Resolution Foundation

EU-turn

Resetting the UK-EU relationship through strategic dynamic alignment

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The Government has pledged to reset its relationship with the EU, promising growth dividends from stronger ties, regulatory cooperation and enhanced trade opportunities for UK firms. Despite this EU-friendly rhetoric, Labour's "red lines" remain firm, limiting its ability to deliver economic growth by delivering substantially different trading arrangements. But by focusing on practical adjustments without crossing its red lines, the Government could help address the weak performance of UK goods trade since Brexit by reducing future divergence from EU standards.

Labour has signalled a shift from the previous Government's prioritisation of regulatory freedoms to a more pragmatic stance, with initiatives like the Product Safety and Metrology Bill facilitating regulatory alignment with the EU where beneficial. Importantly, the UK is not alone in pursuing such strategies; several EU neighbours have established various form of regulatory alignment and cooperation with the EU to mitigate trade frictions. This is also a strategy adopted by other countries that are not in a full customs union but wish to reduce barriers, including New Zealand and Australia, and Canada with respect to the US.

An alignment that is more extensive than existing Government commitments could unlock significant economic gains for the UK. But this comes at the price of giving up regulatory autonomy; in areas such as climate and data, where divergence risks are significant, this loss could be substantial. As both the UK and EU advance their environmental and regulatory standards, proactive measures will be required to mitigate the costs that could face firms as policies like the EU's Carbon Border Adjustment Mechanism are implemented. Ultimately, the Government must balance the desire for regulatory autonomy with the need for strategic alignment, with the latter crucial to successfully realising the potential benefits of a reset in UK-EU relations and fostering long-term economic growth.

The current Government has promised to reset the UK-EU relationship

The Labour Party Manifesto included a commitment to "deepen ties with our European friends". This sentiment has been repeated consistently and frequently by the Labour leadership team since taking power, most recently at Labour Party conference where Jonathan Reynolds, the Business and Trade Secretary, promised a trade strategy "that resets our relationship with the EU whilst also building new trade opportunities around the world". And this has been framed as an important component to unlocking the Government's growth aims – critical to turning around the UK's low investment, low productivity, low growth economy. The UK's exceptionally weak post-Brexit goods trade performance supports the case that the reset has an important role to play – with goods exports to the EU still accounting for more than 20 per cent of our total exports in 2023.

Yet, despite a clearly more EU-friendly narrative, there is no sign of the Government going back on its red lines: no re-joining the EU, and no return to the single market, the customs union, or freedom of movement. In so doing, this rules out the biggest growth dividends: the UK Government's analysis suggests that rejoining the Single Market would boost GDP by around 3.5 per cent relative to the current Trade and Cooperation Agreement. These red lines are likely to also be perceived as ruling out a UK Protocol arrangement, similar to the deal that Theresa May negotiated and which Northern Ireland enjoys now, despite technically avoiding both single market and customs union membership, and which we have recommended in the past.

But although the reset is unlikely to take major steps in unpicking the negative impacts of Brexit on UK investment, trade and output to date, the Government could meaningfully 'stem the bleed' with sufficient ambition on improving 'regulatory alignment' (i.e. the UK adopting the rules, standards and regulations of the EU in specific sectors or areas through unilateral decisions or formal agreements). Our past research showed that 45 per cent of the long-run impact of Brexit would come from on-going divergence and forgone deeper EU alignment, and that this would materialise gradually as the both the EU and UK update and implement new regulations.[1] Examples of recent deepening of regulatory integration within the EU Single Market include the Digital Single Market Strategy, the European Green Deal and changes to public procurement rules harmonisation. By acting now, though, the UK Government can reduce the impacts from future divergence and attempt to also benefit from this deepening integration, all without crossing any of its red lines.

