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Facilitated Customs Arrangement impact analysis - background note

The White Paper published in July 2018 set out HMG's vision for the future relationship between the UK and EU after we leave the European Union (EU). This included new proposals around customs, the Facilitated Customs Arrangement (FCA), which would support a new free trade area that ensured continued frictionless access at the UK/EU border. This note provides background on the assumptions and the calculations for the figure (included in the White Paper) that under the FCA, 'up to 96% of UK goods trade would be most likely to be able to pay the correct or no tariff upfront, with the remainder most likely to use the repayment mechanism'[5]. As the wording, 'up to' suggests, this is an estimate of what is likely rather than a precise target or commitment.

Up to 96% of UK goods trade would be likely to be able to pay the correct or no tariff upfront under the FCA as these goods would be:

1. trade (imports and exports) with the EU or exports to non-EU countries;
2. imports which are unlikely to see differences in tariffs between the UK and the EU, since they are imported under zero Most Favoured Nation (MFN) tariffs;
3. imports which are unlikely to see differences in tariffs between the UK and the EU, since they are imported from existing EU Free Trade Agreement (FTA) partners or through unilateral preference from Least Developed Countries (LDCs); or
4. imports of finished goods.

The remaining 4% of UK goods trade relates to imports of intermediate/unfinished products for which differences in tariffs between the UK and the EU could arise as a result of the UK's independent trade policy and hence would most likely use the FCA repayment mechanism.

[5] 'The future relationship between the UK and EU', DExEU, July 2018.

Table 1: Summary of calculation

Factor	UK goods trade (%)
Trade with the EU or exports to non-EU countries.	73%
Non-EU imports unlikely to see differences in tariffs between the UK and the EU, since they are imported under zero MFN tariffs.	13%
Non-EU imports unlikely to see differences in tariffs between the UK and the EU, since they are imported from existing EU Free Trade Agreement (FTA) partners or through unilateral preference from Least Developed Countries (LDCs).	4%
Non-EU imports where differences in tariffs between the UK and the EU are more likely to emerge which are of finished goods.	6%
Total	96%

The FCA would avoid customs processes on UK exports to the EU and this is a key benefit to businesses. Alternatives to the FCA do require these customs processes on EU exports from the UK and hence in order to provide valid comparisons against other models exports from the UK are included in these calculations. It would be misleading not to include exports in these calculations.

Detailed assumptions and calculations

The FCA would remove the need for customs processes on UK-EU trade, preserving frictionless trade at the border between the two partners. Exports to non-EU countries are not affected, since the FCA does not affect the ability of importers of UK exports to pay the correct tariff at their border. **Trade with the EU or exports to non-EU countries accounted for 73%[6] of UK goods trade** in 2017. The remaining 27% of UK goods trade is imports from non-EU countries.

An assumption is made that it is very unlikely that differences in tariffs between the UK and the EU would emerge on imports of products from non-EU countries where tariffs are currently zero[7]. **Approximately 13% of UK total goods trade is imports from non-EU countries that currently face zero EU MFN tariffs** and hence it is assumed would pay no upfront tariffs under the FCA[8]**.**

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[6] 'UK Economic Accounts: balance of payments - current account, 2018 quarter 1 (Jan to March)', ONS, July 2018.
[7] It is assumed that where Most Favoured Nation (MFN) tariffs are zero it is unlikely that either the UK or EU would raise MFN tariffs.
[8] Non-EU import data (Trademap, 8 digit-level, 2014-16 averages) matched to the EU's MFN tariffs ('Macmaps', 10-digit level, incorporating industrial tariff suspensions (EU's Customs and Taxation Union website) since there is considerable consistency over time in the products covered by this scheme and averaged to an 8-digit level) for each product.

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An assumption is made that it is very unlikely that differences in tariffs between the UK and the EU would emerge on imports of products from Least Developed Countries (LDCs)[9] or from existing EU Free Trade Agreement (FTA) partners[10]. **Approximately 4% of UK total goods trade comes from EU FTA partners or from less developed countries** under preferential tariffs and hence it is assumed would pay the correct or no upfront tariffs under the FCA[11]**.**

Of the remaining 10% of UK goods trade where differences in tariffs between the UK and the EU are more likely to emerge, **6% of the total is in finished products,** which are assumed to be more likely to pay the correct tariff as they are likely to have shorter, less complex supply chains[12][13]**.** The distinction between finished and intermediate/unfinished goods is used as a proxy for the mechanism that different categories of goods would be most likely use to access preferential UK tariffs[14].

This results in up to a **total of 96% of UK trade** that would be likely to be able to pay the correct or no tariff upfront under the FCA. The remaining **4% of UK goods trade in 2017 was of imports of intermediate/unfinished products** for which differences in tariffs between the UK and the EU could arise as a result of the UK's independent trade policy and hence would most likely use the FCA repayment mechanism.

The FCA would avoid customs processes on UK exports to the EU. This is a key benefit to businesses. Avoiding customs processes on EU imports from the UK is a key benefit to both consumers and UK businesses' supply chains. Alternatives to the FCA do require these additional customs checks and controls hence exports from the UK have been included in these calculations in order to illustrate comparisons with alternative proposals. Removing exports from the calculation is misleading as other customs models would require new export requirements on UK-EU trade.

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[9] Since the EU currently grants zero tariffs through unilateral preferences on imports of all products from these countries other than arms through the Generalised System of Preferences (GSP) and HMG has committed to maintaining current market access for LDCs.

[10] The large majority of imports from EU FTA partners currently enter the UK under zero preferential tariffs, and the UK's policy intention is to transition existing EU FTAs.

[11] Trade import data on UK imports from LDCs and EU FTA partners was taken from TradeMap. Imports from non-LDC unilateral preference partners e.g. India were excluded since significant differences in tariffs on imports could emerge if the UK were to negotiate FTAs with these countries. Only FTAs fully in force were included. In particular, this meant that imports that would face positive MFN tariffs in the absence of an FTA from the following countries were excluded: Canada, Singapore, Vietnam and Japan.

[12] it is assumed that these importers will be most likely to be able to gain pre-authorisation to pay the correct tariff at the UK border through a new trusted trader scheme, under which they would not need to engage with the repayment mechanism. This is because they would find it easier to prove at the point of import that their imports will be consumed (or substantially transformed, when finished goods are used as intermediates in production) in the UK rather than the EU.

[13] Goods imports from these RoW countries (taken 'UK Economic Accounts: balance of payments - current account, 2018 quarter 1 (Jan to March)', ONS, July 2018) were classified as finished products using the UN's Broad Economic Category (BEC) classification Rev. 4. A concordance table from UN Statistics Division was used to match products (HS-2012 codes) to BEC codes.

[14] In reality some intermediate goods would be able to pay the correct tariff at the UK border through the trusted trader scheme, while some finished goods would access preferential UK tariffs through the repayment mechanism.

If the calculations detailed here were repeated for imports only (as opposed to total trade), up to 93%[15] of imports would be likely to pay the correct or no tariff at the border.

[15] Calculated using same sources set out here. 46% of UK imports are from non-EU. 50% of these enter under zero MFN tariffs (leaving 23%) and 16% is left once you take out FTA partners and LDCs. Of this, 7% are left when taking out finished goods.