



Department for  
Business, Energy  
& Industrial Strategy

# UK Internal Market

July 2020



# UK Internal Market

Presented to Parliament by the Secretary of State for Business, Energy and Industrial Strategy

By Command of Her Majesty

July 2020

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# Foreword

For centuries, the UK's Internal Market has been the bedrock of our shared prosperity, with people, products, ideas and investment moving seamlessly between our nations. As a Union, we are greater than the sum of our parts.

Today, we face unprecedented economic challenges recovering from the impact of COVID-19, which has threatened our lives, livelihoods and communities. As we move through the pandemic and into the recovery phase, we must ensure that our Internal Market, which supports countless jobs and livelihoods across our country thrives.



In addition to the enormous task of recovery, from 1 January 2021, hundreds of powers previously exercised at EU level will flow directly to the UK Government and the devolved administrations in Edinburgh, Cardiff, and Belfast. Devolved administrations will have unprecedented regulatory freedom within new UK frameworks, allowing them to benefit from opportunities to innovate. To allow each home nation to take full advantage of these new opportunities, and ensure businesses can continue to trade freely across the UK as they do now, we are consulting on legislating for a UK Internal Market.

Northern Ireland sells more to the rest of the UK than to all EU member states combined. Scotland sells more to the rest of the UK than to the rest of the world put together. And in some parts of Wales, a quarter of workers commute in from England on a daily basis.

Under the plans in this White Paper, the UK will continue to operate as a coherent Internal Market. A Market Access Commitment will guarantee UK companies can trade unhindered in every part of the United Kingdom – ensuring the continued prosperity and wellbeing of people and businesses across all four nations. At the same time, we will maintain our high standards for consumers and workers.

This will give business certainty. If a baker sells bread in both Glasgow and Carlisle, they will not need to create different packaging because they are selling between Scotland and England. Likewise, engineering firms in Scotland using parts made in Wales will know that the parts are compliant with regulations across other home nations.

By enshrining the principle of mutual recognition into law, our proposals will ensure regulations from one part of the UK are recognised across the country. The principle of non-discrimination will support companies trading in the UK, regardless of where in the UK they are based.

These principles will not undermine devolution, they will simply prevent any part of the UK from blocking products or services from another part while protecting devolved powers to innovate, such as introducing plastic bag minimum pricing or introducing smoking bans.

As we fire up our economic engines to recover from coronavirus, business needs stability. By protecting the integrity of the UK's Internal Market, the proposals in this

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White Paper will allow firms to focus on what they do best: creating jobs and opportunities for people right across our United Kingdom.

**The Rt Hon Alok Sharma MP**  
Secretary of State for Business, Energy and Industrial Strategy

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# Introduction

1. The UK Internal Market has for centuries been at the heart of our economic and social prosperity as a country. It dates back to the Acts of Union of 1706 and 1707, and has been a source of unhindered and open trade across the United Kingdom – one which pulls us together as a united country and means that, as a Union, we are greater than the sum of our parts. The UK Internal Market long predates many other countries' economic unions, and has been uniquely successful in driving forward economic prosperity across our whole country, providing businesses with the certainty that they need to grow and thrive.
2. While the Internal Market has been enshrined in British law for over three centuries, the UK's accession to the then-European Economic Community in 1973 saw European law take on a more direct role in providing the legislative underpinning of our economy. European directives and regulations, along with relevant judgements from the Court of Justice, replaced British law and took on an integral role in the legislative underpinning of the Internal Market.
3. As the UK leaves the Transition Period, and leaves the EU's legal order, we will need to legislate to maintain this centuries-old success story and guarantee the continued seamless functioning of the UK Internal Market. Avoiding the creation of new barriers is vital for our brilliant manufacturers, producers and service providers trading within the bounds of our nation; for our partners overseas as we seek to build ever richer trading relationships with other countries; and to secure the prosperity and the livelihoods of our people right across the United Kingdom. We will do this in a way that respects the devolution settlement, and ensures that the devolved administrations receive powers over many more policy areas than they currently hold as part of the EU, whilst ensuring that all intra-UK trade remains frictionless.
4. One of the key features of our economy is its deep integration and strong economic ties that bind the UK together. These ties constitute the UK's Internal Market, the totality of undeniably close, and complex economic relationships between all parts of our country. Examples of such relationships are plentiful. Scotland and Northern Ireland both sell more to the rest of the UK than to all EU member states combined. Scotland itself sells more to the rest of the UK than to the rest of the world together. Maintaining this economic arrangement, and the significant benefits it brings, is even more important as we plan our joint recovery from the COVID-19 global pandemic.
5. Analysis of census data shows that there are significant numbers of workers who commute across the UK daily – over 170,000 people commuted from one part of the UK to another in 2011. In some Welsh local authorities up to 24% of workers come from and 27% of employed residents commute to England (ONS, 2011). And finally, the UK boasts highly integrated services regulation, without instances of overt discrimination against providers from other parts of the UK. With the UK

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as the second largest exporter of services world-wide<sup>1</sup>, services account for four out of five jobs nationwide through the employment of 26.7 million people<sup>2</sup>.

