INSTITUTE FOR GOVERNMENT

Taking back control of regulation

Managing divergence from EU rules

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About this report

The UK has regained its regulatory autonomy, but it remains unclear how the government plans to exercise it. This report explores how divergence from EU rules could arise, why the government might want to act differently, the consequences this could have and how the government should manage the process.

This report sits alongside the Institute for Government's work on the UK's post-Brexit subsidy control regime and the operation of the UK internal market.

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Summary

Announcing the UK–EU Trade and Cooperation Agreement, signed on Christmas Eve 2020, the prime minister declared that "we have taken back control of every jot and tittle of our regulation". Regaining regulatory autonomy was a key UK objective in the negotiations. The question now is what the government wants to do with it.

Six months on, not much has changed. Most inherited EU regulation has been kept on the statute book. But regulatory divergence between the UK and EU will occur over time – either actively, when the UK decides to regulate in its own way, or passively, when EU rules change without the UK following suit. This may not be uniform across the four nations, with Northern Ireland obliged to stay aligned with some EU regulations through the Northern Ireland protocol, and the Scottish government taking powers to voluntarily align with the EU in devolved policy areas.

Regulating differently to the EU may deliver benefits, but may also carry costs. The government is no longer constrained by EU law, and there are many good reasons why ministers may want to do things differently. These include delivering different policy preferences (such as banning the export of live animals for slaughter or permitting greater use of GM foods), better reflecting the UK's specific circumstances (such as its large financial services sector), reducing business costs and incentivising innovation as well as taking advantage of new technology.

Yet exercising the UK's new autonomy will often come at a price. Diverging from the EU could trigger disputes under the UK–EU Trade and Cooperation Agreement (TCA) that lead to a loss of access to EU markets for British firms, undermine the UK's international obligations, make British exporters less competitive and upset already strained relations between Westminster and the devolved administrations. Critically, it also risks deepening trade barriers between Great Britain and Northern Ireland – the 'Irish Sea border' – a prospect opposed by many in the unionist community and could have sensitive political and economic consequences that the government must handle carefully.

And beyond the political rhetoric, there does not appear to be widespread public or political appetite to tear up EU rules in areas like workers' rights and food safety, which are seen to offer strong protections, especially as many firms and policy makers are still adjusting to the huge changes arising from the end of the transition period. Given these potential consequences, the government should avoid divergence for its own sake. It must make a clear case for doing things differently, beyond simply wanting to demonstrate that it can.

In reality, the potential costs of divergence mean a bonfire of EU regulation is unlikely – at least in the near future and outside of specific sectors, like financial services, where the opportunities of divergence are clearest. Even the biggest advocates of autonomy stress the benefits of being able to regulate differently in the future, rather than tearing up the back catalogue of inherited EU rules now.

Recommendations in brief

Divergence from EU rules needs to be carefully managed. We recommend that:

- **The government sets out clear guidance on how departments should exercise the UK's new regulatory autonomy.** The government has set out principles for regulation in its Plan for Growth, but it has not explained how individual departments should navigate the new considerations that apply when making regulation outside the EU.

- **Existing cross-government processes and structures for assessing regulatory proposals are reformed.** Where divergence does occur, cross-government co-ordination will be essential. What appears to be limited divergence in an obscure policy area, promoted by one department, could have wide repercussions and unintended consequences for others. These trade-offs involved must be properly considered before decisions are finalised.

- **The government keeps track of regulatory developments in the EU that will affect the UK.** This will enable ministers to make informed and timely decisions about whether to allow (or promote) divergence or remain more closely aligned.

- **The government works constructively with the Commons European Scrutiny Committee and Lords European Affairs Committee** to agree what information about new EU rules that affect the UK (and its response to them) should be provided to parliament. Without this, it will be difficult for parliamentarians to scrutinise the government's response.

Brexit will ensure that the UK, over time, does things differently from the EU. That could happen in an unplanned, ad hoc way, or UK ministers can decide now to keep a grip on divergence. Having taken back control of regulation, they now need to put in place the mechanisms to ensure it delivers the benefits that have been promised.

1. Introduction

> **"Sovereignty is about the ability to get your own rules right in a way that suits our own conditions"**[1] – Lord Frost, when UK chief Brexit negotiator, 17 February 2020

Regulatory autonomy was a key goal for the Johnson government throughout the Brexit negotiations. This explains why the administration dropped Theresa May's proposed Northern Ireland backstop and Chequers plan – which would have kept the whole of the UK in the EU's regulatory orbit on goods.

The government has largely succeeded in this aim. The UK–EU Trade and Cooperation Agreement (TCA) means that the UK is outside both the EU single market and customs union. It does not need to align with EU rules on goods, at least in Great Britain (the Northern Ireland protocol means many still apply in Northern Ireland, creating potentially controversial regulatory divergence between Great Britain and Northern Ireland), while all of the UK need not align on services.

A key part of the post-Brexit policy debate concerns the extent to which the UK will diverge from EU regulations that have governed many areas of economic activity for decades, and from which the UK had little scope to deviate as a member state. Regulation encompasses a range of government interventions in the private sector. Economic regulation sets market conditions, for example through rules about product standards; social regulation addresses the negative effects of economic activity – such as pollution – or supports desirable social goods.[2]

Since January, after the end of the transition period on New Year's Eve 2020, there has been a flurry of UK government papers and consultations proposing changes to inherited EU regulations in areas like financial services and life sciences. The Plan for Growth, published alongside the March 2021 budget, sets out a "UK approach to regulatory reform".[3] Think tanks,[4] business groups and civil society are also seeking to influence how the government exercises its new powers.

In practice, decisions about regulation will not be made solely through the lens of 'divergence' for its own sake: policy objectives and wider political preferences will usually drive the government's actions. Ministers may find that they have more decisions to take – as those previously made for them in Brussels are returned to London – and have more regulatory options at their disposal.

But even if the UK government stands still, divergence – and its consequences – is inevitable as EU rules are amended or updated without the UK following suit.

The aim of this report is to explain the trade-offs involved in such divergence and how the government should manage the process. As the UK government has expressed most appetite to depart from EU rules, this report focuses on the issues confronting policy makers in London. (The devolved administrations are also grappling with similar

issues – with some powers over devolved matters returning to Belfast, Cardiff and Edinburgh. However, the Scottish and Welsh governments have indicated that they may seek to align with EU rules – at least in some areas[5], and Northern Ireland's room to diverge is limited by the protocol).

Chapter 2 outlines what regulation the UK has inherited from the EU and how divergence might emerge. Chapter 3 explains why the UK government might want to depart from EU rules; Chapter 4 explores why UK policy makers may decide not to. Chapter 5 sets out what the government needs to do to manage divergence and ensure co-ordination across the whole of government.

2. Sources of divergence

As a member state, much UK regulation was set at the EU level. New regulations were proposed by the European Commission and then gradually amended during the EU's legislative process to reach the required majority. While the UK was an influential member in EU debates, the end result would usually reflect a compromise between a range of voices, rather than the preferences of any individual government. And once in place, EU regulation can be difficult to change – even when problems emerge. It was 10 years after issues were identified with the Clinical Trials Directive that the replacement Clinical Trials Regulation was approved, for example. Seven years later, it still hasn't been fully implemented.[1]

EU rules cover a wide range of policy areas, including competition, agriculture and financial services. The result of Brexit is that UK policy makers now have autonomy to regulate differently from the EU in these areas.

As a starting point, the UK government decided to keep most EU rules in place. Theresa May's flagship Brexit legislation, the European Union (Withdrawal) Act 2018, was designed to ensure a "calm and orderly exit" and to avoid a potential regulatory "black hole" in areas governed by EU law.[2] The act effectively copied and pasted EU law as it was on 31 December 2020 into the UK statute book. Alongside EU-derived domestic legislation (such as that which gave effect to EU directives) and case law, this is now known as 'retained EU law'. Using powers in the act, ministers can amend this new category of law to ensure that it works in the UK context. But these powers cannot be used to make substantive policy changes.

While the 2018 Act was designed to provide legal certainty at the end of the transition period, it is inevitable that differences will emerge between UK and EU regulatory regimes, as the two sides amend existing regulation and introduce new regulations in response to social, economic and technological change. Viewed from the UK government's perspective, divergence will follow two (at times overlapping) patterns: active divergence, where the UK government chooses to regulate differently; and passive divergence, where the EU rules change without the UK automatically following suit. There is also scope for divergence when both jurisdictions confront a new issue and decide to take different regulatory approaches.

Active divergence

The UK government has already set out plans actively to depart from EU regulation and has passed several bills designed to provide a legislative framework for new policies covering key areas like agriculture, fisheries and financial services.[3] These bills contain powers for ministers to change retained EU law to implement new policies.

Despite political assertions during the 2016 referendum campaign[4] about tearing up EU rules, most of the changes the government envisages would not involve removing these completely, but rather changing them so that they better suit the UK context. In some areas, this could be by introducing stronger regulation. As Lord Frost, the UK's former chief Brexit negotiator and now minister of state, has argued:

> **"It is perfectly possible to have high standards, and indeed similar or better standards to those prevailing in the EU, without our laws and regulations necessarily doing exactly the same thing."**[5]

Some reforms would alter the outcome that regulation achieves. But others could involve revisiting how regulatory regimes are implemented and enforced rather than aiming for different outcomes. This could include efforts to lessen burdens on organisations and individuals who have to comply with regulation.*

Passive divergence

Passive divergence could arise in several ways. Most simply, this could occur when the EU regulates in ways that the UK does not replicate – which is likely given the UK no longer has a direct say over the design of new rules.

