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Baroness Verma
Chair, EU External Affairs Sub-Committee
House of Lords
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Dear Baroness Verma

I would like to thank you for your report *Brexit: Trade in Goods*. I apologise for the delay in responding.The timing of any information we publish is carefully considered in order to ensure the best possible outcome for negotiations. Our timing and content has also been influenced by the publication of our position papers, '*Continuity in the availability of goods for the EU and the UK*', published on 21 August and the *'Future customs arrangements - a future partnership* paper' published on 15 August, alongside the Florence Speech on 22 September, the publication of the *Customs Bill White Paper* and the paper on *Preparing our future UK Trade policy* on 9 October.

I am grateful to the Committee for examining the key issues facing the UK's goods sectors with regards to our exit from the European Union. I welcome the detailed consideration the Committee has given to these issues, and take note of your recommendations.

As noted in Baroness Anelay's closing remarks to the House in the debate on this report on 18 July, the Government is committed to maintaining the close trading relationship between the UK and the EU. When we leave the EU, the UK will no longer be members of the Single Market or the Customs Union. Instead, we will pursue a new, comprehensive economic partnership with the EU, including an ambitious agreement on trade. That agreement should be of greater scope and ambition than any such existing agreement, covering both goods and services. It should give UK companies the maximum freedom to trade with and operate in the European market, and allow EU companies to do the same in the UK.

The EU is the UK’s largest export market, but the UK is also a key market for the EU27. In 2016, the UK exported £145 billion worth of goods to the EU and imported £242 billion worth of goods from the EU. For this reason, we want to see zero tariffs on trade in goods and to minimise regulatory and market access barriers for both goods and services.

We have started negotiations to secure an exit deal in the national interest that works for the whole of the UK. The Government is working to achieve this through a continuing programme of engagement with businesses, Parliament, the devolved administrations and the public to build a national consensus around our negotiating position.

The Government remains committed to engaging with select committees throughout the process of withdrawal. However, I reiterate that we will not publish anything that would undermine the Government’s ability to negotiate the best deal in the national interest , nor will we prejudge outcomes that are dependent on negotiations. These principles form the basis of our response to your report.

A formal response to each of the recommendations made in the Committee’s report is enclosed herewith. Attached as an annex to this response is the list of sectors used to help structure our analytical work on EU exit. I am placing a copy of the annex in the House libraries.

RT HON DAVID DAVIS MP
SECRETARY OF STATE FOR EXITING THE EUROPEAN UNION

cc: Lord Jay of Ewelme

UK production of goods

1. International businesses are not structured neatly along sectoral lines or national boundaries. The Government must be mindful of the complex structure of businesses, particularly multi-national companies, in its analysis of the impact of Brexit.

The Government agrees with this recommendation. Businesses do not always operate in one area of the economy or one part of the world, and the issues they face in light of the UK's exit from the EU may therefore be varied and complex. This is why DExEU, along with other Government Departments, has been undertaking a comprehensive programme of engagement, including with companies and organisations to help inform our understanding of the key exit issues for business. This has included events which have gathered a large cross-section of our economy together in one place, such as the Prime Minister's Business Advisory Council, which met for the first time in July and will continue to meet regularly, and the two business events DExEU have held at Chevening House in July and September. This continuing dialogue supports and works alongside the programme of sectoral and regulatory analysis being undertaken by officials across Government.

2. The manufacturing and primary commodities sectors are important employers, particularly in regions outside the South East of England. Ensuring that these industries do not face additional barriers to trade with the EU and beyond will be essential to drive growth across the whole country, as envisaged in the Government's Green Paper, *Building our Industrial Strategy*.

The Government recognises the importance of a smooth and orderly exit that works for the whole of the UK, and are working closely with all Government Departments to deliver this. We fully endorse the Committee's reference to the commitments made in the Industrial Strategy to improve living standards by driving growth across the UK. Towns, cities and counties can improve their prospects for prosperity and growth if they are better connected and can attract skilled people, with research and innovation activity and the right institutions to support local clusters and specialisms. The Industrial Strategy will enable the UK to work more productively and boost the earning power of people, businesses, places and the nation as a whole.

We want to agree a deep and special Partnership which minimises any non-tariff barriers to trade between the UK and EU, including for manufacturers and primary commodities sectors. To support the move to a future relationship, we have proposed in our position paper *'Continuity in the availability of goods for the EU and the UK'* that goods placed on the Single Market before exit should continue to circulate freely in the UK and EU, without additional requirements or restrictions. This would ensure continued availability of products on EU and UK markets at the date of the withdrawal.

Regarding Northern Ireland, the UK Government has been clear that we will respect and recognise the unique circumstances of Northern Ireland and its relationship with

Ireland as we leave the European Union. We must avoid a return to a hard border, and trade and everyday movements across the land border must be protected as part of the UK-EU deal. In pursuing our independent trade policy, the Government will take account of these unique circumstances and the priority attached by all parts of the community in Northern Ireland to avoid a hard border and protect cross-border trade and cooperation. Our two position papers on Northern Ireland and Ireland and on Customs set out potential options for the border and show our commitment to as seamless and frictionless a border as possible. Our paper also sets out nine principles to base the potential models for the land border on, including our essential aim of having no physical infrastructure at the border and preventing the creation of new barriers to doing business within the UK, including between Northern Ireland and Great Britain. We will seek to agree these with the EU so they can form the foundation to test proposals for specific customs models in the context of the deep and special partnership. We welcome the Commission's commitment to avoid any physical infrastructure at the border in their guiding principles paper, which agrees with our position paper. We believe that this is an important step forward.

3. Although concentrated in different regions, the production of goods and services is often intertwined. A worsening of trade conditions for goods could therefore have a negative impact on employment in supporting services industries across the country. The Government must seek a trade agreement with the EU which recognises this interlinkage, and secures the best possible terms for both.