6. Open markets enable frictionless trade that supports efficiency and productivity, increases business certainty and facilitates better investment decisions. They are also key in supporting our international competitiveness and maintaining our attractiveness for international investment. The UK's integrated market allows workers to move freely across the country to work in industries and jobs most suited for their skills, boosting wages; unhindered movement across the UK is every citizen's right. These benefits improve consumer choice and help drive reduced prices.
7. The United Kingdom has long been a trusted trading partner in the global economy. Our unyielding commitment to the rule of law and the highest standards – enshrined in law across the board, our dedication to the protection of employees and the environment, our openness to competition and the control of subsidies, or the energy and innovation of our business sector, we are a robust, open and trusted partner, right across the economy.
8. The strength of our Internal Market and our openness to trade are part of the UK's long history as a global free trading state. With UK exports at a record high, it is important that we continue to strengthen the UK's position as a trading nation and reassert our proud history as a beacon of enterprise and innovation. We have provided specific protection in relation to freedom of trade in our law since as far back as the Acts of Union. This economic unity, and the principle that people should have fair access and freedom within the economy wherever they are in the UK, has always been part of what makes us a strong, trusted and prosperous nation.
9. As we leave the Transition Period and embark on an exciting new phase as an independent trading nation, we will ensure that we continue to uphold our UK Internal Market, to protect and enhance the prosperity of our nation and livelihoods of our citizens. To secure the Internal Market for the future, the Government now proposes a Market Access Commitment, which will enshrine in law two fundamental principles to protect the flow of goods and services in our home market: the principle of mutual recognition, and the principle of non-discrimination. This will guarantee the continued right of all UK companies to trade unhindered in every part of the UK.
10. Mutual recognition means that the rules governing the production and sale of goods and services in one part of the UK are recognised as being as good as the rules in any other part of the UK, and they should therefore present no barrier to the flow of goods and services between different regulatory systems. Non-discrimination is already relevant to our Internal Market and will in the future mean that it is not possible for one regulatory system to introduce rules specifically discriminating against goods or services from another. These

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<sup>1</sup> ONS Regional gross value added (balanced) by industry, valid for 2018, Available at: ONS.

<sup>2</sup> ONS Labour Force Survey, valid for Q1 2020.

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principles underpin the Internal Market structures of many other countries, including Australia and Switzerland.

11. A coherent approach to market access will drive efficient supply chains and opportunities for business growth and ensure fair price distribution for consumers. This will create business certainty and the clarity needed for investment decisions, also protecting consumer prices and increased choice.
12. As well as ensuring the continued smooth functioning of our Internal Market, our approach will also give the devolved administrations unprecedented new powers to create their own laws. On January 1 2021, hundreds of powers will be transferred from Brussels to the devolved administrations. This is the single biggest transfer of powers to the devolved administrations in history, and will see new powers transferred to Scotland, Northern Ireland and Wales in a total of 160 policy areas which intersect with devolved competence. Our commitment to high standards within this will be unyielding, which allows us to protect those things most important to us, like our communities and our environment, while ensuring our future prosperity. A legal commitment to reach net zero carbon emissions by 2050 is just one example of this promise.
13. The Government will consider tasking an independent, advisory body to report to the UK Parliament on the functioning of the Internal Market.
14. The Government continues to work with the devolved administrations on the development of Common Frameworks, which will allow a common approach to continue in many areas after the end of the Transition Period. There has been significant progress made on Common Frameworks, but the Scottish Government's decision to withdraw from our Internal Market workstream in March 2019 has impeded our collective approach to ensuring the continued smooth functioning of UK trade, and without the certainty we are now giving to businesses with this approach, would risk creating disruption for citizens in Scotland, Wales, Northern Ireland and England.
15. As part of our overall approach to the Internal Market and our future trade with partners across the globe, the Government is also clear that it needs a single, fair subsidy control regime for the United Kingdom. As such, the Government will seek to expressly provide that subsidy control is reserved (or excepted in Northern Ireland) and therefore a matter for the UK Parliament.
16. The UK is a unitary state with powerful devolved legislatures, as well as increasing devolution across England. The Scottish Parliament, the Senedd Cymru/Welsh Parliament, and the Northern Ireland Assembly are powerful democratic institutions acting within a broad set of competences. Each reflects the unique history of that part of the UK, and their history within the Union of the United Kingdom. This is a history to be celebrated and the Government's approach set out here will ensure that devolution continues to work well for all citizens.



# General information

## Why we are consulting

The consultation seeks the views of businesses, academics, consumer groups and trade unions on the policy options set out in this White Paper through proposals to enshrine in law two principles to protect the flow of goods and services in the UK's Internal Market: the principle of mutual recognition, and the principle of non-discrimination.

## Consultation details

**Issued:** 16 July 2020

**Respond by:** 13 August 2020

**Enquiries to:** [UKinternalmarket@beis.gov.uk](mailto:UKinternalmarket@beis.gov.uk)

**Consultation reference:** UK Internal Market

**Audiences:** Seeks the views of UK businesses, academics, consumer groups and trade unions.

**Territorial extent:** The whole UK.

## How to respond

**Respond online at:** <https://beisgovuk.citizenspace.com/trade/uk-internal-market>

When responding, please state whether you are responding as an individual or representing the views of an organisation.

Your response will be most useful if it is framed in direct response to the questions posed, though further comments and evidence are also welcome.

