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Content

Potential implications of Brexit
Customs and trade

Brexit negotiations officially started in June, and the EU and UK lead negotiators' teams must close a deal on the terms of the UK's exit from the EU by March 2019 that will have broad implications in many areas, including customs and trade.

Considering the possible outcomes of the negotiations leads to the question of what a "hard" or "soft" Brexit means. From a customs and trade perspective, this article reviews possible scenarios and identifies considerations that the negotiators should take into account, and steps that companies can take to prepare for the potential challenges of Brexit.

Brexit scenarios

The result of the negotiations will need to prescribe how the UK should end its membership of the EU, and manage issues such as its future relationship with the EU Single Market (and the EU Customs Union). There are several possible future scenarios, and different degrees of market harmonisation are possible.

Hard Brexit: A "hard Brexit" scenario would see the UK leaving both the Single Market and the EU Customs Union, which is currently the stated aim of the UK Government. The rules governing trade between World Trade Organization (WTO) members (which include the UK, the EU and all EU Member States) would then apply and the UK would need to negotiate itsWTO commitments in its own right, given its current membership is as part of the EU.

The hard Brexit scenario, likely to be the most disruptive from a trade perspective, would require EU and UK businesses to deal with a new border, including applying the related tariff. It also could lead to differences in regulatory regimes between the EU and the UK, and the rise of "non-tariff barriers." A hard Brexit would require customs agencies in the EU and the UK to treat imports from, and exports to, the other party in the same way as they currently manage relations with non-EU/ EEA/Customs Union states, bringing new burdens in controls and risk management, as well as additional resources in relation to information technology systems and staff.

With numerous free trade agreements (FTAs) and trade arrangements currently in place between the EU (including the UK) and third countries, a hard Brexit would imply that the UK would need to renegotiate these FTAs on a bilateral basis. In the event an FTA with the EU is negotiated, similar to Norway or Switzerland's current situation, this would mean that exporters would need to comply with cumbersome specific rules of origin, which would be negotiated under the agreement. The Norwegian and Swiss models, which both allow some access to the single market, also impose certain obligations that would restrict the UK's ability to act as it wishes , e.g. in terms of the free movement of people.

Soft Brexit: Theoretically a "soft Brexit" scenario would see the UK stay in the EU Customs Union, which would guarantee the free movement of goods (with no tariff barriers) with the EU and common external tariffs for goods entering both the UK and the EU from third countries. However, this route would mean the UK could not negotiate its own new trade deals with third countries.

The UK might also retain much of its current level of access to the Single Market in a soft Brexit scenario, although the precise nature of that access would depend on the nature of the scenario agreed. .

Implications of the chosen scenario

After the first three rounds of Brexit talks took place between negotiating parties in Brussels, discussions about the future customs and trade relationship have yet to take place, with the EU stating that as yet they do not have sufficient detail from the UK to enable them to progress the exit negotiation priorities (being the 'exit bill', the Northern Irish border, the rights of EU citizens, the possibility of transitionary arrangements, and the outcome for EU agencies currently based in the UK). The EU remains steadfast that trade talks cannot begin until these issues are further progressed towards resolution, so it remains unclear which model will be chosen.

Part of a "hard Brexit scenario", the least advantageous option would likely be the (interim) solution that WTO membership would provide if no other agreement is reached, which would mean that "most-favoured nation" duties would apply, along with full border controls and inspections. The likelihood of such a (WTO) scenario is not negligible but is not the outcome sought by the UK Government. Ahead of the third round of negotiations, the UK Government published a Position Paper containing the key principles on what will happen to goods on the EU and UK markets after the point of departure in March 2019, stating that the UK Government will "seek an agreement with the EU which allows the freest and most frictionless trade possible in goods and services"[1].

In trade negotiations, good intentions are not a guarantee of good outcomes. Similarly, whereas the expressed UK Government commitment to avoiding disruptions during the move to the future partnership are welcomed, it is no guarantee to a continuation of frictionless trade after the new trade relation enters into force. At this

[1] *See: https://www.gov.uk/government/publications/continuity-in-the-availability-of-goods-for-the-eu-and-the-uk-position-paper (date of publication: 21 August 2017)*

stage, it seems almost unavoidable that the rules will change and will become less favourable for both parties.

