

Public Accounts Committee: Impact of the Trade and Cooperation Agreement

Federation of Small Businesses (FSB) written evidence 18 January 2021

1. The Federation of Small Businesses (FSB) is the UK's leading business organisation representing small businesses. Established over 45 years ago to help our members succeed in business, we are a non-profit making and non-party political organisation that is led by our members, for our members.
2. FSB welcomes the opportunity to respond to the Public Accounts Committee on the impact of the implementation of the Trade and Cooperation Agreement (TCA). We would be happy to provide further detail on any of the issues raised in this response.

Question One: What are the most significant impacts of the UK-EU Trade and Co-operation Agreement (the Agreement) on the stakeholders that you represent?

3. Leaving the transition period and implementing the UK-EU Trade and Co-Operation Agreement (TCA) has had a significant impact on small firms engaged in international trade with the EU. Since 1 January 2021, the most common issues reported by FSB members include: administrative and financial burdens related to customs procedures; unfamiliarity with rules of origin; disruption to supply chains and delivery; increased prices for services provided by fast parcel operators, customs agents, and logistics intermediaries; costs related to VAT; and issues obtaining or moving certifications.
4. A clear majority of small businesses did not feel ready for the end of the transition period and the move to operating under the terms of the TCA. FSB's recent transition readiness survey, conducted in early December 2020, showed that fewer than one in five (18 per cent) of small firms that believed they would be negatively impacted by the end of the transition period had finished preparing. The most common reasons cited for this lack of readiness were lack of clarity and certainty – at that point – concerning future trading arrangements with the EU and the economic impact of Covid-19 and related restrictions.
5. FSB has welcomed the successful negotiation of zero tariffs and zero quotas under the terms of the TCA, however businesses must meet the rules of origin contained in the TCA to make use of these preferential terms. Rules of origin are costly for smaller businesses and affect their competitiveness, particularly versus larger businesses that may be able to meet and prove origin more easily. FSB's recent transition survey showed that more than half (58 per cent) of small businesses that trade in goods do not have experience of dealing with rules of origin, and a third (31 per cent) were not aware of the process.¹
6. The need to complete customs declarations will affect nearly two thirds (63 per cent) of FSB members engaged in international trade, but fewer than half (46 per cent) are confident that they or their staff are able to handle them. The majority of smaller businesses (70 per cent) are likely to contract the services of a customs agent or freight forwarder to help them navigate the new rules, although the

¹ FSB transition readiness survey, 2020: <https://www.fsb.org.uk/resources-page/fewer-than-one-in-five-small-firms-fearing-end-of-transition-have-prepared-new-study-finds.html>

availability and cost of using these providers is proving to be prohibitive to some small businesses.

7. FSB members have reported significant issues relating to leaving the EU VAT area. Depending on the Incoterms used in their contracts and/or their particular business model, many small businesses are having to consider whether they need to register for VAT in the EU Member States to which they export. Due to leaving the EU VAT area, the UK no longer benefits from distance selling thresholds available to EU-based businesses. This means that many small firms are having to consider VAT registration in multiple jurisdictions for often relatively low volumes in sales. The administrative burden involved can be off-putting to many smaller firms.
8. While the TCA contains welcome provisions on co-operation and mutual assistance on VAT and other taxes, this does not remove the requirement to appoint a VAT fiscal representative in all EU Member States. The appointment of a fiscal representative can carry significant costs, both in administrative burden and securities paid towards VAT liability.
9. Issues obtaining or moving certifications: Many businesses will need to undertake processes to demonstrate that their products meet both UK and EU standards and make changes to product labels or markings. FSB research shows that just 6 per cent have made changes to product labelling and markings, and some members have reported that the cost of re-certifying their product may stop them selling in the EU and/or UK.²
10. Similarly, a minority of members (4 per cent) have transferred certificates and authorisations issued by a UK-based body or authority to an EU-based body or authority, or sought new ones.³ Anecdotal evidence suggests that businesses have faced difficulties and increased costs in getting certificates renewed from EU authorities such as the European Union Aviation Safety Agency (EASA). In addition, according to the European Chemicals Agency (ECHA) around 20% of REACH registrations in the UK have not been transferred to the EU. This process will need to be completed by the end of March 2021 or these registrations will be revoked.