Passive divergence could also happen inadvertently if the government does not act in time to replicate EU regulatory changes. The Withdrawal Act repealed the European Communities Act 1972, which was the main route through which EU legislation was put on the UK statute book. This means that the 'snapshot' of retained EU law taken at the end of the transition period can be changed or updated only through fresh primary legislation or where specific powers have been granted to ministers. If the government decides to follow some EU changes, it will need to legislate in a timely way to do so.

Even if UK and EU regulations remain identical, they now exist in separate legal systems. That means that UK and EU courts may develop different interpretations of the same texts, and regulators on both sides may apply them differently. UK courts are permitted to 'have regard' to the post-Brexit case law of the European courts, but they are no longer obliged to follow its decisions if they do not agree with their reasoning.[6]

While the distinction between active and passive divergence can help make sense of proposals to depart from EU rules, it is not always clear cut. For example, since the end of the transition period, the EU has legislated (or is in the process of legislating) to restrict 12 hazardous chemicals, only two of which the Department for Environment, Food and Rural Affairs (Defra) has announced will be restricted under the UK's new chemicals regulatory regime[7] – a mix of passive and active divergence.

* For instance, some provisions to ease border formalities – such as allowing greater use of periodic customs declarations – exist in EU law, but have not been implemented due to challenges in implementation across member states. Outside the EU, the UK could move faster towards this aim. 'The UK Border in 2025: ambition, infrastructure and data', Global Counsel roundtable, March 2021.

3. The regulatory opportunity after Brexit

A standard critique of EU regulation is that it results in a 'one size fits all' approach that doesn't sufficiently acknowledge the economic, political and societal differences between member states. Not all inherited EU regulation will suit UK needs. Below, we set out the economic and political reasons why the government may seek to change regulation in the UK, some of which are reflected in the Plan for Growth, published in March, which sets out the government's proposals to support economic growth in the aftermath of the pandemic.[1]

1. To achieve different policy outcomes

A key reason to diverge from EU rules is to ensure policy preferences on contentious issues are better aligned with UK values. For instance, in December 2020 the UK government unveiled plans to ban live animal exports for slaughter due to animal welfare concerns. When announcing the review, Defra said:

> **"Live animals commonly have to endure excessively long journeys during exports, causing distress and injury. Previously, EU rules prevented any changes to these journeys, but leaving the EU has enabled the UK Government to pursue these plans which would prevent unnecessary suffering of animals."**[2]

The UK government has also proposed changes to EU rules on genetically edited organisms.[3] These would mean that the use of genetically edited organisms that could be produced naturally are not restricted in the way they are under inherited EU rules. The government argues that this represents a regulatory approach that "follows the science" and that safety is dependent on the characteristics and use of a product rather than how it is produced. This contrasts with the EU approach to genetic modification, which is generally much more restrictive.

Much of the debate about leaving the EU focused on the potential for the government to weaken regulation. But the opposite is also true, and it may wish to have higher standards or stronger regulation than the EU in areas where this was not permitted as a member state.* One of the first substantive changes the UK government made to retained EU law after the end of the transition period was to do just this – marginally strengthening inherited EU standards on short selling (selling stock in the hope that it falls in price and can be bought back at a discount) in financial services.[4] The governor of the Bank of England (BoE), Andrew Bailey, has also suggested that the UK could take a more restrictive view of what can count towards the capital that banks must hold to withstand economic shocks, such as discounting 'software assets', which the EU includes but the BoE believes are insufficient to meet the aim of the policy.[5]

* In some areas, like employment rights, EU rules tend to set a minimum standard, meaning that it was possible to adopt a higher standard, as the UK often did – for instance, on maternity leave. HM Government, *Rights and Obligation of European Union Membership,* The Stationery Office, 2016, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/516500/Rights_and_obligations_of_European_Union_membership_print_version.pdf

Another area where the UK may pursue higher regulatory standards than the EU is in environmental protection. In September 2017, the then environment secretary, Michael Gove, hinted at the possibility of a stronger approach to environmental protection after Brexit, arguing that the influence of the German car industry had led to "producer capture" of EU regulators and resulted in a lax approach to the enforcement of diesel emissions: "The EU's laboratory-based mechanisms for testing emissions have proven inadequate, and they have allowed manufacturers to game – or directly cheat – the system. Outside the European Union, we can do much better."

The 2019 Conservative manifesto referenced the possibility of raising environmental standards above EU levels.[6] Recent Institute for Government analysis suggests the government is making progress towards many of its environmental manifesto commitments, although it is not on track to achieve its net zero ambitions.[7]

2. To reflect the UK's specific circumstances or regulatory philosophy

Regulatory reform could be pursued to better reflect the structure of the UK economy and geography. This can be seen in the financial services sector – which makes up far more of the UK's economy than those of most EU member states.[8] For example, Bailey again has suggested that inherited EU rules on insurance could be changed due to the UK's "quite distinct markets and products" that mean some elements of EU regulation "have not proved to work for [UK] markets as well as hoped".[9] Similarly, the UK government's decision not to apply the EU Falsified Medicines Directive in Great Britain from the end of the transition period partly reflects the fact that the directive is aimed at combatting counterfeit medicines, which are not a huge issue in Great Britain (whose lack of a land border with other countries makes this issue more easily tackled using alternative means).[10]

In some areas, the need to depart from inherited EU regulatory regimes is a priority, because stopgap regimes introduced as an immediate response to Brexit are poorly suited to the UK's needs. As part of the EU (Withdrawal) Act 2018 process outlined above, the UK government kept most EU financial services legislation and amended it to ensure it worked in the UK context. But in the Treasury's words, "while the onshoring approach is right for the immediate period after EU exit, it was not designed to provide the optimal, long-term approach for UK regulation of financial services". In response, it launched a consultation in November 2020 on the future regulatory framework in financial services.[11]

Allied to this is the possibility to pursue a different regulatory philosophy from that of the EU. A common argument among proponents of Brexit is that the EU's approach to regulation is too rules-based and prescriptive, and that there would be benefits to returning to a more 'common law' approach that places greater emphasis on the freedom to act unless an activity is expressly constrained.[12] Outside the EU, it is possible that the UK may also adopt a less risk-averse approach than EU regulators, and be more willing to look at potential upsides as well as downsides, especially when assessing innovative technologies.

However, Lord Frost told the European Scrutiny Committee in May that many EU approaches to regulation have been "internalised" during the UK's membership of the EU,[13] potentially limiting the scope to return to the kind of regulatory approach the UK had before it joined the bloc. In any case, the idea of radically changing regulatory philosophies should not be overstated, especially as there are not always bright line distinctions between different regulatory approaches.

3. To reduce burdens on businesses

A common critique of EU regulation among advocates of Brexit was that it often imposed the same requirements on small and medium-sized enterprises (SMEs) as on big companies – irrespective of varying degrees of risk and compliance. In a survey of its members in 2017, the Federation of Small Businesses found that two thirds of small businesses believed the burden of regulation outweighed the benefits and that it cost them proportionally more to comply with regulation than larger firms.[14] In its Plan for Growth, the government cited "easing the regulatory compliance burden on business" as a key aim.[15]

Oliver Dowden, the culture secretary, has also suggested that the UK government could review inherited EU data protection rules, arguing:

> **"In our rule making, we can take a slightly less European approach as set out in GDPR by focusing more on the outcomes that we want to have and less on the burdens of the rules imposed on individual businesses."**[16]

The Confederation of British Industry has suggested that rules around 'cookies' could be revised to reduce compliance costs.[17] Previous 'red tape challenges' – designed to identify regulation that is ripe for reform – excluded EU rules. Outside the EU, these can be reviewed.

Of course, outside the EU the government may also decide to introduce new regulations that increase burdens on business to incentivise or disincentivise certain activities – for instance, to help deliver the government's net zero ambitions.

4. To promote innovation and increase the UK's competitive advantage

The government has repeatedly said that one of the areas where it hopes to make use of its new regulatory autonomy is in areas of new technology. The Plan for Growth includes an aim to "Develop the regulatory system in a way that supports innovation", citing that "Currently only 29% of businesses believe that the government's approach to regulation supports them in bringing new products and services to market".[18] In early 2020 it also launched a new Regulatory Horizons Council in the Department for Business, Energy and Industrial Strategy to advise the government on regulating emerging technologies. There have also been calls to require regulators to take into account the UK's competitiveness when developing new regulation.[19]

A big theme of the chancellor's new approach to financial services is to encourage the growth of the UK as a fintech hub. The Kalifa review, published in the same month as the Plan for Growth, set out the potential prize and ambition:

> **"Fintech is not a niche within financial services... It is a permanent, technological revolution, that is changing the way we do finance... But most importantly, it's about delivering better financial outcomes for customers, especially consumers and SMEs. We want to deliver these outcomes across the UK and export them to the world."**[20]

Fintech is an area where the UK has been successful in recent years and could leverage the benefits of regulatory autonomy, in part by building on existing regulatory innovations such as the use of 'sandboxes' to allow firms to test new products in controlled regulatory environments.[21]

Another strategy to promote innovation that the government appears keen to adopt is to secure a 'first mover' advantage by regulating in emerging sectors before the EU. This could make the UK a preferred destination for innovators and could potentially allow the UK to set the blueprint for regulation in emerging sectors more widely; a 'London effect' to compete with the 'Brussels effect' seen in much existing regulation.[22]

Speaking about the life sciences sector in January, the environment secretary, George Eustice, indicated the government's ambition: "No longer do we have to hold on to the coat-tails of the EU – our scientists make us global leaders."[23] The UK government has also singled out autonomous vehicles as an area where the UK may also be able to benefit from regulating first[24], and given its ambitious net zero targets, there is also scope for the UK to play a leading role in shaping regulatory approaches to promote climate policies.