We recognise the interconnected nature of the UK's services and goods industries and agree with the Committee's recommendation. Firms increasingly use logistics, communications services and business services to facilitate the effective functioning of their supply chains. In particular, the professional and business services sector provides valuable consultancy and administrative services to a range of sectors. We also recognise that many goods sectors benefit from unhindered data flows across borders and the mutual recognition of professional qualifications. As such, our 21 August position paper, *Continuity in the availability of goods for the EU and the UK,* recognised this interlinkage. Furthermore, we aim to agree a deep and special partnership which includes the freest possible trade in both goods and services between the UK and the EU.

4. A new UK approach to immigration must take account of the needs of businesses in the UK. The ability to recruit staff from the EU-27, and move staff to and from the EU-27 through intra-group transfers, is essential to the primary commodities and manufacturing industries. The Government must ensure that it's post-Brexit immigration policy allows this.

In regards to our post-EU exit immigration policy, we are clear that the referendum result should not be regarded as a vote for the UK to pull up the drawbridge. We will remain an open and tolerant country that recognises the valuable contribution that migrants make to our society. The precise way in which the government will control the movement of EU nationals to the UK post withdrawal f is yet to be determined.

As a result, the government has commissioned the Migration Advisory Committee (MAC) to gather evidence on patterns of EU migration and the role of migration in the wider economy, ahead of our exit from the EU. The MAC will provide a clear channel for businesses, including those in the primary commodities and manufacturing industries, to express their views. It will also build on the significant analysis that has been underway in government for the past year. This will help us to design a new immigration system that works in the national interest and ensures that employers have access to the skills they need.

The Prime Minister has also been clear that building our new immigration system will take time and there will be an implementation period. This will avoid a disruptive cliff edge and give businesses and employers enough time to plan and prepare for the new arrangements.

5. We call on the Government also to clarify that the UK's existing level of research funding and collaboration with the EU-27 will continue, or that equivalent domestic arrangements will be established, after the UK's withdrawal from the EU.

Science and research are vital to our country's prosperity, security and well-being. The Government is clear that the UK will continue to be involved in major scientific endeavours in Europe and across the world, and as such one of the UK's core objectives as we exit the EU is to continue to collaborate with European partners on major science, research and technology initiatives. As set out in the Government's future partnership paper *"Collaboration on Science and Innovation"*, published on the 6th of September, the UK will look to build on its unique relationship with the EU to establish an ambitious agreement on science and innovation that ensures the valuable research links between us continue to grow. As set out in the paper, the UK would welcome a full and open discussion with the EU about all of the options for continued collaboration - a sentiment that was echoed in the Prime Minister's speech in Florence on the 22nd of September.

The Government is committed to upholding the UK's world-leading position in science and innovation, which we are putting at the heart of our industrial strategy. We have protected funding up to 2022. The research and development (R&D) funding provided through EU programmes is additional to the protection of science resource funding that was announced at the autumn 2016 Spending Review. This was £4.7 billion over the period 2017-18 to 2020-21. This Government's manifesto made a commitment to raise R&D spending as a proportion of GDP to 2.4 per cent by 2027, and to 3 per cent over the longer term.

The Government also recognises the need to provide certainty to all stakeholders wherever possible, and this is why we are committed to underwrite bids for Horizon 2020 projects submitted while the UK is still a member of the EU. The Government will work with the European Commission to ensure payment when funds are awarded. This has given British participants and their EU partners the assurance and certainty needed to plan ahead for projects that can run over many years.

Trade in goods

6. The EU is, by a significant margin, the UK's biggest trading partner in goods. Both imports from and exports to the EU are essential to the UK's manufacturing industry and primary commodities sectors. Safeguarding UK-EU trade in goods will be a critical factor in ensuring the UK's long-term prosperity post-Brexit.

We are committed to maintaining the close trading relationship between the UK and the EU. This is a relationship from which both parties benefit; the EU is the UK's largest export market, and the UK is also a crucial goods export market for other member states in the EU.

It is in the interests of both the EU and the UK for the deeply integrated trade and economic relationship between both parties to be maintained after our exit from the EU. We therefore want the UK to have the greatest possible tariff- and barrier-free trade in goods and services with our European neighbours and for that cross-border trade to be as frictionless as possible.

7. Norway and Switzerland are two of the UK's largest trading partners outside the EU. They are highly integrated into the EU's Single Market, and so Brexit will change the UK's trading relationship with them. The Government should seek a comprehensive trade agreement with these countries after Brexit, to avoid a worsening of trade conditions.

32. As we concluded in our report on Brexit: the options for trade, it is unlikely that the UK will be able to maintain access to the EU's FTAs with third countries after Brexit. The UK will also not be able to conclude new FTAs with third countries until after it has left the EU.

The UK Government is committed to seeking continuity in its current trade and investment relationships, including those covered by EU FTAs,other EU preferential arrangements or those in the EEA and EFTA. As we prepare to leave the EU, we will seek to transition all existing EU trade agreements and other EU preferential arrangements. This will ensure that the UK maintains the greatest amount of certainty, continuity and stability in our trade and investment relationships for our businesses, citizens and trading partners.

We understand that new independent trade deals with third countries cannot come into effect prior to the UK leaving the EU. Nor would we want to undermine the EU's trade interests. Indeed we are actively supporting EU negotiations with third countries in the normal way.

Tariff barriers

8. In the event that the UK leaves the EU without first either agreeing a comprehensive UK-EU FTA or—pending completion of such a FTA—agreeing a transitional arrangement, UK-EU trade would have to proceed according to WTO rules, and may incur significant tariff costs for UK businesses.

9. All the sectors from which we took evidence expressed concerns about the imposition of tariffs in their sectors, although we note that the level of duties varies considerably between them.

