

CBI response to Treasury Select Committee's inquiry – EU Exit and transitional arrangements

The CBI welcomes this opportunity to submit evidence to the Treasury Select Committee's inquiry on EU Exit and transitional arrangements.

The CBI is a confederation of 140 trade associations alongside individual businesses of all sizes from every region of the UK. The 190,000 businesses we represent employ nearly 7 million people, about one third of the private sector workforce. Our members come from every sector of the economy, including agriculture, automotive, aerospace and defence, construction, creative and communications, financial services, IT and e-business, management consultancy, manufacturing, professional services, retail, transport, tourism and utilities.

The business community is committed to making a success of Brexit. Through thousands of conversations with companies and trade associations in the six months after the vote to leave, the CBI compiled six principles to guide policy makers in achieving this aim. More details of these can be found in the report [Making a Success of Brexit](#). This response will focus primarily on one of those principles: achieving a smooth exit from the EU, avoiding a "cliff-edge" that causes disruption.

To provide the committee with views on the design and desirability of "transitional arrangements", the CBI has undertaken a detailed consultation with its members. Since the Prime Minister's landmark Lancaster House speech, we have held roundtables with businesses in different regions and nations of the UK, detailed conversations with individual companies, and a written survey of members.

In this submission, we take the conclusions of this consultation to argue:

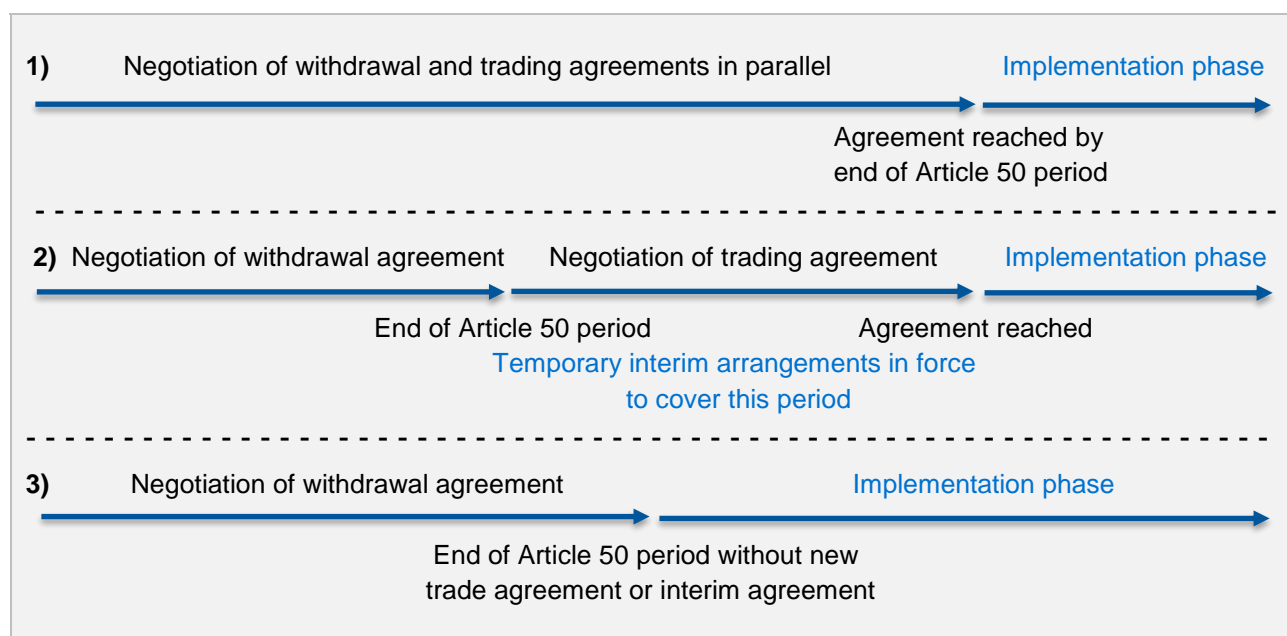
1. Business wants to see the successful negotiation of a comprehensive UK-EU free trade agreement that includes "transitional arrangements".
2. An implementation phase will be necessary once a deal has been struck, to allow companies time to adapt.
3. An implementation phase will also be required for regulators to adapt to changes in their role and scope, and for Governments to bring in any new legislation
4. The greater the change agreed, the longer the implementation phase required.
5. A temporary interim arrangement will be required if a deal cannot be struck within the Article 50 period.
6. The purpose of both an implementation phase and a temporary interim arrangement is to provide the smooth and orderly Brexit both the EU and UK have committed to.
7. In addition to "transitional arrangements", there are many other steps the Government can take to provide business with more confidence.