However, there may be limits to what the UK can achieve in regulating innovative technology. The world is generally regarded as being carved up into three regulatory spheres of interest – dominated by the US, EU and China respectively – and it is not clear how sustainable any innovative UK regulatory regime would be once one of the regulatory powerhouses acts in the same space. It may, however, be possible for the UK to strike a middle ground by forming alliances with other regulators to develop new approaches in multiple markets, or to pioneer new approaches to regulation that make compliance easier or reduce burdens in a way that influences the regulatory approach in the EU (or the US and China).

The Civil Aviation Authority has established an 'innovation hub' and the UK's 'first regulatory think tank', Aviation Futures, to consider pioneering regulation in areas of emerging technology – like drones and flying taxis – and is working with regulators in other countries.[25] Doing this effectively will require partnerships between government departments who hold ministerial policy objectives and arm's length bodies who have the expertise. Departments may need to invest in deepening their own specialist knowledge to do this well.

5. To respond to domestic pressure created by new FTAs

The UK government is seeking to negotiate new trade deals with countries such as the US, Australia and New Zealand. As the Institute outlined in *Trade and Regulation after Brexit*, free trade agreements (FTAs) tend to do little to limit the regulatory outcomes that countries pursue domestically (although they often cover how countries go about implementing this regulation such as by promoting good regulatory practices). However 'side bargains', agreed on the margins of FTA negotiations, could limit the UK's ability to restrict imports from countries with different regulatory standards.

In addition to formal agreements, FTAs often create mechanisms to encourage a dialogue about regulatory approaches, potentially with the aim of harmonising regulations over time. Such dialogues could create pressure to change UK regulation.

Agricultural standards are a likely flashpoint. If new trade deals mean British farmers could have to compete with imported goods produced to a lower standard, UK policy makers will come under political pressure to change domestic standards to level the playing field for British producers. The Trade and Agriculture Commission – established as a concession during the passage of the Trade Bill – has already acknowledged that achieving the balance between an open liberalised trade policy while trying to safeguard standards is a "tough nut to crack" and that "not all [agri-food businesses] will be winners"[26], with some UK producers unlikely to be able to compete with foreign competitors.[27]

A mix of reasons will drive post-Brexit regulatory change

The factors above have been presented as discrete reasons to diverge, but in practice they are not so easily compartmentalised and any decision to do things differently will be driven by a mix of considerations.

Taken together, the reasons above suggest there could be a 'Brexit dividend' from exercising the UK's new regulatory autonomy, which UK ministers have already been keen to demonstrate. So far, this has generally involved making small but politically salient regulatory changes such as banning pulse fishing in the UK's exclusive economic zone[28] and removing VAT on women's sanitary products.[29] The government will also be looking to the Sir Iain Duncan Smith-led Taskforce on Innovation, Growth and Regulatory Reform (TIGRR) – which has produced a report, but details of which have not yet been published – to yield further evidence of a Brexit dividend. George Freeman, one of the other two senior Conservative backbenchers also on the taskforce, said an aim of the review is to "recommend 'quick wins'".[30]

But when the government exercises its new regulatory freedom, it should ensure that it has independent reasons for doing things differently, beyond simply wanting to demonstrate that it can. Divergence for its own sake is unlikely to help the government achieve its wider policy ambitions.

The government will have an eye on how it can use its new regulatory autonomy to further its wider political ambitions, including its 'levelling up' agenda. The prime minister also appears happy to claim a 'Brexit dividend' for policies that have little or nothing to do with the constraints of EU rules – including the government's PR-friendly but ultimately unrealised threat against the establishment of the proposed European Super League.[31] Similarly, the government has announced at least eight freeports "to make the most of our Brexit freedoms",[32] and introduce new tax and regulatory flexibilities, even though freeports themselves are permitted under EU law (subject to constraints) and were used by the UK for more than two decades to 2012.[33]

Attempting to secure economic benefits from regulatory change could partly offset some of the potentially negative economic consequences of a more distant relationship with the EU. For instance, the introduction of duplicate regulatory regimes for medicines has created new costs for pharmaceutical firms serving both the Great Britain and EU markets, which may make Great Britain a less attractive place to do business.[34] But outside the EU, UK policy makers could look to regulatory reforms that streamline medicines approvals and promote Great Britain as a place to trial innovative treatments.[35]

4. Consequences of divergence

> **"The treaty banishes the old concepts of uniformity and harmonisation, in favour of the right to make our own regulatory choices and deal with the consequences."**
> – Boris Johnson, 30 December 2020[1]

There are many reasons why UK policy makers may want to depart from EU rules. But it is important to recognise that divergence may have legal, economic and political consequences. Most will not prevent UK policy makers from taking such action, but they will impose costs that will need to be considered. But a few may impose real constraints on divergence. This section outlines the various factors the UK government must consider when making decisions about divergence.

Divergence could reduce the UK's access to EU markets

Divergence could trigger disputes under the TCA

The Trade and Cooperation Agreement (TCA) largely achieved the UK government's main negotiating priorities: securing tariff- and quota-free access to the EU market with the right to diverge on EU regulation. But while the agreement allows the UK to depart from EU rules, it does not protect it from potential economic and political consequences for doing so – including the imposition of tariffs – that could outweigh the benefits. The limits of the TCA are therefore of a different nature from, and less restrictive than, those imposed by EU law when the UK was a member state, when it had no choice but to follow EU law and could be taken to the European courts for non-compliance.

Tariffs could be imposed as a result of the 'level playing field' (LPF) commitments agreed between the UK and EU, which cover many areas of regulation, including labour and social standards, and environmental and climate standards. These provisions are designed to ensure fair competition between UK and EU businesses and were controversial during negotiations due to fears the UK would try to undercut the EU by weakening standards.[2]

There are two strands to these provisions. First, as is common in free trade agreements, both sides have agreed not to reduce regulatory standards from the levels that existed when the agreement entered force – known as non-regression obligations. But unlike similar trade agreements, like that between the EU and Canada, there are consequences for breaching the non-regression obligations in the TCA.[3] If either side contravenes them, the other is entitled to take retaliatory measures (subject to arbitration), such as imposing tariffs. Second, the TCA also includes a novel 'rebalancing mechanism', which allows either side to take swift counter measures (subject to arbitration), such as imposing tariffs, if "significant divergence" occurs in future, resulting in "a material impact on trade or investment between the parties".

Speaking at an Institute for Government event in March, barrister Anneli Howard QC explained that the two forms of LPF commitments have different aims. The non-regression provisions are designed to deal with isolated incidents where either side departs from the baseline standards set at the end of the transition period, whereas the 'rebalancing' mechanism is aimed at responding to the possibility of systematic policy divergence in future.[4]

The rebalancing provisions could be triggered even if the UK does not pursue a policy of active divergence from EU rules. This could happen if the EU chooses to strengthen its regulation in labour standards, and the UK doesn't take comparable measures. New EU directives on work-life balance, and transparent and predictable working conditions, are due to take effect in 2022, for example. If the UK does not adopt similar measures, the rebalancing mechanisms could be triggered.[5]

The strength of the LPF provisions, and the extent to which they could limit UK policy makers' room to diverge, is as yet untested. The provisions cannot be triggered simply because the UK diverges from EU rules: there needs to be a clear effect on UK–EU trade.* How high these thresholds are in practice is subject to debate[6], and will become apparent only as disputes arise and the terms of the agreement are interpreted by arbitration panels. However, there was consensus among the legal panellists at the Institute for Government event in March that there is likely to be a high legal and political bar to triggering the mechanism, as doing so could signify a breakdown in the wider UK–EU relationship.[7]

Much rests on how the UK and EU manage disputes under the agreement and whether the EU launches formal proceedings at the first sign of the UK departing from EU rules.[8] The EU's ambassador to the UK, also speaking at the Institute for Government, in April, said that the EU is actively monitoring new UK regulation to look for divergence from EU rules that could trigger the LPF commitments.[9]

Beyond the LPF commitments, other parts of the TCA could limit the government's room for manoeuvre. The technical annex on medical products encourages the UK and EU to minimise regulatory divergence and follow agreed international standards, with both sides required to complete an impact assessment and notify the other party of changes to technical regulations.[10] TCA provisions on digital trade may also promote convergence on the outcomes of digital regulation (such as ensuring consumers get redress when their rights are breached), although provide discretion for the UK and EU to achieve them in different ways.[11]

* The precise tests vary between different aspects of the level playing field. The rebalancing mechanism under Article 9.4 of the Chapter on the Level Playing Field requires a "material impact on trade or investment between the parties" to arise "as a result of significant divergence between the parties", whereas Articles 6.2 and 7.2 of the same chapter on non-regression from Social and Employment and Climate and Environmental standards respectively require protections to be weakened or reduced "in a manner affecting trade or investment" between the parties. European Commission, *Trade and Cooperation Agreement Between the European Union and the European Atomic Energy Community, of the one part, and the United Kingdom of Great Britain and Northern Ireland, of the other part*, Official Journal of the European Union, 2020.

Not all areas of potential regulatory divergence are covered by the TCA. For instance, it does little to limit the UK government's room for manoeuvre in financial services – an area where divergence is already on the cards.

Divergence could lead the EU to withdraw measures that help firms trading across borders

In some areas, the EU makes certain cross-border activity dependent on it deeming third country regulatory regimes 'equivalent' to its own – which means they meet comparable standards.