Question Three: What impacts will implementing the Agreement have on your costs, competitiveness and your customers?

11. Prior to the end of the transition period, many small firms had already spent significant sums on their preparations. Among those FSB members that had managed to make some preparations for the end of the transition period before 31 December 2020, more than a quarter (27 per cent) reported the cost of doing so had been in excess of £2,000 while one in ten (10 per cent) said the cost had exceeded £5,000.⁴ For many small firms such sums represent a significant percentage of their overall revenues.
12. There is considerable concern that many UK small businesses will not be able to meet rules of origin or know how to prove origin of their products. As noted above, a majority of FSB goods exporters do not have experience of dealing with rules of origin. The administrative requirements and calculations involved in determining whether goods meet rules of origin in FTAs, particularly for complicated manufactured goods, can often be beyond the capabilities of smaller firms. Should smaller firms trading with the EU in the future not meet rules of origin, their goods

² FSB transition readiness survey, December 2020.

³ *Ibid.*

⁴ *Ibid.*

will incur duties. This may have a significant impact on these firms' competitiveness in the future.

13. FSB strongly welcomes provisions in the TCA that allow firms to prove origin via a supplier's declaration or importer's knowledge. This saves smaller firms the costs of purchasing a certificate of origin. In addition, FSB has welcomed the twelve-month derogation on the need to provide a supplier's declaration. Nevertheless, businesses' goods are still required to meet rules of origin in order to benefit from preferential treatment under the TCA, and customs authorities may retrospectively request proof of origin for shipments made throughout 2021. It is therefore vital that Government raises awareness of rules of origin and how to meet them before the end of this derogation at the end of 2021.
14. There are significant costs associated with customs processes that many smaller firms did not have to contend with prior to the end of the transition period. These can include – but are not limited to – obtaining certain documentation such as ATA Carnets; buying specialist software to interact with HMRC's systems; subscribing to the Management Support System (MSS); paying a customs intermediary to handle certain processes on your behalf; financial guarantees to make use of certain customs easements or reliefs; and more. While individually some of these costs may be low, in aggregate they can be significant for smaller firms.

Question Four: What, if any, concerns have your members raised with you regarding the new arrangements?

15. In addition to the impacts detailed in our response to Question One, concerns raised by FSB members regarding the new arrangements include: increased costs of freight and shipping; issues around EORI numbers; and disruption to supply chains.
16. Anecdotal evidence reported by FSB suggests that businesses are facing significant increases in shipping costs charged by logistics intermediaries and fast parcel operators in light of new customs requirements and anticipated delays when passing through the UK-EU border. Although some large increases seen by FSB members may be a short-term anomaly, overall shipping costs are expected to increase for businesses exporting to the EU versus before the end of the transition period.
17. In instances where shipping costs are borne by the customer, FSB members are concerned that increased costs and delays in delivery may deter customers from buying from UK firms. Some FSB members have reported having orders returned due to customers refusing to pay customs duties and/or VAT due upon delivery. Although businesses may choose to compensate by reducing prices of their products, in many transactions with low margins this may not be possible.
18. Many members are reporting issues relating to the UK becoming a separate customs territory to the EU. Smaller firms that import products to warehouse in the UK before selling directly to customers in the EU are now faced with their goods potentially having duties levied on them twice. While options to alleviate this situation exist, including Temporary Admission, Returned Goods Relief, bonded/customs warehouses, and fulfilling EU orders via EU-based warehouses, such options can carry significant costs and/or administrative burdens for smaller firms and often involve significant changes to supply chains.
19. The long-term impact of the TCA on supply chains is yet to become clear. However, it is notable that in anticipation of supply chain disruption, nearly a quarter (23 per cent) of small businesses reported stockpiling ahead of the end of the transition

period, and ten per cent have sought suppliers or customers in alternative markets to the EU.

