

EU EXIT – ECONOMIC IMPACT

Purpose and Background

1. This paper provides a short summary of what we know so far about the impact of EU Exit on Scotland's economy. As official trade statistics are not currently available, and other information is limited or unverified, the paper presents a largely qualitative account of the impact on businesses so far, based on intelligence received from Scotland's enterprise agencies, business organisations and trade groups, and directly from businesses themselves.

2. As Members know, the Highlands and Islands is likely to be particularly vulnerable to the impact of EU Exit for a number of reasons, including:

the prominence of certain sectors in the region which are more affected by the new arrangements, more heavily oriented to the EU, and more dependent on migrant workers;

the benefits currently gained from EU grant funding;

physical distance from markets and rural setting making getting product – especially short life product – to and from markets more of a challenge; and

the fragile nature of the population itself.¹

3. While some of those factors, and the impact on service sectors, may take some time to make themselves felt, the impact on goods sectors crucially important to the Highlands and Islands – particularly food and drink - is already very apparent.

4. This paper therefore summarises the main known impacts of EU Exit so far, particularly in the food and drink sector, and the Scottish Government's response.

General Impact on Businesses

5. While it is not easy to disentangle the impact of Covid-19 and EU Exit (and it is clear that Covid-19 is still dominating for most businesses), it is clear that we have, in the last couple of months, witnessed the sorts of impacts we would expect from the trade friction caused by replacing membership of the EU Single Market and Customs Union with a relatively narrowly drawn Free Trade Agreement.

¹ October's paper on Regional Impact and Economic Recovery noted that five of the six local authorities judged to be most vulnerable to the impact of EU Exit are in the Highlands and Islands (Outer Hebrides, Shetland, Argyll and Bute, Highland, Orkney)
<https://www.gov.scot/publications/local-level-brexite-vulnerabilities-scotland-brexite-vulnerabilities-index-bvi>

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6. In particular, businesses have reported delays, costs and losses associated with the following challenges when trading with the EU:

Non-tariff barriers, such as extensive, new, Customs and Export requirements and processes - e.g. Export Health Certificates, new Customs documentation, other Sanitary and Phyto-sanitary (SPS) checks, affecting, in particular, the food sector;

New financial burdens – e.g. tariffs and VAT, affecting a range of sectors;

New and complex Rules of Origin (RoO) requirements, affecting, in particular consumer goods, retail and the food sector;

Specific Prohibitions and Restrictions on certain kinds of exports in the food sector;

Disruption, capacity shortages and increased costs in haulage, freight and intermediary sectors. Smaller producers, reliant on shipping consignments through the groupage system, have faced particular challenges .

Business Feedback

7. While some early indicators suggest that trade performance worsened in January, this is likely to have been caused by a number of factors, e.g. EU Exit, further disruption from Covid-19, increased global freight costs and lower trade activity due to proactive stockpiling in December 2020.

8. Feedback from businesses themselves in the most recent ONS Business Impact of Covid-19 Survey covering late January and early February, however, suggests that traders are seeing EU exit as the main cause of their challenges. 43% of Scottish exporting businesses are reporting lower sales, or have not been able to export at all (an increase from 37% in the previous wave of the survey covering early January, and a series high). For importers, such difficulties have increased from 27% to 38% in the same period. The share of Scottish exporting businesses seeing EU exit as the main cause of these challenges has increased from 53% to 59%. For importing Scottish businesses, it has risen from 57% to 65%. Both are at the highest level since these statistics were collected. Both exporters and importers have cited the change in transportation costs, disruption at UK Borders, and customs duties and levies, as their top challenges.

9. Initial findings taken from the latest Highlands and Islands Enterprise (HIE) Business Panel survey in February 2021 show that:

Just over two-fifths of businesses in the Highlands and Islands see EU Exit as one of the top two or three risks facing them over the next 6 months, while re-establishing existing markets and targeting new markets were seen as the two biggest opportunities.

Most importers were currently managing to continue to import using existing mechanisms.

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However, around a third of exporters were experiencing challenges in doing so. Of these, around two-thirds were experiencing delays due to additional checks on goods, the volume and complexity of paperwork and delays due to queues at customs. Groupage challenges were cited by around two in five.

Most expected export challenges to continue in the longer-term (beyond the next few months), with around seven in 10 anticipating that challenges with export processes, retaining or re-establishing customer demand and time taken to get to market would persist and around half that challenges around access to overseas distribution or groupage services would persist.