Alignment could help to deliver more regulatory stability for UK firms, reassuring them regulatory regimes won't drift, making it harder for them to export to the EU in future. As discussed in recent research, there are signs that the current Government is open to a more pragmatic approach to addressing regulatory frictions with the EU: the Chancellor has publicly discussed regulatory alignment on chemicals and the Government introduced the 'Product Safety and Metrology Bill' in the July 2024 Kings Speech. The latter, which will 'recognise new or updated EU product regulations' to help 'provide regulatory stability'

stands in stark contrast to the previous Government's Retained EU Law (Revocation and Reform) Act which actively sought to revoke EU-origin law.[2] Both go beyond the specific Labour Party manifesto commitments to help firms, including delivering a Sanitary and Phytosanitary (SPS) agreement, securing mutual recognition of professional qualifications (MRPQs), and facilitating access for touring artists, which as we have set out elsewhere will be relatively small in value overall. But shifting from the approach of the previous Government, which prioritised greater regulatory freedom and sovereignty over reducing trade barriers with the EU, means explicitly confronting the trade-off with regulatory autonomy and the role of the European Court of Justice. The Government has promised it is not afraid to take unpopular decisions to repair Britain and deliver growth, and this will likely be one of the areas where that resolve will soon be tested.

A broad dynamic alignment can provide economic gains

Regulatory alignment entails the UK adopting the rules, standards and regulations of the EU (in specific sectors or areas) through unilateral decisions or formal agreements. This spotlight focuses on regulatory alignment relating to goods where, as previously mentioned, post-Brexit UK trade has been weakest. Alignment could be undertaken with sector- or product-specific regulations, such as the EU Registration, Evaluation, Authorisation and Restriction of Chemicals (REACH), Construction Products Regulations or Whole Vehicle Type Approval. It could also include more cross-cutting regulation, such as CE marking (the certification indicating a product complies with health, safety and environmental protection standards), General Product Safety Directive (which applies to almost all consumer goods sold in the EU), General Data Protection Regulations or Consumer Rights Directives. These are all examples of regulations where Switzerland at least partially aligns with the EU. The impact on businesses will depend on both the depth and breadth of the arrangements that are pursued and implemented by the Government.
First considering breadth, there are economic benefits to pursuing an approach that aligns by default with EU regulation (except where deemed necessary) – effectively an opt-out alignment. This approach can be tested with the Product Safety and Metrology Bill, but would need to be broadened across sectoral and other cross-cutting regulation to create material economy-wide gains for UK firms.

While on depth the UK Government can pursue easier to deliver unilateral alignment or seek higher impact regulatory alignment arrangements with the EU, which would require negotiations. Unilateral alignment would be the easiest to implement as it lies within the power of the UK Government. It could still reduce costs to exporters of having to meet duplicative regulatory standards. For example, the decision to accept EU conformity assessments indefinitely saves manufacturers the duplicative costs associated with demonstrating product safety with both CE marking for the EU and UKCA marking for the UK. However, by committing the UK to align with EU product standards, it may also become possible to negotiate formal arrangements with the EU, like those in place in either Turkey or Switzerland, to improve access and lower costs further for UK firms.[3] Building trust in the

UK's regulatory regime and goals so as to reach negotiated agreements with the EU would also help deliver stability for business. And, over time, arrangements and institutions could be agreed to give the UK more influence – something that would be lacking with a unilateral alignment approach.

The EU already has a range of dynamic alignment arrangements in place with third countries that the UK could seek to build on or replicate. But as discussed in previous research, the UK and EU could also build on examples from elsewhere, such as New Zealand and Australia's broad mutual recognition agreements, which mean the default is that products can be sold in each other's markets (with some exceptions), or the US and Canada, where Canadian legislation automatically aligns regulations on certain products with the US (known as 'ambulatory incorporation by reference').