This is a key issue for the transfer of personal data from the EU to the UK. The TCA allows data transfers to continue until July. But, unless the EU deems the UK's data adequacy regime 'adequate' by then, businesses and public bodies will have to resort to costly and legally uncertain workarounds. The European Commission has recommended that adequacy should be granted, but these proposals have not yet been finalised by member states and were criticised by MEPs in May,[12] and even if granted, could be subsequently withdrawn by the commission or challenged in the European courts. The European Court of Justice (ECJ) has previously struck down EU data sharing arrangements with the US, for example.[13] The part of the TCA covering law and justice co-operation can also be terminated if there is a serious and systematic deficiency in the safeguarding of personal data.[14]

Such considerations could limit the government's ambitions to diverge radically from EU data protection rules. The UK's apparent intention to pursue a more liberal approach to data transfers in trade deals with other countries could raise alarm bells with the EU,[15] as could suggestions that the UK may depart from EU GDPR data protection rules.[16] As the Institute has argued, long-standing EU concerns about how the UK security services use personal data will also continue to be problematic.[17]

The EU has cited the risk that the UK may diverge from EU financial services rules as a reason why it has still not granted equivalence decisions that would allow UK firms limited access to EU financial markets. The EU was due to make these assessments before the end of the transition period, but (outside two areas) has yet to do so. Many now doubt that it will[18] – with the value of any equivalence decisions likely to diminish the later they are made – given firms will have already adjusted their operations.[19] While the EU paints these decisions as technocratic, in reality they are often political in nature, and can be withdrawn with just 30 days' notice.[20]

The governor of the Bank of England has been critical of the EU's delay, arguing in February that equivalence should not require alignment with EU rules – which would amount to 'rule taking' and be unacceptable to the UK[21] – and that the EU already has equivalence arrangements with countries that regulate differently than the EU.

The UK's other international obligations could limit room to diverge

> **"The rules-based international system is the best friend for any person or country with unfulfilled potential. It is the duty of all of us to defend it. It is what I will work for. It is what the UK will work for."** – Mark Field, the then minister of state for Asia and the Pacific, 17 August 2018[22]

Some EU rules gave effect to international obligations that the UK remains bound by outside the EU, such as many of the UK's obligations under World Trade Organization (WTO) agreements – like the prohibition on total import bans (subject to specific exceptions) and rules on procurement.[23] As the Institute has previously argued, this means the government may find it difficult to diverge from EU rules.[24] For example, any attempt to ban the import of foie gras on animal welfare grounds could still be subject to challenge at the WTO.

But this argument cuts both ways. Some regulations that the UK has inherited from the EU, such as the ban on hormone-treated beef, have already been found not to comply with WTO rules. While the WTO dispute settlement system is not currently functioning – meaning the UK is unlikely to face formal challenge imminently – the government may still come under pressure from the UK's international trading partners to diverge from inherited EU rules to comply with its WTO obligations.

But even if the UK is still bound by international obligations, there may still be scope for the government to change how it implements its commitments outside the EU. For example, the Basel regime (a voluntary international framework introduced after the 2008 financial crisis to make banks more resilient to financial shocks) has always applied to internationally active banks. However, the EU decided to apply these rules more broadly to all banks – including small domestic banks not within the scope of the Basel regime. Speaking in February, the governor of the Bank of England, Andrew Bailey, suggested that the UK could introduce a new, simpler regulatory regime for small banks, as in the US and Switzerland, while continuing to comply with global standards.[25]

Divergence could damage business competitiveness

> **"The ability to define rules and regulations under which we are operating does provide some opportunities, but equally there is a risk side to that. If we have that regulatory divergence from what Europe are doing, that adds cost and complexity to our production."** – Ian Howells, senior vice president, Honda Motor Europe, 23 February 2021[26]

Divergence may increase costs for business

Even if divergence doesn't result in market access being reduced, it could add to the costs of doing business, particularly with the EU. The UK's exit from the single market and customs union at the end of the transition period means that UK firms have already experienced significant change in how they are regulated and the rules they have to comply with when trading with the EU. These changes have often imposed substantial additional new costs – which may prove unsustainable for some firms and require others to adapt their business models.[27]

Future regulatory divergence could make these problems worse, although views vary between sectors and firms. Businesses that export to the EU – particularly in highly regulated sectors like advanced manufacturing and agri-food – are less likely to want divergence, for fear that it could further deepen the barriers to trade between Great Britain and the EU. In contrast, those whose main market is Great Britain– or markets beyond the EU – are often less concerned.

The OECD has identified three 'costs' of regulatory divergence[28], all of which could affect firms trading between Great Britain and the EU:

- Information costs if a business needs to research different requirements in another jurisdiction before deciding whether to locate or sell there
- Specification costs when business may need to make changes to comply with different regulations, including differences in production, packaging, or labelling
- Conformity assessment costs to prove that the specification costs have been met; for example, additional laboratory testing to show that a product meets standards.

In evidence to the Commons Exiting the EU Committee, the Chemical Industries Association said that even if the UK did not formally agree to align with EU standards, most companies in the sector would manufacture to EU standards anyway as they do not "have the luxury" to operate differing manufacturing regimes and EU rules set the "global bar" which businesses will have to abide by.[29] The same considerations apply to data regulation – as the EU's General Data Protection Regulation (GDPR) is often seen as the global standard for data protection law.[30]

Even if firms do not like existing regulatory requirements, many would prefer to have to comply with only a single set of rules. This is particularly true when incumbent firms have already invested heavily in complying with existing regulatory requirements.

While many UK financial services businesses opposed the introduction of the EU's MiFID II rules – which regulate financial markets in the bloc[31] - they have since spent significant sums to comply with the requirements[32] (although there have also been calls for reform post-Brexit).[33] Similarly Adam Marshall, the former director general of the British Chambers of Commerce, said on an Institute for Government podcast in April that businesses don't want to revisit what's "already on the books that they've already adjusted to", but instead focus on regulating sectors of the future.[34]

Businesses generally want to avoid incompatible regulatory standards

Some forms of divergence – such as different labelling requirements – add additional costs. Of more concern is divergence that results in incompatible regulatory standards. For example, major deviation from EU product standards, chemicals or genetic modification regulations could make it impossible for manufacturers to continue producing one product that can be sold on both the British and European markets.[35] As Fergus McReynolds, of industry group Make UK, told the Lords EU Goods Sub-Committee in January: "We want to avoid a separate market in the UK that has a completely different set of requirements, and a completely separate set of rules to comply with, to service the EU market."[36] And it's not just British firms that are affected. US firms have also expressed concern over the potential for different regulatory requirements in the UK and EU.[37]

The greater costs and complexity in international trade that could be associated with regulatory divergence could act as a disincentive for firms that currently operate only domestically to begin trading with the EU, and so undermine the government's aim to encourage more firms to export.[38]

If the costs of complying with different regulatory regimes prove too high, some firms may choose to leave one market altogether. Given that, in most sectors, the British market is typically smaller than the EU's, it is likely that EU firms may choose to leave the UK (or GB) market, potentially meaning less choice for consumers. The chemicals industry has already raised concerns that the additional costs of complying with duplicate regulatory regimes in the UK and the EU could result in reduced choice for UK consumers, or "to put it bluntly, chemicals that are available now across the EU and the UK will remain on the EU market but will disappear from the UK market".[39]

One way for UK policy makers to address these concerns is to unilaterally accept EU approvals or standards – thereby reducing duplication in regulatory requirements. As a temporary measure, the UK government has already done this in some areas.* As these transition periods come to an end, it is likely that the government will come under pressure to continue recognising some EU standards indefinitely.[40] If it does so, it is possible that the government could still introduce new rules that apply to businesses that operate only domestically.

* For instance, the EU's CE products standards mark will be recognised in Great Britain until the end of 2021 (and until June 2023 for medical devices), as will EU approvals on medicines until the end of 2022. Medicines and Healthcare Products Regulatory Agency, 'Regulating medical devices in the UK', Brexit: Guidance, 31 December, 2020, retrieved 20 April 2021, www.gov.uk/guidance/regulating-medical-devices-in-the-uk

Many businesses that sell both into the UK and the EU made clear during the future relationship negotiations that they would favour a deal committing both sides to maintaining regulatory alignment, allowing trade to continue with a minimum of friction – not only being able to supply the same good in both markets, but also avoiding the costs of duplicate regulatory processes.[41]

However, now that the UK has agreed a relationship that appears inevitably to entail friction, business incentives may change and the same businesses who argued for alignment may now look to the UK to lower the regulatory burden they face at home in order to partially offset the additional costs they now incur supplying the EU.

Businesses and government currently have little bandwidth to deal with more regulatory change

> **"[The government's "Check, Change, Go" campaign] made it seem like firms just had to undergo a quick MOT – whereas the reality is that for many, the complexity of the changes required [by Brexit] were more akin to planning a moon landing."** – Adam Marshall, then director general, British Chambers of Commerce, 18 February 2021[42]

Businesses and regulators are still adjusting to the end of the transition period

Several industry groups that we spoke to – representing firms that trade with the EU – made clear that now is not the time to be contemplating further large-scale changes in regulatory regimes.[43] Many firms are still grappling with the consequences of the end of the transition period and ongoing economic effects of the pandemic, and so lack the bandwidth to engage in government consultations and discussions about reform, or the financial resources that may be needed to implement new regimes.

Many UK regulators are also still adjusting to life outside the EU. Several – including the Medicines and Healthcare Products Regulatory Agency (MHRA), Civil Aviation Authority (CAA) and Health and Safety Executive (HSE) – have taken on new roles and responsibilities.[44] This has usually involved taking on new staff, or retraining existing employees, to take on new functions.