## Confidentiality and data protection

Information you provide in response to this consultation, including personal information, may be disclosed in accordance with UK legislation (the Freedom of Information Act 2000, the Data Protection Act 2018 and the Environmental Information Regulations 2004).

If you want the information that you provide to be treated as confidential please tell us, but be aware that we cannot guarantee confidentiality in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not be regarded by us as a confidentiality request.

We will process your personal data in accordance with all applicable data protection laws. See our [privacy policy](#).

We will summarise all responses and publish this summary on [GOV.UK](#). The summary will include a list of names or organisations that responded, but not people's personal names, addresses or other contact details.

## Quality assurance

This consultation has been carried out in accordance with the government's [consultation principles](#).

If you have any complaints about the way this consultation has been conducted, please email: [beis.bru@beis.gov.uk](mailto:beis.bru@beis.gov.uk).

# Executive Summary

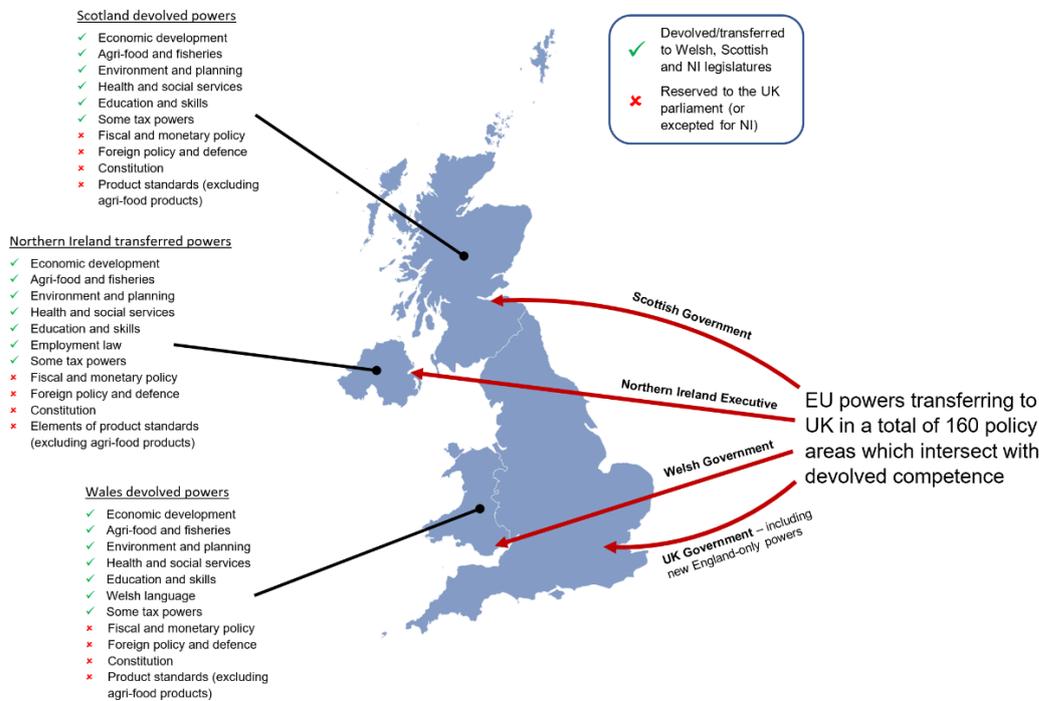
## Setting the Scene: The history of our Internal Market

1. The strength of the UK Internal Market is drawn from the success of our Union, our shared resources, and the ingenuity and capabilities of our people. Centuries before we joined the European Union, the UK's Internal Market received its own articulation through the Acts of Union, guaranteeing basic economic freedoms to all British citizens. Since 1973, these age-old rules were replaced by European law. Decades later, the British people voted to leave the European Union. As EU laws cease to apply, we once again gain the opportunity to articulate our centuries-old rules of the Internal Market, drawing on the laws that constitute an integral part of our shared British history.
2. The Union was created in 1707 when Scotland and England and Wales became part of the Kingdom of Great Britain and the Union grew further when the United Kingdom was established in 1801.
3. The Union delivered new economic opportunities for people all over the new country: drovers guided their livestock from the hills of Wales to market in London. Coal and iron industries saw Wales at the heart of the industrial revolution, spawning ever-developing industries and supply chains in areas like copper-smelting and tin plate production which cemented Wales's role as a powerhouse of industry in Victorian Britain. Wales's strong trading instincts are still evident today. Being part of a strong and united Internal Market remains as important for Wales today as it has ever been.
4. One of the major benefits of the 1707 Union for Scotland was gaining access to England's markets both here and overseas primarily, at the time, for Scottish cattle and linen. The Act of Union saw immediate boosts in Scottish trade, through increased links with the Baltic and elsewhere for Scottish merchants. The echoes of that growth resound through to the present day – modern Scottish towns like Crieff and Falkirk originally thrived as popular merchant markets following the increase in trade. By the 1720s, the Glasgow and Clyde ports were growing as a result of increased trade made possible by the Union. When we look from the vantage point of today – where the rest of the UK is Scotland's biggest trading partner by far – the economic advantages of the Union have more than stood the test of time.
5. Northern Ireland, too, has benefitted from a close economic relationship with the rest of the UK. During the 19th Century, Belfast emerged as a major industrial city, famous for its linen and shipbuilding industries. As the first part of the UK to experience devolution, the economic importance of the Union to Northern Ireland was respected. While the Belfast (Good Friday) Agreement acknowledged the potential for North-South cooperation, the legislation underpinning the devolution settlement of 1998 continues to offer protection for the single market in goods and services within the United Kingdom. Great Britain remains the most valuable market for Northern Ireland goods.

