FUTURE CARIBBEAN TRADE RELATIONS WITH THE UK: SUMMARY OF AREAS OF CONCERN

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Summary

*The new EU/UK rules of origin requirements for the cross-border movement of goods could prove disruptive of certain Caribbean **rum, horticulture**, **sugar** and potentially **rice** supply chains. At the business level this will require a rethinking of routes to markets. At the policy level it will require a sustained engagement to secure a right of **automatic cumulation** for all Caribbean products enjoying duty-free/quota-free access to both the EU and UK markets, when traded across an EU/UK border. Only such a policy innovation would remove the rules of origin complications which threatened to make commercially non-viable the current Caribbean exports which are routed via the EU to the UK market or via the UK to EU markets.*

A COMMERCIAL AND POLICY CHALLENGE OF NEW RULES OF ORIGIN REQUIREMENTS

For goods to claim tariff preferences under trade agreements they need to 'originate' in the exporting country. This requires the elaboration and application of rules of origin, to ensure that only goods which 'originate' in the partner countries are eligible for tariff preferences (1).

The UK's departure from the EU customs union and single market and the new trade agreement concluded, has created some rules of origin issues for Caribbean goods which enter the UK market via the EU, or the EU market via the UK, which simply did not exist previously. This arises from the absence of what is known as '***diagonal cumulation'*** (see box).

This creates a situation for Caribbean goods traded along so-called triangular supply chains where, in order not to ***lose their 'originating' status*** and hence ***face standard MFN tariffs***, these goods need to remain under ***customs supervision*** (under *Common Transit Convention* procedures) throughout the shipping process via the EU to the UK, or via the UK to the EU.

Alternatively, they have to go through '*sufficient processing*' in the EU/UK for them to gain either EU or UK '*originating status*' prior to their onward trade across an EU/UK border. These sufficient processing requirements are defined in the rules of origin annexed to the EU/UK Trade and Cooperation Agreement (1)

What is Diagonal Cumulation?

The inclusion of '***diagonal cumulation***' provisions in the EU/UK trade agreement would have allowed ***inputs from third countries to which both the EU and UK grant duty free access***, to be counted as '*originating inputs*' when traded between the EU and UK. This would have eliminated any rules of origin verification problems faced along current EU/UK triangular supply chains through which Caribbean goods are shipped or where Caribbean originating materials are used in final products traded across an EU/UK border. The inclusion of '***diagonal cumulation***' provisions would have facilitated the continued smooth functioning of such supply chains under current arrangements and the maintenance of existing low-cost road haulage practices for onward trade known as 'groupage'.

Unfortunately, for a ***range of existing Caribbean exports*** delivered to markets along triangular supply chains either these goods ***do not undergo sufficient processing to gain EU or UK originating status*** or ***remaining under customs supervision is not a practical option***. In this latter case, by entering the customs territory of the EU, these goods lose their Caribbean '*originating status*'. This then results in ***UK MFN tariffs being applied to these Caribbean goods entering the UK market*** via the EU or EU MFN tariffs being applied to Caribbean goods entering EU markets (including the Republic of Ireland) via the UK.

As a consequence, this may require a ***fundamental rethink of the routes to market used by Caribbean exporters who currently export along triangular supply chains***. This is a particular problem for Caribbean exports ***via the UK to, for example, the Republic of Ireland,*** given the extent to which the Irish retail sector is integrated with UK supply chains.

Currently particular problems are faced along UK to Republic of Ireland routes, as a result of the requirement for the Irish government to apply from 1 January 2021 standard EU import controls on goods entering from the UK. This trade is now subject to ***documentary and identity checks***, with ***physical inspections taking place on up to 50% of consignments for high-risk products*** (2).

According to the Irish *Road Haulage Association*, Ireland's disjointed customs and clearance systems at Dublin Port is '*causing crippling delays on trade - even though traffic and volumes across the Irish Sea are currently exceptionally low' (*30% of normal levels). Drivers are reporting delays of up to 3 days, with system collapse being seen as a threat '*once trade volumes are restored to normal levels*' (3).

In response to these problems a ***major expansion of direct mainland EU to Republic of Ireland ferry services is underway***. It was reported in mid-January that at Rosslare, Ireland's closest port to France, sailings and cargo capacity for roll-on, roll-off shipments by lorry have ***quadrupled in the past month*** (4). Additional services are also being added along the ***Cork-Zeebrugge*** route (5). However, the most popular service is the ***Dunkirk-Rosslare*** service opened up by DFDS, given its close geographical proximity to distribution networks using the UK 'land bridge' to serve markets in the Republic of Ireland (6). What is more in February 2021 *Brittany Ferries* announced additional services along the ***Rosslare to St Malo*** (7) and ***Cork to Roscoff*** route, as well as a twice weekly services from ***Rosslare to Bilbao***, in Spain (8).