While regulators appear confident that they have the capacity to fulfil their new roles, most are still in a period of adjustment. As mentioned, the UK is continuing to temporarily accept some EU approvals, including on product standards[45] and medicines.[46] This has deferred the full weight of new regulatory burdens falling on UK regulators. When those periods end (in many cases in 2022), there is a risk that some regulators may adopt lighter touch regimes than their EU predecessors, a decision driven as much by resourcing as by pure policy merits.

Some regulators have acknowledged that their 'day one' capabilities will continue to improve over time. For instance, the CAA has acknowledged that it will take time to build capability in new areas of responsibility – such as design approvals, while – as of late April – the Health and Safety Executive was recruiting 60 people to work on chemicals regulation.[47] It is unclear whether UK regulators currently have the capacity

or bandwidth to deliver significant divergence from inherited EU regimes – even if this could ultimately reduce a regulator's workload – at least without additional resources in the short term.[48]

The UK government still needs to increase its policy making capacity

As the UK considers how to make use of its regulatory autonomy, it needs to increase its policy making capacity. Government departments that have historically focused on negotiating EU rules and then transposing the end-product into UK law, now have to develop and own whole regulatory regimes. To do this successfully, departments need officials with both a deep understanding of how inherited EU regimes work (and the problems with them that might suggest that reform is needed), as well as the policy skills to think creatively about how to do things differently. But it is not clear that this expertise is available.* Much of the detailed knowledge of how EU regulations worked in practice resided not in core departments but in arm's length bodies – which are generally not responsible for policy development.

Departments have taken steps to build policy capacity during the Brexit negotiations, but they now need to ensure they build long-term expertise in the areas they must now lead on. It will also take time for departmental mindsets to change – as those that have been used to working closely with the EU adjust to the new policy landscape and their ability to act independently.

Existing regulatory frameworks may fail to provide the right expertise in the right places. Often, regulators possess deep expertise, but are not well placed to think about the wider, cross-government implications of policy decisions. Conversely, some government departments lack expert knowledge of a subject but are better able to see cross-cutting issues. The allocation of responsibilities between departments and regulators is being reviewed in financial services through the Future Regulatory Framework Review.[49]

On the other hand, a lack of capacity within the UK government and regulators appears to be driving divergence in some areas – even when there is no policy imperative to depart from EU rules. As previously mentioned, since the end of the transition period, the EU has restricted, or is in the process of restricting, 12 harmful chemicals. Only two of these are due to be restricted in the UK, a decision the CHEM Trust argues is partly driven by a lack of capacity, rather than a clear policy position to act differently.[50]

* For example, it has been argued that the UK has lacked sufficient capacity to develop a long-term vision for fisheries policy, in part due to a lack of long-term investment in staffing in Defra, which only started to increase after the EU referendum. Amodu T, Barnard C, Bailey D and others, *UK Regulation after Brexit*, UK in a Changing Europe, February 2021, https://ukandeu.ac.uk/wp-content/uploads/2021/02/UK-regulation-after-Brexit.pdf

Public and political appetite for divergence is limited

> **"I don't get any sense from the business community that there is a drive to have a race to be Singapore-on-Thames."** – Rain Newton-Smith, chief economist, Confederation of British Industry, 18 January 2021[51]

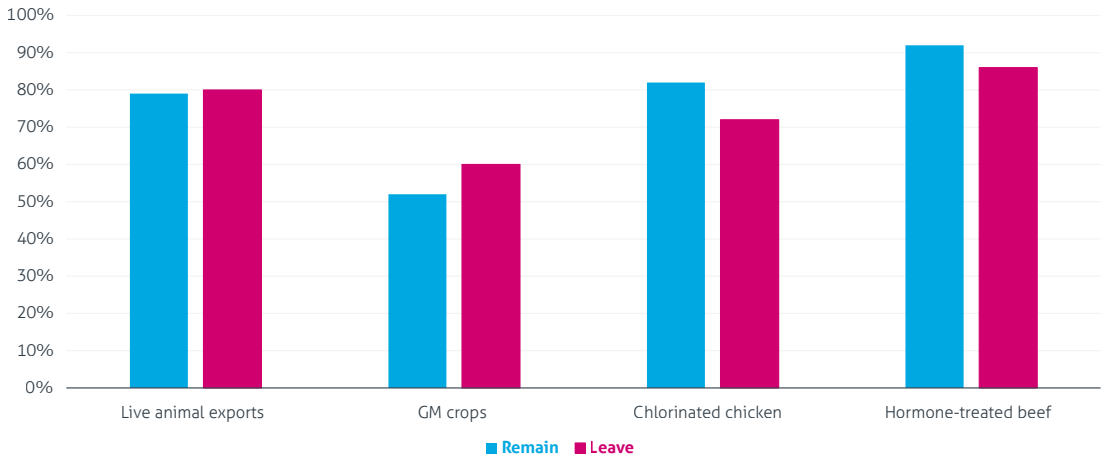
Even if the economic and legal considerations suggest that the benefits of divergence outweigh the potential costs, there may be little political incentive to pursue them. While much of the rhetoric during the Brexit referendum campaign centred on reducing 'red tape', public opinion research indicates a more nuanced, and at times contradictory, desire for regulatory divergence.

The ability to do things differently from the EU clearly motivated many Leave voters in the 2016 referendum. A YouGov exit poll found the most common reason provided for voting Leave was to "strike a better balance between Britain's right to act independently, and the appropriate level of co-operation with other countries". The second most common reason was "to help us deal better with the issue of immigration". Another poll conducted by Lord Ashcroft found similar results.[52]

This is, however, not indicative of the public's views on regulatory divergence specifically. In 2020 the National Centre for Social Research, as shown in Figure 1 below, found that 88% of respondents believed the UK should not allow hormone-treated beef to be imported and 75% were similarly opposed to chlorinated chicken.[53] Follow-up research involving respondents participating in longer discussions on these issues also confirmed broad opposition to a variety of deregulatory proposals.[54] In another YouGov poll, conducted on behalf of the pro-EU campaign group Best for Britain, 28% of respondents wanted to keep environmental regulations the same as the EU, while 57% wanted to make them stricter.[55] The same poll also found three quarters of respondents wanted labour market standards kept the same or improved, with only 11% wanting standards relaxed.

This suggests that the public tend to support high regulatory standards. As EU standards are often seen as the global 'gold standard', this may suggest there is little political incentive to depart from inherited EU rules in publicly salient areas like workers' rights, environment and food standards – at least not to lower protections. However, there are exceptions. As mentioned above, outside the EU, the UK can ban the export of live animals for slaughter – something supported by public opinion (see Figure 1).

Figure 1 **Attitudes towards food regulation, by 2016 EU referendum vote (% answering probably or definitely should not allow)**



Source: Institute for Government analysis of Table 11, Post-Brexit public policy, British Social Attitudes 37, www.bsa.natcen.ac.uk/media/39375/bsa37_post-brexit-public-policy.pdf

The impact of public opinion on the government's ability to pursue regulatory divergence has already been seen. In February the government quickly distanced itself from reports that it was considering reforms to the EU Working Time Directive, after widespread opposition to the suggestions were voiced. Responding to concerns his department was planning to reduce UK workers' rights, the business secretary, Kwasi Kwarteng, said: "We want to protect and enhance workers' rights going forward, not row back on them."[56] Sir Iain Duncan Smith, charged by the prime minister with suggesting post-Brexit regulatory changes, has also said that his review is not a "slash-and-burn exercise", but rather a look at where the government could be "nimbler".[57]

Even if the government did decide that it wanted to diverge significantly from EU regulation, it cannot take for granted that it will have the parliamentary majority to secure it. Public scepticism about changing agricultural standards is echoed across parliament. Ministers have already been forced to put the Trade and Agriculture Commission – which was initially due to be a temporary body advising on the implications of trade deals for the sector – on to a permanent statutory footing.[58] As Nick von Westenholz, director of trade and business at the National Farmers' Union, has argued: "The government might have thought three years ago that they could do large-scale trade liberalisation quickly in agriculture, but they are now much more aware of producer sensitivities and public opinion."[59]

Divergence from the EU could cause conflict with the devolved administrations

> **"Our overall vision is that we believe that devolution provides the best of both worlds and that, in all those parts of the United Kingdom in which there are devolved administrations, both Governments should work together for the good of our citizens."** – Michael Gove, chancellor of the Duchy of Lancaster, 10 September 2020[60]

Divergence from EU rules may arise as a result of changes made by different levels of government in the UK. In reserved areas, such as financial services, divergence from the EU will arise from actions taken by the UK government. In other areas, including much environment and public health regulation, the power to change regulation is devolved.[61] In these areas, the UK government is responsible for regulation only in England, while the devolved administrations make decisions for their jurisdictions. How regulatory divergence should be managed within the UK is a politically fraught question – and we don't yet know if the UK government sees maintaining good relations with the devolved administrations as a check on its regulatory ambitions. Its views could change over time, in light of increasing concerns about the future of union.