Of those experiencing exporting challenges, more than half reported that challenges were creating additional costs (84%), required increased staff time (66%) and resulted in delays to (73%), or the inability to fulfil customer orders (52%).

Short, medium and long term impacts

10. While some of these issues could be short term in nature, reducing as businesses adjust, such issues can of course pose an existential threat to small businesses, exposed sectors and fragile communities.

11. Other issues could be longer term structural problems, inherent in the nature of the deal. Still others will be part of an accumulation of many – often fairly minor – changes and challenges, perhaps changing and compounding as negotiations and discussions continue, and combining to threaten business viability over time. Such impact, and that of business foregone, is particularly hard to measure. The introduction of more import controls on Sanitary and Phyto-Sanitary products in the coming months may also exacerbate some of these issues. Those changes could potentially cause further delays at borders, some supply shortages of goods for general use and consumption - and of materials required for manufacturing and production - and/or price rises (an issue which could be particularly problematic in the Highlands and Islands, given its more remote physical location).

12. Scottish Government modelling forecasts that the more profound impact of EU Exit will be in the longer term, as impacts accrue over time and compound the harm caused by Covid-19. The immediate disruption from new trade barriers will start to be overtaken by supply-side impacts such as diversion of trade, foregone investment, productivity, migration and, ultimately, growth. The Scottish Government's assessment remains that, in the long term, the Trade and Cooperation Agreement will leave GDP in Scotland lower by around 6%, compared to continued EU membership, by 2030

Impact on Sectors

Food and Drink

13. There is considerable evidence that post- EU Exit regulations have created extremely difficult trading conditions for Scottish exporters, particularly smaller businesses or in sectors most oriented to the EU market, or otherwise vulnerable to the introduction of customs controls, rules of origin and non-tariff barriers. Those reliant on groupage to ship consignments have faced particular difficulties.

14. The most immediate, severe and visible impacts have unsurprisingly been disproportionately concentrated in sectors of fundamental significance to Scotland, and particularly to the Highlands and Islands. Scotland's food and drink sector is the nation's largest export: during 2018, exports totalled £6 billion, over 70% of which went to the EU. The sector is worth £15 billion per annum and supports 120,000 well-paying jobs – many in rural communities at the forefront of Brexit impacts. This sector is also the most heavily affected by the new prohibitions and restrictions introduced by the Trade and Co-operation Agreement.

15. The disruption to the seafood sector since early January has offered the clearest evidence of the additional costs and losses associated with becoming an EU third country, and the trade frictions that introduces, including dealing with new and untested processes.

16. These observations are supported by Enterprise Agencies' and SDI's ongoing work with a number of trading companies deemed to be particularly vulnerable to the impact of EU Exit, who have reported transportation costs, disruption at UK and GB Borders and labelling requirements as the greatest challenges. That work has also found that, compared to other sectors:

More food and drink businesses are exporting less than normal, with some not able to export at all since the end of the transition period; and

A higher number of food and drink businesses trading with the EU are experiencing disruption, and reporting that disruption as relatively more severe.

Seafood

17. Issues in the seafood sector² are heavily interlinked, a consequence of the deal itself and a lack of preparation time, both here and in EU Member States. A range of new non-tariff barriers, such as time-consuming and detailed certification requirements, have been increasing costs and delays substantially and damaging the competitiveness of Scottish seafood, particularly exports of high value, time-sensitive

² Over 70% of Scottish seafood exports were to the EU in 2019, worth over £770 million. Over half (approx. £435 million) of all Scottish fish and seafood exports bound for the EU go to France. Much of the remaining exports go to Spain (£91 million), Italy (£56 million), the Irish Republic (£46 million) and Germany (£39 million). In 2019, seafood accounted for 57% of Scotland's overall food exports and had a total value of £1.02 bn.

fresh produce such as shellfish. Significantly increased complexity to export or land seafood into the EU, and delays in obtaining certification here, or at the border, have been impacting on product value and delivery, leading to reports of catastrophic losses for some businesses³. Those moving small consignments of seafood using groupage have been particularly affected. Some businesses have decided not to export at all, while problems are ongoing. Whilst some issues may ease with experience, many companies or markets are at risk of becoming unviable.

Salmon farming

18. Recent figures released by the Scottish Salmon Producers' Organisation estimated losses of at least £11 million in January alone, as a result of EU Exit changes, e.g. extra paperwork, new layers of bureaucracy, delays and confusion; an immediate loss of sales of around 1,500 tonnes of product; increasing costs of around £200,000 due to additional export documents and resources, logistics costs, administrative and veterinary costs and lost custom; and delays in harvesting 700 tonnes of fish in order to minimise spoilage.