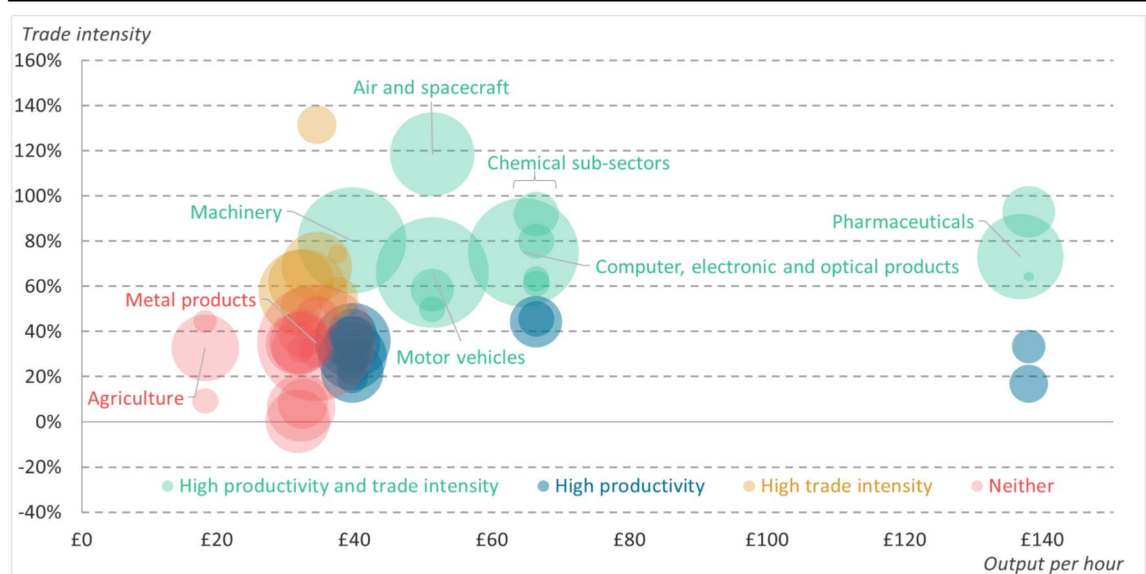
A focus on growth-enhancing alignment means looking at where regulatory divergence risks are highest, and which sectors are most productive

Broad coverage is important to deliver substantial benefits, but a single negotiation (especially given the current state of 'Brexit fatigue' and strained relationships) delivering broad alignment is unlikely to materialise soon. Instead, the approach the Government is currently taking is implicitly prioritising certain sectors and products (specifically, chemicals impacted by EU REACH (regulation governing the safe production, distribution, and use of chemicals within the EU) and machinery, medical devices and other sectors covered by the CE marking). A strategic growth-enhancing approach must target those areas where exporters have struggled post-Brexit and where sectors are highly productive, but also those areas where the risks from divergence are highest.

There are many ways to assess which sectors would be the best to seek alignment for. A simple approach would be to focus on large sectors (based on value added), which have higher-than-average productivity and trade intensity.[4] As shown in Figure 1, several of the UK's largest manufacturing sectors are both highly traded and productive, such as chemicals, transport and computer and electronic manufacturing. The chart also highlights some relatively large sectors that are likely to be less growth-enhancing based on these metrics, such as agriculture and manufacture of metal products.

Figure 1 **Many of the UK's largest manufacturing sectors are both highly exposed to trade and highly productive**

Sectors by trade intensity in 2019 (vertical axis) and nominal output per hour by industry in Q4 2019 (horizontal axis): UK



Notes: Bubble size represent gross value added in 2019. Trade intensity is calculated as total imports and exports over total supply (at purchaser's prices). Sectors are categorised as high productivity if sectoral productivity is greater than the whole economy average and as high trade intensity if trade intensity is above the unweighted average of all goods sectors.
Source: RF analysis of ONS, Supply and Use Tables and ONS, Labour productivity statistics.

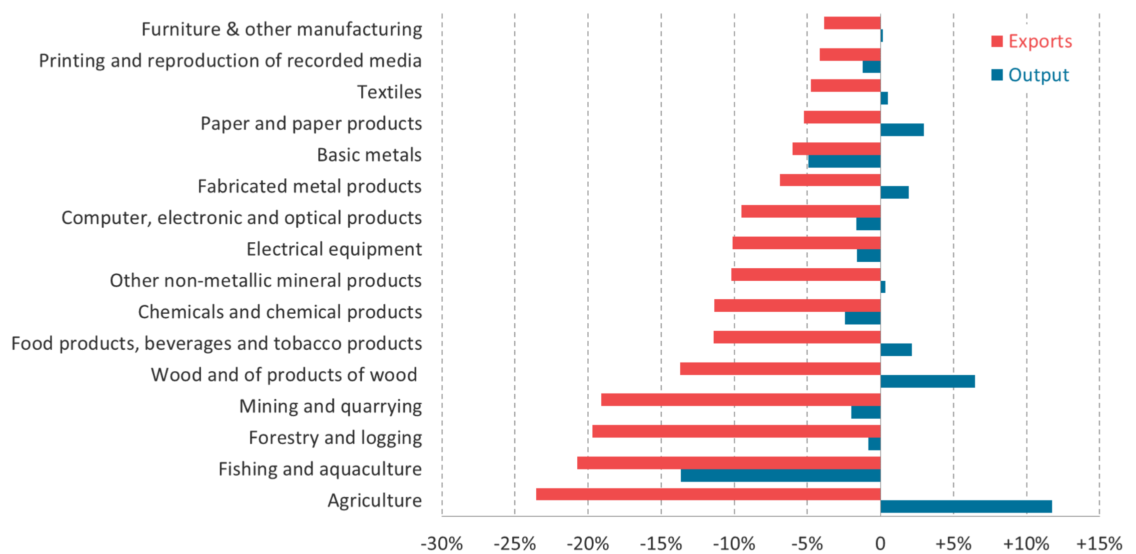
It is also important to assess which sectors are at highest risk of damage from on-going regulatory divergence. Figure 2 shows the modelled impact of forgone EU integration on certain sectors. A number of goods sectors are expected to experience a hit to both exports and output, including chemicals, electrical equipment, computers and electronics, and basic metals. For chemicals, this has already materialised – the volume of chemical exports has fallen, led by exports to the EU which fell by 24 per cent (between January to July 2016 and the same period in 2024) compared to 8 per cent to outside the EU.

