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Background

The conclusion of the UK-EU Trade and Cooperation Agreement (TCA) at the end of 2020 avoided the imposition of tariffs on goods traded between the EU and the UK. However, it has led to the introduction of a series of new non-tariff barriers (NTBs) to trade, especially checks and controls on goods crossing the GB-EU border. The EU introduced full import controls from January 2021, while the UK adopted a phased approach to the introduction of checks and controls on goods imported from the EU, with several delays and postponements. This led to an asymmetry between GB exports to the EU and GB imports from the EU, causing significant uncertainty among traders regarding the new arrangements under which goods can be traded between the two markets. This is in addition to the already high levels of uncertainty regarding future trade arrangements that firms on both sides of the border had to face since the result of the 2016 referendum, affecting both the decision of firms to enter foreign markets (Crowley et al. 2020), as well as the intensity of trade transactions between the UK and the EU (Douch et al., 2021). This uncertainty has been shown to be starting as early as 2015 general election (Douch et al., 2021). However, the negative effect of uncertainty on trade in goods have not been homogeneous, badly affecting in particular smaller traders, which on average are less productive and lack the resources needed to quickly adjust in response to international shocks. These firms are even more exposed to Brexit-induced trade uncertainty, given their limited basket of traded goods and their overreliance on geographically proximate EU markets.

Responses to consultation questions

1. What have been the overall consequences to date of the implementation of the Trade and Cooperation Agreement and the end of the transition period for GB-EU trade in goods, in the UK’s first year outside the Single Market and Customs Union?

Overall effect

The implementation of the Trade and Cooperation Agreement for GB-EU trade in goods has finally concluded a period of high uncertainty regarding the new trade arrangements between the EU and the UK. Several studies have shown how trade policy uncertainty could dampen trade flows and the international activities of firms, due to the high level of long-term investment required to plan future international transactions and the need to be able to predict future trade regimes (Handley and Limao, 2015). This has been shown in the case of Brexit as well, where uncertainty regarding the structure of the EU-UK new trade agreement has affected aggregate trade flows and firms' export participation (Graziano et al., 2020; Crowley et al., 2020).

Using the UK HM Revenue Customs (HMRC) quarterly trade transaction level data for the population of UK exporters, our research shows how trade policy uncertainty during the Brexit period (2015-2018) had an heterogeneous effect on UK exporters of different sizes, negatively affecting in particular micro exporters, many of which had to cease their exports towards EU markets (Douch et al., 2020). At the same time, uncertainty caused trade diversion for small and medium enterprises, significantly reducing exports towards the EU, but at the same time partially replacing these with more exports towards extra-EU markets. On the contrary, larger exporters managed to maintain stable trade relationships with EU partners, further exploring extra-EU markets. As a consequence, the growth in the number of products exported to EU markets decreased by 2.5% in comparison with extra-EU markets, and the number of EU destinations reduced by 2.8%, limiting as well the introduction of new products to new EU export markets. These effects are not homogenous across EU countries. Brexit-related policy uncertainty has reduced in particular the value of UK SMEs exports towards specific EU partners, such as France, Spain and Portugal, and many Central and Eastern European countries (Douch and Du and Vanino, 2020). The significant negative impact on smaller exporters is particularly relevant, given that even if smaller exporters account for only a third of the UK total value of exports, they represent more than 95% of the total number of exporters in the UK, employing about 2.5 million workers (HMRC, 2020).

Traders of different size
These heterogeneous effects of the policy uncertainty are explained by the traders likelihood of exporting products that could have faced an increase in tariffs under a "no-deal" scenario, moving from a zero tariff to a most-favoured nation (MFN) duty. These products include in particular agricultural goods, chemicals, textiles and transport equipment. This translates into a larger negative effect of trade policy uncertainty for micro and small exporters, which clustered most of their limited products baskets in the exports of products potentially facing higher trade barriers. This has led in the post-referendum period to total export values growth for micro and small firms to decrease by 45% and 19% respectively, while medium exporters have experienced a similar pattern but of a smaller magnitude (Douch and Du and Vanino, 2020).

Although the implementation of the TCA has removed the ambiguity regarding the imposition of tariff barriers to trade in goods between the EU and the UK, uncertainty regarding the application of non-tariff barriers to trade in goods still remains high. This is caused in particular by the continuous delays in the introduction of import controls by the UK Government, and the lack of clarity regarding the customs requirements. Again, this will disproportionally affect smaller exporters, which lack the appropriate knowledge and resources needed to handle an increasing bureaucratic and administrative burden in dealing with new customs regulations, and therefore might be pushed out of international markets.

Traders Support
Managing supply chain risks, their vulnerabilities and uncertainties is key to mitigate potential long-term effects. This is because additional checks and controls will act as new non-tariff barriers to trade, and it would take time for businesses to plan and respond to the change in the trading environment. Given the heterogeneous effect of uncertainty on UK traders estimated in our study, the UK Government should focus its efforts in trying to support and help in particular smaller exporters and importers. Especially this group of firms are particularly vulnerable to changes in trade policy and arrangements, given their limited resources and the overreliance on mature manufacturing goods and

proximate EU markets. This could include targeted training for export support admin workers, government-backed trading credit for SMEs, and expedited and simplified customs procedures for smaller traders

3. What are the implications of continued 'asymmetry' between GB and EU border controls, for example on the competitiveness of GB businesses, on border security, and on customs revenue? Are these asymmetric arrangements sustainable?

Our previous research on the asymmetric effects between UK exports and imports shows that again it is mostly micro firms that suffer from Brexit uncertainty, with effects similar to exports, although larger in magnitude. Smaller firms reduced the overall value of goods imported from the EU, reducing as well the number of intermediate inputs imported, but not reducing the number of EU countries from where they source their inputs. This suggests that smaller firms, exporting, importing or both, react more strongly to the mounting uncertainty about the post-Brexit trade regime, presumably because of their vulnerability facing looming risks. While the negative effect has been much stronger for micro and small firms in terms of imports rather than exports, there has been a positive effect in terms of values of imports for large firms. This could have been driven by large firms stockpiling as trade uncertainty increased, while micro and small firms have seen their limited import flows based on a few products lines disrupted by the uncertainty about Brexit. Thus, the imposition of border controls on imports from the EU could have potentially an even stronger negative effect on UK firms than the introduction of EU controls on exports, further disrupting their supply chains in a period of acute supplying shortages. [i]

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[i] Crowley, M.A., Exton, O. and Han, L., 2020, May. The looming threat of tariff hikes: entry into exporting under trade agreement renegotiation. In *AEA Papers and Proceedings* (Vol. 110, pp. 547-51).
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