1. Business wants to see the successful negotiation of a comprehensive UK-EU free trade agreement that includes "transitional arrangements".

- 1.1. The UK business community welcomed the Prime Minister's Lancaster House speech, as a commitment to seek an ambitious and comprehensive free trade agreement that delivers on many of business' principles for the negotiations.** The Prime Minister set out the Government's ambitions for a tariff-free, barrier-free – or "frictionless" – trading relationship between the UK and the EU. This is one of business' leading priorities. Other welcome steps included the Government's openness to continued involvement in certain EU programmes, the recognition of the important role financial services play in the economy, the acknowledgement of the vital contributions of EU citizens in UK businesses, and the drive for a refreshed global trade agenda.

- 1.2. However, there are a large number of areas where clarity on the Government's approach is needed.** Ruling out membership of the Single Market has reduced options for maintaining a barrier-free trading relationship between the UK and the EU. Among other areas, businesses are seeking further information on how a border between Northern Ireland and the Republic of Ireland will be avoided, how vital regulatory cooperation will continue in every sector, and how business will be consulted throughout the negotiations. Some further acknowledgements of these areas have been made in the UK Government's White Paper on Brexit, but there a large number of important questions remaining.
- 1.3. "Transitional arrangements" will be an important part of a successful deal.** For business, these refer to two different potential phases of the Brexit negotiations. Some have sought "transitional arrangements" to cover a period of time after agreement of a new UK-EU trading relationship has been reached. Some have sought "transitional arrangements" to cover a potential period of time beyond the two years provided by Article 50, should agreement of a new UK-EU trading relationship not have been reached but negotiations are ongoing.
- 1.4. The purpose of "transitional arrangements" of either form is to provide a period of relative stability to allow for the UK's "smooth and orderly exit" from the EU and move to the new relationship, whatever the timing and process of the negotiation.** This is particularly important if no deal been agreed as change would be substantial. Should agreement on a new trading relationship not be reached within the Article 50 period, a temporary interim arrangement will be required to retain stability until one has been agreed. Should no agreement on a new trading relationship be possible, this would be seriously disruptive and at the least an implementation phase will be required to ensure there is time for significant changes to be undertaken. Businesses are considering the implications of each of these scenarios, as illustrated in Exhibit 1. The alternative to the "transitional arrangements" in each of these scenarios is an abrupt change, or "cliff-edge" for UK and EU Governments, businesses and regulators.

Exhibit 1 – The role of "transitional arrangements" in potential scenarios for the negotiation



2. An implementation phase will be necessary once a deal has been struck, to allow companies time to adapt.

- 2.1. One of the most welcome sections of the Prime Minister's Lancaster House speech was the commitment to an implementation phase once the deal is agreed.** Business understands the importance of leaving the EU quickly but it will need time to implement any changes resulting from the deal. The Government's recognition of that is encouraging.

2.2. Businesses are fluid organisations, and are used to adapting to changes in both the policy and economic environments. There are areas of businesses that undergo changes on a regular basis because of internal changes – for example, payroll. In many industries, prices are regularly adjusted to take into account competitive pressures, inflation, exchange rates and shifts in policy. Similarly, businesses must be adaptive if they operate in areas where requirements change regularly, or from region to region of the UK. Businesses are practical, resilient and pragmatic.

2.3. But it is not yet clear what changes will be required of businesses after the UK leaves the EU. Some companies are mapping the areas of their businesses where change might be expected, but this is a huge challenge as the scale of possible changes presented the UK's exit from the EU is immense. It is not possible to prepare for all eventual models. It is particularly difficult for small and medium-sized businesses to anticipate and prepare for potential changes, as resource usually does not allow for the kind of sophisticated internal analysis many larger companies can commission.

2.4. An implementation phase will be required so that, once the UK-EU relationship is clear, companies can adapt their strategy. For example, additional investment may be needed by a Human Resources department to respond to changes in the immigration system, but it may also be needed in Customer Services to explain changes to clients or consumers. It is difficult to make that strategic choice before the deal is agreed. Adjustments may be required in pricing strategies, plans for land use, customer targeting, or investment strategies. Exhibit 2 shows how a decision on a single part of the negotiation can affect the strategy of a UK University.

