Major implications for timber trade as Brexit enters the endgame

The long drawn-out process of the UK breaking ties with the EU, which started with the referendum of July 2016, is finally in the endgame. Since formally leaving the bloc on 31 January 2020, the UK's relationship with the EU has been governed by the Withdrawal Agreement. This has allowed the UK to continue on the same terms it had with the EU prior to departure during a so-called `transition period'.

This transition period will come to an end on 31st December and it is only then that the full impact of the UK's departure from the EU, which so far has been muted by the transition arrangements, not to mention the pressing effects of the COVID-19 pandemic during 2020, will become apparent.

The effects will be particularly dramatic if the EU and UK fail to reach agreement on a deal to govern trade relations from 1st January. At the start of December, there was optimism that a deal could be finalised before the end of the month.

On 6th December, the Guardian, a UK newspaper, reported "a major breakthrough in negotiations on the rights of European fleets to fish in UK waters", one of the very few remaining hurdles in the text of a trade agreement extending to over 600 pages which, according to the Irish government, is "97% done"

However, the most challenging hurdle was left till last. This is the "level playing field" with the EU demanding wide-ranging powers to unilaterally impose so-called "lightening tariffs" when it judges that the UK government is failing to keep up with future EU rules and regulations.

The UK government has rejected this "ratcheting clause" as a threat to sovereignty and instead argues that the EU should be empowered to implement more limited and specifically targeted tariffs after a process of independent arbitration has determined a real threat of material injury to EU trade and industry.

Speaking to EU leaders late on the evening of Thursday 10th December, Ursula von der Leyen, President of the European Commission, said that Britain exiting the transition period without a trade and security deal is now the most likely outcome.

On Sunday 13th December, the EU and UK subsequently agreed that talks towards a possible trade agreement should continue until the very last minute on 31st December. However, at the same time, Boris Johnson, the UK Prime Minister, reaffirmed his view that the UK and the EU will be unable to finalise a trade agreement in that time and that a "no deal" Brexit is "the most likely thing now".

Irrespective of whether a trade deal is agreed, the UK will be leaving the EU single market from 1st January. This means that there will no longer be "frictionless" trade between the UK and EU. New customs controls and procedures will lead to longer lead times and higher transaction costs, even under the most favourable scenarios for a trade relationship.

This combined with the high levels of uncertainty, made worse by decisions having been delayed until the very last minute, are already contributing to significant trade disruption between the EU and the UK. This is also likely to feed through into slower economic growth in the short and medium term.

The effects of the economic disruption will fall much more heavily on the UK than the EU. However some individual EU countries, such as Ireland, Belgium and the Netherlands, are likely to suffer more than others.

For the timber trade, the additional economic shock of Brexit, coming on top of the very severe and on-going disruption created by the COVID-19 pandemic, will likely lead to a decline, or at least much slower growth, in the overall size of market.

Taking a more positive view, there is some expectation that large government stimulus measures in both the EU and the UK, combined with commitment on both sides to “build back better” with a strong focus on enhanced environmental performance, may mitigate some of the worst effects of the combined COVID-Brexit downturn.

For tropical suppliers, new opportunities may arise in the UK market from a “no deal” outcome. This would lead to UK imports of timber products from EU countries, which dominate UK trade, being treated on the same terms as imports from other countries with no trade agreement with the UK. The relative competitiveness of EU-based hardwood suppliers, that currently benefit from completely frictionless trade with the UK, may be reduced in the UK market.

The potential opportunities are more significant in the hardwood sector because the UK, unlike the EU, does not have a large domestic hardwood resource. Manufacturing capacity for a large range of wood products - such as kiln dried lumber, panels, joinery, and furniture - is also much more restricted in the UK than in the EU.

There may also be some significant disruption of the trade between UK distributors and large hardwood traders in continental Europe – notably in Belgium and the Netherlands - with potential to encourage once again more direct imports of tropical woods into the UK.

Worst year for UK economy in more than 300 years

While there may be new opportunities created for some wood products suppliers to the UK at the end of the transition period, it seems very unlikely that these opportunities will be enough to offset the severe disruption to the wider market and implied reduction in overall consumption, at least in the short to medium term.

The end of the transition period comes at a time when the UK economy already shows signs of extreme fragility. Britain experienced its steepest recession on record earlier this year as coronavirus restrictions crushed economic activity. The latest data from the Office for National Statistics (ONS) shows that UK GDP grew for the sixth month in a row in October, but by only 0.4%, down from 1.1% in September.

