



31 January 2017

Treasury Select Committee Inquiry

UK's future economic relationship with the EU – Transitional Arrangements

Introduction

The Tobacco Manufacturers' Association (TMA) is the trade association for the UK tobacco industry. The TMA's members are British American Tobacco UK Ltd., Imperial Tobacco Ltd. and Gallaher Ltd. (a member of the Japan Tobacco Group of companies).

The UK's decision to leave the European Union (EU) has created considerable uncertainty for business. Once Article 50 has been triggered, the UK will have two years to negotiate the terms of Brexit, although that period can be extended by the mutual consent of the UK and the remaining EU Member States. Assuming that the two year period is not extended, and the UK and the EU fail to conclude a permanent Free Trade Agreement (FTA) between them by that time, World Trade Organisation (WTO) rules will instead govern trade between the UK and the remaining EU Member States. This means that the UK will have to apply Most Favoured Nation (MFN) tariff rates to imports from EU countries, which are in practice the same as the tariff rates that the UK currently applies to imports from non-EU countries which are also members of the WTO. In the case of cigarettes, for example, this would be a tariff of 57.6%.

It is therefore clear that, in the case that the UK and the EU have not concluded a permanent free trade agreement by the time that the UK leaves the EU, a transitional arrangement would be necessary in order to protect UK businesses from a sudden disruption to trade, pending the conclusion of a permanent FTA between the UK and the EU.

Tariff-Free Trade

Tobacco products are already a uniquely highly taxed consumer good. Given the existing high taxation, any tariff would have the effect of a large and unplanned increase in tobacco duty, and would cause considerable disruption to the UK tobacco market. It is also likely to undo HM Treasury's carefully balanced tobacco duty calculations, and lead to a very sudden increase in the size of the illegal market.

In the light of the above considerations, the tobacco industry seeks, in any transitional arrangement, a continuance of the status quo, i.e. tariff free trade in tobacco and tobacco products between the UK and the EU. Previous industry experience suggests that the reorganisation of a sophisticated supply chain, in a manner that protects UK consumers from sudden price fluctuations, could take at least two years to complete. Our expectation is that this timescale would be typical of any complex manufacturing industry. Therefore, a minimum of a two year period of assured tariff-free trade under a transitional arrangement would serve to minimise disruption to UK importers.

As the UK imports almost all manufactured tobacco products, it is important that the supply of goods from the EU should suffer as little interruption as is currently the case.

Of critical concern is the Excise Movement and Control System (EMCS), which ensures that, during the movement of all excisable goods, including tobacco and alcohol, between EU Member States, excise duty is suspended until the products have reached their final destination. The sudden closure of such a system could again lead to disruption for the import of goods from the EU. The EMCS was designed to assist customs authorities in the prevention of fraudulent movements, and the post-Brexit closure of such a system would again make a transitional arrangement desirable.

Free Movement of Employees

Like any knowledge intensive business sector, the tobacco industry relies on highly skilled labour, including scientists and product development experts. Identifying, attracting and developing top-talent is a concern for any large business, and whilst many of the specialists employed in the UK tobacco industry are UK citizens, a significant number do come from other countries, including other EU Member States.

As a result, in common with other international businesses present in the UK, the tobacco industry seeks an arrangement which assures the continuation of simple, non-bureaucratic access to highly skilled individuals from across the EU, to avoid further complicating the process of recruiting talent into the UK.

Again, if the terms of Brexit do not immediately provide for this once the two year negotiations conclude, a transitional arrangement would be highly desirable; firstly to protect existing EU citizens working in the UK, secondly to support multi-national businesses in moving employees from EU countries to their UK operations, and finally to allow the continued recruitment of specialist talent from across the EU into the UK sector.

Personal Allowances

The UK's membership of the EU currently theoretically permits UK citizens to bring into the UK unlimited quantities of both alcohol and tobacco from other EU Member States, provided it is for their own personal consumption. This is known to be one of the routes

exploited by criminals to avoid UK excise duties and is one part of an illegal industry which deprived HM Treasury of £2.4 billion in 2015/16.

This trade is driven by high price differentials between tobacco products available for purchase in the UK and those in other EU markets. For example the price of cigarettes in the UK is approximately €525 per 1,000 – this is around twice the price in Germany (€267) and more than three times that in so-called ‘high-risk’ markets like Poland (€157), Lithuania (€139) and Romania (€164)¹.

The tobacco industry would welcome the introduction and strict enforcement of fixed limits for personal imports, aligned with those for ‘duty-free’ products (200 cigarettes or 250g of hand-rolling tobacco). This is an opportunity, as a result of Brexit, to clamp down on one key channel for the illegal tobacco trade.

In this case, a transitional arrangement, implemented now, before the conclusion of Brexit negotiations, could be used to steadily decrease the permitted personal importation levels from EU Members States. It may be most effective to introduce this measure for ‘high-risk’ markets at first before introducing it for all EU members. For context, Germany currently restricts personal tobacco imports from a number of Eastern European markets².

Conclusion

In the event that the two year Brexit negotiations fail to deliver a permanent FTA governing trade between the UK and the EU, a transitional arrangement to allow businesses time to adjust to a tariff regime would be essential. In addition, continued, unencumbered trade arrangements and support for businesses that need to employ specialists from other EU Member States would be highly desirable. And finally, Brexit presents the UK Government with an opportunity to clamp down on one of the routes used by criminals to facilitate the illegal trade in tobacco products.

¹ EU Commission, July 2016, EXCISE DUTY TABLES Part III – Manufactured Tobacco

² See https://www.zoll.de/EN/Private-individuals/Travel/Travel-within-the-EU/Taxation/Alcohol-tobacco-and-products-containing-coffee/alcohol-tobacco-and-products-containing-coffee_node.html