THE IMPACT OF A NEW CUSTOMS AND REGULATORY BORDER WITH THE EU FOR UK COMPANIES TRADING GOODS

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KEY POINTS

- The introduction of a new regulatory and customs border has made it more difficult and more expensive to trade with the EU. This impacts UK firms who import and export from and to that market.
- However, the impact of Brexit on UK importers and exporters is not homogenous. This paper identifies the nine most common responses to Brexit.
- Confusion about the new rules has resulted in a widespread lack of compliance. Often companies that have realised that they have not been compliant choose to “put a line under it” rather than disclose it and amend the records, citing the lack of sufficient guidance as justification.
- Increased costs resulting from the new border impact profit margins. These additional costs need to be absorbed at some stage in the supply chain or passed on to the final consumer.

INTRODUCTION

Have you ever wondered why some companies are so vocal about the extra costs, administrative burden and difficulties they are facing while trading post-Brexit while others just seem to carry on as normal?

Leaving the EU has led to the creation of a new customs and regulatory border between the UK and the EU. This is a fundamental and systemic change in the way trade flows between the two parties. In addition, a new unique and one-sided border for trade in goods was erected between Great Britain and Northern Ireland. These changes have meant the introduction of new formalities and paperwork which has had a profound impact on (some) UK companies – namely the ones that import and export to the EU. The latest available statistics on the number of UK firms trading by destination are from Eurostat for 2018. They show that 81% of UK exporters export to the EU; 63% export to non-EU countries, and 44% export to both the EU and non-EU destinations[1].

To complete border formalities, companies either need to pay an agent or attempt to handle the new paperwork themselves. Both options require a degree of awareness and understanding of customs as well as other requirements. Using a broker neither prevents a company from being liable for the correctness of the information submitted to HMRC when importing or exporting

1 See the European Statistical Recovery Dashboard database: https://ec.europa.eu/eurostat/data/database

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nor from the need to meet all the relevant requirements in order for the goods to clear the border. Understanding customs liability can be a challenge. Even experienced importers and exporters are often not fully compliant with UK customs requirements.

The new customs and regulatory border impacted UK companies as it became more difficult and more expensive to trade with the EU. Various studies have attempted to estimate this impact. While it is still early days, UKTPO analysis of the evidence from the first three months of 2021 suggests that UK exports to the EU have reduced by 15% and imports by 32% during that period.[2] The Centre for European Reform estimated that leaving the European single market and customs union has reduced UK trade in goods by £10 billion or 13.5% in May 2021.[3] These are significant changes.

Surveys conducted since January 2021 provide a mixed picture regarding the impact on UK importers and exporters. In March 2021, EY and London First surveyed 1,040 UK businesses.[4] 75% of the surveyed companies stated that they were facing disruptions resulting from Brexit. However, only 21% described these disruptions as high. Of businesses that were experiencing disruption, 72% experienced problems with their customs and supply chain delays.

In June 2021, a survey of 651 companies carried out by the Institute of Directors for the Financial Times found that 17% of UK companies that previously traded with the EU have stopped — either temporarily or permanently.[5] At the same time, well over 50% of surveyed companies reported no change in their trade with the EU.

This Briefing Paper identifies the factors and considerations that determine which companies are impacted, and thus why some might choose to cease to trade, while others experience no change in their trade with the EU. The key point is that the impact of Brexit on UK businesses importing and exporting goods from and to the EU is not homogenous.

The way in which companies have been affected by the changes relating to the UK's departure from the EU and the way they have responded depends on their specific circumstances. In particular, it will depend on the following factors:

- **Firm characteristics:** size, import and export experience, familiarity with customs procedures and in some cases location (Northern Ireland);
- **Business environment:** supply chains including the location of processing, sourcing, business model and whether support from HQ/related companies is available and target markets;
- **Industry:** regulatory requirements and additional paperwork needed.

As a result, there are a plethora of responses within and across sectors in the UK to Brexit as a systemic change to trade with the EU. This can make understanding the impact of Brexit on the UK economy and measuring the private sector's response particularly difficult. It also means that looking only at aggregate statistics on the impacts of Brexit is likely to mask considerable variation across firms and sectors.

It's also important to note that this is an ongoing process for UK companies. The EU has introduced border formalities and checks as of January 2021. UK exporters have been working within that framework from day one. However, the UK Government took a different approach and decided to gradually introduce border requirements and formalities for imports from the EU throughout 2021 and 2022. This means that UK importers are yet to feel the full scale of the impact. As a result, the processes and phenomena described in this paper are only going to become more widespread and deepen. New ways of responding and dealing with the new trading relationship with the EU are also likely to emerge over time.