The total size of the UK economy was still 7.9% below its February pre-pandemic level in October. The slowing recovery came before lockdown rules were tightened once again in November in an effort to forestall a second wave of the virus. The UK may well be in recession in the fourth quarter of this year, pulling the economy into a double-dip downturn.

The Confederation of British Industry forecasts a 1.7% fall in UK GDP in the fourth quarter, meaning a total contraction of 11.1% for the whole of 2020, the worst year for the UK economy since 1709.

The UK Treasury’s independent spending watchdog, the Office for Budget Responsibility (OBR), said in its latest report, released in November, that a failure to reach a free trade deal with the EU would knock 2% points off UK GDP growth in 2021. That would reduce growth next year from 5.5% to 3.5%, significantly hampering the UK's recovery from the massive shock of this year's pandemic.

The OBR main forecast, which assumes an EU deal is agreed and that vaccines against the pandemic are effective by summer 2021, sees the UK economy returning to its pre-crisis level by the end of 2022. However, a no-deal Brexit would push that back until the end of 2023.

According to OBR, the short-term impact of no-deal is due to various temporary disruptions to cross-border trade, while there would be lasting damage from higher structural unemployment, lower investment and harm to productivity growth.

EU economy more resistant than UK to COVID-Brexit downturn

The economic effects of both the pandemic and Brexit on the EU, while significant, are muted compared to the UK. The EU's Autumn 2020 Economic Forecast released on 5 November projects that the euro area economy will contract by 7.8% in 2020 before growing 4.2% in 2021 and 3% in 2022.

This projection already factors in the potential for a "no deal" Brexit. According to the EU, one "technical assumption" in making the forecast was that "given the lack of clarity on future trade relations, there will be no deal between the EU and UK and the two will trade on WTO Most Favoured Nation (MFN) rules from 1 January 2021 onwards".

Another technical assumption, that public health measures will remain in force to some degree throughout 2021 and 2022, may be too pessimistic. The signs that several vaccines are effective and will soon be approved for use in some European countries imply there is scope for a better outcome.

The direct effects of a no deal Brexit on total EU-UK trade were assessed in research published in November by Allianz, one of the world's largest insurance and asset management companies. For the UK, Alliance estimates an immediate 15% fall in the total value of exports. At present, 47% of all UK exports are destined for the EU, making it the UK's single largest market.

On the EU side, the damage is much less both proportionally and in absolute terms. Only 4% of all of the EU's exported goods and services ended up in the UK last year. Nevertheless, the impact is still significant. According to Allianz, a no deal could cost around EUR33bn in annual EU exports, with Germany (EUR8.2bn), the Netherlands (EUR4.8bn) and France (EUR3.6bn) hit the hardest in absolute terms. The Halle Institute for Economic Research has forecast that EU companies exporting to Britain could lose more than 700,000 jobs if no trade deal is agreed.

New border checks on UK wood imports from EU disrupt just-in-time trade

Until the end of this year, trucks can just roll into the UK from the European continent with no checks. This all changes from 1st January 2021. Irrespective of whether or not there is a deal, any good arriving into the UK from the EU will be treated as an import and traders will have more work to do.

New controls at the UK border with the EU are expected to add delays to the supply chain, as product origins are checked and relevant duties applied. This is likely to have a significant impact on `just-in-time' procurement which in turn will slow down progress and add to costs of manufacturing and on projects across numerous sectors.

In the UK construction sector, the major driver of UK timber demand, the turnaround time for delivery to building sites in Central London was previously only two days. Already there is considerable congestion at UK ports as distributors of all commodities and products are rushing to build stocks before the end of the year. This, combined with COVID related supply problems, has greatly increased lead times which now extend to weeks instead of days.

Due to tightening operating conditions and sawmill shutdowns throughout the pandemic, combined with a surge in demand for timber for DIY and garden projects during the lockdown period, timber stockholdings in the UK builders' merchant sector are already much lower than usual at this time of year.

The UK Timber Trade Federation issued a warning early in December that the overall tight timber supply conditions in the country will continue "certainly into Q2 2021, if not longer". It was also noted that "companies can no longer expect to get what they need through just-in-time buying".

UK timber companies that used to rely on frictionless trade with the EU are now having to adjust to the need for customs checks. The UK hardwood sector, which is already sourcing globally, is generally better prepared than the softwood sector where there is huge reliance on EU suppliers.

