Working paper: Border controls on cross border trade in goods

1. The unique geopolitical position of Northern Ireland has integrated North-South (Ireland) and East-West (GB) trading relationships into the economy. Understanding the balance of these relationships is essential to support decisions on any necessary border controls, particularly customs and phytosanitary checks which could have significant impacts on the economy.

2. Due to the range of complex areas captured by the border work stream the analysis in this paper has focussed on the movement of goods, and an assessment of border controls on these trade flows. As the location of border controls is not yet clear the analysis has looked at both North-South and East-West flows. The movement of people and cross border services is being covered separately, although these strands will need to come together in a holistic assessment of the impact of border controls on the Northern Ireland economy.

3. The trade data shows there is **no quick-win in terms of locating border controls**; the economy has become integrated into both the Irish and GB markets, so there would be disruption and potential for negative economic impact whether the controls were sited at the land or sea border. The data also shows that **the agri-food sector is particularly exposed** and any **mitigations need to be targeted at small and micro businesses**, as failing to protect these areas of the economy from the financial and administrative burdens of border controls could have a significant impact in Northern Ireland. Finally, it also clear that **a disorderly Exit would present a return to something akin to the 'borders of the past'**, although more work is required to quantify this impact.

Operations at the border

4. We understand there are 17 checks and controls carried out in relation to goods entering and leaving the UK. The UK's exit from the EU brings these functions in to sharp relief as, subject to the outcome of negotiations, they may create tariff and non-tariff barriers at the land border.

5. Operations that are likely to be particularly relevant to goods crossing the Northern Ireland land border are:
    - customs checks on individuals and goods;
    - import and export of vehicles;
    - movement of firearms and dual-use goods;
    - inspection of animal and food products;
    - inspection of wood imports;
    - intercepting counterfeit medicine;
    - detaining dangerous and illegal items, including toys, clothing, cosmetics and electrical appliances; and

- import and export of waste.

High level picture

6. The high proportion of micro-businesses and dominance of the agri-food sector make the NI economy vulnerable to tariffs and controls that may be administered by agencies operating at the UK-EU border.

7. Micro-businesses make up the vast majority of businesses in Northern Ireland (95%) and consistently account for around 40% of total sales (sales in NI, GB and exports) annually. Our working assumption is businesses employing less than ten people will not be able to absorb the administrative and financial costs of border controls.

8. The second key issue is the prevalence of the agri-food sector. In 2014, total sales of the NI food processing industry were estimated to be £4.1bn and gross output of the farming sector was estimated to be £1.9bn. Agri-food's integration across the land border and reliance on imports/exports make it particularly exposed to WTO tariffs, quotas and phytosanitary checks. The dairy sector's share of exports to Ireland means it could be amongst the most impacted sectors.

Volume of goods

9. Freight data provides an indication of the volume and number of goods moving between Northern Ireland and Ireland/GB, and therefore an indication of how many individual checks may be required.

10. The Irish Revenue Commissioners estimate that 177,000 lorries, 208,000 light vans and 1.85m cars cross the border each month. All of these movements could be impacted by controls at the land border.

11. This data is likely to include goods in transit to GB, Europe or the Rest of the World. Similarly, goods sold to GB via Northern Ireland's sea ports may be ultimately be bound for other markets. In both cases it can be difficult to disaggregate goods in transit from final sales due to the 'Rotterdam effect'[1]. Notwithstanding these challenges, it will be important to improve our understanding of goods transiting through Ireland or GB to other markets. In particular, we should seek to establish any relationships between sectors and

[1] The Rotterdam effect is the theory that trade in goods with the Netherlands is artificially inflated by those goods dispatched from or arriving in Rotterdam despite the ultimate destination or country of origin being located elsewhere. Some commentators feel that the Rotterdam effect distorts the UK's trade relationship with EU and non-EU countries. For example, oil exported from Saudi Arabia to Rotterdam and re-exported to the UK (possibly without processing) may be counted as an EU import rather than a non-EU import. Conversely, a product exported by the UK to Rotterdam and subsequently transited to a non-EU country may be counted as an export to the EU rather than the rest of the world.

transit routes, and the profile of businesses using Ireland and GB as a 'land bridge' to other markets.