The paper is based on my work as a customs consultant and conversations with clients and other companies across various sectors. The majority of these companies were small and medium-sized companies although large multinational companies were also represented. As such, the paper is based on anecdotal evidence, has not been quantified and its main purpose is to show what's happening on the ground and the vast differences in the way companies are responding to Brexit.

2 Ayele Y., Larbalestier G., Tamberi N., 2021, Post-Brexit: UK Trade in Goods, UKTPO: https://blogs.sussex.ac.uk/uktpo/publications/post-brexit-uk-trade-in-goods/
3 Springford J., 2021, The Cost of Brexit: May 2021, CER: https://www.cer.eu/insights/cost-brexit-may-2021
4 Jones S., Riddell G., How UK businesses are responding to post-Brexit trade, EY: https://www.ey.com/en_uk/ey-brexit/how-uk-businesses-are-responding-to-post-brexit-trade
5 Thomas, D., Foster, P., 2021, Six months in and UK businesses are still battling with Brexit, *Financial Times*: https://www.ft.com/content/eadc7c23-2125-4381-93ae-a54104e5ccc7

THE IMPACT AND TYPES OF RESPONSE TO BREXIT

1. DAZED AND CONFUSED

Any major change in regulation and border processes is bound to lead to an initial period of confusion. This is particularly the case if it is introduced without sufficient time to plan and prepare because crucial information is only made available at the very last minute. The last-minute nature of the trade deal between the UK and the EU did not go unnoticed by the private sector. Companies speak openly about the fact that they were not given enough time to prepare and that the guidance was not available on time. This was also the case for Northern Ireland, where vital information on which goods would be considered at risk of entering the EU market via Northern Ireland - and as a result potentially subject to tariffs - was published only a few weeks before the change took place. As a result, the most common private sector response to Brexit in the initial months of 2021, was confusion about the new rules.

Even though we are nearing the end of 2021, UK companies are still coming to grips with new formalities and obligations gradually introduced since January 2021. Further explication of the new rules was gradually published in the form of updates and new guidance throughout the year. However, in Northern Ireland, companies have reported obtaining contradictory information from the Trader Support Service (“TSS”) – a Government-sponsored support and customs broker service for traders located in Northern Ireland.

It will come as no surprise that the changes seem to disproportionately affect smaller companies. Often, smaller companies are not able to rely on internal resources to understand the new rules and don’t have the ability to hire external help. In general, large or multinational companies with in-house specialists and/or the ability to obtain support or advice from HQs, have found it much easier to adjust. They were often also able to use the knowledge and experience gained from trading on international markets previously. However, it is also important not to underestimate small firms’ ability to successfully export and import and overestimate the larger ones’ ability to do the same. This is not a hard-and-fast rule. Many small, even micro-companies in the UK have a good grasp on import and export requirements and have been trading internationally for years. These are, for example, companies that already have experience in exporting to foreign markets. Interestingly, this does not seem to depend on the sector and we’ve seen examples of this from machinery to textile sectors. Many larger companies have been overly reliant on their customs brokers and as a result, do not understand their own liability and responsibility when it comes to customs formalities. This is yet another example of how difficult it is to generalise when discussing the private sector’s response to Brexit. Nonetheless, it is generally speaking more difficult for smaller companies to adapt to these changes.

Confusion about the new rules often results in a lack of compliance which companies may or may not be aware of, particularly regarding imports and customs formalities. As mentioned earlier, new rules and formalities are being gradually introduced in the UK. Brexit simplifications allowing companies to postpone submitting a full customs declaration for up to six months were introduced in January 2021. Safety and Security declarations have been postponed several times with the latest deadline being 1 July 2022. Sanitary and Phytosanitary (SPS) formalities and checks will be introduced in stages until 1 July 2022 in Great Britain and have also been postponed in Northern Ireland.

These simplifications were introduced due to IT systems and infrastructure not being ready and were meant to give companies time to adjust to the new formalities. Unfortunately, due to lack of information and clear guidance and the last-minute nature of the deal, this meant that many companies continued to import without completing any additional formalities – whether due to lack of awareness or on purpose. It was and still is possible for a shipping company to bring goods into the UK with only a minimum of information provided at the border and no customs formalities or checks completed. Companies were then required to submit customs paperwork within 175 days. In June, when the first of these supplementary declarations became due, HMRC started becoming aware that some companies were simply not submitting them. Either due to miscommunication with the shipping companies or customs agents or for a number of other reasons. This was also not entirely unpredictable, given the levels of confusion in the private sector.

