COVID-19 and Brexit Impacts on the UK Food Supply Chain this Winter

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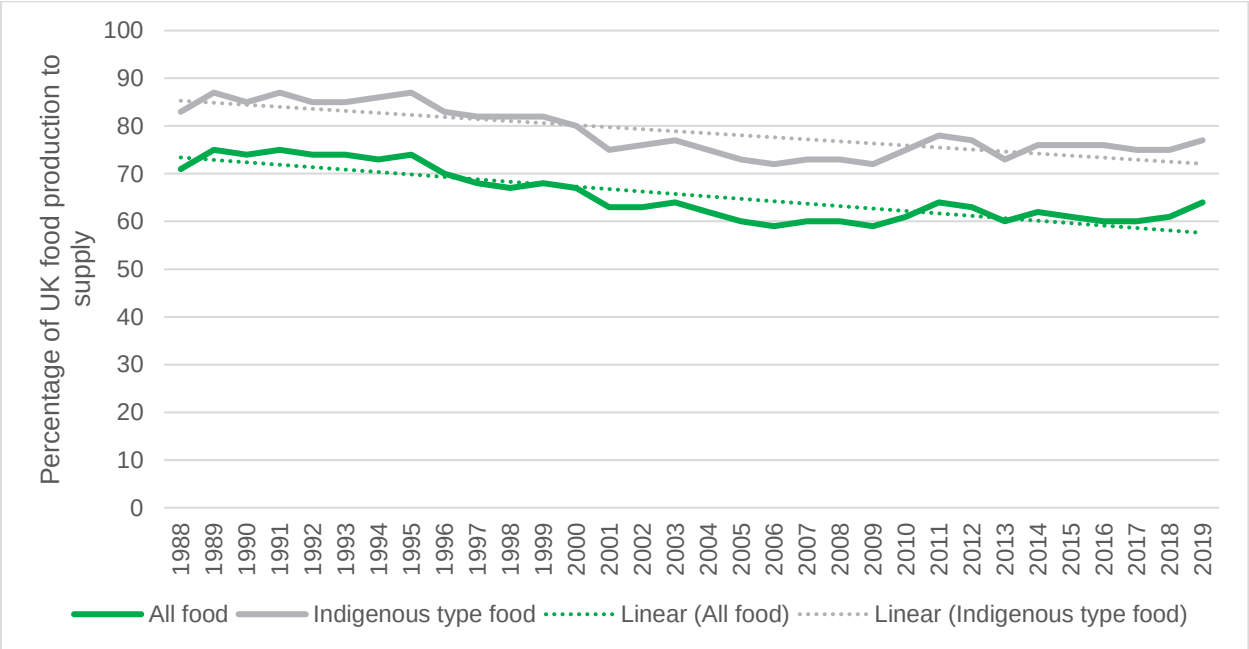
The UK Government's third unilateral deadline to agree a Brexit deal with the EU came and went in the middle of October. At the same time, the ongoing COVID-19 crisis has necessitated local lockdowns and/or short-term circuit breakers for more than half of the UK population. How will this "perfect storm" of Brexit and COVID-19 impact on the UK's food supply this coming winter?

The UK food supply chain

According to the UK's Department of Environment, Food and Rural Affairs (Defra) figures, the UK has become ***less self-sufficient*** in both all food and in indigenous food over time.



In fact, only just over half (55%) the farm-gate value of unprocessed food consumed in the UK in 2019 was produced domestically. ***Around a quarter (26%) was imported from EU Member States***, with the rest drawn from global suppliers including Africa, North America, South America and Asia, which all accounted for 4% of the total, and Australasia, which accounted for 1%.

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The only major food group in which the UK had an exportable surplus by value in 2019 was beverages, led by Scotch Whisky. The UK had a net import requirement by value of £10.2 billion in fruit and vegetables, £4.5 billion in meat and £1.8 billion in cereals. The UK is currently dependent on the Netherlands and Spain for vegetables and salads and Italy for tinned tomatoes and pasta.

