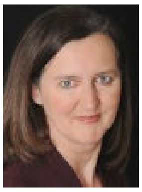
Disrupting supply chains: Why leaving the Single Market means systemic breakdown



The UK will leave the Single Market at the end of this year, with new rules set to be implemented that will have an important impact on British businesses. **Monica Horten** *writes that these changes have the potential to lead to uncertainties of supply, price hikes and potentially shortages. Prompt action could alleviate the situation, but ignoring it will result in long term damage.*

When the UK finally quits the Single Market on 1 January, rule changes will come into effect for businesses. With or without a 'deal', new trade barriers will be erected. Customs declarations will be needed for goods going in or out of the country, traders will have to demonstrate compliance with standards and 'rules of origin', and depending on the outcome of the negotiations with the EU, a tariff payment will be required. The latest UK-EU discussions about 'cabotage' – rules for pick up and drop off in the EU27 – underscore how deep the changes will run. In all likelihood, it will lead to uncertainties of supply, price hikes and potentially shortages, the like of which we are not used to and which will not marry well with our modern way of life.

This is not just about a few lorry drivers who will have to sit in a queue at the border, but thousands of vehicles stacked up near access roads to ports around the country, potentially carrying perishable goods like fresh seafood and live animals. What we are talking about is a structural change being imposed on the industry, with massive implications that will run through our entire economy. The visible symptom will be the lorry parks defacing the Kent countryside, but the hidden effect will be a complex industrial dislocation that will affect consumer prices for food, clothing and household goods. The government has been warned by multiple trade associations of the issues that need to be addressed to keep business running on an even keel. Ministers' ongoing refusal to address them points to a deep-rooted failure inside the government.

If the Covid-19 emergency has taught us anything about the UK economy, it's who the key workers are. Not bankers, not restaurateurs and pub keepers, no, it's the couriers, the crop pickers, the shop workers, the warehouse shelf stackers and packers. They kept our deliveries going despite the emergency lockdown restrictions and they did so in the face of a significant disruption to the food supply chain and shifts in the patterns of demand. Following the initial panic, supermarket shelves re-filled, and goods ordered online turned up without delay. It is significant, however, that there were price increases especially for fresh produce that is imported. We cannot assume that the same continuation of supply will occur when we leave the Single Market on 1 January. This relates to the underlying dislocation that is set to happen. Let's examine why.

What these workers all have in common is that they are all part of a vast industrial system that is the essence of 21st-century business. It is a system of inter-linked hubs and spokes of varying intensity, stretching over borders, land and oceans around the world. We commonly refer to it as logistics, but this seems to underrate what is actually happening. These are the 21st-century industries that keep our modern life going.

They operate supply chains that sync together the factories, growers, farmers, processing plants, warehouses and stores so that we can eat and look after our families. They make it possible to get fresh salad and strawberries all year round. Thanks to them, consumers can pop to the shops whenever they run out of something at home. Product is never unavailable or in short supply. Likewise, shops and restaurants can keep their inventories low, in the knowledge that an order can be placed and delivered next day – or even same day.

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The couriers and their lorries are the poster-boys, but it would be wrong to assume that they are a standalone function. The whole system integrates tightly with manufacturing, processing plants, warehouses, component or ingredient suppliers, and shipping – this is the so-called supply chain. An example of a supply chain for the food processing industry is here. It illustrates how, in order to get from raw ingredients to the packaged product, our food goes through farmers, food processors, wholesalers, retailers and ultimately to the consumer.

Keeping the system flowing, pumping the lifeblood of our economy, are the freight transport operators. They include road haulage firms, the so-called cold chain transporters (who carry temperature-controlled goods) and the shipping companies. Technology is integral to the whole process, with systems managing inventories, demand prediction, deliveries, support services and product planning up and down the supply chain (see here, for example). This digital support infrastructure is critical. Transaction data, barcodes, product availability, operating logs – the data that is the stuff of modern business may be shared around an international sales and distribution network. Many companies will use cloud services, beneficial where goods cross borders every day or where factories in different countries co-ordinate design and production. There is a shift towards advanced technologies such as artificial intelligence, for example, building optimised flow routes and volumes according to weather forecasts (according to this report by McKinsey – see p33). It's an area that is predicted to grow significantly between now and 2024.

The effect of leaving the Single Market will be felt most strongly when goods cross over borders. At the moment, goods, and the lorries that carry them, cross borders under EU rules, with no special paperwork because we are all part of the Single Market. Product standards are harmonised and there are no customs barriers and no tariffs. That is why the trade flows can be so tightly optimised to bring us year-round salads and hook us into pan-continental manufacturing processes. The Single Market is an enabler of the industrial structure that supports modern living. It is especially so in the UK, which has no land borders and relies on a few major ports to bring in such a large percentage of its food and other supplies. Notably, 80% of food is imported into the UK, according to analyst research from HSBC. The figure takes account of raw ingredients as well as packaged products.