Despite this expansion hauliers maintain up to 20 further sailings a week are needed to meet demand, particular once the relaxation of Covid-19 travel restrictions sets commercial hauliers in competition with holiday makers for deck space (4).

The Caribbean sectors most obviously affected by these new rules of origin issues include:

Rum Sector

- Bottled rum exports from smaller Caribbean exporters shipped via the EU27, which now need to ***remain under customs supervision until delivery to the UK***.
- Similar considerations arise in regard to bottled rum and bulk rum shipped directly to the UK for customers in the Republic of Ireland.
- Bulk rum exporters where bottling operations take place in the EU27 prior to onward shipment as 'own label' products to UK supermarkets. Here, ***MFN tariffs will be faced*** as a result of the loss of 'originating status', since insufficient transformation takes place through the bottling process to gain EU originating status and hence the benefits of duty-free access under the EU/UK trade agreement. What is more, the bottling process itself, under current arrangements, makes it impossible for the goods to remain under the CTC procedures.
- In addition, smaller Caribbean bottled rum exporters are likely to face ***substantial additional road haulage costs*** when shipping along triangular supply chains, as a result of the likely abandonment of low-cost cargo 'groupage' practices for on-ward shipping. Road hauliers are currently seeking to avoid shipping 'groupage' loads across the EU/UK border given the administrative complications which can arise for such loads if the paperwork of even just one consignment within the 'groupage' load is not fully compliant with new border clearance requirements.

What are 'Groupage' Cargoes?

'Groupage' cargoes are loads consisting of consignments from multiple different suppliers who face different administrative requirements for crossing the new EU/UK border. 'Groupage' cargo practices previously provided a low cost means of onward shipment between the EU and UK. However, the complications and delays this is generating for hauliers has seen a sharp increase in haulage costs for such loads, even where carriers can be found willing to move such loads across an EU/UK border.

Horticulture Products

- Horticulture product exports to the UK which are ***air freighted via distribution hubs in the Netherlands***, will lose their originating status unless they remain under customs supervision throughout the shipment process until final landing and discharge from customs in the UK.

- This will result in the ***loss of duty-free access for these Caribbean products*** and the application of MFN tariffs on imports to the UK, unless they remain under customs supervision until arrival in the UK (9).

- In addition, similar 'groupage' challenges for onward shipment to those facing rum exporters will be faced in the horticulture sector, in an even more severe form, given the short shelf-life nature of these products.

- Similar considerations arise in regard to horticultural products exported to the Republic of Ireland via the UK, where, as a result of the loss of originating status EU MFN tariffs would be applied (see companion epamonitoring.net article, '***The Case of Fresh Horticultural Products What Does the New EU UK Trade Agreement Mean for ACP Triangular Supply Chains?***', 19 January 2021).

Sugar Supply Chains

- Under the new rules of origin, ***raw sugar exported from the Caribbean to the UK and refined in the UK prior to onward trade into EU27 markets, will lose its initial 'originating' status and face standard MFN tariffs on entry to the EU***. This arises since refining sugar does not result in UK originating status being gained, since the generates only a change in tariff sub-heading, when a change in tariff heading is required for originating status to be gained under the EU/UK trade agreement (see companion epamonitoring.net article, '***What Does the New EU UK Trade Agreement Mean for ACP Sugar Exporters?***', 21 January2021)

- This will disrupt ***Belize Fair Trade sugar and any other Caribbean sugar exports to the EU27***, ***where refining takes place in the UK*** (with particular concerns arising for sales to the Republic of Ireland and Northern Ireland given the close integration of these markets with UK based supply chains).

- Complications will also be created for the ***use of cane sugar in high sugar content food and drink products manufactured in the UK, for both UK and EU27 markets*** (including both the Republic of Ireland and Northern Ireland). This could well result in manufacturers of high-sugar-content products ***turning their back on raw cane sugar sourcing***, in favour of UK or EU produced beet sugar, since this simple expedient would sidestep all sugar related rules of origin complications. This needs to be seen in a context where over 70% of sugar consumed in the UK and EU is in the form of food and drink product. *Nestle UK and Ireland* has already made announcements to this effect (10).

These are simply the most obvious Caribbean export supply chains which would be affected. Other supply chains such as Guyanese ***rice*** exports would also appear vulnerable, given the ***instability in the geographical patterns of customs clearance of Guyanese rice exports to the EU28***. Since 2015 Guyanese rice exports to Ireland have varied from 239,311 tonnes to 86 tonnes in 2019, to Portugal from 154,328 tonnes to 85,608 tonnes, to Italy from 101,951 tonnes to 47,762 tonnes and the UK from 138,521 tonnes (2016) to 95,165 tonnes (2019), in the context of a 43% decline in the overall tonnage exported to the EU28 over the 2015-2019 period.