## Part 1: Our Internal Market after the Transition Period

6. In January 2020 the UK left the European Union. Following the end of the Transition Period this year, the way we regulate labour, capital, goods and services in the UK will no longer be decided by the EU. Instead, we in the UK will be able to regulate our trade in goods and services in a tailored manner, specifically designed to benefit our businesses, workers and consumers, while maintaining our high regulatory standards.
7. This ability to decide how best to manage our trade in goods and services in all parts of our country will be instrumental in preserving the coherence of our shared Internal Market – *i.e. the total set of trading relationships that exist across the UK*. At this historic moment, we will be able to give business certainty and best facilitate the transfer of new powers to the devolved administrations by upholding the rules that govern our internal economy.
8. At the end of this year, new powers will transfer from the EU to the UK Government and devolved administrations, enhancing different levels of Government’s ability to regulate in accordance with the needs of their local populations, in areas such as agriculture and food standards, amongst others. This in turn, will provide a pivotal moment for the UK as a country to evolve its own bespoke regulatory system with certainty, which is so important for the UK’s businesses, citizens and economy as we recover from the impact of COVID-19.

Figure 1. Example areas of devolved competence and volume of new powers transferring to the devolved administrations<sup>3</sup>



<sup>3</sup> The list of devolved areas here is not comprehensive. It should also be noted that each devolution settlement is unique and the distinction between reserved and devolved powers can be complex – for example, policy areas can be devolved/transferred for one nation but not others, and elements of one policy can be reserved/excepted whilst others are transferred. For the number of new powers exercisable by each devolved legislature see, Revised Frameworks Analysis: Breakdown of areas of EU law that intersect with devolved competence in Scotland, Wales and Northern Ireland, April 2019, [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/792738/20190404-FrameworksAnalysis.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/792738/20190404-FrameworksAnalysis.pdf)

9. Maintaining frictionless trade across the UK will be essential as we look to take advantage of the opportunities presented by leaving the EU, including the ability to rapidly and flexibly develop regulation that works best for citizens in every part of the UK. The UK Government is not just committed to retaining high regulatory standards (such as animal welfare) – but exceeding the various protections offered by the EU.
10. Our country has a long history of having a seamless and highly integrated Internal Market. Guaranteed access to the UK economy across all parts of the UK remains invaluable to the welfare and prosperity of its citizens, and the free flow of goods and services is one of the fundamental economic rights that should be preserved for all.
11. We will, as the influence of the EU Single Market laws fall away, need to act to enhance our existing architecture to strengthen our Internal Market, enshrining in law new mechanisms that ensure we can trade freely across all parts of the UK.

## This White Paper

12. In this paper, the Government presents a UK-wide approach to ensure that the seamless trade across the UK's Internal Market is maintained by providing a Market Access Commitment to all businesses and citizens across the UK. Through this consultation, we aim to ensure that the voice of the business and wider stakeholder community is represented within the detailed policy design.
13. The Government aims to implement a system that works alongside new devolved powers while guaranteeing consistency and clarity for business and citizens. We want to do this through implementing new legislation to enshrine a fundamental Market Access Commitment in law, minimising domestic trade costs, business uncertainty and bureaucracy. We want to legislate for this fundamental commitment by the end of 2020, as we exit the Transition Period, to ensure the protection of all UK business and consumers from Day 1.
14. Responses to the White Paper questions will inform the Government's approach to the legislation.

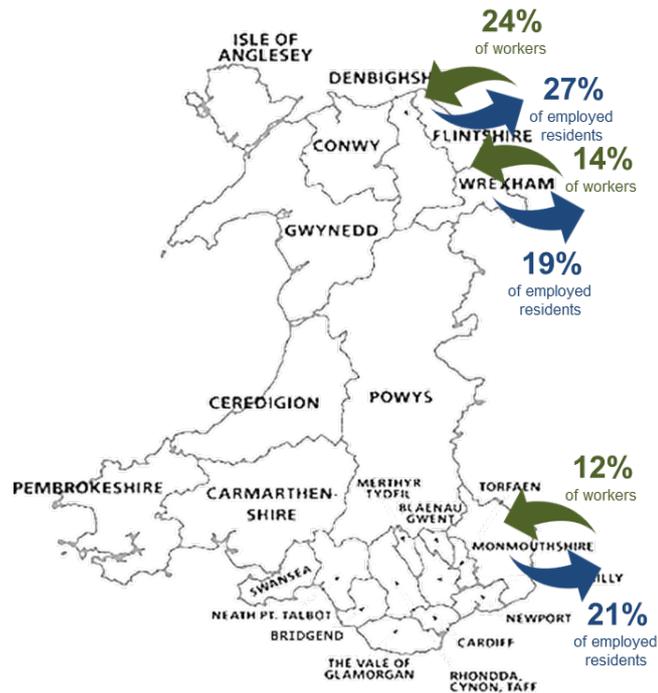
## Maintaining market access with regulatory difference

15. As mentioned in the opening statement of this White Paper, one of the key features of our economy is its deep integration. This is evidenced not only through Scotland's and Northern Ireland's overwhelming reliance on domestic UK trade, or the hundreds of thousands of commuters crossing from one UK nation to another each year. Our tourism industry provides a similarly compelling example, in 2019, Great Britain's residents took a total of 122.8m overnight trips to destinations in England, Scotland, or Wales. This amounted to 371.8m nights and £24.7bn was spent during these trips<sup>4</sup>.