10. Many of these sectors are integrated into efficient EU-wide supply chains. They are both significant importers of goods from the EU and exporters to the Single Market. It is imperative that a trade deal with the EU seeks to avoid the imposition of tariffs on trade in both directions.

The EU is the UK's largest export market, the UK is a key export market for goods from other member states, and both the UK and EU are important contributors to highly integrated supply chains. We are confident that the UK and the EU can reach a positive deal on our future partnership. We want to see zero tariffs on trade in goods and we will approach the negotiations on our future relationship committed to securing a deal with the greatest possible tariff- and barrier-free trade in goods and services. Both the UK and EU Member States benefit from our close trading relationship. Departments across Whitehall are working with DExEU to understand the impacts that exiting from the EU will have the economy.

11. Many UK businesses cannot easily substitute their imports from the EU with UK products. For example, the UK no longer produces three of the major feedstocks required for the chemicals industry. It may also be difficult for exporters to find new markets for goods. For example, perishable products from the UK food and beverages sector may have a short shelf-life, and customer demand for such products may not exist in non-EU markets.

We have been carrying out a programme of sectoral and regulatory analysis to identify the key factors for UK businesses that will affect our negotiation position. We recognise that many goods sectors have highly globally integrated supply chains, with parts and components moving backwards and forwards across borders both within and beyond the EU. It is important to note that by leaving the EU we will have the opportunity to strike free trade agreements with countries around the world. We are committed to significantly increasing UK trade with the fastest growing export markets in the world.

Moreover, the principles outlined in our position paper, *Continuity in the availability of goods for the EU and the UK,* are aimed at smoothing the move to a future relationship and ensuring that producers can continue to supply products beyond the withdrawal date.

12. When establishing its own schedules at the WTO, the UK Government must give particular consideration to the implications of tariffs on the UK agricultural sector. High tariffs on imports would raise the cost to UK consumers, whereas lower tariffs could reduce the cost of food to consumers, but might undermine the domestic agricultural sector's competitiveness.

The Government recognises that many EU agricultural tariffs are high, particularly for livestock products and agrees with the Committee's analysis. We too are conducting a broad range of analysis at the macroeconomic and sectoral level to understand the impact of leaving the EU on all aspects of the UK, including the agriculture sector. Defra is also working closely with DExEU, DIT and other government departments to look at future trade arrangements and their impact on the the UK economy. However, at the point of exit, as set out by the Secretary of State for International Trade in his Written Ministerial Statement to Parliament, in order to minimise disruption to global trade, the UK will prepare draft schedules of commitments in the WTO which replicate as far as possible our current obligations.

Non-tariff barriers

13. Non-tariff barriers can pose as significant or greater a barrier as tariffs to trade in goods.

The Government recognises this. We recognise the importance of minimising non-tariff barriers to trade; we are aiming to minimise the regulatory and market access barriers for both goods and services and to agree a deep and special partnership which includes the freest possible trade in both goods and services between the UK and the EU recognising that we start from an unprecedented position for we have the same rules and regulations as the EU. For example, as referenced in response to the first recommendation of the Committee's report, many countries have Authorised Economic Operator schemes, which means that exporters with supply chains that are demonstrably secure are subject to fewer and less stringent checks at the border. This is just one existing precedent, and the exact form of our customs arrangement with the EU will be subject to negotiation. As the Prime Minister has said in her Florence speech, there is no need to impose tariffs where we have none now.

14. Were the UK to agree a FTA with the EU, rules of origin (which determine where a product and its components were produced) would apply. They would also apply where the UK and EU to trade under WTO rules. Applying rules of origin will generate significant additional administration, and therefore costs and delays, to UK businesses.

15. If the UK and the EU were to agree a FTA, compliance with preferential rules of origin might be so administratively burdensome for some sectors, such as chemicals, as to outweigh the benefit of tariff reductions. It will be important for the Government fully to assess the benefit, sector by sector, of preferential rules of origin under a FTA as compared to non-preferential rules of origin under WTO terms.

16. Some industries with an integrated EU supply chain and high levels of both imports and exports, notably the automotive sector, might be unable to comply with the local content requirements contained in the EU's preferential rules of origin. In this scenario, WTO most favoured nation tariffs would be imposed, increasing costs and disrupting the UK's place within the EU supply chain.

The Government wants to see zero tariffs on trade in goods and to minimise the regulatory and market access barriers for both goods and services. The role of preferential or non-preferential Rules of Origin in this deal, and our approach to minimising administration, will depend on the precise nature of the agreement. We are working with stakeholders in various sectors, including the automotive sector, to understand the needs of UK industry.

17. Regulatory standards are a significant non-tariff barrier. If the current level of EU-UK trade is to be maintained, ongoing harmonisation or mutual recognition of regulatory standards may be required. We welcome the Government's decision—by means of the Great Repeal Bill—to preserve existing EU regulations in domestic law as a first step towards regulatory co-operation with the EU.

18. As we stated in our report *Brexit: the options for trade*, the Government will have to make a trade-off between its desire to determine UK laws and regulations, and how far-reaching a FTA it can agree with the EU (and other partners).

19. Operating to two separate regulatory standards—for the domestic and EU markets—would be costly for UK businesses.

20. We urge the Government to maintain close dialogue with the EU over the development of UK and EU standards post-Brexit, to avoid unnecessary divergence.

21. But a comprehensive FTA is likely to require more than just such dialogue: it is likely to require a legal commitment by the UK to maintain a high level of harmonisation or mutual recognition of regulations and standards with the EU. This would require the UK Government to limit its exercise of regulatory sovereignty, in order to secure liberal conditions for trade. It might also require the UK to agree with the EU a new arrangement for oversight and dispute resolution.