While this is based on anecdotal evidence and HMRC has not issued any estimates of the numbers involved, it issued a Customs Information Paper on “non-compliant imports” in July 2021.[6]

6 HMRC, 2021, Goods arriving in Great Britain without an import declaration (CIP 1): https://www.gov.uk/government/publications/goods-arriving-in-great-britain-without-an-import-declaration-cip-1/goods-arriving-in-great-britain-without-an-import-declaration-cip-1

The paper explains different ways in which companies that have realised they have not been compliant can correct/amend the records. The fact that this guidance was published suggests that the phenomenon is widespread and not sector-specific.

Companies that have realised that they have not been compliant since the beginning of 2021 often choose to "put a line under it" rather than disclose it and amend the records. Many of them have cited the lack of sufficient guidance and information provided on time ahead of January 2021 as a reason why they feel justified in not correcting the initial mistake.

2. NORMALISATION

In time, UK companies will of course become increasingly familiar with the new border requirements. For some companies, the period of initial chaos is now over and they can focus on how to continue to operate and grow under the new circumstances. This has been mainly the case for UK exporters as for UK importers important changes are yet to come. The downside of the staged approach to border controls in the UK is that they prolong the initial implementation period.

As companies gradually become more comfortable with new border requirements being introduced, this initial period of concussion should eventually come to an end. This is not necessarily the case for other effects on this list.

The issue of ongoing uncertainty is particularly relevant for traders in Northern Ireland. Companies in Northern Ireland are also expecting new rules and formalities to be introduced once the situation with the Protocol becomes clear. The ongoing discussion on the implementation of border controls under the Northern Ireland Protocol has led the UK to unilaterally extend the grace periods for SPS products twice already. The repeated mentions of invoking Article 16 of the Protocol do not help provide certainty for local businesses and potential investors.

3. ABSORBING COSTS

If there was one consequence of Brexit that's virtually universal it's the fact that it is now more expensive to trade with the EU. The new customs and regulatory border leads to many new direct and indirect costs. Customs duties, if applicable, or when companies are not able to meet rules of origin, and fees paid to customs agents are examples of direct costs. Higher prices or time spent by in-house staff on additional training and reading the guidance are examples of indirect costs. The extra cost will vary depending on the company, tariff rates and many other variables. The additional costs also differ for companies in Northern Ireland. Companies can use the free TSS programme and do not necessarily need to pay a service fee for submitting an import declaration.

All this is taking place against a backdrop of global shipping and container crises caused by the Covid pandemic as well as domestic issues such as the shortage of drivers. Shipping and transportation costs are increasing. If a product crosses the border several times in an integrated supply chain, these costs are multiplied each time customs and other border formalities need to be completed. For some companies, the overall extra cost is relatively small and easily absorbed into the profit margin. For many, however, it's a noticeable cost that impacts the profit margin significantly.

The key question here is which side should cover the Brexit related costs: the seller or the buyer? For example, if tariffs are due, they are paid by the importer. However, to retain their EU clients, some UK companies have decided to take the hit, at least initially. This meant EU clients recharging any applicable tariffs back to the UK seller. In many cases, we've also seen EU clients unwilling to take any responsibility for imports into the EU. That meant that the UK company needed to deal with (and pay for) not only export formalities in the UK but also import procedures in the EU. That led to a number of complications in terms of establishment and VAT requirements. While the scale of this is again difficult to measure, it was significant enough for several shipping and customs brokerage companies to start providing dedicated end-to-end, export-import services paired with a VAT solution.

Absorbing the extra costs is an expensive strategy and not one that fits every business. At least not for long. This is particularly difficult for smaller businesses and industries with a low profit margin.

A few UK companies were able to negotiate different arrangements. For example, some companies were able to agree to split the tariff cost 50/50 with their EU sellers. This is a rare scenario and one that is mostly limited to large companies (which translated into big and valuable clients) with a long-term relationship with their EU seller. Therefore, this will not be an option available to many UK businesses, in particular the smaller ones.

The final option available to UK companies is to pass or split the additional cost with UK consumers. We have seen evidence of this starting to take place.[7]

4. SLOW DECLINE AND SHIFTING SUPPLY CHAINS

As mentioned in the previous section, the extra costs can be significant for many companies. Especially those with low profit margins. While absorbing the cost can be a temporary solution, many of the companies that have decided to do so, have also reported that they are considering other options going forward.