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<sup>4</sup> VisitBritain, Great Britain Domestic Overnight Trips Summary – All Trip Purposes, 2019, <https://www.visitbritain.org/great-britain-tourism-survey-latest-monthly-overnight-data>

Figure 2. Cross-region commuting between England and Welsh local authorities<sup>5</sup>



16. As the EU regulatory powers fall away, there is a danger of regulatory barriers emerging. These would bring risks not just to the wider UK economy, but also to England, Scotland, Wales and Northern Ireland individually. Any reduction in Scottish and Welsh GDP is likely to be 4 and more than 5 times larger respectively, in comparison to the overall UK GDP loss, given their high degree of integration with the rest of the UK.
17. Without an up-to-date, coherent market structure, economic barriers could block or inhibit trade in goods across the UK, and services could be significantly and detrimentally impacted. Complexities in key sectors such as construction could arise, were differences in regulations to emerge over time. If England and Scotland diverged on their approach to building regulations or processes for obtaining construction permits, it would become significantly more difficult for construction firms to design and plan projects effectively across the UK. Moreover, different approaches to the regulation of construction professionals, such as differing qualifications for plumbers and technicians, could limit access to skilled construction workers, and make it harder for Scottish construction companies to bid for contracts in England.
18. Even in areas where specific powers are not returning, the absence of EU rules could make it easier for new barriers to arise. This could include areas of significant future economic activity, and new professions and products that play an important role in driving the UK's scientific and technological leadership. For example, if different qualifications or other regulations on professionals working in Artificial Intelligence emerged in England and Wales, this could deter workers from qualifying for the smaller Welsh market, limiting growth and investment

<sup>5</sup> ONS, Census, 2011.

there. This could also increase costs for companies looking to hire such workers from across the UK and reduce the UK's global attractiveness to foreign investment in new technologies.

19. The above costs could also ultimately reach consumers, increasing prices, or decreasing choice. It is therefore clear that significant and unmanaged economic barriers across the UK could not only cause serious harm to both the interests of our business and consumers, but also threaten the prosperity of the UK economy as a whole.

## Common Frameworks

20. The UK Government is already engaging in a process to agree a common approach with the devolved administrations as part of its vision for the UK Internal Market. The Common Frameworks programme is the mechanism most advanced in its development to address regulatory coherence. Common Frameworks are designed to support the functioning of the Internal Market, the management of common resources and the UK's ability to negotiate, enter into and ratify trade and other international agreements.
21. Common Frameworks aim to protect the UK Internal Market by providing high levels of regulatory coherence in specific policy areas through close collaboration with devolved administrations to manage regulation. They do this by enabling officials to work together to set and maintain high regulatory standards. However, Frameworks on their own cannot guarantee the integrity of the entire Internal Market. As they tend to be sector-specific, they do not address the totality of economic regulation or the cumulative effects of divergence, i.e. the consequences of regulatory difference in one sector that affects other sectors. Finally, they do not fully address the question of how best to substitute the wider EU ecosystem of institutions and treaty rights had on the UK Internal Market.
22. The UK Internal Market legislation discussed in this White Paper complements Frameworks by providing a baseline level of regulatory coherence across a wider range of sectors. This means that the areas without a Common Framework will still benefit from a low-level regulatory coherence underpinning. Crucially, market coherence will be provided for issues that fall around or between individual sector-focused frameworks.

## Scope

23. In order to provide UK citizens and businesses with security, the Market Access Commitment will cover the UK economy across goods and services. Reserved areas will be out of scope including, for example, fiscal and monetary policy, and intellectual property regulation. Taxation and spending, captured by the fiscal frameworks, will also not be covered. Certain social policy measures with little Internal Market impacts, and pre-existing differences and policies, will also be excluded. Ongoing monitoring will assess the impact of localised divergences, for example between Combined Authorities in England.

## Key objectives

24. The Government's priority in developing these proposals is to protect opportunities for business, consumers, workers and the third sector in all parts of the UK. The Government values the principle of devolution and believes that the UK's exit from the EU offers the chance to support the devolution settlements, while maintaining the highly successful functioning of the UK Internal Market.
25. As set out above, the UK Internal Market system will therefore be driven by the following three overarching policy objectives:
  - a) to continue to secure economic opportunities across the UK;
  - b) to continue competitiveness and enable citizens across the UK to be in an environment that is the best place in the world to do business; and
  - c) to continue to provide for the general welfare, prosperity, and economic security of all our citizens.
26. These objectives will be supplemented by the following three supporting aims:
  - a) to continue frictionless trade between all parts of the UK;
  - b) to continue fair competition and prevent discrimination; and
  - c) to continue to protect business, consumers and civil society by engaging them in the development of the market.
27. Finally, the UK Internal Market will also follow two main design rules:
  - a) foster collaboration and dialogue; and
  - b) build trust with business and maintain openness.