Exhibit 2 – University Research Strategy

The UK's continued involvement in European research programmes (Horizon2020 and its successor) is one part of the UK-EU negotiations. The Prime Minister has signalled the UK's openness to continued involvement, and much of the European research community wants the UK to remain involved in its collaborative projects. However, UK Universities cannot be certain this will be agreed. Many are therefore currently exploring alternative strategies for securing research income - such as focusing more on UK Research Council funding, industrial funding and industrial contracts.

Changes in strategy like this requires the reallocation of resource: it takes time and effort to apply for grants, and a strategy for applying to one organisation will not work for another. Universities are seeking to remain part of the European research programmes, as these alternative sources of funding cannot bring the same benefits as the pan-European collaboration of industry and academia enjoyed by Horizon2020 participants. However this scenario planning is being undertaken in advance of the decision on UK involvement in Horizon2020, because there is no guarantee that either this or an implementation phase will be agreed in sufficient time.

2.5. These strategic changes may be taking place at a local level or an international one, creating additional complications for the decision making process. This is firstly because multinational companies make strategic decisions about where to place investment, and UK subsidiaries compete with subsidiaries in other countries to attract that investment. It is also because pan-European companies often have a centralised policy function that decides the company response to policy decisions made at EU level. This is intended to create a more cohesive response across the company.

2.6. The most significant strategic decision companies are contemplating is the relocation of some resource into or out of the UK. There have been several media reports of financial services companies making these considerations, but the CBI has heard the same concerns raised by companies in numerous sectors. Exhibit 3 shows the considerations a cosmetic company may have to make. Companies are clear that they do not want to make these significant changes, but that if sufficient market access cannot be secured, they may need in order to continue providing goods and services to consumers.

Exhibit 3 – Relocation Case Study

The packing of all cosmetics products sold in the EU must list an address for the company that produced it. That address must be in the EU and must be a staffed office. The cosmetics industry is seeking an agreement covering mutual recognition to allow UK cosmetics products to be sold in the EU from a UK address, and vice versa. If it is not successful, a cosmetics company in the UK will have to change strategy.

Large companies may relocate resource into the EU and establish an office there. Alternatively, an analysis of the costs and benefits may show the costs of a new office not justifiable, and they may stop exporting to the EU. Or small companies in particular may sell their IP rights for their products to larger companies with European offices.

2.7. Businesses in both the UK and the EU may need to adapt their supply chains if tariff and non-tariff barriers make trade more complex and costly – and an implementation phase will be needed so they can do this once the UK-EU relationship is clear. Currently, UK businesses are part of integrated supply chains criss-crossing the EU, and production lines are set up to take account of this. However, if cross-border UK-EU trade becomes more complex and costly, UK businesses may find themselves excluded from EU supply chains, and vice versa, as companies seek to avoid these costs. This is seen as a real concern across the whole business community, as many EU companies have “buy Europe” policies – but it is exacerbated in sectors that would face high tariffs, such as the automotive industry concerned about tariffs on exports and imports of around 10%, and agri-food where the average tariff is 22%. Uncertainty about how top-tier

Exhibit 4 – Examples of UK-Ireland Integrated Supply Chains

- 30% of milk produced in Northern Ireland is processed in the Republic of Ireland
- 80% of flour used in the Republic of Ireland is sourced from the UK
- 48% of trade through one Northern Irish port originates from or goes to the Republic of Ireland
- One drinks company estimates their trucks cross the Irish border 13,000 a year

companies may adjust their supply chain strategy is already affecting small and medium-sized suppliers. It is also a particular concern for the whole-island supply chains on the island of Ireland, and for the integration between the UK and the Republic of Ireland overall. Exhibit 4 shows how comprehensive supply chain adjustments have to be on the island of Ireland if a comprehensive agreement is not struck.

2.8. However, it is important to note that few companies will be able to adjust their supply chains to avoid all trade barriers – because alternatives do not always exist. It is estimated, for example, that only 40% of a car’s components can be sourced in the UK, and domestic industry could not be redesigned. Other examples range from specialist radio products required by telecommunications companies which are only produced in three countries globally, to geographically

protected products like Scotch whisky which could not be produced in any other location to avoid trade barriers. Aside from goods, there are many examples of UK companies being unable to commission services locally, despite efforts to do so. There is also the element of consumer choice to consider: consumers will still want goods and services from abroad. If these imports are to become more expensive, an implementation phase would allow companies to start pricing in additional cost burdens gradually.