As the committee notes, the Government has already committed to convert EU legislation as it applies to the UK into domestic law, through the European Union (Withdrawal) Bill which was introduced in July. This Bill will ensure that, wherever possible, the same rules and laws apply on the day after we leave the EU as before. This approach maximises certainty and stability for businesses and citizens as we leave the EU.

The Prime Minister has committed to prioritising how we manage the evolution of our regulatory frameworks to maintain a fair and open trading environment. We start from a unique position with regulatory frameworks and standards that match, and we agree that it would be costly and unnecessary to re-erect tariffs and other barriers to trade between the UK and the EU. We also understand that UK companies will, as they trade within the EU, have to align with rules agreed by institutions of which we are no longer a part, just as UK companies do in other overseas markets.

To support the move to a future relationship, in our position paper *'Continuity in the availability of goods for the EU and the UK'* we have also proposed that where businesses have undertaken compliance activities prior to exit, they would not be required to duplicate these activities in order to place goods on the UK and the EU market after exit. This includes recognizing the validity of type of approvals, certificates and registrations issued prior to exit, thus avoiding duplication of activities and providing legal certainty. We also propose that any agreement should facilitate the continued oversight of goods to support market surveillance authorities taking action with respect to non-compliant goods.

In considering regulatory standards, many frameworks are initially developed at a global level rather than through the EU. For example, the Codex Alimentarius are harmonised international voluntary food standards, which the EU then adopts into regulations; and the UNECE develops international vehicle standards that the EU references in legislation. After withdrawal, the UK will continue to play a leading role in these organisations, in line with our continued support for international rules-based systems.

Additionally, we recognise that voluntary standards, such as those developed by industry through the European and International Standards Organisations support trade and an open and competitive business environment. or some EU regulations, these voluntary standards can be used by business as a means of demonstrating conformity with the essential requirements of legislation. These standards are developed by private organisations that are non-EU bodies. The UK Government is working closely with the BSI to ensure that our future relationship with the European Standards Organisations continues to support a productive, open and competitive business environment in the UK.

As the Prime Minister has said in her speeches at Lancaster House on 17th of January and in Florence on 22nd of September, we do not seek a model already enjoyed by other countries. The UK's economic partnership with the EU will be bespoke, but there are a number of existing free trade agreements between the EU and third countries that provide for regulatory cooperation, including mechanisms for dispute resolution. As the Prime Minister set out in her speech on 22 September, we will need a strong and appropriate dispute resolution mechanism to deal with disagreements when they arise. On the 23rd of August, the government published the paper *Enforcement and dispute resolution - a future partnership paper.* This paper describes how the UK and EU needs to agree about how the provisions of the Withdrawal Agreement, and our new deep and special partnership, can be monitored and implemented to the satisfaction of both sides, and how any disputes which arose can be resolved.

22. As part of this regulatory alignment, there may be significant benefits in the UK continuing to participate, where legally possible, in EU agencies. We regret the lack of information in the Government's White Paper regarding the UK's strong and abiding interest in continued membership of such agencies.

23. The UK has in particular benefited from hosting and participating fully in the European Medicines Agency (EMA). The Government's decision to rule out membership of the Single Market means that the UK may be unable to maintain its membership of this body. We regret this, and urge the Government to bring forward proposals for future collaboration with the EMA.

25. The European Aviation Safety Agency is the civil aviation industry's 'route to market'. We urge the Government to confirm whether the Government intends to seek continuing membership of the EASA after Brexit, and if so on what terms.

The White Paper *The United Kingdom's exit from and new partnership with the European Union* published on 2nd February 2017 sets out a number of EU agencies which have been established to support EU Member States and their citizens. Until we have left the EU, we are committed to playing a full role in these agencies in line with all the rights and obligations that membership of the EU entails. While these agencies have served us well over the years, as we define a new relationship with the European Union we will also be defining a new relationship with these agencies.

As part of our negotiations the Government will discuss with the EU and Member States our future status and arrangements with regard to these agencies. These will include discussions on how best to continue cooperation in the field of medicines, and aviation, among others, in the best interests of both the UK and the EU. How this is achieved is a matter for detailed negotiation.

The system centred on the European Aviation Safety Agency has delivered a standardised high level of aviation safety. The Government is considering carefully all the potential implications arising for our aviation industry from the UK's exit from the EU, including the implications for the continued participation in the European Aviation Safety Agency system. The Government appreciates the importance of retaining a close relationship with our European neighbours on aviation safety issues, and the precise form of our relationship with the EU on aviation - including with respect to EASA - will be a matter for the negotiations.

As set out in the letter from the Health and Business Secretaries (dated 4th July, published in the Financial Times) the UK is fully committed to continuing the close working relationship we enjoy with our European partners, and our overall aim is to ensure that patients in the UK and across the EU continue to be able to access the best and most innovative medicines whilst being assured that their safety is protected. As part of the negotiations we will be discussing with the EU and Member States how best to continue cooperation in the field of medicines regulation in the best interests of businesses, citizens and patients of the UK and the EU.

24. We call on the Government to confirm whether vehicle type approvals issued by the Vehicle Certification Agency will remain valid after Brexit.

We recognise that this is an important issue, particularly for automotive manufacturers that use the Vehicle Certification Agency (an agency of the UK Government) for Type Approvals. As we enter the negotiations, the Government is committed to providing certainty wherever we can, and in our position paper, *Continuity in the availability of goods for the EU and the UK'* we have proposed that approvals issued prior to exit should continue to be valid in both markets. As noted in the White Paper *The United Kingdom's exit from and new partnership with the European Union*, many vehicle standards and type approval requirements are developed through the UN Economic Convention for Europe, and after exit the UK will continue to play a leading role in this forum.