This modelling estimated the long-run impacts of Brexit, but other recent research has found that trade continued to adjust to Brexit between 2021 and 2023 in a broad range of sectors. The most adversely affected exports seem to be within agri-food, textiles and clothing, and material-based manufacturing (such as wood, paper and pulp) sectors, but several higher-value manufacturing sectors exports, including vehicle and chemical subsectors, were also hit. However, it is important to note that the sectors expected to experience the largest *export* shocks were not all expected to see the largest *output* shocks; for example, some less productive sectors, such as agriculture, were expected to benefit from lower import competition despite substantial export shocks. (However, this is still bad news for the UK's overall productivity: it negatively impacts within-sector productivity (less-productive firms benefit from lower import competition, while more productive exporters lose out) and

rebalances economic activity towards less-productive sectors (more agriculture but less professional services).

Figure 2 **Several goods sectors are set to lose out from forgone EU integration**

Estimated change in exports and output as a result of forgone EU integration, by 2030: UK



Notes: EU integration assumes a continuation of past integration patterns across sectors within the EU, which the UK forgoes outside the EU. Chart shows the 16 sectors with the largest export shocks. The full methodology of this modelling is presented in S Dhingra et al., The Big Brexit: An assessment of the scale of change to come from Brexit, Resolution Foundation, June 2022.

Source: Previous modelling published in S Dhingra et al., The Big Brexit: An assessment of the scale of change to come from Brexit, Resolution Foundation, June 2022.

Another way to think about the issue is to look at the prevalence of past regulatory changes: this can suggest where the risk of regulatory divergence may be most significant. One key indicator of the regulatory changes that the EU deems essential for goods trade are those reflected in amendments to the Northern Ireland Protocol Annexes. Since the transition period ended (1 January 2021), a number of changes have been made (and a detailed summary can be seen here). This includes new rules relating to medicinal products, plants and agricultural vehicles, and cross-sector temporary trade measures on Ukraine and Moldova, but also several repealed and replaced laws concerning:

1. Chemicals: fertilising products, medicated feedstuffs, veterinary medicinal products, organic pollutants and explosives precursors.
2. Manufacturing: motor vehicles, tyres, arms: dual-use items (goods, software, and technology that can be used for both civilian and military purposes) and weapons, and agricultural machinery and vehicles.
3. Agriculture and food: plant protection, fishery and aquaculture products.