20. The majority (73 per cent) of FSB exporters had a UK EORI number prior to the end of the transition period. However, many FSB members have raised issues relating to applications for an EORI number being declined without explanation.

Question Five: Are there any specific gaps in the Agreement that will affect your members if they are not developed/negotiated further?

21. FSB welcomes the interim period agreed by the UK and EU that ensures that the UK shall not be treated as a third country for the purposes of data transfers for a limited time. Although some FSB members have renegotiated contracts prior to the end of the transition period to insert Standard Contractual Clauses (3 per cent), the vast majority have not. FSB research from 2019 showed that over half (62 per cent) of small businesses were not aware of the ICO's Standard Contractual Clauses.⁵
22. As a consequence, failure to secure an adequacy agreement from the EU would have a significant impact on the large number of small businesses that transfer data between the UK and EU or store data within an EU Member State. In the UCL-New Economics Foundation report *The Cost of Data Inadequacy*, to which FSB contributed qualitative and quantitative data, the cost of the EU not granting an adequacy decision to the UK was estimated to be up to £1.6 billion.⁶
23. The TCA leaves the mutual recognition of professional qualifications to bilateral negotiation between professional bodies from each respective party. This means that, until such recognition is agreed, independent professionals and businesses' employees looking to deliver a service in the EU that relies on the recognition of their qualification will have to seek that recognition directly in each respective Member State in which they operate. Depending on the Member State concerned, this process can often be time consuming and difficult to achieve for non-residents. Within the TCA, FSB welcomes the agreement of a framework for recognition through the Partnership Council but encourages Government to work closely with the EU and relevant regulatory authorities to achieve mutual recognition in key sectors within a reasonable timeframe.

Question Six: To what extent do you feel that your members are getting the information and support that they need from government to understand and comply with new arrangements? If there are areas where more information or support would be helpful, please provide details.

24. Government has so far been responsive to business requests for and feedback on guidance. FSB welcomes the range of detailed guidance that has been published in quick time since the agreement of the TCA. Nevertheless, FSB would welcome more detailed guidance in several key areas, including Member State-level guidance on the delivery of Mode 4 services and on VAT registration requirements.

⁵ FSB transition survey, August-September 2019.

⁶ UCL European Institute with the New Economics Foundation, 'The Cost of Data Inadequacy: The economic impacts of the UK failing to secure an EU data adequacy decision', November 2020, <https://www.ucl.ac.uk/european-institute/news/2020/nov/cost-data-inadequacy-economic-impacts-uk-failing-secure-eu-data-adequacy>

25. FSB strongly welcomes the inclusion of an SME Chapter in the TCA. FSB now calls for the rapid roll-out of the SME Contact Point foreseen in the SME Chapter of the TCA. Such a contact point is an important means of enabling smaller firms to understand the terms of the TCA and helping them to understand how to use it.
26. Small businesses often do not have the financial or human resources needed to adapt to the UK's trading arrangements. As noted above, the vast majority of small businesses that believed they would be negatively affected by the end of the transition period had not finished preparing or did not feel they were able to prepare. Discounting uncertainty regarding the future trading relationship with the EU, the most common reasons for not finishing preparations cited were lack of time and/or resources. This is a situation that has been exacerbated by the economic impact of the Covid-19 crisis and associated restrictions.
27. In addition, many small firms require access to bespoke support that reflects their particular business models, products, or services. While Government guidance has been welcome, it is often not easily applied by smaller firms to their particular circumstances. Smaller firms lack the human and financial resources of large firms, and often do not have distinct legal or export departments to call upon.
28. In response, FSB has called on Government to support smaller businesses through the introduction of transition vouchers: small grants of up to £3000 that firms can spend on the expert advice and training needed to navigate a new relationship with the EU and make use of the TCA. Transition vouchers could be modelled on similar "Brexit voucher" schemes introduced in the Republic of Ireland and the Netherlands.⁷

Question Seven: Are your members able to access the support they need from private sector organisations that facilitate trade, such as customs intermediaries or software providers?

