Consequences of a 'Hard Brexit' for Food & Agribusiness

EU Market Closes for UK, While UK Will See Food Price Inflation

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Summary

In the absence of a Brexit deal – a so-called ‘hard Brexit’ – the UK will become a 'third country' to the EU on 30 March 2019. In practice, this will mean that UK companies lose access to the EU market for exports of most agricultural products, due to the introduction of import tariffs at the EU border.

It is most likely that the UK will not introduce import tariffs for imports (from both EU and other countries). Nevertheless, food price inflation in the UK can be expected to rise due to the rising costs of crossing the border with the EU and a further weakening of the British pound, because the UK is a net food importer. The chances of imports from other countries taking over the role of EU suppliers are small, at least in the short term. UK quality standards are not easy to meet for most suppliers outside the EU, while the UK market competes with many alternative destinations for exports. Raw sugar is the only product for which we may see an increase in imports.

The administrative burden of trading with, or having operations in, both the EU and the UK will rise. Customs controls will not only lead to higher costs of border crossing, but time spent at the border will also increase, which is detrimental for the quality and value of fresh produce. A highly sensitive issue will be the border crossing between the Republic of Ireland and Northern Ireland, as the 'hard Brexit' scenario entails a hard border between the two.

Food companies will have to reorganise their supply chains to adapt to this new reality. Efficiencies based on cross-border EU-UK value chains will be lost.

Part of the damage incurred by UK farmers due to the loss of access to the EU market will be compensated for by a further weakening of the British pound, as it improves their competitive position vis-a-vis imports.

For seafood, a 'hard Brexit' entails serious damage to both UK and EU fisheries industries as long as there is no agreement in place for access to each other's fishing waters and markets. In grains, a significant volume of grains currently processed into ethanol might come available on the UK market, depending on the future support to ethanol in the UK.

Introduction

In this note, ‘hard Brexit’ means the UK will leave the EU without a Brexit deal. As a result, the UK will become a third country to the EU on 30 March 2019. This means it will no longer be part of the EU and its internal market. Its trade relationship with the EU will be the same as that of the EU with other third countries. In the absence of a Brexit deal, the transition to this new situation will be sudden and far-reaching.

In our previous note: *Impact of the Draft Brexit Deal on European Food and Agribusiness; Limiting Negative Effects of Brexit as Far as Possible*, we describe the short and longer term impact of the draft Brexit deal on trade flows between the EU and the UK. Overall, based on the draft deal, we wrote ‘it can be expected that in the short run, the UK will remain close to the EU, but over time will increasingly go its own way in international trade’. In case of a ‘hard Brexit’, the UK will go its own way as per 30 March 2019. The longer term impacts explained in the previous note will be felt immediately instead of after a transition period of two to four years. In this note we provide an overview of the most important changes that will enter into effect on 30 March 2019, in the absence of a Brexit deal.

Introduction of EU import tariffs

In the absence of a trade deal, WTO tariffs will apply to all EU imports originating from the UK, just as they apply to imports from other third countries. For agricultural products, these tariffs are significant and oftentimes prohibitive for trade (*see Table 1*). This will lead to UK suppliers losing access to the EU market. Although the UK is a net food importer, for many products it is also an exporter. Value chains in food have a cross-border character while raw agricultural products consist of various components (such as various parts of an animal’s carcass) that cannot always be sold in one and the same market.

Table 1: MFN import tariffs on EU imports

Product category	Tariff level
Dairy products, beef, sugar	High (>30%)
Pork, poultry, seafood, eggs, fruit & vegetables, grains, consumer foods	Medium (10%-30%)
Flowers, fertilisers, oilseeds, beverages, tropical products	Low (<10%)

Source: International Trade Centre, Rabobank 2019

To prevent food price inflation, the UK will most likely set its import tariffs at, or close to, zero. Although the UK could apply the same import tariffs as the EU to imports, it can be expected that the UK will be less restrictive as it is dependent on imports for its food needs. Some sensitive UK products might receive protection by setting import tariffs. Examples are: sheep meat and beef, products for which the UK is less dependent on imports and that are pivotal for maintaining the rural landscape.