To manage the risk created by divergent regulations across the UK, the UK government passed the UK Internal Market Act 2020, which guarantees that goods and services produced in one part of the UK have access to the whole-UK market – even if regulatory divergence does arise. There has been some concern about how these provisions apply to goods. In practice, they mean that goods meeting the UK government's regulatory requirements for England will automatically be acceptable for sale in Scotland and Wales (and vice versa), even if there are different requirements in force in those nations. The act proved controversial, and was opposed by the Scottish and Welsh governments, who argued that having to accept goods made to different standards could undermine their policy objectives, distort the UK internal market by encouraging a 'race to the bottom' on standards and permit the sale of controversial goods, such as chlorinated chicken – rendering Scottish or Welsh government bans on such items ineffective.[62]

Separately, the four governments are in the processes of agreeing a set of 'common frameworks', which set out processes for managing potential divergence between different parts of the UK in specific policy areas. It was originally envisaged that they would consist of common goals, minimum or maximum standards, harmonisation, limits on action, or mutual recognition.[63] In areas covered by these frameworks, the UK government will need to consult the devolved administrations on regulatory change, but such intergovernmental agreements do not formally constrain its actions.

Whether the UK government invests in the more conciliatory common frameworks approach, or instead relies on the UK Internal Market Act to manage divergence within the UK, will provide an indication as to the extent UK ministers see maintaining good relations with the devolved administrations as limiting their freedom to regulate.

Clearly tensions are on the horizon. For instance, the Scottish government has passed an act giving Scottish ministers a general power to "keep pace" with EU law in areas within their devolved competence[64], signalling a desire to keep in line with EU rules (as preparation for a future application by an independent Scotland to join the EU). Elsewhere, while the UK government is looking to change rules on gene editing in England, the Scottish government's rural affairs minister, Ben Macpherson, has said that Scotland "will be maintaining Scotland's GM-free crop status, in line with our commitment to stay aligned to EU regulations and standards and have made our views known to UK ministers".[65]

The Institute for Government will be publishing a more detailed report on how the UK government should manage such tensions.

Divergence from the EU could deepen the border in the Irish Sea

> **"One concern that I have is that GB agricultural policy will diverge significantly from the EU's, and that will be a huge hindrance to trade between GB and NI going forward."** – John Martin, field development manager, Holstein Northern Ireland, 28 April 2021[66]

The Northern Ireland protocol obliges Northern Ireland to continue to follow more than 300 pieces of EU legislation affecting the trade in goods. Those obligations provide political and economic arguments against departing from EU rules elsewhere in the UK, which are already being aired.

Divergence could deepen trade barriers between Great Britain and Northern Ireland

To avoid a hard border on the island of Ireland, the protocol states that many EU rules on goods will continue to apply in Northern Ireland. It does not, however, require the same of the rest of the UK, creating the possibility of regulatory divergence on goods between Great Britain and Northern Ireland. Legally, it is the UK government's responsibility to ensure rules aligned to the EU are in place (although, in practice, in devolved areas, it will usually be for the Northern Ireland assembly to implement them). Unless it agrees specific exemptions with the EU, failure to do this risks a breach of the protocol (possibly leading the European Commission to launch infringement actions against it and aggravating political tensions with the EU and in Northern Ireland).

The protocol doesn't apply to all regulation – and excludes services completely – leaving open the possibility of divergence from EU rules in Northern Ireland in some areas.

The combined effect of the protocol and TCA is that trade and regulatory barriers have been introduced down the Irish Sea, with goods moving from GB into NI subject to a range of new paperwork and checks – including customs formalities and sanitary and phytosanitary (SPS) checks on agri-food goods.

However, a grace period for SPS paperwork for supermarkets and their suppliers – agreed between the UK and EU in December and unilaterally extended by the UK in March – means that the full impact of those checks has yet to be felt. There is a live conversation about whether the UK should go further and align more closely with EU rules on agri-food goods than currently provided for in the TCA, to avoid introducing new frictions once the grace periods end. However, the UK government appears reluctant to commit to this, given it would constrain its regulatory freedom and could make it more difficult to reach free trade agreements.[67]

The UK and EU also agreed a year-long grace period for medicines but concerns have been raised that the supply of medicines could be affected once all rules take effect.[68]

Further regulatory divergence between Great Britain and Northern Ireland could deepen trade barriers, making it more difficult and costly for businesses that trade goods between the two. There is evidence this is already happening. On 21 April, the EU changed its requirements on some agri-food imports (such as 'composite products' containing products of animal origin, like pre-prepared meals), with further changes due in August. Under the terms of the protocol, these rules apply in Northern Ireland, but the UK government has decided not to introduce them in Great Britain. This means that businesses moving agri-food goods from Great Britain to Northern Ireland may have to use revised export health certificates, or that a single product may now require multiple certificates, not one, as previously required.[69]

The UK government has introduced a range of schemes designed to help firms trading between GB and NI comply with the new requirements – but these are currently temporary and do not remove burdens for firms altogether. The UK government has more scope to mitigate the impact of regulatory divergence on NI–GB trade, in line with its commitments to ensure unfettered access for NI businesses into the GB market. The UK Internal Market Act guarantees that 'qualifying' NI goods that meet Northern Irish (and therefore, in many cases, EU standards) will be automatically accepted on the GB market and prevents any new checks or processes on goods moving from Northern Ireland to GB. One area of regulation where this plays out is in product standards. The UK government will allow the EU's CE product standards marking – which must still be used in Northern Ireland but is being replaced in Great Britain – to continue to be used on goods entering GB from Northern Ireland.[70]

Divergence between Great Britain and Northern Ireland could be politically fraught

Aside from the economic implications, the Northern Ireland protocol has exacerbated identity politics in Northern Ireland. Some members of the unionist community – including the Democratic Unionist Party – have voiced their concerns, arguing that the protocol distances Northern Ireland from the rest of the UK. Opposition to the protocol – alongside a range of other factors – contributed to recent violent unrest in Northern Ireland and is a stark reminder of the fragility of the peace process that both the UK and EU have pledged to uphold.

Naomi Long, leader of the non-aligned Alliance Party, has argued that a lack of honesty from the UK government over the impact of the protocol has played a part in recent disquiet:

> **"They promised people unfettered access, which is not the case. And they denied the existence of borders, even as those borders were being erected. I think that that dishonesty, and the lack of clarity around these issues, has contributed to a sense of anger in parts of our community."**[71]

Any additional regulatory changes that may deepen the trade barriers between Great Britain and Northern Ireland could fuel further political tensions if not managed well. As the Institute has previously argued, divergence is not inevitable; it is a political choice.[72] Every time the Johnson government considers regulatory reforms that could deepen economic and political barriers between Great Britain and Northern Ireland, it needs to think carefully about the consequences for Northern Ireland's economy and politics. So far, the government's actions indicate that it is willing to stomach the economic and political consequences. But there may come a point where political and business opposition to deepening the Irish Sea border means the UK government avoids diverging from some EU rules.

The chancellor of the Duchy of Lancaster, Michael Gove, has argued that the protocol presents Northern Ireland with "the best of both worlds", with one foot in both the EU and UK markets.[73] If these benefits come to fruition, it could weaken some opposition to the protocol. But speaking at a recent Institute for Government roundtable, one participant said that while the hope was that the protocol left NI at the centre of both the UK and EU markets, the risk was that it could end up on the periphery.

As we set out in Chapter 5, the UK government will need to track changes in EU regulation that apply in Northern Ireland to ensure informed decisions can be made about whether to allow divergence between Great Britain and Northern Ireland to occur. In *Implementing Brexit: The Northern Ireland protocol*, we recommended that the UK government should produce a Northern Ireland Protocol Impact Statement alongside new legislative measures, to ensure policy makers think through the implications of regulatory divergence between GB and NI.[74]

If the UK government chooses to diverge, it will need to consider how it will mitigate the possible political and economic implications – which could include building on the support schemes already in place to help firms trading between GB and NI, and the 'unfettered access' commitment to ensure that NI firms can trade into the GB market while complying with EU regulatory requirements. The government may also need to rethink how it works with business, to be more transparent about its plans to ensure that firms don't make decisions based on the risk of divergence that might occur, rather than changes that are actually happening.

While the government has made a firm commitment on unfettered access – backed up by the UK Internal Market Act – over time, regulatory divergence between Great Britain and Northern Ireland could make this commitment more difficult to maintain. For instance, many EU rules on pesticide residues in food and feed continue to apply in Northern Ireland under the protocol – and NI goods produced to these standards can be sold in the GB market. But outside the EU, British authorities are no longer involved in EU decisions on pesticides regulation. While GB and EU rules are currently closely aligned, it is possible that they could diverge in future – and that EU standards could fall below GB standards.[75] If this was to occur, GB policy makers may become uneasy about allowing potentially dangerous products into the GB market, over which they have no oversight. However, this concern may prove less problematic in practice, given that EU regulations are usually seen as the global standard.

The government needs to take account of the consequences of divergence

It is clear that diverging from inherited rules will often carry costs. How much weight the government gives to these considerations – and the extent to which they may point away from divergence – is ultimately a political question and is likely to vary between sectors and over time.

Early indications are that the government believes the benefits of divergence outweigh the costs in some sectors – notably in financial services. The TCA does little for this sector, which is not caught by the NI protocol, and it is increasingly unlikely that the EU will grant UK firms extensive access to EU markets, reducing the government's incentives to stay close to EU rules.[76] The UK's comparative strength in the sector (and the importance of it – 6.9% of GDP in 2019)[77] also means it is well placed to adopt its own regulatory approaches – with several reviews and new legislation already pointing to change.

But in other areas, the incentives to diverge are weaker. Failing to strengthen labour standards in step with the EU could trigger disputes under the TCA, prompt public opposition and cast doubt on the government's commitment to maintaining high standards. Significant differences between GB and EU SPS rules could further deepen barriers to GB–NI trade, with potentially severe political consequences in Northern Ireland.