From 1 January, the rules will change. Lorries carrying goods for export will need permission to head from a customer's post in a lorry park to the Kent Coast in order to cross to France. There's also the cost of paperwork. A 196-page document from the government sets out what traders (the business that is actually selling the goods) and hauliers (the business that transports the goods) will have to do. As a brief summary, traders and hauliers will need to register with the government and obtain an Economic Operator Registration Identification (EORI) number. Drivers will need international permits for driving in the EU27, and in some countries, they may also need a special licence. A negotiating text released last week by the EU asks for British drivers to accord by level playing field rules including working time and use of tachographs.

Traders will need to establish commodity codes and customs values for the goods being imported to the UK. Both importers and exporters will have to make customs declarations and a safety and security declaration. Importers will have to pay the appropriate tariff and VAT. From 1 January, they have 6 months to submit declarations, but from 1 July, they will have to submit as the goods enter the country. VAT will be payable on imported goods. For certain types of goods, such as live animals and plants, there will be additional checks. Guidance from the Road Haulage Association helpfully confirms that these changes will apply whether or not there is a deal with the EU.

The cost for new border infrastructure is currently estimated at £705 million. Three new government IT systems are planned in order to manage the new processes. These are the Goods Vehicle Movement System (GMVS) and the Goods Movement Reference (GMR) system, and an app known as SmartFreight, that will be used by the lorry drivers. The timing of their implementation is still to be finalised as far as the current information suggests.

The government estimates that there are around 245,000 UK businesses trading exclusively with the EU. The Financial Times has estimated a cost to business of £7 billion for customs forms. It is estimated that there will be 215 million extra customs declarations and the government's own Impact Assessment from HMRC calculates a cost to UK businesses of £7.5 billion per year. HMRC further estimates the total administrative burden on UK-EU trade, taking into account the cost to businesses in the EU27, is around £15 billion, and it issues a reminder that these costs will impact on supply chains and will have implications for consumers. In addition, it is estimated that the tariff bill could total around £3.5 billion. These costs, of course, do not take account of the cost of delays, nor of the lost business opportunities that could be caused by delays and additional costs. They will ultimately be passed on to consumers, who will also experience uncertainties of supply that they aren't used to. Hence, these consumers are likely to see price increases.

For UK businesses, the prospect of this hard border means ongoing disruption. It raises a damaging perspective, according to James Selka, CEO of the Manufacturing Technology Association: "Supply chains are very integrated across the EU, thanks to the free movement of products facilitated by the single market over four decades. Any disruption caused due to non-tariff barriers caused by a bad EU trade deal will disrupt our businesses significantly at a time when we can least afford this." The Road Haulage Association has warned that Britain is heading for a 'cocktail for potential disaster'. Shane Brennan, of the Cold Chain Federation, tweeted "Time to plan for disruption". The disruption won't just be a short term blip and it will come at a time when the economy is already suffering the effects of the Covid-19 health crisis. UK GDP has fallen by a whopping 20% and inflation has risen to 1%.

Young livestock may be put at risk if the vehicle carrying them is stuck for any length of time, and fresh seafood is also vulnerable. A government consultation document suggested that these could be prioritised. But what about other fresh food? The UK imports 47.5 % of vegetables and a massive 84% of fruit, according to LSE research, which highlights the threat to our food supply. Andrew Opie, of the British Retail Consortium, warned the House of Commons Select Committee on Environment, Food and Rural Affairs, "we potentially face a bigger challenge than the food supply chain faced in Covid… If we see the borders disrupted in January from a disorderly Brexit, we have a big problem."

Michael Gove, the UK government Minister responsible for the EU negotiations, speaking to the Select Committee on the Future Relationship with the EU, dismissed the industry warnings as just 'part of the general to and fro' of lobbying. Indeed, the lobbyists' job is to put their position to policy-makers. However, the looming break with the Single Market exposes a disconnect between industry and government. The contrast could not be more marked between this highly inter-connected, international industry, and antediluvian machinery of government.

The new hard border is a structural change that is incompatible with modern life and is being imposed by the government on industry. Systems designed to optimise the flow of goods cannot function when businesses have to go through costly document checks and lorries are parked up for hours waiting to cross the Channel. The lorry parks will be the visible evidence of a systemic breakdown. The open question is how severe the disruption will be.

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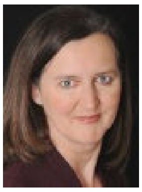
Note: This article first appeared on our sister site, LSE Brexit. It gives the views of the author, not the position of EUROPP – European Politics and Policy or the London School of Economics. It also appeared on the author's blog.

About the author



Monica Horten – *LSE*
Monica Horten is a Visiting Fellow in the LSE's Department of Media and Communications.

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