Value of exports and external sales

12. Estimates of Northern Ireland's exports (sales outside the UK) and external sales (sales outside NI) range from £5.4bn to £9.1bn. This paper focuses on the Northern Ireland Broad Economy Sales and Exports Statistics (BESES), as this source uniquely shows both North-South and East-West trade.

13. At a high level the BESES data illustrates that sales by NI based companies to the rest of the UK is worth nearly four times as much as sales with Ireland, by value (GB £10.7bn, Ireland £2.7bn) and GB sales are worth nearly 2.5 times as much as sales to the EU (£4.3bn).

Table 1: Total sales, external (outside of NI) and exports (outside of UK): 2011-15 (£ millions)

Broad Destination	2011	2012	2013	2014	2015
Total Sales	45,168	44,661	46,885	48,520	48,541
NI Sales	27,959	27,072	28,739	30,164	30,272
GB sales	9,221	9,651	9,735	10,352	10,771
ROI sales	2,764	2,758	3,022	2,832	2,749
Rest of EU sales	1,799	1,661	1,869	1,765	1,599
Rest of World sales	3,426	3,518	3,520	3,408	3,211
Total External Sales	17,209	17,589	18,146	18,357	18,270
Total Exports	7,988	7,937	8,411	8,004	7,559

14. A breakdown of sectors within this data shows the value of all sectors' trading is dominated by sales to GB, with the exception of wholesale and retail where trading is a more balanced. However, the Standard Industrial Classification codes only provide a very broad picture of the North-South and East-West trade structure. Presenting this data at product level would provide a more detailed indication of the businesses exposed to border controls.

Size of businesses

15. Looking exclusively at the value of sales only gives part of the picture. Due to the profile of the Northern Ireland economy we must understand trade flows amongst micro and small businesses, in terms of both the potential reduction of the overall value of external sales, and the business and community level impact of trade barriers on low value cross border trade.

16. Charts 1 and 2 provide a breakdown of the number and value of micro-businesses (0-9 employees), small businesses (10-49), medium businesses (50-249) and large businesses (+250) selling good to GB and Ireland (NI's main external markets).

Chart 1: Number of businesses selling goods to Ireland and Great Britain, by size of business measured by number of employees