Given the sensitivities around the Northern Ireland protocol, managing the impact of regulatory divergence between Northern Ireland and the rest of the UK is likely to be the most difficult task for the government, at least until the protocol is operating on a more stable basis. It is imperative that the government carefully assesses how its plans to diverge from EU rules will affect Northern Ireland and takes steps to mitigate the most disruptive effects.

If the government judges that there could be significant disadvantages from divergence, it should be prepared to consider changing UK regulation to remain aligned with EU rules. However, this will be more complicated than it was as a member

state. In most cases, new primary legislation would be needed, as ministers no longer have powers to implement EU measures through secondary legislation. Nonetheless, the government should recognise that choosing to stay aligned with the EU – in order to manage the internal consequences or to facilitate trade with the EU – does not prejudice the UK's newly reacquired sovereignty. So, it should take a pragmatic view of its options.

How important the UK government perceives the factors set out above may also change over time. If nationalist sentiment remains strong in Scotland, the government may seek to avoid conflict with Holyrood by not diverging from EU rules that politicians in Scotland wish to retain. Conversely, appetite for divergence could increase once businesses and government have fully adjusted to life outside the EU, and they have the bandwidth to think more freely about how the UK could exercise its regulatory autonomy.

Box 1 **Case study: EU Chemicals Strategy for Sustainability**

The EU is in the process of introducing a new Chemicals Strategy for Sustainability. This will involve a range of regulatory changes – including banning non-essential use of harmful chemicals and new measures to address the risks posed by mixtures of chemicals. The UK government agrees on the broad objectives of the strategy and is looking to change UK regulation to address the same issues, but does not intend to mirror the new EU strategy.[78]

This is an example of both passive and active divergence and could have various consequences that the UK government must consider in regulating chemicals:

UK–EU Trade and Cooperation Agreement: If the UK does not introduce comparable measures to those in the EU strategy, it could trigger a dispute under the level playing field provisions of the TCA for creating a competitive advantage for the UK – a possibility raised by the European Scrutiny Committee.[79]

Business costs: If the UK government does not mirror EU rule changes, it could further increase costs for chemicals businesses trading between Great Britain and the EU.

Policy making and regulator capacity: There are concerns that the UK government lacks the policy making and regulatory capacity to remain aligned with EU rules, even if the government agrees with EU regulation.

Public opinion: The public tend to be in favour of high regulatory standards. In 2017, a poll commissioned by the CHEM Trust found that 63% of those surveyed believed there should be no reduction in regulatory standards that protect people and the environment from potentially harmful chemicals post Brexit.[80] Given EU chemicals rules are seen as the 'gold standard', the government could face calls to mirror new EU rules.

Relationship with the devolved administrations: Some changes proposed by the EU strategy affect areas of regulation that are devolved in the UK, risking the prospect of divergent regulation across the UK.

Northern Ireland protocol: The new EU strategy will involve changes to some of the EU legislative acts listed in the Northern Ireland protocol – including the REACH regulation – which means many aspects of the strategy will apply in Northern Ireland. If the UK government adopts different rules in GB, this could deepen barriers to trade between Great Britain and Northern Ireland.

This example illustrates how the government will need to balance several factors when deciding how to respond to developments in EU regulations. These factors indicate that not aligning with EU rules – or at least adopting comparable standards – could carry legal, economic and political costs.

5. Managing divergence

Brexit has changed the context for UK regulatory policy – so the government needs to adapt its processes. Ministers have lost the obligation to transpose EU law into UK law and no longer face the threat of enforcement through the European Commission and the European Court of Justice. But as we have set out, there are many new factors that they must consider.

Having left the EU, regulating in areas previously governed by EU law is no longer about working within EU frameworks to try to make EU legislation best fit the UK or devolved context. There is now a presumption of regulatory freedom, but policy makers need to take account of the new context and potential political, economic, domestic and international consequences.

The risk is that if regulatory policy is made in the same bottom-up, department-led way that was used before Brexit, the cross-cutting implications of divergence will not be properly anticipated and ministers will find that their time and political capital is wasted on managing unintended consequences. This chapter explores four key areas the government must focus on to avoid such pitfalls, with specific recommendations offered for each.

1. Ministers must set out how they propose to manage divergence

The government's Plan for Growth outlined a "UK approach to regulatory reform", with the ambition that regulations "support science and innovation, enable businesses to flourish, and boost growth whilst maintaining our high standards".[1] It set out four principles to shape regulatory policy:

- Using regulation to unlock cutting-edge technologies such as drones and autonomous vehicles
- Modernising our approach so that we deliver sophisticated policy making that benefits citizens and the economy
- Easing the regulatory compliance red-tape burden on business
- Hard-wiring competition principles into regulatory decision-making.*

But these principles say nothing on their own about managing divergence from the EU. It should also be noted that, being published by the Treasury, they reflect the UK government's priorities, not ones agreed with the devolved administrations.

* It also said that the UK government would publish a policy paper on its proposed system of economic regulation "focused on providing a clear and predictable framework which can rise to the challenges and opportunities of the 21st century".

A framework for the government to manage active divergence from EU regulation would help ministers to prioritise areas with maximum benefits, and reduce the risks of unintended consequences. This would also help officials identify which proposals for regulatory reform may prove problematic and need to be escalated within government.

The findings of the Taskforce for Innovation, Growth and Regulatory Reform (TIGRR) may provide an indication of the government's proposed approach – but it is unclear if the panel, led by Sir Iain Duncan Smith, will provide a comprehensive strategy.

- **The government needs to supplement the principles that underline its approach to post-Brexit regulation, and any specific proposals emerging from the TIGRR exercise, with clear guidance on how it intends to take account of the risks and benefits of divergence.**

The guidance should set out the factors that departments need to consider when making new regulation, such as:

- Do the proposals risk deepening the trade barrier between Great Britain and Northern Ireland?
- Could the proposals trigger the TCA level playing field provisions?
- Could the proposals result in the EU removing adequacy or equivalence decisions?
- Could the proposals undermine the UK's other international obligations?
- Could the proposals affect the UK's trade ambitions?
- How are the devolved administrations likely to react?

It should also indicate when departments should seek legal advice or input from other parts of government to ensure these considerations are properly considered.

As the Institute set out in *Trade and Regulation after Brexit*, a coherent regulatory strategy would also help the government prioritise what it hopes to achieve from new trade agreements and resist pressure from trading partners during negotiations.[2]

2. Processes for assessing regulatory change should reflect the post-Brexit context

There are long-standing cross-government processes to review proposals to change regulations. Under the existing Better Regulation Framework, departments have to produce a regulatory impact assessment setting out the costs and benefits of their proposed course of action, what alternatives they have considered and what the implications would be of action or inaction.[3] Departments then have to submit their impact assessments to the Regulatory Policy Committee (RPC)[4], an independent advisory committee that works alongside the Better Regulation Executive in the Department for Business, Energy and Industrial Strategy. The RPC gives a verdict on the adequacy of the impact assessment, which can include issuing a 'red rating' if it deems an impact assessment is not fit for purpose because it insufficiently assesses the effects of new regulation on business. However, it does not have any power to tell ministers not to proceed.

The scope of regulation caught by the framework has increased post Brexit. When the UK was a member state, most EU-derived regulation was exempt* as – once it was agreed at the EU level – the UK did not usually have a choice over whether to implement it. Now that the UK has left the EU, regulation previously made by the EU that now falls to the UK government does fall within its remit.

A revised version of the Better Regulation Framework was due to be produced last year, but has not yet materialised. A consultation on the new framework is now expected in the summer. It is unclear to what extent the new framework will require departments to assess whether new regulations would result in divergence from EU rules and what consequences this could have. Some impacts of divergence – such as the effect of new regulation on trade – are already included in the impact assessment process. In a discussion paper published in August 2020, the RPC said it was considering whether trade impacts of new regulation needed to be considered more explicitly in its review process[5] and the RPC's chair has recently indicated that he is keen for the RPC to be able to 'red rate' proposals for failing to adequately assess trade impacts, which it cannot currently do.[6] But other consequences of divergence, such as the effect on the TCA or UK internal market, are not currently captured by the Better Regulation Framework.

Even if the consequences of divergence are included in the framework, it's unclear if the RPC in its current form is best placed to assess whether departments have taken them all into account. It usually considers measures only at the end of the policy making process, after decisions have already been made (although the chair hopes to increase the committee's involvement earlier in the policy making process).[7] And while the RPC clearly has important expertise in assessing the economic implications of new regulations, it may lack the political clout and necessary expertise to advise on some

* An exception applied when the UK government 'gold plated' EU regulation, such as where legislation implementing a European directive failed to use an available derogation which could have reduced costs on businesses, the UK government implemented an EU directive imposing a net burden on businesses earlier than required under EU law or the UK government chose to retain higher pre-existing UK standards.

of the more sensitive cross-cutting political and legal implications of divergence – such as the effect on GB–NI trade, the relationship with the devolved administrations or limits of the TCA.

Since the end of the transition period, the government has introduced other new processes and structures to manage its regulation programme. There is now a small 'better regulation sub-committee' of the National Economy Recovery Taskforce (NERT), chaired by the chancellor. It is meeting regularly and tasked with "making the most of the freedoms" Brexit offers and "injecting pace at the centre of government",[8] and is also understood to be leading the review of the Better Regulation Framework. A new unit is also being established in the Cabinet Office Europe Unit to develop the post-Brexit regulatory agenda, to be led by someone recruited from outside government.[9] There are also separate teams in the department considering common frameworks, the Northern Ireland protocol and the TCA. The Regulatory Horizons Council has also mentioned the need to balance the "opportunity for regulatory reform" with the "risks of uncertainty through divergence".[10]

While these steps suggest that the government is taking the need to co-ordinate its post-Brexit regulatory agenda seriously, it is unclear how these different components are intended to work together and how they will ensure departments think through the consequences of divergence when making new policy.