2.9. Businesses at various stages of the production process are concerned about needing an implementation phase to allow time for major changes to infrastructure. Most changes to infrastructure are not simple, quick or cheap - and in some instances they are logistically very challenging. The ports, airports and logistics companies which handle the UK’s goods imports and exports face the prospect of significantly increased bureaucracy should the UK and EU be unsuccessful in negotiating a deal. Processing UK-EU trade in the same way as UK-rest of world trade would require additional space for both the company and HMRC to undertake new processes. In many facilities, significant space for customs has not been required for decades, and business units have been built up where new customs buildings may be required. However, as in Exhibit 5, this concern is not limited to the logistics companies, but many other firms as well. Many large manufacturers are anxious that

delays will require them to buy more components in bulk and store them, with all the associated costs of additional people to manage the space, stock and new processes. Additional space and equipment may also be required if separate production lines are needed to produce UK and EU goods, as may be necessary if UK goods have to go through divergent licensing requirements.

Exhibit 5 – Importer Infrastructure Case Study

A technology company has branches in several different countries. Currently, it ships the specialist products it makes in the EU directly to customers in the UK. However, the goods it produces in Norway and Switzerland have to be shipped to one of the company's UK sites. This is because the products from outside the EU (even inside the EEA) have to be accompanied by VAT paperwork showing the cross-border price. This has to be removed before the good is sent to the customer.

If the same arrangement was required for all the company's products entering from the EU, additional warehousing would be needed, along with extra staff and machinery. Estimated order times would also have to be increased as it would take longer for products to reach customers.

2.10. To enforce new requirements resulting from the new relationship between the UK and EU, companies may need an implementation phase to introduce new compliance and governance procedures. It will take time and resource for businesses to properly establish new processes to ensure they are compliant with any new trading requirements. For large, complex companies it can take two years or more to substantially design policy changes, deliver them within organisations, and create monitoring procedures to ensure continued compliance. For smaller companies, outside agencies may be required to assist them in implementing changes.

2.11. Changes to policy cannot be implemented without mechanisms for them to be communicated throughout businesses, which also takes time. Training programmes for staff members have to be designed once new processes have been established. It may be that multiple training programmes are required to cover different areas of organisations – for example, training for sales staff to verify prices from suppliers in the new environment, or operational staff to understand new shipping processes. It may be necessary to commission these programmes from an external organisation, and/or the diversion of resources from other business activity.

2.12. Installing or updating IT systems to deliver new requirements can be both costly and complex, and is likely to be necessary for many companies if the UK and EU are unsuccessful in negotiating a deal. Updating IT systems is a multi-stage process – an objective must be set, a specification agreed, the system built and then tested before application throughout a business. Seemingly minor changes can, in reality, imply serious costs, as in Exhibit 6.

Exhibit 6 – IT Upgrade Case Study

Revision of the Union Customs Code procedures, which is the framework regulation for customs, required a manufacturing company to add a number of extra fields to each of its databases. However, this update had to be done manually, and as result a small change took 9 months to complete.

2.13. Businesses are also likely to experience significant changes when the Government introduces a new migration policy. As with trading arrangements, clarity on immigration rules well in advance of those rules entering into force is needed to give firms the best possible chance of being successful within the parameters of a new system. The greater the adjustment to be made, the longer the lead-in time that is required. A much longer lead-in time will be required than that usually applied to changes to the non-EU Tier 2 route, for example. Time is also needed to adapt to changes to study visas, with many Universities already planning to adapt their student recruitment strategies, redeploying resource from EU countries to third countries, though recruitment is often more difficult in these geographies. Companies may also have to seek legal and planning support to ensure new systems within the business can deliver on any new requirements. Airports, in particular, may need time to adjust their layouts to provide more space for Border Force agents and queues if additional visa requirements come into force.