26. The Prime Minister has stated the Government's intention to leave the jurisdiction of the Court of Justice of the European Union. Full UK participation in EU agencies after Brexit would be likely to require some form of oversight and dispute resolution, in the specific areas covered by these agencies. We urge the Government to clarify whether it would accept such conditions for co-operation with specific EU agencies, and if so on what terms.

The Prime Minister has made clear that the direct jurisdiction of the European Court of Justice in the UK will end. As part of our future agreements and ongoing cooperation with the EU, there will need to be an agreed, strong and appropriate means of resolving any disputes that might arise. We will be seeking a bespoke arrangement unique to the UK in our future relationship with the EU and its agencies, and our approach to dispute resolution will also need to be unique in order to work best for both the UK and the EU. We will continue to work with the EU to preserve UK and European security, and to fight terrorism and uphold justice across Europe.

Costs of administering tariff and non-tariff barriers

27. Leaving the EU customs union would result in costly administrative requirements and customs procedures, whatever new framework for trade is established. This would result in a significant additional administrative burden for companies, and delays to consignments of goods, incurring additional costs.

29. We welcome the Government's commitment to seeking simplified customs procedures for EU-UK goods trade. We note that the customs agreement proposed by the Prime Minister would be unprecedented, and we are unclear whether it will be possible outside a formal customs union (including the Common External Tariff).

30. If a comprehensive FTA between the UK and the EU can be achieved, there may be scope within it to simplify some customs procedures.

When the UK leaves the EU, it will also leave the Customs Union. As set out in the *Government's Future Partnership Paper on Customs*, we are seeking a mutually beneficial customs agreement with the EU that provides as free and frictionless a border as possible.

We want to ensure that UK companies have the maximum freedom to trade with and operate within European markets and vice versa, whilst also being able to negotiate our own trade agreements around the world.

Two approaches to achieving these goals were set out in the *Customs Future Partnership* paper.

The first is a highly streamlined customs arrangement, which is based on having an efficient customs border between the UK and EU. We would look to agree bilateral customs facilitations with the EU alongside implementing efficient processes in the UK.

The second is a new customs partnership with the European Union. This seeks to avoid a UK-EU customs border by aligning our approach to the external customs border, for example, by potentially mirroring the EU's requirements for imports from the rest of the world whose final destination is the EU.

Our ultimate customs arrangement will depend on our negotiations with the EU. However, under either approach, both the UK and EU Member States would benefit from time to fully implement the new customs arrangements, in order to avoid a cliff-edge for businesses and individuals on both sides. The Government believes a model of close association with the EU Customs Union for a time-limited implementation period could achieve this.

We have also detailed further thoughts in the *Customs Bill White Paper* published on the 9th of October, which paves the way for eventual legislation that will ensure the UK is ready for the first day after exit.

The Treasury's Customs Bill White Paper, which sets out plans to legislate for the standalone customs, VAT and excise regimes the UK will need once it leaves the EU.

The Government is seeking a deep and special partnership with our European friends and allies as we leave the EU. This is the mutually beneficial choice and we are confident we can achieve this. We think that is by far and away the highest probability, but we have a duty to plan for the alternative.

The Customs Bill will give the government the ability to operate a standalone customs, VAT and excise regimes from 29 March 2019, even in a scenario where the UK leaves the EU without an agreement on a future customs arrangement.

31. The Authorised Economic Operator scheme provides an opportunity for registered companies to streamline certain customs procedures, and we recommend that the UK Government adopt the provisions of the current AEO scheme into UK law after Brexit. The scheme would not, however, remove the requirement for customs checks to be implemented between the UK and the EU after Brexit, and would not prevent the additional burden of associated administration and costs from arising.

As part of a deep and special partnership with the EU, we are aiming to agree a bold and ambitious agreement that makes our trade with the EU tariff-free and as frictionless as possible. We want to have a new, mutually beneficial customs agreement with the EU that supports these objectives, but we have an open mind about the form of that agreement.

As we look to build our future customs relationship with the EU and the rest of the world, we start from a strong position. As a large trading nation, we possess a world-class customs system which handles imports and exports from all over the world, and not just the EU. The World Bank's Logistics Performance Index 2016 ranked the UK 5th for the efficiency of its customs services.

We already have highly efficient processes for freight arriving from the rest of the world. HMRC figures show that 92% of all declarations relating to goods arriving from third countries are cleared for UK customs purposes in less than 5 seconds.

In the Government's Future Partnership Paper on Customs we set out two potential models of future customs relationship that could meet our objectives.

Under the highly streamlined customs arrangement model, the UK would negotiate trade facilitations with the EU and implement unilateral improvements to our domestic regime to make trade with the EU and rest of the world easier. The promotion of the free flow of trade in both directions between the UK and the EU would require the EU to implement equivalent arrangements at its borders with the UK. One component of this model is the negotiation of mutual recognition of Authorised Economic Operators with the EU.

Under the new customs partnership model, the need for a UK-EU customs border would be avoided by aligning our approach to the external customs border, for example, by potentially mirroring the EU's requirements for imports from the rest of the world whose final destination is the EU.

Whatever form our new customs arrangement with the EU takes, and whatever the mechanism to deliver it, we will seek to maintain many of the facilitations that businesses currently enjoy. We will work with businesses and infrastructure providers to ensure that the UK's own customs systems and processes continue to be as effective as possible, including through the use of digital technologies.

28. Administering UK-EU tariffs and non-tariff barriers—in the absence of a common regulatory system—would also significantly increase the work of HMRC, a task for which it is not currently resourced. The UK would also have to establish new customs posts, develop a new customs code and consider improvements to the UK's systems for trade processing. We call on the Government to set out its plans for reviewing and if necessary increasing the resources available to HMRC and other agencies.

49. We welcome the Government's commitment to report to Parliament on the cost of new infrastructure and of additional staffing at customs posts.