The UK has operated a lean, reliable and efficient "just-in-time" supply chain for around 40 years. Prior to the introduction of this system by Tesco in the 1980s, UK retailers held most of their stock in store and incurred the associated overheads. The switch to smaller and more frequent deliveries (from a smaller number of suppliers) to regional distribution centres minimised store inventories and allowed the retailers to reduce consumer prices. The system is most extreme in the fresh and chilled sector where stores typically restock on a daily basis. ***Membership of the EU's Single Market, and efficient transport logistics across the EU, have allowed this system to flourish***, underpinned as it is by a very well-developed understanding of daily consumer demand. However, while this system is normally highly efficient, it is vulnerable to disruption. Any disruption is passed through the supply chain and can be magnified where this is complex, such as in the case of food manufacturing which requires inputs from several different sources.

COVID-19 panic buying

The UK entered lockdown in late March 2020. Understandably people prepared for this by building up stocks at home to reduce the need to shop frequently. This increase in demand was exacerbated by the fact that meals taken out of the home (office worker lunches, school canteens, evening meals, etc.) were replaced by food sold through retail. Even though most people may have only added a few extra items to their basket, at the aggregate level, this amounted to a sea change in daily demand. This disrupted the just-in-time supply chains and resulted in empty shelves in many stores throughout the country for the first time since World War II rationing ended in 1954. Faced with empty shelves and concerns about shortages, ***consumers tended to stock up on what they could when they could which simply exaggerated the demand-side shock***. As a result, supermarket sales in March were comparable to those around Christmas, for which retailers usually make significant preparations well in advance.

In response, manufacturers increased production of goods in high demand where this was possible, and retailers increased supply; the Government relaxed competition law and restrictions on driver's hours. The success of the response was facilitated to some extent by the preparations that retailers had made for a no deal Brexit, including the identification of alternative suppliers and ways to mitigate expected bottlenecks. Restoring supplies of some products was more problematic for structural reasons. For example, only a small minority of flour in the UK is sold through retail with the majority sold in larger pack sizes to the catering and food manufacturing sectors. This meant that, while there was no shortage of flour, there was a bottleneck in packing this for sale through the retail sector.

Impact of Brexit on UK food supply and prices

So COVID-19 caused a ***demand-side shock*** to the UK's food supply system. Brexit raises the prospect of a ***supply-side shock***. The basic logic behind the creation of the EU's Single Market was that it would create a larger market by removing impediments to trade including different rules on standards and labelling, as well as by providing mutual recognition of professional qualifications so that, for example, lorry drivers could operate across the EU. The creation of a Single Market therefore removed transactions costs, trade frictions, and reduced the cost of trade between EU Member States.

It follows that by leaving the Single Market, standards and rules in the EU and the UK could diverge meaning that measures will have to be taken by both sides to approve standards and qualifications, etc. for use in each other's markets. There would also be a need to check products and paperwork at the border. This trade friction implies

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additional costs which will be in place simply by virtue of the UK leaving the Single Market, i.e. ***these costs will be experienced whether the UK and the EU agree a trade deal or not***.

Added to this, leaving the EU without a trade deal with the EU also means that the EU's Common External Tariff will apply to imports from the UK. In return, the UK would have to apply the same tariff schedule that it applies to all WTO members to imports from the EU.

The Government published a revised UK Global Tariff in May 2020 (after an initial tariff schedule was published in March 2019). This revised tariff schedule effectively converted the EU's Common External Tariff to Sterling with some simplifications. In the event of the UK leaving the EU without a trade agreement, this tariff means that food imports from the EU, in addition to increased trade friction costs, will be subject to ***tariffs which commentators say average out at around 18%***, although this hides considerable diversity from, for example, £253 + 12% per 100kg for boneless fresh or chilled beef to £20 per 100kg for plain yoghurt with a fat content between 3% and 6%.

As mentioned above, 26% of the value of food consumed in the UK is imported from the EU. This implies that ***there will be price increases, in some cases substantial, as a result of the imposition of tariffs***. Any price increases must be added to increased trade friction costs. All increases in cost will be borne in the first instance by the supply chain, but ultimately by consumers.

Food prices in the EU are often higher than in some other countries due to higher production costs resulting from environmental and animal welfare legislation, as well as relatively high labour costs. It is therefore possible that the UK will be able to source some food products from non-EU countries at lower prices than the EU, even if these countries have to pay the same import tariff and will often have higher transport costs due to their location. However, these imports may not be produced to the same standards as those imposed on UK farmers and processors and, in any case, would still be higher cost than imports from the EU have been while the UK was a member of the Single Market.