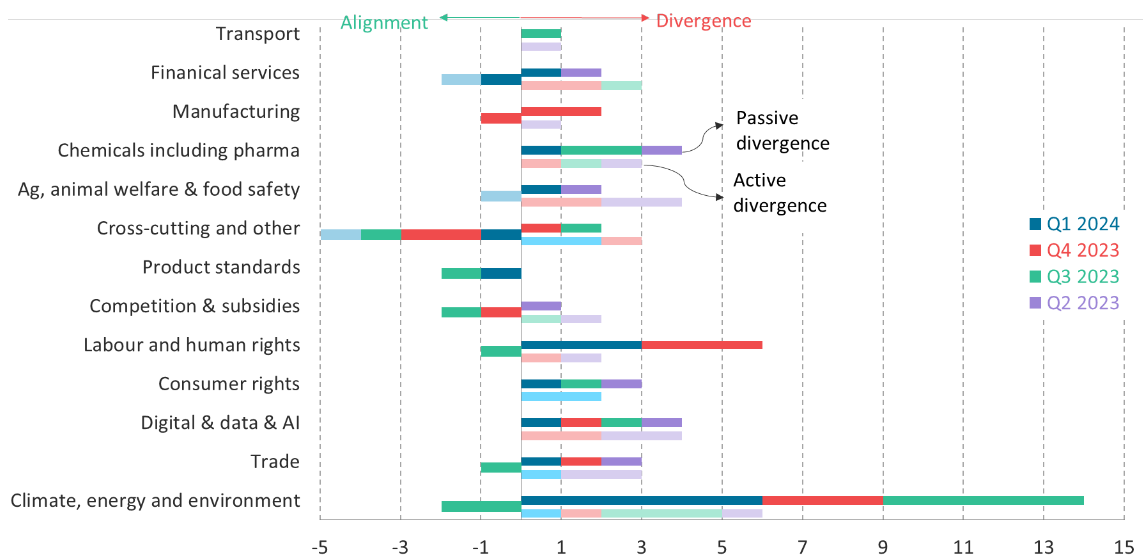
4. Cross-cutting: mutual recognition of goods between member states, excise duty, controls of cash entering / leaving the EU.

It is also possible to assess where either the EU or UK is shifting from the pre-existing status quo, which both shared due to the UK's former EU membership. Any regulatory changes signal 'divergence', with changes to UK regulation classified as 'active divergence' and EU changes as 'passive divergence'. UK in a Changing Europe has published a quarterly regulatory divergence tracker that monitors both types of divergence, as well as instances of alignment (such as the UK's choice to continue accepting EU CE markings), across different regulatory areas and sectors.

It's important to note that the measures in this tracker are not cumulative (some regulations, like the EU Packaging and Packaging Waste Directive, appear multiple times) and that not all measures are equally significant (some may represent consultations on regulatory change while others may represent implementation). However, the tracker provides insight into where the risk of regulatory divergence is highest. A summary of the changes made over the last four quarters, shown in Figure 3, highlights that climate, energy and environment regulation is a particularly high-risk area, along with chemicals and digital and data. Climate, energy and the environment here cover divergence on a range of regulatory issues, such as deforestation-free products, Carbon Border Adjustment Mechanisms, Emission Trading Schemes and even bans on the sale of new fossil fuel cars.

Figure 3 **Chemicals, data and climate seem at highest risk of divergence**

Number of regulatory alignment and divergence actions taken by the EU and UK between Q2 2023 and Q1 2024



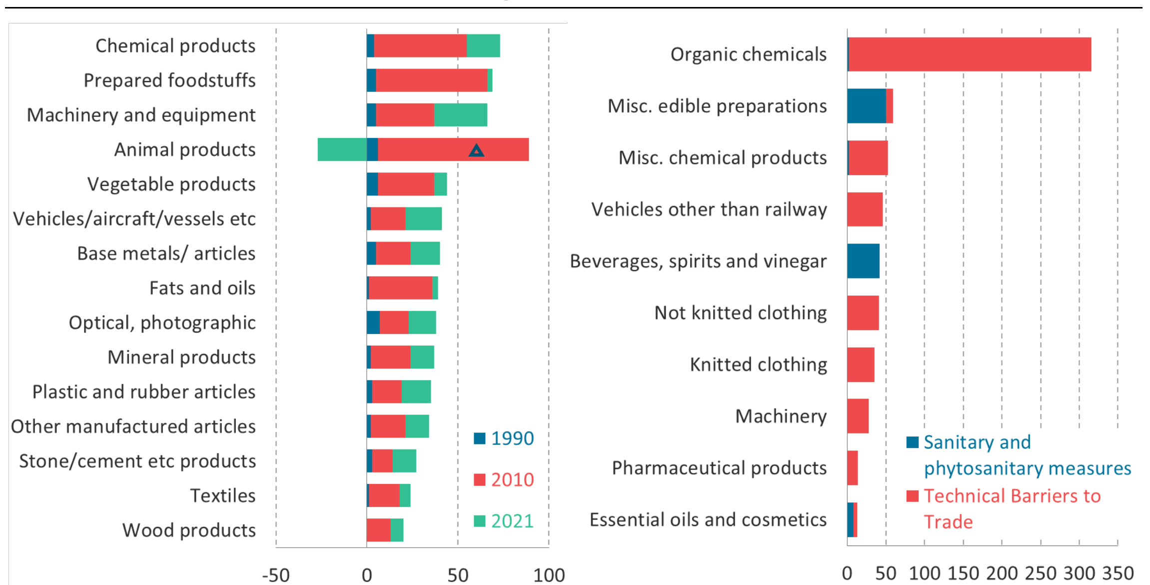
Notes: Measures are not strictly additive as several actions could relate to the same bit of regulatory divergence. Lighter bars represent active divergence (actions taken by the UK) and darker colours represent passive divergence (actions taken by the EU) with the colour corresponding to the relevant quarter and year action is taken.
Source: RF analysis of UK in a Changing Europe, Regulatory Divergence Tracker.