With respect to the important trade relationship between the UK and the other EU Member States, the consequences of redefined external borders and new "rules of the trade game" may have far-reaching implications and bring significant disruption.

44% of UK exports go to the EU states, while only 7% of EU exports have the UK as their destination. According to Eurostat, the annual value of exports from the UK to the EU-27 more than doubled between 2003 and 2015 (from EUR 110 billion to EUR 230 billion), with an annual average growth rate of 6%. Whereas the Netherlands and Germany have the highest trade surplus in terms of intra-EU trade, the UK shows the highest negative trade balance (importing EUR 119 billion more than the country exported in 2015).

Considerations for negotiators

From a customs and trade perspective, inter alia the following issues are to be taken into account by Brexit negotiators and companies when assessing the different options:

- A new regulatory framework on customs and global trade will need to be established in the UK, to deal with the movement of goods across borders, as well as cooperation between customs authorities.
- The UK will need to draft a new customs code with respect to customs handling and cooperation (the UK could copy the current EU Union Customs Code that entered into force in 2016).
- The status of "authorised economic operator" (AEO) authorisations issued by HMRC (the customs and excise authorities in the UK) is uncertain—will they remain valid, or will they be revoked by the UK and/or the EU? The same question applies to binding origin and classification information (BOIs and BOTs), valuation rulings, inward processing relief authorisations, (cross border) bonded warehouse authorisations, simplified procedures, and other items granted by HMRC. The installation of borders could create a significant burden; for example, in Ireland today there are no border or inspection points, but over 250 road border crossings that would potentially be subject to border checks after the UK leaves the EU Customs Union. Acknowledging the deep integration between the UK and Northern Ireland, including across the land border between Northern Ireland and Ireland, the UK Government has recently published a Position Paper on the Ireland issue, where it expresses a commitment to finding a solution "that protects businesses' ability to access these important markets" and "avoids a hard border with regards to the movement of goods"[2].
- Full border controls and inspections for goods traded between the UK and EU would require the collection of duties and taxes, and inspections according to the agreed standards and conditions for imports.
- A concern related to border controls is the customs authorities' capacity to manage additional work (including the performance of the current customs management systems used by the UK and the EU). It is estimated that the number of declarations that would need to go through the UK HMRC customs system if the UK leaves the Customs Union would surpass 400 million annually, which the current system (CHIEF) cannot handle. HMRC had already commissioned a new system, called Customs Declaration Services prior to the Referendum vote.

Steps companies could take to prepare for Brexit

Companies can consider the following among options to prepare for Brexit:

- Assess the level of exposure under different potential trade scenarios and identify any actions that should be prepared ahead of time
- Alongside applying for new licenses and rulings, company processes will need to be adjusted and systems will need to be changed, including both compliance and ERP systems (e.g. in relation to the determination of tax codes).
- New controls may need to be designed, implemented and embedded in processes.
- All contractual arrangements in place will need to be reviewed or redesigned.

Economic operators that are dealing with customs authorities today may understand and recognize some of these points. However, small and medium-sized enterprises (SMEs) that trade between EU and UK today are less likely to be fully prepared to deal with Brexit-related challenges. Currently, SMEs can freely move and ship goods without the obstacles of borders and controls, and they will face new customs and trade requirements, such as the administrative burden of imports and exports, including proof of origin.

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Conclusion

Many questions exist regarding the impact of Brexit, and no definite answers are available yet. In any case, costs and delays relating to customs and trade are expected to increase for both corporate and public sector bodies.

Some companies may see their business grow and will look for new opportunities, but many are likely to lose out, or fear for their competitive position. The new reality will depend on how the negotiators, 28 governments and the European Parliament handle the challenge. They have over 3,000 points to discuss within a period of two years, of which trade is a critical issue but nevertheless one of many to be agreed.

[2] *See: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/638135/6.3703_DEXEU_Northern_Ireland_and_Ireland_INTERACTIVE.pdf*

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