Distilleries

Gin and whisky distillers and suppliers have also struggled to ship products to EU customers, with smaller operators in particular reporting confusion over paperwork for alcohol shipments, difficulties in dealing with differing approaches to excise duty in individual EU countries, and a resultant lack of freight forwarders willing to ship single pallets of spirits to the EU.

Prohibitions and Restrictions in the Food Sector

19. The nature of the third country trading relationship set out in the TCA has also resulted in various prohibitions and restrictions on a range of export goods. For example, seed potatoes, one of Scotland's key quality exports to the EU, are now prohibited from export, with exporters potentially facing losses in the region of £11 million. Live bivalve molluscs from Class B waters, including scallops, are also facing a complete export ban. Other goods – such as the movement of sheep – are facing new barriers to exportation.

Other Goods Sectors

20. The new arrangements are also increasingly impacting business costs, competitiveness and viability in other goods sectors, for example, textiles, a sector important to the Highlands and Islands.

21. In those sectors, complex new Rules of Origin, customs and VAT requirements - and inconsistencies in EU Member States' treatment of them - are increasing costs and delays. This is impacting on the availability, cost and speed of hauliers and delivery companies. These issues are impacting on supply chains and the ability of

³ At one point, James Withers of Scotland Food and Drink estimated that Scottish seafood exporters to the EU could be losing upwards of £1 million in sales a day as a result of the disruption.

businesses to meet delivery obligations, undermining competitiveness, jeopardising cash flow and future business and customer confidence.

22. Issues around the availability and cost of EU haulage and delivery companies have been particularly well documented, with many declining to service UK markets because of complex red tape and consequent delays and costs, resulting in goods stranded abroad, excessive stockpiles building up and orders unfulfilled.

Scottish Government response

23. The Scottish Government is doing everything in its power to mitigate the impacts of Brexit. To that end, we and our partner agencies, business organisations, businesses and others have been working closely to assess the impact of EU Exit, help businesses to adapt to the new arrangements – including through the Prepare for Brexit⁴ website and helpline - and provide financial support where necessary.

24. We have been working particularly closely with the food and drink sector, its trade bodies and Food Standards Scotland (FSS) to ensure that there is a balance of business support available to help business trade through the effects of Covid and the new EU relationship, offering businesses a range of guidance, one to one support, training and access to grants. Key steps we and our partners have taken include:

Working with Food Standards Scotland to create 3 logistics hubs to streamline the Export Health Certificate signing service, minimising the impact on local authorities.

Working intensively with hub operators, stakeholder organisations and individual businesses to improve and speed up that service.

Launching the £7.8 million Seafood Producers Resilience fund to help support shellfish and trout aquaculture businesses that have lost all or part of their relevant market due to the COVID-19 pandemic and EU Exit.

In Europe, SDI's In-Market Food and Drink Specialists providing assistance to Scottish businesses exporting into different EU member states, and providing data and research on live issues at EU customs and Borders.

Working with Scottish Chambers of Commerce to assess additional demands for customs support from businesses, and the need for additional capacity.

Working with Defra to host its Scotland Food and Drink Rules of Origin day on the 25th February, running a number of webinars for key subsectors to increase understanding of the new regulations for businesses exporting to the EU.

25. We are also continuing to press the UK Government to acknowledge the gravity of the issues facing many of our sectors, and to act to address them where we cannot, including through providing funding and compensation. To that end, the Cabinet

⁴ The Prepare for Brexit website and helpline offer access to a wide range of guidance and advice, including links to key UK Government guidance

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Secretary for Economy, Fair Work and Culture recently wrote to the Rt Hon Michael Gove M.P and Lord Frost, urging the UK Government to:

Provide urgent financial support to enable small and medium-sized businesses to utilise the services of customs brokers/agents and to increase the supply of those advisers to meet demand.

Take urgent steps with the EU to improve and simplify VAT on cross border trade, to remove trade barriers and support businesses, particularly SMEs.

Work urgently with industry to devise a simpler groupage system; streamline the increased bureaucracy and customs documentation; and incentivise EU hauliers to move freight between the EU and the UK.

CONCLUSION AND RECOMMENDATION

26. Members are invited to discuss this paper and offer their views on:

- 1) The EU Exit issues you are seeing in the Highlands and Islands, in particular how those issues are impacting on sectors, businesses and communities.**
- 2) What help the Scottish Government, UK Government and others could most usefully provide.**