It should be noted that, in the absence of preferential trade agreements, import tariffs are equal for all trading partners, meaning that countries such as the US, Canada, Brazil, Australia, and New Zealand will benefit from the same zero import tariffs as the EU. As a result, competition on the UK market may increase for both UK and EU suppliers.

Quality standards to be maintained

We do not expect the UK to lower its quality standards compared to today’s situation. Therefore, imports from non-EU countries will be limited, at least in the short term. This will especially be the case for sectors in which suppliers from third countries face difficulties meeting these quality standards. For example, hormone-treated beef, chlorinated chickens, GMO grains and oilseeds of varieties that have not yet received EU approval are currently prohibited in the EU and the UK. Furthermore, private sector standards, such as animal welfare standards in pork, create barriers to imports from suppliers that are not compliant with UK standards.

As a side note, the degree to which third countries will enter the UK market after Brexit will also depend on international market developments. For example, in the past few years, New Zealand did not fill its EU import quota for lamb meat and dairy products, despite the fact that it can enter the EU (and thus the UK) at zero tariffs under these import quota. Also, the growing import demand for pork in China as a result of the swine fever problems may draw more pork to China – this means the UK is certainly not the only option for countries looking for export markets.

Depreciation of the GBP

In the case of a 'hard Brexit', we expect the pound to slide towards parity with the euro, where it currently trades at 0.88. This would mean a depreciation of the GBP versus the EUR of 10 percent to 15 percent. Domestic prices of most agricultural products can be expected to increase by this percentage because the UK is a net importer for most agricultural products and will therefore see a rise of import prices to the same degree. This will also pull up prices of domestically-produced products. UK farmers will benefit as prices rise. While consumers will see food price inflation rise. Furthermore, margins in food processing and marketing may come under (further) pressure.

Food price inflation due to the weakening of the GBP, in combination with slower economic growth can be expected to lead to consumers trading down. In other words, consumers will switch to cheaper products.

At the same time, due to the depreciation of the GBP by 10 percent to 15 percent, non-UK inputs will rise in price by the same percentage. Examples are agricultural machinery, energy, fertilisers and crop protection chemicals. This will contribute to a rise in cost price at farm level, taking back some of the gains from higher product prices.

Introduction of custom controls, risks of delays

At the UK-EU border, from both sides, checks will be introduced to check the origin of goods, and whether the goods meet the requirements of the importing country. Companies trading between the UK and the EU need to register as exporters/importers. Goods need to be declared to Customs at the border, duties may have to be paid, and records of traded goods have to be kept. Customs authorities will check goods, but the UK has already declared that they will not stop goods at the border – they will execute document and identity checks remotely.

Even a short stop of a few minutes per truck could cause hours of delays at ports, because the capacity to park trucks at ports is very limited. This could delay the unloading of vessels and lead to longer unloading times. For fresh produce and flowers, these delays can lead to a loss of value/quality because it could mean that the early morning delivery window in city centres could be missed.

New and changing administrative requirements

For EU companies, the administrative burden of trading with the UK will increase, as will having activities in both geographies.

As mentioned earlier, companies trading between the UK and the EU need to register as exporters/importers. Goods need to be declared to Customs at the border, duties may have to be paid, and records of traded goods have to be kept. Furthermore, for live plants, phytosanitary certificates will be required, and for live animals veterinary certificates are needed. Those certificates are issued by national authorities in the country of origin.

In some sectors, companies need to be on a positive list in order to be allowed to trade with the EU. This is the case for slaughter houses, transporters of live animals and irradiation facilities, for example.

Some products – such as food from animal origin – can only be imported into the EU via border inspection posts. Not every port has a border inspection post, and, therefore, this requirement could lead to a redirection of trade flows.

In some cases, authorisations will no longer be valid. Authorisations by UK authorities will no longer be valid in the EU, for example, as a UK authority can no longer grant EU authorisations. UK companies may be forced to acquire new authorisations from another EU member country to be able to continue to trade and operate in the EU. For example, UK-certified seed, propagating material and UK testing of plant varieties would no longer be accepted in the EU. And, UK-recognised breed societies and operations involved in the trade and movement of purebred livestock and germinal products would no longer be recognised societies or operations in the EU.