Costs aren't the only factor that forces certain UK businesses to re-organise or look for new solutions. One other factor is the loss of EU clients. It is particularly difficult to measure the scale of this phenomenon as it has been happening gradually over the last couple of years. Companies have reported that their EU clients are simply not renewing contracts. The reasons are not always clear and while it's very likely that it's the extra costs and formalities resulting from Brexit it's not always stated openly.

Whatever the reason, for some UK companies the outlook is somewhat gloomy. That is also the case for many importers. The introduction of full controls on the UK's side is bound to make imports even more time-consuming and expensive. Many companies have reported that they are currently rethinking their business model. There are no shortcuts or easy answers here. Companies need to evaluate their operations and reliance on the EU and assess how sustainable that model is.

5. THE SUBSTITUTE

For many companies, the EU is still where the majority of their sales take place. Some companies grew and expanded thanks to access to the EU market. Successful UK businesses can have a relatively low percentage of domestic sales and for those companies maintaining and continuing to grow their EU sales is still important.

The first hurdle companies faced this year was ensuring that their products meet rules of origin under the UK-EU Trade and Cooperation Agreement (TCA). Based on the UKTPO analysis undertaken by Yohannes Ayele, the preference utilisation rate for UK exports to the EU in April 2021 was just shy of 70%, rising from just below 60% in January 2021.[8] This is based on the official data which does not take into account the fact that many companies provided confirmation of originating status for goods that did not in fact meet rules of origin.

If the products do not qualify for tariff-free trade full tariffs are due at import. This can make a UK product much more expensive on the EU market and therefore not competitive. When I work with companies in this position, there are a number of variables we can use to try to ensure that the goods are eligible for tariff-free trade. For many companies, particularly where the rules of origin rely on the percentage of originating versus non-originating content, the answer is to introduce changes to the supply chain. Namely, to purchase more qualifying inputs and components from the UK or the EU.

For example, a company producing manufactured goods might have been purchasing a certain number of parts and components from a third country under one of the EU's trade deals. Before January 2021, this would have been simple. The products would likely arrive in the UK duty-free under the respective trade deal. They would have been processed into the final product which was then sold to the EU without any customs formalities. That is no longer the case and content from third countries no longer qualifies under the UK- EU trade agreement. In some cases, the value of parts and components from third countries simply exceeds the non-originating content allowed for a given product under the TCA. As a result, the product does not meet the rules of origin and is subject to full tariffs in the EU.

As of January 2021, companies that realised they were in this situation have started to slowly look for alternative suppliers. Wherever qualifying UK or EU substitutes were available, companies considering this option were able to eliminate the need to pay tariffs and meet the rules of origin. However, some companies were not able to find the items they needed in the right quantity or of the right quality in the UK or the EU. This can often be the case for textile companies. But it can also change over time. Some companies entered into partnerships with new providers to support them in

7 Eley, J., 2021, UK retail trade signals prospect of higher food prices, *Financial Times*: https://www.ft.com/content/ed511b7d-229a-494f-82d0-e86ef69af5b3

8 Ayele Y., 2021, Tariff-free trade with the EU: not so PUR and simple, UKTPO: https://blogs.sussex.ac.uk/uktpo/2021/07/29/tariff-free-trade-with-the-eu-not-so-pur-and-simple/

developing products that meet the criteria here in the UK.

It is important to note that thanks to the special provisions on cumulation of origin negotiated by the UK in its continuity agreements, this is not the case the other way round. UK companies can still use inputs from the EU, produce the final product in the UK and export to the continuity agreement partners, with the EU content being treated the same way as the UK content.

6. THE DISAPPEARING BUSINESS MODEL

There is also a group of companies that have found it impossible to mitigate the negative impacts of the new border. In some cases, it was simply due to the extra costs that turned out to be too high for the company to absorb while remaining competitive and wiped out the entire profit margin. For these companies, it is no longer profitable to continue trading in the same way as they have in the past.

One of the most commonly quoted examples was the distribution business model. For example, companies that distribute products purchased in third countries, especially in the countries with which the EU had trade deals. As described in the previous section, tariff-free movement of such products is no longer possible. Therefore, companies that build their business around purchasing from sellers located in FTA partner countries and distributing around the EU or companies that purchased from the EU and resold to the EU (e.g. the Republic of Ireland) needed to rethink their business model. For companies for which distribution across the EU was the sole activity, there was no way around tariffs. That is because there is a requirement to process products in the territory of the FTA before they can be eligible for tariff-free trade. This standard provision means that goods simply shipped and for example, repackaged or grouped into sets cannot be eligible for tariff-free trade.

