefit. It was ever thus; it is not a new happening, as any constituency Member will tell you.

The Chairman: Are you confident that you are going to be able to find these people?

Mel Stride MP: Yes.

The Chairman: Because of historical remembrances, we know that big IT systems tend to take some time to bed in. That disruption to any business, whether small or large, will end up with them having to claim recompense from somewhere.

Mel Stride MP: I am confident about people, because the recruitment at HMRC is happening; we can already demonstrate that we are well on our way to where we need to be in a no-deal scenario.

On the issue of systems, a fortuitous element is that work on the CDS was launched some time ago, even before the referendum in 2016, so there has been a long lead time. The National Audit Office stated recently that our objective of bringing it into full operation next January is not unreasonable. The NAO is not saying that it is without risk. Any big project will have risk, but I am satisfied that it will be in place and will handle the additional volume of declarations, if they are necessary.

The Chairman: Otherwise we will see a lot of lorries stacked up somewhere if it all goes a bit wrong.

Mel Stride MP: That goes back to the point about Dover and making sure that we keep the flow moving, because it would not be in our interests or the interests of France or any other European state for that to happen.

Q117 **Lord Triesman:** You may feel that you have answered most of this, so it may just be your additional thoughts.

Mr Stride, you said in response to Lord Dubs that not all the matters in the reciprocal arrangements are in our hands. You also made the point that it would be in the interest of companies and Governments in the EU to see that flows work smoothly as well. A number of witnesses have said broadly the same thing, as you can imagine.

Could you say something about the engagement between the Government here and the Governments in France, Belgium and elsewhere to ensure preparedness? What has been the depth of that engagement?

Robin Walker MP: There has been engagement from DExEU with every member state and with the Commission on these matters, but it is fair to say that that engagement was only able to go so far while the arrangements on contingency planning were necessarily kept in private. One of the advantages of the announcements that we will be making over the summer, and the technical notes we will be able to provide, is that they will allow for much more engagement, both with businesses domestically and, very importantly, with other member states.

We have already seen, and you will have noted in the last few days, the Commission and a number of member states announcing some of their plans in the unlikely event of a no-deal arrangement. It is important that we all bear in mind that that is not the objective of either side. So it is right to have greater openness about that, which is why I welcomed what Mel said at the beginning and what my Secretary of State said earlier in Questions about publishing more information on contingency planning over the summer.

It all needs to be looked at through the prism of the fact that we think we have a mechanism that avoids all that, and which will be hugely in the interest of the member states with which we trade most closely, and indeed of all member states because of the complex supply chains that straddle the whole of the European Union. That is why it is so important to put something forward at this stage that could save a lot of cost, time and effort in contingency planning if all parties agree to take it forward.

Lord Triesman: I entirely get the point that there is a discussion going on, and nobody wants to speak too openly at this stage about it. We are considering these matters now and in advance of that discussion, and I do not think anybody on the Committee would particularly want to issue a report that had been so overtaken by events as to make it irrelevant. Do you think it would be possible, even in advance of that and without compromising any negotiation, for our Chairman to be briefed on what those kinds of elements are, just so that we do not do things that turn out to be foolish?

Robin Walker MP: I am happy to look into that from our department’s perspective and to see whether there could be a conversation with my colleague, Chris Heaton-Harris, who has been recently appointed and is leading on the PDC work. As I said, we will be bringing forward information very shortly, and announcements have been made in Parliament, both in yesterday’s debate in the House of Commons and in Questions today. Mel picked up on some of that in his earlier comments.

There is some information, but we will be bringing more information into the public domain very shortly. I am not necessarily sure how much further we can go on that before it is made public. It is something I am happy to take away and look at, and perhaps I could write to the Committee about whether there is anything that could be arranged on Privy Council terms, or as appropriate, to organise a briefing.

Lord Triesman: We appreciate that.

Q118 **Lord Stirrup:** The October European Council meeting is looming large. How confident are you that an agreement can be reached between the UK and the Commission on a proposition on customs arrangements and a customs backstop by then? Are both sides standing ready for almost non-stop negotiations between now and then?

Robin Walker MP: That is very much part of the messaging that my new Secretary of State is taking to Brussels: that we are prepared to move at pace on this and across a wide range of areas, and we really want to accelerate the tempo of negotiations. So far, that is what we have heard back from the Commission too. The scene is set for that to go forward, but of course it will depend on the formal negotiations over the months to come.

We think it is very important that we get out and explain the proposals in the White Paper to member states. All the Ministers in my department will be travelling over the summer to make sure we do that. My officials are working hard on establishing with whom we can meet next week and during the first couple of weeks of August so that we make sure that we get that messaging out as widely as possible. Clearly there is a challenge, as an awful lot of politicians and officials in EU member states will not necessarily be in their offices during August, but we are very keen to find out who is so that we can talk to them and keep the process moving forward.

There is recognition on both sides of the negotiation of the need to up the tempo of the pace of negotiations on the withdrawal agreement, as you say. Crucially, now that clear proposals on the future partnership are out there in the public domain and we can engage on them, we must make sure that businesses see as much detail as possible on the future relationship when we have the agreement on the future framework in October. That is something that we are very keen to take forward on the basis of the White Paper and engage on.

Lord Stirrup: Especially since the withdrawal agreement really depends on the customs arrangements. The border with the Irish Republic hinges on that.

Robin Walker MP: That has always been part of the conundrum and is one of the reasons why we were not very keen on sequential negotiations in the first place. We have to be very clear that we now have proposals that are realistic, principled and sensible, and respect the legal orders on both sides. We should move forward and reach agreement on those as quickly as possible.

Lord Stirrup: Action this day is the mantra of the moment.

Robin Walker MP: Absolutely.

The Chairman: And at pace.

Robin Walker MP: Yes.

The Chairman: Thank you very much, Mr Stride and Mr Walker, for coming in this morning. This has been a very useful session. We could probably have done with another hour with you, but I know that time does not permit on your side. Hopefully, we will be able to call you in after Summer Recess to see what progress has been made as we head towards the closer date of the October Council.

Mel Stride MP: Thank you. We look forward to it.

The Chairman: Thank you.