## A legislative underpinning for the UK Internal Market

28. The Government will seek to introduce new legislation that will commit, to all citizens and businesses, free access to the economic activity across the UK. This will ensure continued market access across the UK, delivered through the principles of mutual recognition and non-discrimination. Without such a legislative underpinning, unnecessary regulatory barriers could emerge between the different parts of the UK. Businesses need certainty and clarity to operate smoothly across the UK and encourage investment, and only this package of interventions enshrined in law can fully meet this objective. In the absence of specific Internal Market legal provision, courts faced with businesses seeking to prove their rights will lack clear guidance about governments' intentions.
29. The Government's aim is to ensure this legislative underpinning operates on a full UK-wide basis, taking into account the obligations that apply under the Northern Ireland Protocol (our approach to which was set out in the Command Paper, the UK's approach to the Northern Ireland Protocol)<sup>6</sup>. A central part of that approach will be legislating for full unfettered access for Northern Ireland goods to the UK

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<sup>6</sup> UK's approach to the Northern Ireland Protocol, <https://www.gov.uk/government/publications/the-uks-approach-to-the-northern-ireland-protocol> (May 2020).

market by the end of this year, reflecting Northern Ireland's integral place in the UK's Internal Market and customs territory.

30. These measures will preserve the integrity of the UK Internal Market on an ongoing basis. The Government will look to build on precedent to ensure that we continue to have the most effective mechanisms to deliver that objective. We will also seek to ensure that there is widespread public understanding of the benefits of the UK Internal Market as an integral part of our union. In this White Paper, we invite thoughts and ideas on the best way to ensure that this message is effectively communicated.

## Maintaining high standards

31. The UK's exceptionally high standards will underpin the functioning of the Internal Market, to protect consumers and workers across the economy. These high standards are neither dependent on EU membership nor on what is agreed in Free Trade Agreements we sign with other countries. They are domestic standards. In many cases, the UK either goes beyond EU standards or is the first mover to improve standards before the EU. We will maintain this world-leading position moving forward.
32. Under the Government's proposed approach, the devolved administrations would retain the right to legislate in devolved policy areas that they currently enjoy. Legislative innovation would remain a central feature – and strength – of our Union. The Government is committed to ensuring that this power of innovation does not lead to any worry about a possible lowering of standards – by both working with the devolved administrations via the Common Frameworks programme and by continuing to uphold our own commitment to the highest possible standards.
33. The UK has some of the highest standards in the world on goods. The rules for non-food products, which in most cases apply across all of the UK, already mean that consumers are protected from the risks posed by dangerous or faulty goods. Examples include rules that makes sure:
  - consumer electronics like mobile phones, laptops and tablets are compliant;
  - cosmetics do not contain dangerous ingredients; and
  - toys do not present a choking hazard.
34. The UK also has some of the most robust standards on food, with world-leading food, health and animal welfare standards. We will not lower our standards nor put the UK's biosecurity at risk as we negotiate new trade deals. The Government remains committed to promoting robust food standards nationally and internationally, to protect consumer interests, and ensure that consumers can have confidence in the food they buy. We will continue to protect human, animal and plant life and health, and the environment and continue to cooperate with stakeholders across all four parts of the UK via bodies such as the Trade and Agriculture Commission.

35. We remain firmly committed to upholding our standards outside the EU and the European Union (Withdrawal) Act 2018 will transfer existing EU food safety provisions, including existing import requirements, into the statute book. These import standards include a ban on using artificial growth hormones in domestic and imported products and set out that no products, other than potable water, are approved to decontaminate poultry carcasses. Any changes to existing food safety legislation would require new legislation to be brought before the UK Parliament and the devolved legislatures.
36. The Food Standards Agency and Food Standards Scotland will continue to ensure that all food imports comply with the UK's high safety standards and that consumers are protected from unsafe food. Alongside this the UK will repatriate the functions of audit and inspections that are currently carried out by the European Commission to ensure that trading partners continue to meet our import conditions for food and feed safety, animal and plant health and animal welfare.
37. The UK has a proud record as a leader in health and safety in the work place, in many cases going beyond the requirements of EU law. The Health and Safety at Work etc Act 1974 (with parallel legislation in NI), which developed independently of the EU, introduces general duties on employers to ensure the health, safety and welfare at work of all their employees. UK businesses are more likely to have a health and safety policy, and to follow this up with formal risk assessment, compared to EU member states. We have one of the most successful health and safety records in the world, and perform consistently well compared to the EU average on key health and safety outcomes.
38. The UK has led on workers' rights. The UK offers a year of maternity leave; the EU minimum is just 14 weeks. The UK introduced two weeks' paid paternity leave in 2002; the EU has only recently legislated for this. The UK allows eligible parents to share paid leave – and so caring responsibilities – in the first year following birth or adoption; the EU does not provide for this right. The UK introduced the right to flexible working in the early 2000's – the EU is just catching up now. This applies to all employees in the UK – the EU agreed rules last year which will offer the right to parents and carers only. The UK banned exclusivity clauses in zero hours contracts in 2015; equivalent EU rules were only agreed in 2019.
39. The UK has a world class competition regime in the Competition and Markets Authority (CMA). This is independent of the EU's standards, having adopted robust measures voluntarily in the Competition Act 1998 and the Enterprise Act 2002 – and the UK's regime already exceeds that of the EU's in areas. The UK is the only country in Europe whose competition authority can impose enforceable structural and behavioural remedies following a market investigation. These powers go beyond Regulation 1/2003, from which the EU derives its powers for a sectoral inquiry. The UK also has criminal sanctions for cartels and director disqualification powers which the European Commission and most Member States lack.
40. The UK has a robust and progressive consumer protection regime. In recent years, the UK has been influential in resisting harmonisation of EU law that would have reduced these standards. The UK has successfully negotiated to maintain