29. As noted above, the majority of small businesses (70 per cent) suggested that they were likely to contract the services of a customs agent or freight forwarder to help them handle customs declarations following the end of the transition period and over half (58 per cent) had already done so.
30. Anecdotally, FSB members have reported issues with finding and contracting the services of customs intermediaries. FSB Members who have been able to contract the services of customs intermediaries have reported significant increases in charges for services delivered.
31. In addition, according to examples provided by FSB members, businesses are facing significant increases in shipping costs charged by fast parcel operators in light of new customs requirements and anticipated delays at the UK-EU border.

Question Eight: In the longer-term, what would you like to see the UK government do to help the stakeholders that you represent to minimise the administrative burden, and maximise the opportunities, associated with leaving the European Union?

32. FSB welcomes the efforts of the Government and Department for International Trade to incorporate the needs of smaller businesses into its support for exporters

⁷ InterTradeIreland Brexit Voucher, <https://intertradeireland.com/brexit/funding/voucher>; Netherlands Enterprise Agency Brexit vouchers, <https://business.gov.nl/subsidy/brexit-vouchers/>

and trade policy work. There are however a number of areas where business support could be optimised to help small businesses maximise the opportunities of leaving the European Union and new trade agreements.

33. In FSB's 2020 report *The representation of SME interests in free trade Agreements: Recommendations for best practice*, written in conjunction with the University of Sussex's UK Trade Policy Observatory (UKTPO), we identified the common challenges that smaller exporters face when understanding or using the provisions of FTAs. In particular, the report noted that the utilisation rates of FTAs by smaller businesses was disproportionately low when compared to larger firms. A major means of supporting exporters in the future will be ensuring that smaller firms can successfully unlock the benefits of the UK's negotiated FTAs.⁸
34. The Government should therefore ensure the inclusion of a dedicated and comprehensive small business chapter in future trading agreements. FSB has strongly welcome small business chapters that have already been agreed in the TCA, the UK-Japan CEPA, and numerous UK continuity trade agreements. FSB additionally welcomed the Government's published ambition of negotiating small businesses chapters in FTAs currently under negotiation with the USA, Australia, and New Zealand.
35. As noted above, smaller businesses would benefit from the creation of a transition vouchers scheme of up to £3000. Grants could be spent on buying in the bespoke expert advice and training that small firms often need to understand and take advantage of the opportunities offered by international trade and, specifically, FTAs.
36. FSB views the business support services and products provided by the Department for International Trade (DIT) as integral to small firms taking advantage of the opportunities of international trade, both with the EU and with non-EU markets. According to FSB's 2016 report *Destination Export*, Government support and advice is the type of support most frequently accessed by small firms looking to trade internationally.⁹ However, this support is not always adequately aimed at smaller firms' needs.
37. In particular, FSB would welcome better targeting of support provided by International Trade Advisors (ITAs) at micro and small businesses; the simplification of application processes for UKEF products; and greater financial support for firms making use of the Tradeshow Access Programme (TAP).
38. Amongst recent DIT initiatives, FSB welcomed the creation of the 'Report a trade barrier' tool on great.gov.uk. FSB would like to see the tool promoted more effectively to smaller businesses. In addition, FSB welcomed the creation of the DIT Europe Trade Hub in April 2019. FSB would welcome similar regional hubs being established for other regions around the world.

⁸ FSB, *The representation of SME interests in Free Trade Agreements*, January 2020, <https://www.fsb.org.uk/resources-page/fsb-trade---tpo-report-pdf.html>

⁹ FSB, *Destination Export*, July 2016, <https://www.fsb.org.uk/static/e0e19b59-9d58-4a4f-bb59f080cbf2d05a/fsb-destination-export-report-2016.pdf>