The UK already has highly efficient processes for freight arriving from the rest of the world. Even where we currently apply customs requirements on trade with the rest of the world, it is not the case that every container needs to be inspected at its point of entry into the UK - 8% of goods are identified for further control requiring examination of paper documents or physical inspection. We will work with businesses and infrastructure providers to ensure those processes are as frictionless as possible.

The forthcoming Repeal Bill will incorporate the latest EU customs code (the UCC) into UK law to provide as much certainty as possible to businesses. UK Businesses are already implementing this legislation and have been given until 2020 to do so. Any further changes which the government might make to the UK's customs code post-exit will be implemented with sensitivity to the cost to business of adjusting to such changes.

Our new Customs IT system, Customs Declaration Service, is on track to be delivered in January 2019 and will be able to support international trade once the UK leaves the European Union. The move will give us greater flexibility, functionality and capacity to deal with increased volumes of imports and exports and will help support UK businesses.

All departments are developing plans to deal with exiting the EU. Where resource pressures arise from new areas of business, HMT will engage with departments and agree any changes to this approach. Where changes are needed, budgets will be re-prioritised accordingly to enable agencies to implement any post-Exit arrangements.

The EU and preferential trade with third countries

33. Thus Brexit is likely to result in a cessation of the preferential conditions of trade with non-EU countries currently enjoyed by UK businesses. This is likely to result in significant tariff costs and other reductions in market access for many of the sectors we considered, until new preferential arrangements can be put in place post-Brexit.

The UK Government is committed to seeking continuity in its current trade and investment relationships, including those covered by EU FTAs and other EU preferential arrangements. As we prepare to leave the EU, we will seek to transition all existing EU trade agreements and other EU preferential arrangements. This will ensure that the UK maintains the greatest amount of certainty, continuity and stability in our trade and investment relationships for our businesses, citizens and trading partners.

As the Prime Minister set out in her speech in Florence, the UK will seek to agree a time-limited implementation period with the EU, during which access to one another's markets should continue on current terms. This would help both the UK and EU to minimise unnecessary disruption and provide certainty for businesses and individuals as we move towards our future deep and special partnership with the EU. The UK would intend to pursue new trade negotiations with others during the implementation period, having left the EU, though we would not bring into effect any new arrangements with third countries that were not consistent with the terms of our agreement on an implementation period with the EU.

This will give businesses time to plan and prepare for our arrangements with both the EU and those countries which currently benefit from preferential conditions of trade. The Prime Minister has repeatedly said, we want to avoid a cliff-edge and to provide certainty where we can. We are exploring ways to achieve this with our trading partners so as to deliver maximum continuity and certainty for businesses once we leave.

34. We welcome the Government's efforts to engage with non-EU countries to lay the groundwork for future FTAs. However, trade negotiations are time consuming and complex, and it is important that the Government focus its efforts where they can deliver maximum benefit. In particular, the Government should focus on countries where the EU already has FTAs in place, with a view to securing the current level of market access enjoyed by UK businesses. The terms of the EU's existing FTAs and those under negotiation are likely to form a useful starting point for future UK agreements with these countries.

35. The Government needs to demonstrate that it has the capacity to negotiate with the EU, and simultaneously open preliminary discussions on FTAs with third countries. We are concerned that there may be significant delays to the Secretary of State for International Trade's plan to agree new FTAs with 15 countries shortly after leaving the EU.

We will look to build on our trade and investment links with key trading partners around the world. We have already established a series of working groups and high-level dialogues to explore the best ways of progressing our trade and investment relationships. We have been clear we will respect our obligations while we remain in the EU, and while we cannot conclude new trade deals until after we have left the EU there is much that can be done to prepare and to achieve now.

Many countries including China, Brazil, and the Gulf States have already expressed their interest in enhancing their trading relationships with us, and the United States Administration, the world's biggest economy, has said that they are interested in an early trade agreement with the UK. We understand and take seriously the importance of ensuring we have the right resources going forward, and since its creation the Department for International Trade's (DIT) strong and capable trade policy team has quadrupled in size since June 2016 and is continuing to grow.

36. The Government must consider negotiating access to the EU's preferential trade arrangements with third countries for a transitional period.

37. The EU's frameworks for preferential trade are a valuable tool of the EU's foreign and development policies. In leaving the EU, these will no longer automatically apply to the UK: though future agreement may be reached to closely co-ordinate policies. Without this, the UK would lose access to a wide range of developing countries, such as the ACP and LDC groupings. We therefore welcome the Government's commitment to continue or improve access given to developing countries under economic partnership agreements signed with the EU.

38. We expect the Government to assess the full range of EU trade agreements, and their role in furthering the UK's foreign and development policy objectives. We recommend that the Government consider recreating such agreements on a bilateral basis, including a UK General System of Preferences.

The UK remains committed to ensuring developing countries can reduce poverty through trading opportunities.

As announced by the International Trade and International Development Secretaries on 24 June 2017, the Government will use Brexit to cement Britain's standing in the world and meet our commitments to the world's poorest by securing their existing duty-free access to UK markets and providing new opportunities to increase trade links.

We are looking at all EU trading arrangements including those with developing countries to ensure continuity and to avoid disruption for them and for UK businesses which rely on imports from these countries.

On leaving the EU, the UK Government will also explore options to expand on relationships with developing countries such as Jamaica, Pakistan and Ghana – all of which currently benefit from a mixture of reduced or zero tariffs on the goods they export to the UK – as well as maintaining existing trading arrangements and avoiding costly tariffs.

Investment and business climate

39. Sterling has fallen substantially since the EU referendum. While devaluation has brought some benefits to exporters, it has also raised the cost of imports. Many UK export industries are embedded within wider EU supply chains, with a significant reliance on imports. The effect of sterling's fall upon UK exports is thus complex and mixed.