However, there are now many UK trading companies having to apply for the first time for a so-called Economic Operators Registration and Identification (EORI) number which identifies businesses or operators that export or import to the EU. They are having to familiarise themselves with the customs codes and duties applied to traded products and with new VAT procedures. They are being advised by both UK government and the TTF to hire customs agents and logistics specialists.

Implications of UK Global Tariff Schedule on wood trade

From 1st January the UK will implement a new "Global Tariff" regime which closely mirrors the existing EU tariff regime. The tariff codes exactly match those used in the EU's "Combined Nomenclature". The UK General System of Preferences (GSP) will provide trade preferences to the same developing countries as the EU GSP.

The main point of difference between the UK and EU schedule, at least initially, is that it reduces tariffs on UK imports of a range of products, including some wood products. The UK is either reducing or totally removing tariffs for certain industries which are important in the EU, and therefore partially protected through EU tariffs, but which have little presence in the UK.

For wood products, the UK has a very long tradition of fulfilling its wider wood needs through imports, much more so than elsewhere in the EU, and is therefore more inclined to reduce wood import tariffs.

This is of no account for quite a few wood products. The EU already imposes zero-tariffs on all logs and rough sawn timber, together with all finished wood furniture, as well as for all types of wood fuel, including chips, pellets, charcoal, sleepers, tools, shuttering, shingles and shakes, posts and beams, glulam, tableware and kitchenware.

However, the UK is reducing tariffs for many wood products where these are imposed including:

- The EU tariff of 2.5% that applies to all "sanded" sawnwood to be reduced to zero in the UK.
- The EU tariff of 2% specific to tropical hardwood that is "planed" to be reduced to zero in the UK.

- The EU tariff on veneers, which ranges between 3% to 6% depending on degree of processing and species, to be reduced to zero in the UK.
- The EU 7% tariff on some plywoods, including with outer ply of some (but not all) tropical hardwoods (4412110/44123190), other hardwood (44123300/4412400), and softwood (44123900), to be reduced to 6% in the UK.
- The EU 7% tariff on MDF and other fibreboard, OSB and other particle board to be reduced to 6% in the UK.
- The EU 2.5% tariff on picture frames and similar products made of tropical wood, to be reduced to 2% in the UK.
- The EU 3% tariff on wooden doors and door frames, windows and window frames, parquet flooring panels, which applies to all wood species including tropical wood, to be reduced to 2% in the UK.
- The EU's 3% tariff on statuettes and jewelry and cutlery boxes made specifically of tropical wood, to be reduced to 2% in the UK.
- The EU 4% tariff on wood packing cases, boxes, crates, box pallets and similar, to be reduced to zero in the UK.
- The EU 5.6% tariff on bamboo and rattan furniture to be reduced to 4% in the UK.
- The EU 2.7% tariff on wooden furniture components to be reduced to 2% in the UK.

The UK is retaining the existing 10% EU tariff on tropical hardwood plywood defined under 44123110 (that is faced with dark red meranti, light red meranti, white lauan, sipo, limba, obeche, okoumé, acajou d'Afrique, sapelli, virola, mahogany "Swietenia spp.", palissandre de Rio, palissandre de Para or palissandre de rose).

Other wood products where the UK will retain the existing EU tariff are: laminates and veneered panels under 441294 and 441299, for which there is a tariff of 6% or 10% depending on the exact specification; bamboo plywood which will continue to be subject to a 10% tariff; and wood marquetry, subject to a 4% tariff.

The EU applies a quota system to just one wood product, allowing up to 650,000m3 of coniferous plywood to be imported duty-free each year after which 7% duty is applied. The UK will also apply a quota to this product in 2021, allowing the first 170,000 m3 of coniferous plywood to be imported duty free, after which 6% duty will be applied.

A key issue to be resolved through the on-going negotiations between the EU and UK is whether suppliers in the EU and UK will be subject to tariffs when trading with each other. In the event of "no deal" trade between the EU and UK will be on World Trade Organisation (WTO) Most Favoured Nation (MFN) rules. Under these rules both partners would be obliged to apply the same tariffs on trade with each other as they do on trade with other WTO members where there is no comprehensive trade agreement.

Under a no-deal Brexit, UK imports from the EU will be subject to the same tariffs (and a quota system in the case of softwood plywood) as UK imports from countries outside the EU. Even if the UK simply adopts the EU's existing tariff schedule, non-EU suppliers would now be trading on a level playing field with EU suppliers.