The Potential for Trade Diversion to the Caribbean

The outcome of the UK/EU trade negotiations while generating a commitment towards continued duty-free/quota-free access in mutual EU-UK trade has failed to address a multiplicity of non-tariff issues, which, under present conditions, are likely to generate ***significant disruptions in UK exports to the EU***.

This will most notably affect ***UK exports of livestock products to the EU***, with this potentially generating a situation where UK exporters are left desperately searching for alternative markets, beyond the EU's border.

The scale of this trade diversion in some sector could well ***dwarf current levels of UK extra-EU exports***. The most notable area of concern for the Caribbean relates ***UK poultry meat exports***. In 2019 Caribbean countries took fully ***12.5% of UK extra-EU poultry meat exports***, a disproportionately large volume.

These Caribbean import volumes pale into insignificance when the volume of UK exports likely to be displaced is considered. In 2019 the UK exported some 340,289 tonnes of poultry meat to the EU. The diversion of just 5% of current UK poultry exports to the EU to Caribbean markets, would double UK poultry meat export volumes to the Caribbean, while the diversion of 10% of these current UK exports to the EU would triple the current UK volumes exported to the Caribbean.

It is unclear what level of expansion in UK poultry meat exports would be required to have a disruptive effect on the functioning of individual Caribbean poultry markets.

Comment and Analysis

In terms of the ***rules of origin*** complications along triangular supply chains it is unclear what value of Caribbean exports will be adversely impacted.

In 2019 Caribbean countries exported € 67.8 million in ***sugar***, €11.6 in ***rum***, € 131.1 million in ***bananas***, and €7.4 million in vegetables and € 15.9 million in ***other fruit*** (non-banana trade) to ***UK markets***; and € 9.3 million in ***sugar***, €122.0 in ***rum***, € 191.9 million in ***bananas***, and €14.1 million in vegetables and € 49.3 million in ***other fruit*** (non-banana trade) to EU27 markets.

What proportion of this trade (valued in total at €620 million) then goes on to cross EU/UK borders is unclear, given the free movement of goods within the EU28 until 1 January 2021, makes tracing the final destination of these products difficult. The extent of this onward trade needs to be assessed Caribbean supply chain by supply chain.

It should be noted that in the ***rum sector*** while only 5 Caribbean states export directly to the UK, fully 13 export rum in one form or another to the EU27. Given the range of Caribbean country specific rums available in the UK, this suggests some countries export rum to the UK along triangular supply chains.

The area of greatest concern would appear to be for Caribbean ***sugar*** exports, given the wider impact of the ***new EU/UK rules of origin on the sourcing decisions of high sugar content EU and UK food and drink manufacturers.*** This could see high sugar content food and drink product manufacturers ***systematically turning their back on cane sugar in favour of EU or UK produced beet sugar***. This would then carry serious implications for the market position of companies such as ***Tate & Lyle Sugars*** in the UK. Implications which would be compounded by ***the 'accounting segregation' possibilities which beet focussed sugar cane co-refiners could exploit***, to provide food and drink manufacturers with ***guarantees as to the rules of origin compliance of the sugar they supply***.

There are three levels of solution to the new challenge generated by the basis for the UK's departure from the EU customs union and single market:

1) A rethinking of the routes used to serve both UK markets and markets in the Republic of Ireland, to avoid the need to cross an EU/UK customs border.

2) Use of the ***Common Transit Convention*** for horticultural products and bottled rum exports.

3) The launching of political and technical initiatives to secure modification to the CARIFORUM/UK rules of origin to allow full automatic cumulation where goods pass through the EU on route to the UK.

In terms of ***rethinking routes to markets***, those serving markets in the Republic of Ireland via the UK, have a growing number of options. The utility of these routes will vary from supply chain to supply chain.

Thus, bottling operations in Spain for Caribbean bulk rum exports serving market in the Republic of Ireland, could make use of the new **Bilboa-*Rosslare*** ferry service operated by *Brittany Ferries*, while horticulture exporters distributing products from initial landing sites in the Netherlands or Belgium could make use of the new ***Dunkirk-Rosslare*** service, in order to avoid the need to cross an EU/UK customs and regulatory border.

In terms of serving sugar markets in the Republic of Ireland consideration may need to be given to ***shifting over to refining partners in the EU27*** and then exporting directly from the mainland EU to the Republic of Ireland using the new ferry services.

In all of these instances this would side-step rules of origin complication, additional border clearance costs and additional road haulage costs arising from the creation of a new EU/UK customs and regulatory border, since this trade would remain within the EU customs union.