3. An implementation phase will also be required for regulators to adapt to changes in their role and scope, and for Governments to bring in any new legislation

3.1. Whatever the nature of the deal struck, it is likely that regulators in both the UK and the EU will face changes in their roles. On multiple occasions since the referendum, the Prime Minister has stated that “we will take back control of our laws and end the jurisdiction of the European Court of Justice in Britain”. This implies that the role of regulators in the UK and the EU is likely to change, with responsibilities for UK regulators set to increase – in some cases significantly.

3.2. For business, regulatory harmonisation *must* be a major part of the negotiation, and as such it is likely that the role of UK and EU regulators will not be clear until agreement is reached.

Businesses across the economy are clear that, in order to achieve the Government’s ambition of a “frictionless” trading relationship, the UK and EU will have to negotiate significant levels of regulatory harmonisation, cooperation and mutual recognition. The range of areas in which this agreement must be sought are vast and vary significantly by sector (see Exhibit 7). The complexity of these issues means – even if political agreement is reached in advance – the practical mechanisms for administering that agreement will take some time to be developed.

3.3. An implementation phase will be necessary to allow affected UK regulators time to prepare for changes after agreement is reached. Once the nature of changes to regulation and the role of UK and EU regulators is clear, those regulators will need to adjust. This may require an increase in resources. Businesses think it is important that their regulators have the capacity to deliver their expanded roles. In particular, as many EU-level regulatory bodies provide a dispute moderation role, businesses want to see reliable and fair mechanisms for this in place in the UK after exit – and a smooth transition to this system.

3.4. An implementation period would also allow the EU regulators time to adapt. In particular, should a change in arrangements require legislative change in the Republic of Ireland in order to maintain the common travel area for people and goods, time will need to be allowed for those processes to take place. Time will also need to be allowed for the EU to produce guidance on the change in the UK’s status and how EU-level agencies should respond to the deal agreed. That guidance will have to be produced in all the languages of the EU.

Exhibit 7 – Examples of regulatory harmonisation

Harmonised EU-level Regulatory Decisions

The **European Medicines Agency (EMA)** is the European body that licenses medical products across the EU. The **Medicines and Healthcare products Regulatory Agency (MHRA)** and the **Veterinary Medicines Directorate (VMD)** are the UK’s national authorities that ensure the standards set by the EMA are enforced domestically.

The **European Aviation Safety Agency (EASA)** is the European body that provides a single regulatory and certification process for the aviation industry, with exclusive competence over some areas, such as airworthiness. The **Civil Aviation Authority (CAA)** is the UK’s aviation regulator. Its functions, such as air traffic management, are overseen by the EASA.

Agency Cooperation

The **European Data Protection Board (EDPB)** is being established as the forum for national data protection authorities to coordinate, through sharing of information about cross-border privacy breaches, investigations, and sanctions. The **Information Commissioner’s Office (ICO)** is the UK’s data protection authority and will represent the UK in the EDPB.

NB: Almost all the other agencies in this table all also cooperate at EU level in this way.

Mutually Recognised Licensing

The **Vehicle Certification Agency (VCA)** is the UK’s Vehicle Licensing Authority, which provides testing and certification for vehicles, systems and components. The VCA provides UK automotive manufacturers with a certificate that licenses them to sell that type of vehicle throughout the EU.

The **United Kingdom Accreditation Service (UKAS)** is the UK’s accreditation body that provides certification for a range of businesses - including laboratories, environmental management services, food safety, health and safety management and much more. An accreditation from the UKAS allows certified companies to also provide services to the EU.

3.5. An implementation period could also provide for the completion of the final stages of the “Great Repeal Bill”. Changes to UK primary and secondary legislation may be required after the negotiation is complete, to take into account agreed roles for regulation and regulatory harmonisation. An implementation period would provide time for this to take place with the full input of affected stakeholders.

4. The greater the change agreed, the longer the implementation phase required.

4.1. The Prime Minister stated that the implementation phase would be short, and business believes that a successful deal which keeps barriers to trade as low as possible would mean that the implementation of the UK’s exit from the EU can be quick, as it should not require significant adaptation for most companies.

4.2. Implementation phases are a common feature of both trade deals and regulatory change, and range in length depending on scale of change. Some of the regulatory changes businesses have implemented in the past, and the steps companies have had to take to adapt to these changes, can be found in Exhibit 8.