The UK may seek to conclude trade deals with non-EU countries and some of these, for example, the USA, Australia and New Zealand, have large, export-focused agricultural sectors. However, as noted above, the USA (with Canada) currently supplies only 4% of food consumed in the UK by value and Australia and New Zealand only 1% between them. This is a long way short of the current supply from the EU and it is by no means clear that these (or other) countries could replace certain products on the UK market, for example, fresh fruit and vegetables which have a short shelf life. In fact, fresh chicken only has a shelf-life of 7-10 days meaning that long-distance supply will either involve a significantly shorter shelf life or additional cost due to the need to air freight. In short, ***the UK may have little practical choice but to maintain supplies from the EU, even if this involves significantly higher prices***.

COVID-19 and Brexit – a "perfect storm"

Likely impact of COVID-19

As COVID-19 cases pick up as the UK moves through autumn into winter, an increasing proportion of the population is likely to be placed under some form of local lockdown or short-term circuit breaker. This is likely to see a ***return to shopping patterns last seen in March 2020*** with people reducing the frequency of shopping and bulk buying products where possible. Even with lockdowns in place over Christmas, people are still likely to make additional seasonal purchases which will exacerbate this.

Greater case numbers may necessitate the temporary shutdown of food processing and manufacturing sites which is likely to add a supply-side shock to the main COVID-19 demand-side shock. COVID-19 may also result in

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reduced capacity in the logistics sector as a direct result of illness and also if lorry drivers are reluctant to travel across borders in case they end up trapped in local lockdowns. Port capacity may also be reduced due to illness and/or the need to maintain social distance in the workplace.

Many commentators believe that COVID-19 will ultimately lead to significant job losses as government schemes to support employment inevitably weaken over time due to cost implications. A significant rise in unemployment will reduce household budgets and this could weaken demand for some foodstuffs, although demand for essentials will remain. This may mitigate some of the demand-side shocks expected.

Likely impact of Brexit

When the UK leaves the EU Single Market on 31 December 2020, frictionless trade with the EU will cease. This will mean border checks and ***inevitable delays which will disrupt the food supply system*** and create a supply-side shock to add to the COVID-19 demand-side problems. In addition to national border checks, lorries entering Kent and bound for the cross-channel terminals will require a Kent Access Pass. To be meaningful this will require some sort of policing which is also likely to result in logistical delays. The certainty of delays is clear in the Government's contingency planning in Kent where the M20 motorway is partitioned ready to serve as a lorry park and ten sites across the country, mainly in the south east, have been identified as lorry parks/customs checkpoints. ***Delays at the ports will result in missed delivery slots and will reduce the shelf life of fresh products which is likely to lead to additional losses and reduced supply.*** If severe enough, delays may make supply from certain origins untenable.

An inevitable consequence of the loss of frictionless trade will be additional cost. While the supply chain may seek to absorb some of these additional costs, at some point a proportion of ***these costs will work their way through to consumers***. If the UK leaves the EU without a trade deal in place, tariffs will add to these price increases, although will be watered down somewhat in processed products manufactured in the UK where the imported product constitutes only a part of the finished product.

The "perfect storm"

COVID-19 has so far mainly resulted in a demand-side shock which came close to breaking the UK's just-in-time food distribution system. However, Brexit will add a supply-side shock which, in combination, will greatly increase the problems likely to be experienced this winter.

The UK looks set to experience an uncomfortable winter of rising COVID-19 cases, local lockdowns, higher unemployment and reduced incomes, reduced supply of food, especially fresh products and higher prices. The recovery from COVID-19 and the outcome of the UK's departure from the EU Single Market are likely to result in structural change to the UK's food supply system beyond 2021. As disposable incomes decline due to higher unemployment and higher taxes, people's shopping basket will change. The mix between in-store purchase and home delivery will change, as will the viability of business district convenience stores.

For food retailers, securing supplies and reconfiguring supply chains are activities that will need to continue, with unconventional approaches considered. For example, airfreight of certain perishables is not uncommon globally and this could be increased to the UK. For farmers and food manufacturers, there is an opportunity to look at the shifting relationships and redirect production and marketing activities. And for all participants, constant monitoring of the shifting landscape with respect to basic supply-demand fundamentals and price is a must as these are the indicators that will guide actions. Agricultural markets for the past five years have been relatively calm. The volatility of the past year will be more the norm for some time to come.

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