Figure 4 summarises two additional data sources that shed light on sectors at risk of regulatory divergence. The left panel shows the UK Trade Policy Observatory's regulatory intensity indices, which highlight the sectors experiencing the largest increases in regulatory intensity in the EU between 2010 and 2021: chemicals, machinery, and vehicles.[5]

The right panel shows UN Trade and Development data on the number of new EU non-tariff measures (i.e. policy measures that can affect international trade in goods that are not tariffs) implemented between 2019 and 2022. It focuses on two common measures directly related to the domestic regulatory environment: technical barriers to trade (which includes technical regulations, conformity assessment procedures, and standards for product quality and safety) and sanitary and phytosanitary measures (those intended to protect the health of humans, animals, and plants). The data suggests that the largest UK exporting sectors – chemicals, food and beverages, and vehicles – have seen the biggest increases in regulatory barriers introduced by the EU. This suggests that these are the areas where newer EU regulatory changes are specifically affecting exporters to the EU.[6]

Figure 4 **Newer regulatory barriers have been focussed in chemicals, food, machinery and vehicle sectors**

Regulatory intensity indices by HS section (left panel) and non-tariff measures introduced between 2019 and 2022 (right panel): EU



Notes: Both use the harmonised system for classifying traded products – left panel uses HS sections and right panel uses HS 2-digit categories (which are more disaggregated) limited to categories where UK exports to the EU exceed £1.5 billion in 2018. Triangle (left panel) gives regulatory intensity index for animal products in 2021.
Source: UK Trade Policy Observatory, Regulatory Intensity Indices (left panel) and UNCTAD TRAINS (right panel).

The Government is right to prioritise chemicals and product safety, but it also needs a strategy for rapidly changing climate and environmental regulation

These measures of regulatory divergence risks are largely backwards-looking (although the regulatory divergence tracker shown in Figure 3 provides some forward-looking insights

about regulatory changes not yet implemented). Yet they consistently suggest that the relatively productive chemicals sector is at high risk of divergence, supporting the Chancellor's implied prioritisation of alignment on EU REACH. The focus on CE marking and other cross-cutting product standards will impact several productive goods-producing sectors that have struggled post-Brexit, such as clothing, cinematographic goods, and toys and games. On the other hand, although food standards and regulation also appear at high risk of divergence, and at high-risk of a substantial and continued negative impact on UK exports, this sector is not a priority from a growth-prioritisation perspective – agri-food sectors are generally less productive and more domestically oriented (see Figure 1).

Any strategic trade policy should, of course, be aligned with the Government's Industrial Strategy (due to be published later this month). This might prioritise government support for some sectors to meet alternative objectives (for example resilience, rather than growth). But if the Government aims for the UK-EU reset to contribute to its growth goals, then it must be strategic, particularly when prioritising where to pursue any negotiated arrangements with the EU. This might suggest deprioritising the objective to deliver a veterinary agreement which, while important for some stakeholders, has small overall value, estimated to increase goods trade by just 0.4 per cent.

Looking ahead, data and digital and climate and environmental regulations are fast-evolving regulatory areas with a high-risk of both active and passive divergence of EU and UK regulations. On data and digital the UK has closely aligned with EU GDPR, likely linked to actively pursuing the EU's data adequacy decision that allows the free flow of personal data.