Exhibit 8 – Examples of previous implementation phases for business and regulator adaptation

<i>The General Data Protection Regulation (GDPR)</i>	
This regulation changes the way that businesses process and transfer personal data. It enshrines a “right to erasure”, an obligation for most companies to have a Data Protection Officer and to report company data breaches within 72 hours, sanctions for non-compliance, and additional requirements for digital consent, responsibility and accountability.	
Timeline: <i>April 2016:</i> Regulation agreed and adopted <i>May 2016:</i> Regulation entered into force -Implementation phase- <i>May 2018:</i> Regulation applies	Case study – a health and care company’s response: <ul style="list-style-type: none"> • Formation in May 2016 of a project Steering Group with senior stakeholders from various parts of the business. • Steering Group undertakes analysis of the complex impacts to IT infrastructure and compliance, taking approximately 8 months to fully gauge effects. • Analysis identifies that significant enhancements are needed to adjust business process, business policy, staff training and IT systems. • These changes will require significant investment to deliver • Resource is also assigned to link with industry forums and regulators, and to hire external counsel to ensure compliance.
<i>The Human Tissue Act 2004</i>	
This law changed the way that human bodies, organs and tissues are lawfully used, removed, stored and disposed of – affecting universities, laboratories, and health organisations in England, Wales and Northern Ireland.	
Timeline: <i>November 2004:</i> Law received royal assent -Implementation phase- <i>April 2005:</i> Regulator created <i>April 2006:</i> Regulator’s powers entered into force	Case study – a University’s response: <ul style="list-style-type: none"> • New governance structure established. • New IT system introduced to track samples. • New storage facilities installed to store samples securely. • Staff training to explain new governance structure and IT systems and how to understand and implement the new law. • Initial implementation took between 12-18 months, but the regulator has updated guidance numerous times since initial implementation, requiring further changes.

The Classification, Labelling and Packaging Regulation (CLP Regulation)

This regulation adopts the United Nations' Globally Harmonised System on the classification and labelling of all chemicals, to ensure all chemicals are labelled in the same way to increase health and safety.

Timeline:

January 2009: Regulation entered into force
-Implementation phase-
December 2012: Regulation applies to all substances
June 2015: Regulation applies to all new mixtures for sale from this date
June 2017: Deadline for mixtures placed on market before June 2015 to be relabelled

Case study – a chemicals manufacturing company's response:

- Audit of existing stocks, sales patterns, risk assessments and working practices took place to establish the plan.
- Guidance was not produced until August 2013, complicating implementation.
- Multi-step training programme for all staff members was introduced, and induction training overhauled.
- Replacement of all signage and written materials for use within the facility was required, including new systems for record keeping, emergency plans, and maintenance of equipment.
- New labels had to be designed for all products and additional testing regimes introduced.
- Resource had to be increased in customer communications team in order to contact all customers to inform them of the changes.

4.3. While a negotiation that results in only small changes for businesses would require a short implementation phase, greater changes will take longer to adjust to. There have been some estimates by sector of the time they would need to adjust if no deal was achieved, with some in financial services estimating two years, some in the wine industry estimating three years, some in the beauty industry estimating four years, and some in the logistics sector estimating five years or more. The design of the implementation phase may have to reflect this, with smaller changes requiring less time and larger changes – for example to infrastructure – requiring longer. Ultimately, the scale of change and the industries effected will determine the time required for companies to implement the new deal.

Exhibit 9 – Example of previous regulatory change business found difficult

The ePrivacy Directive

During the 15 month implementation phase provided for this change, most businesses chiefly had to overhaul how they informed users about the use of 'cookies' on websites, but telecommunications companies had to undertake more substantial changes. Because the Directive was badly designed, regulators found it difficult to issue guidance. This led to wide-spread confusion, inconsistent implementation and, ultimately, the need for the Directive to be reviewed.

4.4. Business wants the process of leaving the EU to be swift, but it must not be rushed. Companies want to see the UK-EU relationship become clear as quickly as possible, but the issues are complex. To make a success of Brexit and strike the right deal for the long-term, neither the negotiation nor the implementation should be rushed. Businesses do not want delays, but when legislation is badly designed, regulators unprepared, or guidance not well communicated, companies face real challenges. These challenges lead to wasted money, unproductive use of resource and – ultimately – incomplete implementation. One example of such an error can be found in Exhibit 9. Any implementation phase should be of sufficient time to allow the Government's intentions to be fully realised.