40. Larger companies may be able to hedge currency risk, but devaluation has a disproportionate impact upon smaller companies, which are less able to hedge.

Sterling fell by around 15% in trade-weighted terms after the EU referendum. It has risen slightly in recent months but is still around 11% lower than it was in June last year. At Spring Budget this year, the Office for Budget Responsibility (OBR) forecast that this depreciation of sterling would support exports in the near term and the OBR expect net trade to contribute 0.3 percentage points to GDP growth both this year and next.

Currency hedging can help firms to insulate themselves from fluctuations in exchange rates in the short term. Whilst the Government does not set a target for the value of sterling, the Government and the UK's financial supervisory institutions monitor closely the effects of any fluctuations in sterling on the economy. This includes the effects across the economy.

41. Uncertainty is the enemy of investment. Lack of clarity on what Brexit will entail has caused concern in the business community, particularly in sectors reliant on international investment. While the Prime Minister's clarification that the UK will pursue a FTA with the EU is a start in providing greater certainty, it is critical that the Government does more to help businesses to plan for the future.

43. International investment is critical to the UK manufacturing and primary commodities sectors. We urge the Government to engage regularly with the government of significant non-EU investors, as well as with individual businesses.

We recognise the importance of providing certainty to industry. We have committed to providing business and the wider public with as much information as possible without undermining the national interest. We are achieving this through regular engagement with businesses at both a Ministerial and official level across Whitehall, and using our diplomatic network to engage with stakeholders throughout Europe and beyond. DExEU Ministers alone have undertaken a wide-ranging programme of stakeholder engagement since the referendum, including attendance at over 75 round tables and over 300 bilateral meetings. At the same time, Ministers and officials in the Department for International Trade are working with counterparts in a range of non-EU markets to promote the UK as a great place to do business and with which to trade.

The Government has also sought to offer stability and provide clarity where it can, without publishing anything that might undermine our negotiating position. *The United Kingdom's exit from and new partnership with the European Union* White Paper, published on 2 February, sets out a clear direction of travel and provides a comprehensive vision of what we are seeking to achieve. This clarity will help people to plan effectively, recruit appropriately and invest as necessary while the negotiations continue and the new partnership we will enjoy with the European Union is being formed.

We want to have reached agreement about our future partnership by the time the two-year Article 50 process has concluded. We will need to build a bridge from our exit to our future partnership, to allow business and people time to adjust, and to allow new systems to be put in place. It makes sense for there to be only one set of changes. A strictly time-limited implementation period where we continue to have access to one another's markets on current terms and take part in existing security measures will help investors, businesses and citizens in both the UK and the EU adjust in a smooth and orderly way. We expect this to last for a period of around two years. It should be agreed as early as possible, so as to provide certainty.

42. The Government's explicit support for Nissan to remain in the UK was welcome. We are not clear, however, what commitment was made by the Government, and whether any offers to the company apply more broadly to the automotive sector as a whole, or whether similar offers will be made to other sectors.

Greg Clark, the Secretary of State for Business, Innovation and Skills, provided Nissan with four reassurances, which were important in securing this investment, and which are also relevant to the broader automotive community. These were set out in the House of Commons on 31 October. The Government committed to:

- Continuing its longstanding programme of support for the competitiveness of the automotive sector;
- Working with the automotive sector to ensure more of the supply chain can locate in the UK;
- Maintaining a strong commitment to the research and development, and take up of ultra-low emission vehicles; and
- In negotiations to leave the EU, emphasising the common ground that exists between ourselves and EU member states to ensure that trade between us can be free and unencumbered.

For all sectors, we want to have the greatest possible tariff- and barrier-free trade with our European neighbours.

44. The Government has limited freedom to offer guarantees to any industry: the UK-EU conditions of trade will require negotiation with the 27 EU Member States, and the UK is obliged to comply with WTO rules on MFN status, subsidies and the coverage of FTAs.

As noted in our response to recommendations 41 and 43, we are committed to providing businesses with as much certainty as possible within the laws, rights and obligations that exist.

The Government's view

45. If the UK and EU are unable to agree a FTA within the two years provided for in Article 50 TEU, preferential terms for trade between the UK and the EU would cease, and WTO rules would apply. This can only be avoided by negotiating a transitional arrangement. Businesses, both domestic and foreign, would welcome such a period of adjustment.

46. We urge the Government to establish at the outset of negotiations a clear strategy for a future transitional agreement, with specific proposals to what form it should take.

47. We welcome the Prime Minister's commitment to a phased implementation of Brexit. We note, however, that this commitment is conditional upon the UK and EU agreeing a FTA within the two years provided for in Article 50 TEU. This is inherently ambitious, and there has been no indication so far that the EU is willing to contemplate such a truncated negotiation.

Article 50 sets out the procedure for how a state may leave the EU. We want to have reached an agreement about our future partnership by the time the two-year Article 50 process has concluded. We start from a unique position and as we build this new relationship, there is no point starting from scratch. We start from having the same rules and regulations as the EU and a spirit of cooperation stretching back decades – so we are confident that we can reach agreement in the time period set out by the Treaty.

From that point on, we believe a time limited period of implementation, in which both Britain and the EU institutions and Member States prepare for the new relationship that will exist between us, will be in our mutual interest. We want to minimise disruption and provide as much certainty as possible. Britain's future is bright because our fundamentals are strong but the best way for both us and the European Union to succeed is to fulfil the potential of the partnership the Prime Minister has set out.

48. We are concerned that the introduction of a new IT system for customs—planned for the year that the UK leaves the EU—may add to the complexity of the trading conditions facing businesses in the wake of Brexit. We urge HMRC to ensure that the system is robust and fully tested before it is rolled out, to prevent further disruption to businesses.