On climate and environmental regulations, both the UK and EU acknowledge the benefits from a high degree of international coordination and cooperation in this area, with both actively supporting international organisations attempting to set global standards and improve coordination across countries, for example the International Sustainability Standards Board. And this suggests there may be scope for more bilateral coordination in the future. These regulatory changes would affect a range of sectors, including the high-value industries highlighted above. And the demand for progress from business is evident: for example, one of the CBI's ten priorities for improvements to UK-EU relations in 2021 was to advance linkage between the UK and EU Emissions Trading Schemes.

The introduction of an EU Carbon Border Adjustment Mechanism (CBAM), and likely a separate UK version, represents the next significant challenge facing UK firms. Without an exemption for UK exporters, business in sectors like iron and steel or fertilisers will soon face even more paperwork at Calais, relating to carbon emission reporting required by their EU customers. This would mean new administrative costs and a new risk of goods being rejected at the border if customs authorities find carbon-related documentation fails to align with CBAM regulations. UK importers from the EU will also face higher administrative burdens if EU firms exporting to the UK are not exempted from a future UK CBAM. Unilateral alignment here will not be enough - avoiding these additional barriers means negotiating an

exemption from the full administrative burdens of CBAM and would likely require formal linkage of Emission Trading Schemes.

Yet delivering alignment in this area is likely to be more politically challenging than more technocratic measures like chemicals and cross-sectoral product regulation. Environmental regulations can be politically sensitive issues where the domestic context is important, as seen in the public debates surrounding policies like ULEZ and petrol car bans. Since leaving the EU, the price of emission trading scheme permits has diverged, with UK permit prices now considerably lower (around £36 per tonne compared to £52 in the EU). This means realigning the schemes would likely mean unpopular higher domestic electricity costs and may also conflict with domestic objectives around increasing the uptake of electric heating and electric cars. As the Government develops its plans to support business and achieve net zero goals, it must confront trade-offs between regulatory autonomy and the benefits from alignment.

Yet even here, political risks may be relatively low. The EU and UK share climate and environmental goals, even where specific regulations have diverged (for example, both are looking to be implementing a CBAM to prevent 'carbon leakage' through imported emissions). From a political perspective, one could argue that sacrificing regulatory autonomy here is unlikely to be a major vote winner or loser –in the run-up to the 2024 general election, YouGov polling showed the share of voters that considered the environment as one of the most important issues facing the country (20 per cent on 1 July 2024) was half that for immigration (41 per cent). Rachel Reeves also previously suggested that she believed regulatory autonomy was not a top priority for voters, saying that "when my constituency voted leave, it was purely because of immigration", although polling evidence at the time suggests regulatory autonomy played a larger role in Leave voting decisions than this suggests.

Conclusion

The UK Government's commitment to reset relations with the EU suggests a more pragmatic approach focused on regulatory alignment in key sectors like chemicals and product safety. But it is also time for a thoughtful discussion on whether to align more with EU environmental regulations, particularly the Emission Trading Scheme and CBAM. Across regulatory areas, navigating the trade-offs between regulatory autonomy and alignment will be crucial for realising the potential of this reset to address the UK's growth challenges.

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[1] This on-going alignment within the EU is based on evidence showing rate of decline in intra-EU trade costs was approximately 40% faster than trade costs between other OECD countries over the period 1995-2004 (i.e. the EU completed the Single Market Program (SMP) in 1992).

[2] However, despite the seemingly anti-EU regulation stance taken by the previous Government, it extended the decision to allow use of CE marking in the UK for a number of products.

[3] As part of its customs union agreement with the EU, Turkey has aligned product safety legislation and its conformity assessment bodies (CABs) are so-called 'notified bodies', meaning they can assess a domestic

product's conformity with CE marking across affected sectors. Likewise, Swiss bodies are allowed to assess products in the sectors covered by Mutual Recognition Agreements.

[4] This includes both import and export intensity as regulatory alignment could ease barriers for firms either importing from or exporting to the EU – by allowing them to avoid certain costs associated with dual regulatory compliance.

[5] Regulatory intensity here captures the scale and complexity of the obligations that EU Regulations impose on products.

[6] However, it should be noted this represents measures applied to any trading partner, not just the UK, and this data suggests no specific new non-tariff measures have been introduced on the UK over this period.