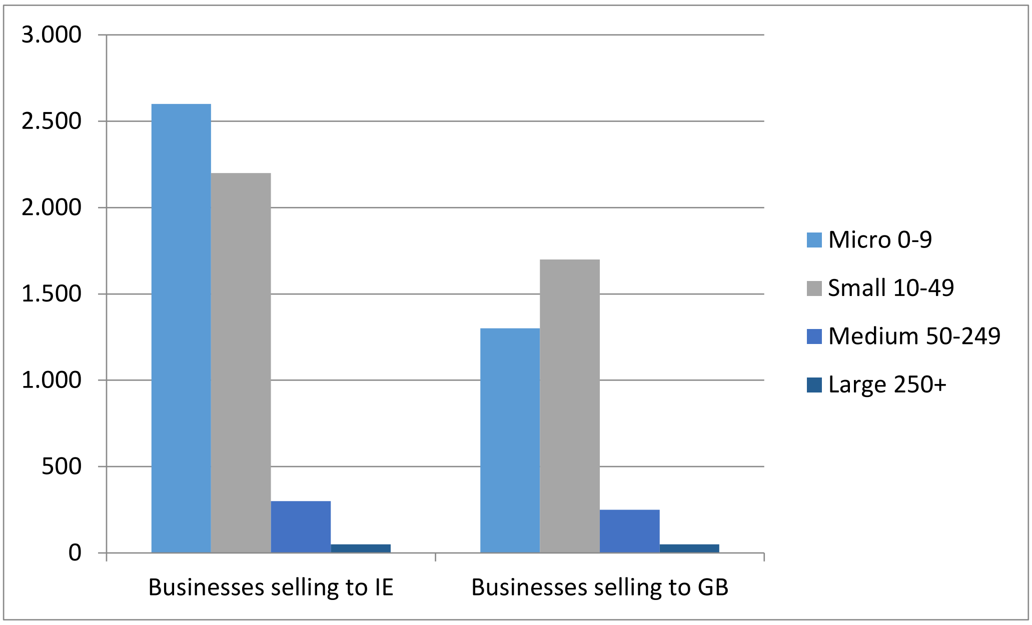
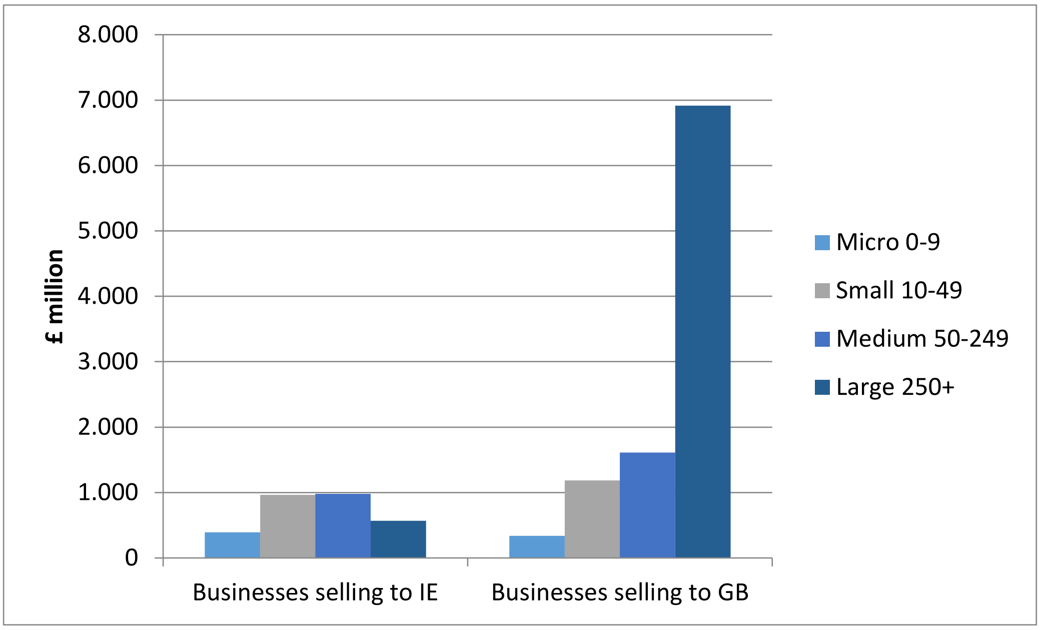


Chart 2: Value of external sales (goods only) to Ireland and Great Britain (£ millions), by size of businesses measured by number of employees



17. This analysis shows that the value difference between GB and Irish trade relates primarily to higher-value sales by a very small number of large businesses, and that there are more micro and small businesses engaged in cross-border trade

with Ireland than GB (around 1,300 more micro-businesses and 500 more small businesses).

18. Despite the higher number of small businesses and a similar level of medium and large businesses, the value of trade with Ireland is lower than trade with GB for these businesses sizes: deficits of £220m, £630m, £6.3bn respectively. While there is a higher value derived from micro businesses selling into the Irish market (£56m more than GB), the total value of trade is relatively small. These findings could indicate that trade across the land border is more likely to be from low-value and small-margin businesses, but more analysis is required to determine the complete picture.