Food labelling also has to be adapted, as non-EU origin has to be mentioned explicitly on many food labels.

Efforts that have been put into approval procedures initiated in the UK – which can sometimes take more than a year – can turn out to be waste of time and effort, as the UK authority is no longer authorised for EU approvals. As a result, these procedures have to be restarted in an EU member state.

The border between the Republic of Ireland and Northern Ireland

Trade between the Republic of Ireland and Northern Ireland will be a highly contentious issue in case of a 'hard Brexit'.

In theory, cross border traffic of agricultural goods will be subject to the same customs procedures as in other instances of EU-UK trade. This would entail a hard border between the Republic of Ireland and Northern Ireland. Border crossing of, for example, fresh milk, live animals and barley and alcohol for whiskey production may become too costly due to import tariffs and Customs requirements. To illustrate: Northern Ireland produces around 2.2bn litres of milk a year, of which some 30% is processed in the Republic of Ireland. Companies that have facilities on both sides of the border would be forced to separate their Irish and Northern Irish facilities into much less efficient, separate, standalone operations.

In practice, today, there are no check points at the border. These would have to be re-established. This could be politically unacceptable, although an easy alternative is not available.

Labour, towards a skills-based UK immigration policy

Existing citizen rights will be continued. This means that EU citizens currently working in the UK can continue to do so. The same goes for UK citizens currently working in the EU. However, after Brexit day, other EU citizens can no longer move freely to the UK. The UK will move to a skills-based immigration system, allowing access to the UK only for people that have skills that are needed in the UK and that are sponsored by companies operating in the UK. This more restrictive policy on immigration, in combination with the to-be-expected depreciation of the GBP, will most likely result in a lower availability of foreign labour in the UK. This particularly affects the food value chain as on average one-third of employees in the food value chain are EU citizens.

Fishing rights

For seafood, a 'hard Brexit' entails serious damage to both UK and EU fisheries industries as long as there is no agreement in place for access to each other's fishing waters and markets. In the absence of a fisheries agreement after Brexit, EU vessels will lose access to UK waters, while the same goes for UK vessels to EU waters. For EU vessels this would mean a loss of over GBP 500m in value in seafood that they can no longer catch from the UK's Exclusive Economic Zone. For UK vessels, loss of access to the EU-market would also be damaging, as the UK exports what it catches. Top species caught in UK waters are mackerel, langoustine, and scallops, which are largely exported to EU countries. The UK's total seafood exports to the EU amounted to GBP 1.3bn in 2017, and made up 70% of the UK's total seafood exports. This trade flow will become subject to significant EU import tariffs. Concluding, the fisheries sector in both the EU and the UK will face serious economic losses in case of a hard Brexit.

Potential raw sugar imports

Part of the UK sugar industry may benefit from a hard Brexit. EU restrictions on the import of raw sugar from third countries no longer apply. As a result, the underutilised capacity for raw sugar refining can potentially be put into operation with additional imports of raw sugar. Contrary to the situation in other sectors, quality standards are not expected to be an obstruction to imports in the sugar sector. As a result, UK beet sugar producers would face increased competition from these lower-cost raw sugar imports. Therefore, it is imaginable that some import restrictions could be created. For the EU, the increased import of raw sugar in the UK could potentially replace 300,000 tonnes to 400,000 tonnes of EU white sugar exports to the UK.

Biofuel policy

The key question in grains is what will happen to the 1.2m tonnes of grains that are currently processed into ethanol as part of the EU biofuel policy, that requires blending of biofuel into normal fuels. If this policy is not continued in the UK, it can be expected that biofuel production will become unattractive, creating an additional supply of grains on the UK market. This would result in significant price pressure for grains. Industries that would benefit are the feed industry (and the livestock industry that uses feed as input), the milling industry (although UK wheat is not always of milling quality) and in the longer term the beer and whisky industry due to lower-priced barley, as farmers would switch to barley.

Export of feed grains

UK exporters will have to find new export destinations for their grains exports. The introduction of import tariffs on UK grains at the EU border will make UK imports uncompetitive on the EU market.

Farm payments

The UK government intends to commit the same cash total for farm support until the end of this parliament, expected in 2022.

Imprint

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