The existing Customs Declaration system (known as CHIEF) requires updating after 23 years of service. This system will be replaced through the delivery programme called Customs Declaration Service (CDS). It will replace an ageing, inefficient system with a more modern and flexible customs declaration service.
The decision to replace CHIEF was made to ensure the UK's international trade community has the best possible operating conditions going forward and was taken well before the Referendum. The move will give HMRC greater flexibility, functionality and capacity to deal with import and export and will help support UK businesses.

As part of a phased approach, formal transition from CHIEF to CDS begins in August 2018. Both CHIEF and CDS will run together for this period until HMRC have migrated all users onto CDS. It should be noted that continuing to run both systems is a contingency, with one of the main limitations that CHIEF cannot cope with the full scale of new functionality necessary under the Union Customs Code, but trade will continue to flow as expected.

HMRC are clear that the new Declaration Management System within CDS, procured from IBM, is scalable and can cope with the expected increases in transaction volumes. HMRC have defined their approach to testing services with industry, and have shared information about the first technical release to support that test approach (as part of their ongoing engagement with delivery partners and stakeholders).

The delivery timetable remains tight, but that is a product of the need to have the system ready by a fixed deadline of March 2019 and at this stage we have no reason not to believe HMRC's and the recent NAO's assessment that the department remain on track to complete delivery of the new CDS system in August 2018 and transition users onto the new system by January 2019.

50. We welcome the Government's efforts to increase the promotion of UK trade overseas. We ask the Government to confirm that it is confident it has sufficient commercial staff in UK embassies overseas to promote the UK's trade interests, in particular in comparison to the staffing of the embassies of other European countries.

DIT support is targeted where government can add the most value, and global export promotion exercises are prioritised by identifying the sector-market combinations that present the greatest opportunities. This approach allows the Government to focus on a number of high value areas to achieve maximum impact and success.

We are committed to ensuring we have the right people in the right places to provide the best support for UK companies to export overseas, and to facilitate inward investment to the UK. DIT currently have commercial staff based in 109 countries around the world, who are delivering on highly ambitious targets for export and investment. In a study of other export promotion agencies conducted in 2015, the UK had significantly more staff working on export promotion around the world than any other developed country looked at. This included a number of European countries.

DIT’s network comprises of over 1200 people and we ensure that our staff based overseas are embedded in the right markets and equipped with the required sector skills to drive demand for British goods and services. Overseas, DIT works alongside an extensive network of HMG representatives, including FCO Prosperity Officers, who work to support UK business promotion for the prosperity of both the UK and their host countries.

Annex A - List of sectors used to help structure analytical work on EU exit

The Department for Exiting the European Union, working with officials across government, continues to undertake a wide range of analysis to support our negotiations. We are pursuing a unique and ambitious economic partnership with the EU based on our rules and regulation being the same at the start, and on maintaining our commitment to free trade and high standards – while allowing for us both to make changes where we want to, in a stable and orderly way.

As part of meeting these objectives, Government has been looking at more than 50 areas of activity, or sectors. A sectoral approach is useful because:

- It provides structure to economy-wide analysis allowing sector specific and common issues to be identified.

- It reflects the way that businesses and other important stakeholders tend to organise themselves.

We set out below, in alphabetical order, 58 sectors. This draws on different classification approaches as there is more than one way to classify sectors. The ONS has one method based on internationally agreed classifications.[1] Industry groups often create different definitions to reflect their membership and the complexity of their supply chains. For example there are other ways of categorising sectors such as the "creative industries" which includes: advertising and marketing; architecture; crafts; product, graphic and fashion design; film; tv, video, radio and photography; IT, software and computer services; publishing; museums, galleries and libraries; and music, performing arts and visual arts.

We estimate that these 58 sectors cover around 88% of the UK economy. A further 10% of the UK economy is "imputed rent"[2] which is not traded. The remaining areas of the economy include sectors with strong links to other sectors covered, and sectors where the issues are the same as those in other sectors in the list.

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[1] The Standard Industrial Classification (SIC) compiled by the ONS (which are also consistent with the statistical classification of economic activities in the European Community (NACE)).

[2] ONS define owner occupiers imputed rent as an estimate of the housing services consumed by households who are not actually renting their residence. It can be thought of as the amount that non-renters pay themselves for the housing services that they produce.

1. Advertising and marketing
2. Aerospace
3. Agriculture, Animal Health and Food and Drink manufacturing
4. Architecture
5. Asset Management
6. Audit and accounting
7. Automotive
8. Aviation
9. Broadcasting
10. Bus and coach transport
11. Business services
12. Catering: retail and wholesale
13. Chemicals
14. Construction and Engineering
15. Consumer Goods
16. Crafts
17. Defence
18. Design: product, graphic, and fashion design
19. Electricity market, incl. renewables
20. Electronics
21. Environmental Services: waste
22. Environmental Services: water
23. Film, TV, video, radio and photography
24. Fintech
25. Fisheries
26. Gambling
27. Gas market
28. Higher Education
29. Insurance and pensions
30. IT, software, and computer services (incl. video games)
31. Legal Services
32. Life Sciences
33. Machinery and equipment
34. Maritime/ports including marine equipment
35. Market infrastructure (financial services)
36. Medical devices
37. Medical services and social care
38. Museums, galleries, and libraries
39. Music, performing and visual arts
40. Nuclear
41. Oil and fossil fuel production (including gas)
42. Payment services and systems
43. Pharmaceuticals
44. Post
45. Professional services
46. Publishing
47. Rail including manufacturing
48. Real Estate
49. Retail
50. Retail and corporate banking

51. Road haulage and logistics
52. Space
53. Steel and other metals/commodities
54. Technology (ICT)
55. Telecommunications
56. Textiles and Clothing
57. Tourism
58. Wholesale markets and investment banking