5. A temporary interim arrangement will be required if a deal cannot be struck within the Article 50 period.

5.1. While the Government has agreed to seek an implementation phase once the new UK-EU relationship is agreed, it has not committed to a temporary interim arrangement should one prove necessary. An implementation phase seeks to smooth the move from EU membership to a new relationship. A temporary interim arrangement seeks to avoid a much steeper "cliff-edge" – the fall into trade under WTO rules that would occur if the UK leaves the EU without a new preferential deal in place.

- 5.2. There are serious concerns that, if temporary interim arrangements are not in place to avoid a “cliff-edge” in this scenario, provision of goods and services will be disrupted.** This is because the EU would begin, overnight, to treat the UK as a third country with no preferential relationship. If the UK is not an EU member, and no preferential deal is agreed, both sides will be obliged to do this by WTO law. This could cause a “cliff-edge” for every sector of the UK and EU economies.
- 5.3.** Without an agreement on data flows between the UK and EU, for example, any company that transfers data cross-border will face complex and unwieldy additional requirements. Without an agreement on mutual trade in financial services, companies providing cross-border travel insurance, loans, credit, and payments systems may be unable to do so. Without an agreement on audio-visual services, channels based in the UK will no longer be permitted to broadcast into the EU as freely as they do now. Without a sophisticated and comprehensive agreement on goods trade – including tariffs, customs procedures and regulatory harmonisation – UK-EU goods trade will face additional costs, delays and disruption. This will affect consumers in both the UK and the EU.
- 5.4. This disruption would not be limited to UK-EU trade.** For example, if the UK is outside the customs union and no longer part of its existing third-country trade deals, supply chains outside the EU will face disruption – as in the case study in Exhibit 10. UK exporters might also face disruption in international markets if UK goods are no longer recognised as meeting EU standards. While there may be ways to avoid some of these effects through bilateral arrangements, it may not be legally possible to do so until the UK-EU arrangement is clear. An implementation phase may provide time to allow these bilateral arrangements to be negotiated, but disruption is inevitable if no UK-EU deal is struck and no temporary interim arrangement is in place.
- 5.5. Without a preferential UK-EU trade agreement or temporary interim arrangement avoiding a “cliff-edge”, there will be delays.** Additional requirements at customs, particularly if no time is allowed for adjustment, will lead to delays. This will be extremely problematic for short life-span goods like food and plants, and for industries that require just in time deliveries. If goods do not arrive in time for just in time deliveries, production may have to stop. Such line stoppages occurred during “Operation Stack” and were costly for a number of companies. Delays in the trade in goods also result in pressures on working capital for small businesses, who do not receive payments until goods are received. And where shipping is irregular, delays are not a matter of hours but a matter of days or even weeks. If businesses are forced to increase their anticipated order times as a result, they will be less competitive.
- 5.6. Additional requirements, delays and disruption should the UK and EU not agree a deal or temporary interim arrangement will also lead to an increase in costs for businesses and consumers.** Some of those costs will be direct costs through tariffs and increasing resource to deal with additional requirements. Some of these costs will be indirect – with businesses anticipating facing a range of concerns from the effect of business confidence on investment intentions, to having a narrower choice of suppliers. This has to be considered in the context of the cumulative burden of the Government’s other policies, including the apprenticeship levy and minimum wage rises, compounded by the need to manage currency changes and inflation.

Exhibit 10 – Third Country Exporter Case Study

A product is made with parts from factories in the UK, Mexico, Poland and South Korea. Each factory makes ~25% of the final product. The UK, Polish and Mexican factories export their parts to South Korea where the final product is assembled. As 75% of the final product comes from the EU or South Korea, which has a trade agreement with the EU, this product can be sold tariff-free.

However, if the UK leaves the EU without a deal taking this into account, only 50% of the final product will come from within the EU and South Korea. According to the EU-South Korea trade deal, 60% of the product must be from the EU or South Korea for it to be tariff-free. The UK factory is therefore concerned about the real risk that it will be excluded from this supply chain in future.

6. The purpose of both an implementation phase and a temporary interim arrangement is to provide the smooth and orderly Brexit both the EU and UK have committed to.

6.1. The UK and the EU have both made commitments to minimise disruption for business. In the UK Government's February White Paper on EU exit, a chapter is dedicated to "delivering a smooth, orderly exit from the EU". The European Commission's Chief Negotiator Michael Barnier has also stated he is aiming for an "orderly" exit. This is what an implementation phase and a temporary interim arrangement – should it be required – seek to provide.