flagship protections to preserve consumer confidence in areas such as faulty goods and online ticketing platforms. Working alongside the CMA, the objectives for international policy are to build on and develop international consumer enforcement cooperation where possible. The UK was the first Member State to develop a consumer protection regime for purchases of digital content, an approach that the EU has now adopted. Unlike most Member States, the UK stands out in giving consumers a right to an immediate refund if a good is faulty.

41. The UK was the first major economy in the world to set a legally binding target to achieve net zero greenhouse gas emissions from across the economy by 2050. The UK is a global leader in the fight against climate change, and future Free Trade Agreements will not get in the way of this. Our innovative framework of carbon budgets established under the Climate Change Act 2008 ensures continued progress towards our emission reduction targets. We are seeking to increase ambition under the Paris Agreement through the process of revising Nationally Determined Contributions (NDCs). As incoming COP26 President in partnership with Italy, we will continue to work tirelessly with our partners to deliver the increased ambition needed to achieve the objectives of the Paris Agreement.
42. The UK has world-leading environmental standards. The Environmental Performance Index, produced jointly by Yale and Columbia Universities in collaboration with the World Economic Forum, ranked the UK in the top 10 of 180 countries in 2018. The UK has been quick to take action against single-use plastic, with a ban on the supply of plastic straws, drinks stirrers and cotton buds coming into force in October 2020, nearly a year ahead of the EU's own timetable of July 2021. The UK's Clean Air Strategy, published in January 2019, was praised by the World Health Organization as "an example for the rest of the world to follow", setting out ambitious new goals to cut public exposure to particulate matter pollution based on stringent targets.
43. The UK's environmental standards in many areas go beyond the EU's. The UK is introducing one of the world's strictest ivory bans to protect elephants from poaching, with our legislation adopted in December 2018 – the same year that the EU began consultations on tightening restrictions though it is yet to legislate on this issue, despite pressure from stakeholders. The UK is taking the lead in marine protection, leading the '30by30 initiative' to ensure that at least 30% of the global ocean is protected by 2030 – this represents a trebling of the present target. The UK-led Global Ocean Alliance will call for this ambition to be adopted at the next Convention on Biological Diversity conference in China. The UK's microbead ban came into effect in January 2018, a landmark step in the introduction of one of the world's toughest bans on these harmful pieces of plastic. The EU did not move to introduce an equivalent ban until 2019.
44. In maintaining these high levels of protection, we are also building in the capability to review them so that they can keep pace with best practice and where appropriate simplify them to help businesses comply.

## International trade

45. Ensuring the UK remains a coherent and integrated economy will be key to fostering all the opportunities in trade. A system that delivers across the whole of the UK will help develop and implement ambitious trade deals that can bring UK-wide benefits to businesses and citizens. It will also help make the whole UK more attractive to foreign investment and build confidence in our present and future trade partners. Helping business thrive will support UK exports, and enable companies to become more competitive, boosting the UK's trading reputation around the world. A well-functioning Internal Market system, tailored to the interests of businesses across the UK, will therefore play a vital role in supporting our long-term global trade ambitions, ensuring the UK as a whole is capable of competing on the international stage.

## Securing investment

46. The Government will ensure that where towns and cities have previously been left behind, they will be able to benefit from UK-wide government initiatives such as protecting the UK Internal Market, as part of the levelling-up and Coronavirus recovery agendas. This package of measures will help us deliver on our ambition to ensure our advanced economy provides benefits and access to opportunities to businesses and citizens across the UK.
47. The Government will also consider which spending powers it needs to enhance the UK internal market, to help people and businesses in each nation to take advantage of it, and to further its ambition to level up every part of the UK. In exercising any such new powers, the Government will provide funding fairly across the nations.

## Part 2: Mutual recognition and non-discrimination

48. The proposed legislation will be based on the principles of mutual recognition and non-discrimination, and will apply across both goods and services. Alongside other elements such as Common Frameworks, these principles will ensure that the UK Internal Market works for all.
49. The fundamental aim of all mutual recognition systems is to ensure that compliance with regulation in any one territory is recognised as compliance in the other(s). For example, if a good produced in Scotland, and adhering to the Scottish labelling regulations, can be placed on the Scottish market, it can also be placed on the English and Welsh markets without the additional need to comply with English or Welsh requirements.
50. Mutual recognition will not, however, be appropriate or possible in all areas. Within a mutual recognition system there will be, "exclusions". These will refer to areas outside scope when the system comes into force. This has been a feature of the UK Internal Market since 1707 (such as legal systems). Any exclusions will need to be agreed at the outset and will not generally be expected to change. If

the UK Government or a devolved administration introduces regulation that falls within an exclusion, then the mutual recognition system will not apply, such as in taxation and spending, existing reserved areas, or social policies with little Internal Market impact.