The exception to this would be suppliers in countries that have signed a Free Trade Agreement (FTA) with the EU but not subsequently with the UK. Like EU suppliers, they would now face tariffs that were previously not applicable for their trade with the UK. In practice this problem is mitigated by the UK's ambitions to sign its own FTA's with non-EU countries as soon as possible.

Amongst tropical countries, the EU has signed FTAs with Singapore (in 2019) and Vietnam (in August this year). There is also an "Association Agreement" with Central American countries (Honduras, Nicaragua, Panama, Costa Rica, El Salvador, Guatemala) and "Stepping-Stone Economic Partnership Agreements" with Ghana and Cote d'Ivoire, in place for several years offering lower tariffs.

The EU has also negotiated an FTA with the Mercosur countries (of which Brazil and Paraguay are tropical wood suppliers), but there has been resistance to ratification on the EU side, particularly from the French government. An EU-Mexico FTA is under negotiation.

The UK is trying to replicate these deals as soon as possible. The UK agreed to replicate the "Association Agreement" with Central American countries in August 2019. The "Stepping Stone Agreement" with Côte d'Ivoire was replicated in November this year providing immediate duty-free, quota-free access to all goods exported from the Côte d'Ivoire into the UK. The UK signed an FTA with Singapore on 10th December and another with Vietnam on the next day, 11th December. The latter will see 99% of tariffs between the two countries eliminated after seven years.

Cash flow: another potential obstacle in UK-EU trade

Irrespective of decisions taken with regard to duties on UK trade with the EU from 1st January, the UK timber trade has expressed concern about the implications of the UK's departure from the EU single market for cash flow. For all internal EU transactions, VAT is not charged on the supply of goods between businesses from another EU country by the supplier. Instead, a business recipient is required to charge itself VAT, known as acquisition VAT, which is typically an accounting transaction on the VAT return.

When the UK leaves the EU VAT area on 1st January, it becomes a third country in relation to EU trade. This means that while the EU exporter will still not charge VAT, the UK importer is obliged to pay VAT to UK tax authorities at the point of import alongside any applicable customs duties. Given the huge volumes of timber involved, this has raised concerns amongst UK importers over the cash flow implications.

The UK government has sought to mitigate this concern with the introduction of "postponed accounting" for import VAT. This will shift the VAT accounting and payment away from the border and back to the VAT return.

To further reduce concerns about cash flow and other procedural delays immediately after the UK leaves the single market on 1st January, the UK government has also stated that for the first 6 months (until 30 June 2021) there will be no need to make immediate import declarations for goods imported from the EU at the UK border. However importers wishing to benefit from this system of delayed declarations will need to be pre-approved by the UK tax authorities.

Looking longer term, with the UK government keen to facilitate more global trade, it is possible these procedures for delayed accounting of VAT and duties for imports from the EU for pre-approved traders may be applied to imports from all countries.

In October, the UK government also published plans for the creation of a number of Freeports which, it is claimed, "will improve upon both the UK's existing customs arrangements". Firms will be able to import goods into a UK Freeport without paying tariffs, process them into a final good and then either pay a tariff on goods sold into the domestic market, or export the final goods without paying UK tariffs.

The Freeport plans include a package of tax reliefs on investment by businesses within Freeport tax sites and measures to speed up planning processes to accelerate development in and around Freeports

Phytosanitary controls extended to UK imports from EU countries

Another significant impact of the UK's exit from the EU single market on 1st January will be the requirement for phytosanitary certificates, which currently apply to a range of wood products imported into the EU, to be extended to UK's imports from other EU countries (and vice versa).

The direct effect of this on tropical wood products is limited by the fact that existing EU phytosanitary controls on commercial timber products apply almost exclusively to temperate woods since these give rise to by far the greatest risk to the health of European forests.

However, the indirect effects of phytosanitary certification on trade flows can be significant since requirements for certification, which may include specific treatments and in some cases limit trade to wood from narrowly defined regions, can greatly increase costs and limit access to raw material.

The phytosanitary rules are often complex, subject to change in response to ongoing monitoring of pest outbreaks, and frequently lead to temperate hardwood products from outside the EU being held up at ports for additional inspections or returned to the seller for compliance failures.

Notable commercial wood species requiring phytosanitary certificates for EU imports include: oak from the United States; maple, birch, aspen, ash and walnut from North America, Russia and Asia; cherry from Asia; and coniferous wood with bark from all locations.