Here again, absorbing the cost was an option for some of the affected companies. For some, however, it was not. These companies either ceased to exist, reorganised or found a different solution.

One of the potential solutions is a restructuring of the distribution model. Bringing products not designed for the local market into Great Britain will result in double administrative charges and potentially double tariffs. The other option is, for example, to supply the Republic of Ireland or even Northern Ireland directly from the EU - avoiding the UK and the border customs formalities and charges. In some cases, this was sufficient to mitigate the most direct costs and impact of Brexit. In other cases, more extreme steps were required.

7. THE BIG MOVE

One of the most unfortunate responses to the new border is a UK company relocating to the EU. It is particularly unfortunate when you get to the part of the conversation when relocating to the EU is the best available option. For example, some of the distribution companies mentioned in the previous sector have decided to move to the EU and continue to operate from there. This generally occurs when companies realise that the additional post-Brexit costs are too high to absorb and they cannot continue to operate in the same way as before.

It is very difficult to estimate the scale of this shift as it often takes place over time. For example, a company that sells goods imported from the EU directly to end customers in the Republic of Ireland could initially establish an Irish sister company to be able to import products into Ireland on behalf of their clients. It could then gradually shift some of its activities and responsibilities to that company.

What is important to point out is that this is also happening in the other direction. Some EU companies realised that for various reasons they need a foothold in the UK.

8. INDIFFERENCE

Not all UK companies have been affected by Brexit. There are companies for which the EU is simply not a significant trading partner. This can be because they produce mainly for the domestic market and don't rely on inputs from the EU. There are also many UK companies that have successfully been exporting to many trading partners for decades – the EU is just simply not one of them.[9] While this is a minority of UK companies, it is important to note that they exist.

These companies have been successful in international markets but for various reasons did not find the EU market equally attractive. This might be because of local competition or lack of demand for certain products. Companies like these would not be directly affected by Brexit. Thanks to the continuity agreements signed by the UK Government with the EU's FTA partners, trade

9 Technically, before 1 January 2021 movements of goods from the UK to the EU were not considered exports.

with third countries continues to follow the same principles as before.

Finally, some UK exporters do not rely on trade deals. For example, companies that have grown through exports to the US, whether or not their products are subject to tariffs.

While not directly impacted, these companies may have been indirectly impacted. For example, by border delays at the beginning of the year or increasing prices and decreasing availability of customs brokers. Or the impact on the economy as a whole. For the most part, though, these companies have continued to trade as they did last year.

9. COMPARATIVE ADVANTAGE

It would be remiss not to mention the very small proportion of companies that were able to benefit from Brexit. For example, the customs brokerage sector has experienced unapparelled demand and growth. However, we have also seen cases of other UK companies experiencing increased demand. Such companies would also find it more expensive and complicated to export to the EU post-Brexit but would have gained a comparative advantage. One example would be a company that is able to meet rules of origin under the TCA and export to the EU tariff-free while, due to the differences in supply chains, their main competitors are not. An example here could be a company that invested in long-term cooperation with a local supplier of a key component, while its competitors were importing the components from abroad under a trade deal. Scaling up the production of this component in the UK would require time. A company like this, provided it took time to get ready for the new border formalities, could easily find itself benefiting from a comparative advantage if the exported products were subject to tariffs. It is worth pointing out that these are rare cases that apply to a very limited number of UK companies.

CONCLUSION

The UK’s departure from the EU is having a significant impact on UK businesses. However, the way companies have been affected and how they responded to that impact in the short run, and in the longer term, differs significantly. These differences will continue to deepen as the changes continue to take place - as border formalities and checks are introduced in the UK - and to the extent that there is further divergence in terms of product regulation, all leading to more supply chain shifts and changes to firms’ investment plans.

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FURTHER INFORMATION

The UK Trade Policy Observatory (UKTPO), a partnership between the University of Sussex and Chatham House, is an independent expert group that:

1) initiates, comments on and analyses trade policy proposals for the UK; and

2) trains British policy makers, negotiators and other interested parties through tailored training packages.

The UKTPO is committed to engaging with a wide variety of stakeholders to ensure that the UK's international trading environment is reconstructed in a manner that benefits all in Britain and is fair to Britain, the EU and the world. The Observatory offers a wide range of expertise and services to help support government departments, international organisations and businesses to strategise and develop new trade policies in the post-Brexit era.

For further information on this theme or the work of the UK Trade Observatory, please contact:

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