19. The impact of border controls on small and micro businesses selling into Europe is also a consideration. Replicating these tables for sales to the EU26 and overlaying this data with the known transit routes of goods to Europe will help illustrate the exposure of these businesses to border controls.

Imports

20. The data on Northern Ireland's imports is less detailed. HMRC's published Regional Trade Statistics (RTS) shows goods imported to Northern Ireland from outside of the UK in 2015 amounted to £6.1bn, with Ireland being the largest import partner (£1.65bn). A breakdown of the data shows that agri-food, manufacturing and wholesale dominate the commodities imported from Ireland. However, this does not provide a product level picture. Accessing the HMRC product level trade data (a NISRA request for data is currently in train), and partnering this granular analysis with the work completed by InterTradeIreland/ESRI, will improve our understanding of imports.

21. The position on goods moving from GB to NI is particularly limited. Getting a better picture of imports from GB is particularly important for understanding the impact of border controls on the 77% of businesses that only sell to the NI market, most of which are small or micro-businesses. It is reasonable to assume that these businesses are using the UK single market to meet the demand for domestic sales. Border controls on goods entering NI from GB could therefore impact on the majority of businesses in NI. We understand the BESES data can help here.

Impact of tariff and non-tariff barriers

22. Analysis commissioned by InterTradeIreland uses CSO product level trade data to establish the impact of falling back to WTO trading regulations for Ireland to GB, GB to Ireland, Ireland to NI, and NI to Ireland trade flows.

23. The research has found a significant proportion of cross border trade will be affected by high tariffs. Although a substantial fraction of products would face no

tariff, the small percentage (2%) of products that would incur tariffs of over 35% in a WTO scenario make up a significant share of cross-border trade. In 2016 this range of products accounted for 19% of exports from Northern Ireland to Ireland. When the bracket is widened to tariffs over 15% the proportion of trade affected increases to 33%.

24. Depending on the combination of tariffs, non-tariff barriers and a 10% fall in the exchange rate the research estimates cross border trade could be reduced by 11% to 19%. The main driver of the fall in trade comes from the effect of tariffs and estimated non-tariff barriers on the food sectors. The dairy sector is found to be particularly exposed; milk and cream accounts for half of the estimated reduction in trade from Northern Ireland to Ireland.

Conclusions and recommendations

25. There is no quick or simple solution to the land border. There is likely to be some negative impact on the economy whether border controls are sited at the land or sea border, at least in the short-to-medium term. The policy question is therefore how these impacts can be minimised and what transitional support is required.

26. More analysis required to support this work. A framework for this work programme on goods is set out at Annex B (Nb. this is a policy tool to guide thinking and not intended for wider publication). In particular, we need:

    - a granular picture of trade flows, using product level data, to target policy analysis on at-risk business areas;
    - improved understanding of goods transiting through Ireland to/from GB and Europe, and the use of GB as a 'land bridge' to/from Europe;
    - Rules of Origin analysis showing the proportion of goods with NI-only, Irish, GB, EU26 and RoW components or value added;
    - an assessment of the interdependencies between trade flows; and
    - an understanding of the operational impact of border controls for businesses currently managing declarations, tariffs and border checks.

27. When the at-risk sectors/businesses and the likely maximal impact of border controls is known a deep dive into these sectors can be completed, and mitigations framed around this evidence base.

28. There is also a need to gather data on the movement of people with goods across the border, e.g. cross border shoppers. This is particularly relevant in a 'no deal scenario, where a strict application of the EU's Customs Code could require customs controls on goods worth more than €300.

29. Ultimately work on checks and controls on goods at the land border cannot be looked at in isolation. There will be a need to align this work with wider trade data to present the full picture of border controls and their economic impact, and also bring this work together with the migration analysis. This will need to include analysis on cross border trade in services, the provision of shared services, access to services, mutual recognition of professional qualifications and the security risk at border inspection posts.

Department for the Economy

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Annex A

Issues tree: border controls on goods