6.2. The ideal mechanisms for both forms of "transitional arrangements" are similar. In both an implementation phase and a temporary interim arrangement, trading conditions, customs arrangements and regulatory requirements must remain as similar as possible. Guaranteeing these arrangements would soften the need for the contingency planning that businesses are undertaking now, as it would provide certainty on the short-term situation.

6.3. For these "transitional arrangements" to be successful, the legal status of regulations, transactions, contracts and judgements produced at different times must be clearly defined. As a guiding principle, it should be clear that the legal status of actions taken before the UK leaves the EU are protected, and ongoing contracts and transactions are not undermined. This is important to reduce the risk of interruption of goods and services, for example ongoing financial arrangements such as long-term staged release finance agreements, where the borrower accesses proportions of the capital at various points within the loan period. Other examples include long-term service agreements for machinery, long-term contracts supplying retailers and the legal status of products currently on the shelves.

6.4. From the start of any temporary interim arrangements, there should also be clarity for businesses implementing EU legislation that is agreed before the time of exit but not yet fully enacted. Until agreement has been reached to the contrary, it is right that the UK continues to uphold its obligations, as it has with the continued implementation of changes to REACH regulations and the General Data Protection Regulation. It will also be important for the UK to maintain its approach of "business as usual" to economically relevant EU organisations wherever possible, as it has with its post-Brexit involvement in the new Unified Patents Court. The adoption of this approach throughout a temporary interim arrangement should both provide stability and enhance the likelihood of achieving the regulatory harmonisation business needs.

6.5. Early agreement on an implementation phase once a deal has been agreed, and openness to a temporary interim arrangement should no deal be reached within the Article 50 period, would allow these costs and delays to be avoided, and would give businesses confidence. It would also remove business' most critical concerns about a "cliff-edge", disruptive Brexit and allow negotiations to focus more productively on the long-term strategic needs of both the UK and the EU. If a disruptive Brexit seems a realistic probability, businesses will also start to put back-up plans into action, including work to relocate certain functions in a range of industries, even if such a situation ends up being avoided.

7. In addition to "transitional arrangements", there are many other steps the Government can take to provide business with more confidence.

7.1. There are many other steps the UK and EU Governments can and should take to reassure businesses throughout the negotiations. The business community will be paying close attention to the tone and progress of negotiations, and taking them into account when making decisions about strategies, investments and whether to begin implementation back up plans.

7.2. Many companies believe that the negotiation should take place in stages, with "easy wins" that are mutually beneficial negotiated up front, and communicated clearly by both the UK and the

EU once agreements have been reached on certain important issues. One example of this is an agreement on the rights of EU nationals in the UK, and UK nationals in the EU, but there are others – such as tariffs. If both the UK and EU seek early agreement not to raise tariffs on each other's trade, that could be clearly communicated and give businesses confidence. Similarly, it would be sensible for both the UK and EU to seek early agreement on ensuring a “cliff-edge” for the aviation industry is avoided. Once agreements have been reached in areas such as this, the UK Government can then take unilateral steps to provide businesses with further clarity on its longer-term intentions on issues such as environmental regulation, where confidence is important for investment.

7.3. For as long as a failure to strike a successful deal is a possibility, the UK Government should plan for this scenario, consider the mitigations it should have in place, and communicate to business that it is prepared to act to prevent disruption. Until commitments are made for a temporary interim arrangement should no deal be struck, and in case they are not, the UK Government should begin preparations for a “no deal” scenario. Business should be consulted and involved in helping to prepare the Government's response to such a situation, as companies should also be prepared so long as this is an option. This “back up plan” should include communicating how the Government will continue policies that make trade easier – such as Inward Processing Relief. It should also include policies to mitigate the negative effects businesses and consumers will face if trade becomes more costly and complicated.

7.4. The Government's industrial strategy is clearly an important part of delivering for business throughout and beyond the negotiations. A modern Industrial Strategy will be a landmark opportunity to build a successful, modern economy as the foundation for a prosperous, fairer and more inclusive society. It must help fix the country's productivity problems and remove the regional inequalities that have dogged our country for generations, having a positive impact on living standards, wages and the future opportunities of many people. Businesses across every region and nation of the UK will have a fundamental role to play to help shape the thinking and – most importantly – deliver the impact we all want to see.