The UK is mirroring the EU plant health regulations in its own plant health legislation with the result that, from 1st January, specific requirements for phytosanitary certification will be extended to UK imports from EU countries as well as from non-EU countries.

UK wood products imports from the EU to be subject to phytosanitary certification for the first time from 1st January include walnut from all EU countries, and all wood products of a range of hardwood species including maple, alder, birch, beech, ash, plane, poplar, willow, lime and elm from Austria, France, Finland, Germany and Italy. All coniferous wood product imports into the UK from Spain and Portugal will also be controlled to prevent spread of pine wood nematode.

Another change relates to wood packaging material (WPM) moving between the UK and the EU, including Switzerland and Liechtenstein, which moves freely without checks and controls in the EU single market. From 1st January 2021 all WPM moving between the UK and the EU must meet ISPM15 international standards by undergoing heat treatment and marking. All WPM may be subject to official checks either upon or after entry to the EU or UK. This requirement is already in place for WPM moving into the EU and UK from the rest of the world.

It is noteworthy that there are no new phytosanitary controls on UK imports of EU oak products and UK trade of softwood products will continue largely as now, as woods with bark will face plant health controls, while processed woods fully debarked, except from Portugal and Spain, may be imported unheeded without certificates.

UK-EU timber products trade subject to due diligence

From 1st January, the EUTR will be replaced in the UK by the UK Timber Regulation (UKTR). The scope of UKTR, in terms of regulated 'timber and timber products' is the same as EUTR. The requirements established for an "Operator" in the EUTR, defined as the first placer of the timber and timber product on the EU market, will apply to the first placer on the UK market in UKTR. UKTR obligations are identical to EUTR, requiring operators to exercise due diligence to ensure negligible risk of illegal harvest when placing products on the UK market.

The "Green Lane" for products covered by FLEGT licenses and CITES certificates imported directly into the UK applies equally to UKTR. However, if a product is imported into the EU with a FLEGT license or a CITES certificate and then subsequently shipped to the UK, the UK operator would be required to undertake due diligence with respect to that timber.

This highlights that the most significant change with respect to the scope of the UKTR relative to EUTR is that it imposes due diligence requirements on all UK timber and timber product imports, including those from inside the EU. The same of course applies to (much more modest) EU imports from the UK.

As the representative of one large UK hardwood importer noted when discussing the new UKTR at the online London Hardwood Club (LHC) meeting on 9th September "it will be interesting to see how well due diligence is being carried out in other EU countries. It is possible that UK regulators will conclude that some products accepted as compliant to EUTR due diligence requirements do not meet UKTR requirements. A concern in relation to EUTR is that enforcement is not uniform across the EU and UK importers will now have to take that into account in their due diligence".

Another issue raised at the LHC meeting related to commercial confidentiality. It was suggested that the need to identify the source of wood products to mitigate risk under UKTR may present another obstacle to UK hardwood importers buying from EU distributors. EU operators may be reluctant to identify their overseas suppliers to their customers in the UK. The same applies to UK distributors selling into the EU.

To support UK importers implement the UKTR, the Timber Trade Federation has developed a free interactive toolkit. The toolkit runs through the due diligence process step by step, providing guidance on information gathering (what questions to ask and data sources to use) and on risk identification. It generates a pdf report of the due diligence steps undertaken with respect to individual products that can be used for compliance purposes. The TTF is continuously updating the toolkit in response to feedback and as new guidance and due diligence tools and information sources are made available. The toolkit can be downloaded at https://ttf.co.uk/download/ttf-due-diligence-toolkit/

Potential for duplication of quality standards and testing regimes

Until the end of 2020, the quality of construction goods, materials and products are controlled by EU regulations, specifically the CE mark. To avoid any short term uncertainty, the UK government has indicated that CE marked products will continue to be recognised in the UK market until 31st December 2021.

However, from 1st January 2022, manufacturers wanting to supply the UK construction sector will have to use a new UKCA (UK Conformity Assessment) mark in place of the CE mark.

It is still uncertain at this stage, in the absence of a trade deal, the extent to which the UKCA will harmonise to the CE to allow goods to pass the equivalent CE standard without any need for further testing. Without harmonisation of standards and mutual recognition of Notified Bodies (NB), manufacturers will have to duplicate testing of construction products for the UK and EU markets, adding significant cost and delays.