- **In updating the Better Regulation Framework, the government needs to clarify how the processes it has introduced to manage divergence fit together and contribute to its wider regulatory reform agenda. That includes explaining whether and how the role of the RPC and the Better Regulation Executive should change to reflect the post-Brexit context, the role of the different Cabinet Office units and the membership and remit of the better regulation committee.**

3. The government needs to fill the gaps in its knowledge of new EU regulations

The EU's regulatory landscape is also changing. It is vital that the UK government keeps abreast of these reforms, both because Northern Ireland will need to remain aligned to EU regulations in areas covered by the protocol, but also because passive divergence from EU rules may have wide-ranging political and economic implications for the UK. Irrespective of how the UK government chooses to respond to regulatory developments in the EU, ministers need to be aware of them so they can make informed decisions.

There are still many UK government officials in London and Brussels with experience of working with the EU, and with personal relationships with contacts in the European Commission and member states. Much EU legislation is published in draft at an early stage, which will help ensure that the government keeps abreast of developments in the EU. But despite this, officials already fear that there are holes in the horizon scanning effort, especially for EU rule changes that do not just affect the Northern Ireland protocol, where there is no discrete list of EU measures to be monitoring for change.

To remedy these, the government should:

- **Ensure the UK mission in Brussels (UKMis) is adequately resourced to keep policy makers in the UK informed of new EU regulations and ECJ judgments.** UKMis needs to be given the chance to comment on the likely EU reaction to major regulatory changes initiated in the UK. To be effective, UKMis needs to maintain strong links with policy departments across Whitehall and the Cabinet Office (including through the relationship between the UK's ambassador to the EU and the head of the Europe Unit in the Cabinet Office – which in the past was the critical axis for joining up the UK's approach to EU issues). It also needs to be adequately resourced for the task.[11]

- **Consider establishing a government–business forum to allow firms to alert ministers to their concerns about regulatory divergence and to help co-ordinate efforts to influence new EU regulation.** This would complement or supersede existing departmental forums and the new Build Back Better Council (set up to support the government's Covid recovery plans), and build on the successful model of the Brexit Business Taskforce – used to communicate with businesses about preparations for the end of the transition period.

- **Use the committees under the TCA as a forum for intelligence gathering about future regulatory developments, and to head off potential regulatory disputes between the UK and the EU.** Now the TCA has been ratified, these committees should be established as soon as possible.

- **Use the UK–EU Joint Committee (which oversees the implementation of the Withdrawal Agreement) and the joint consultative working group to ensure the consequences of divergence for the Irish Sea border are foreseen and managed.** This includes ensuring the UK government and Northern Ireland executive meet their obligations under the protocol.

As the Institute for Government has previously argued in *Influencing the EU after Brexit*, the UK may want to put effort into lobbying against EU changes that it thinks will adversely impact UK interests. But as a non-member state, there are limits to how much influence it can have. Ultimately, the UK cannot make decisions for the EU – just as the EU cannot stop the UK from acting.

4. The government needs to facilitate parliamentary scrutiny of new EU regulations that affect the UK

Until the end of the transition period, the House of Commons European Scrutiny Committee (ESC) and the House of Lords EU Committee scrutinised new EU policy and legislation to assess its legal and political impact in the UK. The ESC reviewed and commented on a huge range of EU documents. To facilitate this role, the government deposited new EU documents and produced explanatory memoranda explaining what the EU measures did and setting out the government's position on them.

Since the end of the transition period, the government has deposited documents and accompanying explanatory memoranda only for new EU measures that "engage" the Northern Ireland protocol (a phrase that hasn't been defined), which the ESC continues to review. In the Lords, a new EU Affairs Northern Ireland sub-committee has taken responsibility for reviewing new EU legislation that applies in Northern Ireland.[12]

Scrutiny of new EU measures and the government's response to them remains important for a number of reasons, many of which were highlight by the Commons Future Relationship with the EU Committee (CFREU) in its final report,[13] including:

- New EU measures that apply in Northern Ireland could have an impact on the UK internal market
- There is a risk of an accountability deficit arising from the application of EU law in Northern Ireland without direct representation in the EU
- New EU measures could trigger disputes under the TCA
- Divergence could make it harder for British businesses to trade with the EU.

How the government manages these trade-offs is a political choice and it is imperative that parliament is able to hold the government to account for the decisions it makes. CFREU argued that this function should be played by a new sub-committee of the Liaison Committee, and that the government should bring forward proposals for Commons scrutiny of the UK–EU relationship by the end of April.[14] This has not yet happened. The situation is clearer in the Lords, which introduced a new committee structure in April – including a new European Affairs Committee.

It is now clear that the ESC will continue to scrutinise new EU measures (beyond those that directly affect Northern Ireland) in some form. Speaking at an Institute for Government event in January, David Jones MP, a member of the committee, suggested that the ESC's expertise meant it was well-placed to play this role. Since the start of the year, it has written to the government asking for more information about changes to EU rules that could impact businesses in Great Britain selling into the EU[15] and developments in EU law that could trigger the rebalancing provisions in the TCA.[16]

As the Institute has previously argued, how the ESC operates will need to change.[17] This could involve a shift to a hybrid model encompassing both continued scrutiny of some EU documents (potentially only those reaching a certain 'threshold' of importance or impact on the UK) and inquiry-based work. Any change in the ESC's role will need to take account of how the committee's work will interact with that of the departmental select committees, and – where relevant – the devolved legislatures. The development of a 'European affairs unit' within the House of Commons – to provide a single source of official-level support for committees working on European issues is a welcome development that should support greater co-ordination in the Commons.

Since the end of the transition period, the ESC has shown it is willing to review proactively new EU decisions not brought to its attention by the government.[18] The committee also has access to the UK National Parliament Office in Brussels, which can provide information on upcoming EU regulation. However, to a large degree, how the ESC functions will depend on what information the government provides. Unless the government agrees to deposit new EU measures and explanatory memoranda setting out its position on them, the committee is likely to lack the capacity to keep abreast of relevant changes in EU law and how the government plans to respond to them (if at all).

Appearing before the ESC and Lords European Affairs Committees in mid-May, Lord Frost said that conversations about parliamentary scrutiny have taken place between the Cabinet Office and the ESC and the Lords European Affairs Committee, but had not yet "ended up in quite the right place". He also said that the government should provide explanatory memoranda when there is a question of EU law that "affects" the UK, but implied that the scope of this commitment was limited to measures covered by the protocol.[19]

- **The government should work constructively with the European Scrutiny Committee and Lords European Affairs Committee to agree what information about upcoming EU regulations (and the UK government's position on them) the government should provide.** As a minimum, this should include any EU measures that apply in Northern Ireland under the protocol as well as those the government believes could trigger the level playing field provisions in the TCA. The government may need to change what information is included in explanatory memoranda. During the transition period, the template was amended so that the government flagged whether new EU measures would affect the NI protocol. There is a strong case for another update, requiring the government to identify whether the new EU measure could lead to regulatory divergence between the UK and EU and what the government believes the political, economic and legal consequences would be.

Conclusion

After nearly 50 years of EU membership, the UK now has new regulatory freedoms. But it also has new and complex relations to manage – not just with the EU, which continues to be its largest trading partner, but also closer to home. The governments in Holyrood and Cardiff are both potentially at odds with Westminster's approach, and keen to exercise their new powers, while in Northern Ireland the executive is grappling with an increase in cross-community tensions. All the while, the UK government must still focus on the pandemic, and its recovery, and take steps towards meeting its flagship manifesto commitments of net zero and 'levelling up'.

UK ministers have already sought to show that Brexit means the UK can do things differently: from a new migration regime and radical plans to transform agricultural support to a new generation of freeports and (contested) claims that the UK's vaccine roll-out was made easier because we were no longer in the EU.[1]

In future ministers will want to exercise their new-found regulatory autonomy – not just taking back control but using that control to benefit the population of the UK. But diverging from EU regulation will often carry political and economic costs that ministers must weigh against the benefits of taking a different approach.

Making these trade-offs is the difficult part, and the government is still learning. In many areas it is trying to develop a post-Brexit regulatory agenda without having properly assessed the pros and cons of divergence; more needs to be done to ensure co-ordination between departments.

A lack of appetite from voters and MPs for lowering standards, and pressure from a business sector still reeling from the double hit of coronavirus and Brexit not to exacerbate barriers to EU trade could make the case against divergence. But the government's reluctance to align with EU SPS rules indicates that it is willing to accept economic and political costs to preserve its new regulatory autonomy – even if it remains largely unclear what it wants to do with it.

In the short term, the UK government is unlikely to light a giant bonfire of inherited EU regulation. Concerted divergence will probably be confined to sectors where the UK has global reach and felt constrained inside the EU – like financial services and life sciences. Regulatory innovation is also likely to come in new fields, where the UK may try to use its ability to legislate fast to set the pace.

But even if the UK doesn't rip up inherited EU rules, UK and EU regulation will inevitably drift apart as EU rules change without the UK following suit, unless a deliberate effort is made to keep in lockstep. Understanding how EU rules are changing and the economic, political and legal consequences that could have for the UK is essential if the government is to make informed decisions about the consequences of changing UK regulation. The government may have regained regulatory autonomy, but its real test will be learning how to use it.

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5. Managing divergence

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Conclusion

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