Although the ferry services to the Republic of Ireland are undoubtedly more expensive, where the alternative would be for trucks to return empty, the ***haulage charges to the Republic of Ireland may become highly competitive***. This needs to be seen in light of the imbalance in the volume of Irish exports compared to the volume of Irish imports.

In terms of moving away from serving the UK market via EU member states, the situation is more complicated. The Covid-19 pandemic has reduced both international air freight and sea freight options open to Caribbean exporters. For many smaller Caribbean exporters who use triangular supply chains, ***directly serving UK markets is not seen as commercially viable***. This is likely to remain the case unless efficient regional cargo consolidation arrangements can be set in place, to make the most of available cargo routes direct to the UK. Here again the options available will vary from supply chain to supply chain.

The situation is further complicated by the rising costs of securing the services of **customs agents** to clear goods through UK customs, given the massive surge in demand for the services of customs agents and the consequent 'sellers-market' which has emerged in the customs intermediary market. This has seen fees charged by customs agents increase dramatically.

More broadly in the ***sugar*** sector, developing commercial relations with the beet co-refiners where '*accounting segregation*' potentially offers a means of side-stepping some of the rules of origin complications which act as a disincentive to food and drink industry sourcing of cane sugar for high sugar content products, could offer new opportunities for some Caribbean raw sugar exporters.

In terms of using ***Common Transit Convention*** procedures there are currently a number of practical problems faced by Caribbean exporters. It has become apparent that substantial new investments along supply chains will be required if extensive use if to be made of *Common Transit Convention* procedures. This includes in regard to:

a) The establishment of bonded warehouses (in the EU27), for the handling of cargoes prior to onward shipment.
b) The establishment of the necessary handling and customs discharge facilities across the UK.
c) The familiarisation of ACP exporters with the procedures to be used in exporting goods under customs seal.
d) The training of freight operators in the new procedures and requirements for the operation of CTC procedures
e) The effective installation and operation of the new IT systems which will be needed to ensure the integrity of the customs seal throughout the cargo movement process.

At present, much of the infrastructure for the handling of cargoes under *Common Transit Convention* procedures is simply not in place, particularly in the UK. This could remain the case until well into 2022. As result, using the *Common Transit Convention* process is likely to be expensive in the short term, with these costs needing to be balanced against the MFN tariffs which would be applied in the case of a loss of originating status.

These practical problems suggest a need for an urgent policy intervention by Caribbean governments to address the underlying rules of origin issue.

This 'rules of origin' complication could be addressed through a revision of the ***<u>Direct Transport</u> provisions under the rules of origin applicable under the UK-CARIFORUM EPA***. This would require the *Direct Transport* article in the rules of origin annex to be modified to allow full ***automatic cumulation for Caribbean goods enjoying duty-free/quota-free access to both the UK and EU markets***. This would allow Caribbean goods to continue to enjoy duty free access to the UK market ***even where simple processing operations have been undertaken in the EU*** (e.g., the bottling of bulk rum or simple onward shipment of horticultural exports). However, some documentary proof of initial origin would still need to be provided when onward traded to the UK.

This issue should be urgently taken up at the ***political level*** in the ***CARIFORUM-UK Trade and Development Committee*** and be resolved at the ***technical level*** in the ***Special Committee on Customs Cooperation and Trade Facilitation***

Prior to taking this issue up at the political level an assessment should be made of the main Caribbean export supply chains affected and the ***scale of the trade involved***.

It needs to be recognised that in the ***absence of policy interventions*** some Caribbean exporters will simply be ***driven off markets in the UK and Republic of Ireland*** because of the commercial implications of these rules of origin complications.

In terms of the ***scope for trade diversion in the poultry meat sector***, at a policy level, Caribbean governments will need to determine ***what level of increase in UK poultry meat exports could constitute a threat to local poultry producers*** and just how Caribbean governments should respond to such a sudden increase in UK poultry meat exports.

This issue needs to be assessed in close consultation with the *Caribbean Poultry Association*. The policy response meanwhile needs to be seen in light of the commitments reiterated in the CARIFORUM-UK Continuity Agreement. These include commitments which '***prohibit the use of quantitative restriction'*** on imports from the UK, require '***national treatment'*** to be accorded to UK exports and include ***'tariff standstill'*** commitments, which require Caribbean governments not to raise tariffs on imports from the UK above established levels.

The potential policy response also needs to be seen in light of the South Africa's frustrating experience of the use of ***anti-dumping provisions*** of trade agreements with the EU and the EU's record of challenging the use of ***safeguard provisions*** allowed for under the South African agreement with the EU. This South African experience highlights the limitations of the trade defence mechanisms nominally available under trade agreements with the EU (see companion *epamonitoring.net* article, '***EU Formally Challenges Application of SACU Safeguard Duties in the Poultry Sector***, 27 June, 2019).

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