51. The mutual recognition system will be combined with a non-discrimination principle. This will protect businesses, workers and consumers from discrimination by ensuring that an authority must regulate in a way that avoids differential and unfavourable treatment to goods or services originating in another part of the UK to that afforded to its own goods or services. The focus of the non-discrimination principle will be on ensuring that any discriminatory barriers are addressed (e.g. regulating against goods from a specified nation within the UK), while mutual recognition will aim to reduce the overall regulatory burden a business might face as a result of diversity in regulation affecting goods and services. The Government's view is that direct discrimination should be prohibited; it is also seeking views on how to legislate for indirect discrimination. The two respective definitions of discrimination are set out in Part 2 below.

### Part 3: Governance, independent advice, and monitoring

52. Intergovernmental arrangements will have to be expanded to account for Internal Market legislation and we will support these arrangements with two independently undertaken functions.
53. **The first function** will provide regular ongoing monitoring of, and reporting on, the health of the UK Internal Market as it develops. This will include monitoring the cumulative impacts across sectors or regions and horizon-scanning for emerging trends.
54. **The second function** will be to proactively gather business, professional, and consumer views to strengthen the evidence-base needed for independent advice and monitoring.

### Part 4: Subsidy control

55. Subsidies refer to support (financial or in kind) from any level of government to selected businesses. As a result of our membership of the EU, we have been subject to EU rules on State Aid regulated by the European Commission. It is important that we continue to have a coordinated approach to the way we support businesses across the UK.
56. The UK Government will work with the devolved administrations to determine how subsidies should be given in a coherent way across the UK that protects the coherence of the Internal Market, whilst ensuring the devolved administrations can continue to control their own individual spending decisions within this system. Given that the rules relating to subsidising business are an issue on which a uniform approach is key to our ability to remain a competitive economy, the Government's view is that this should be reserved (or excepted, in Northern

Ireland<sup>7</sup>). While not covered in this paper, it is important to enable the Government to legislate for a single, unified subsidy control regime, should it decide to do so.

## Part 5: Conclusions

57. This will provide certainty and consistency to businesses and consumers. At a time of deep economic uncertainty due to COVID-19, providing stability will be key to encouraging investment across the Internal Market, helping to ensure the UK's recovery is as strong and as swift as possible. This will uphold our shared prosperity as a Union and allow us to flourish as an independent nation outside of the EU.

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<sup>7</sup> Scottish and Welsh devolution is split between reserved issues (where the UK Parliament is responsible for legislating) and devolved issues (where the devolved legislature can legislate). Northern Ireland devolution has different terminology and splits into three areas: 1) transferred matters – where the Northern Ireland Assembly has full legislative powers; 2) excepted matters – where the UK Parliament retains legislative responsibility; and 3) reserved matters – where legislative authority generally rests with the UK Parliament, but the Northern Ireland Assembly can legislate with the appropriate consent from the Secretary of State. The Government's position is that subsidy control should be excepted in Northern Ireland.

# Setting the scene: the history of our Internal Market – a story of shared prosperity

58. For centuries, the UK Internal Market has been the bedrock of our shared prosperity ever since 1707 when the Acts of Union formally united England and Wales with Scotland. The Union predates the German Zollverein, the economic unification of Italy and the economic reforms introduced after the creation of the French Republic. There can be little doubt that then – as now – the scope and scale of a wider economic base and access to a bigger Internal Market were a benefit to all parts of the United Kingdom.
59. The contemporary desire to boost and revitalise the economy post COVID-19 is reflected in the original Treaties themselves. Investment in manufacturing was secured with conditions as part of the negotiation, and 15 of the 25 separate articles of the 1707 Treaty of Union dealt with economic matters. The Treaties provided for many of the essentials of the UK Internal Market, for example Articles 16 and 17 standardised how goods were to be weighed, measured and paid for. Yet at the same time, the Treaty did not fundamentally change the religious, legal or local government systems of Scotland or England & Wales.
60. The Act of Union saw immediate boosts in Scottish trade, through increased links with the Baltic and elsewhere for Scottish merchants. The echoes of that growth resound through to the present day – modern Scottish towns like Crieff and Falkirk originally thrived as popular merchant markets following the increase in trade.
61. By the 1720s, the Glasgow and Clyde ports were growing as a result of increased trade made possible by the Union. Wales also made the most of the opportunities that these expanding markets provided, both within the United Kingdom and across the globe. Drovers guided their livestock from the hills of Wales to market in London. Coal and iron industries saw Wales at the heart of the industrial revolution, spawning ever developing industries and supply chain in areas like copper-smelting and tin plate production. South Wales became synonymous with exporting coal and iron and steel. North Wales exported slate to roof buildings across the globe.
62. The Union continued to grow with the Act of Union in 1801. Northern Ireland, too, has benefitted from a close economic relationship with the rest of the UK. During the 19<sup>th</sup> Century, Belfast emerged as a major industrial city, famous for its linen and shipbuilding industries.
63. By the mid-20<sup>th</sup> century, the Internal Market connected the economies of England, Wales, Scotland and Northern Ireland, with the provisions of the Acts of Union playing a key role in keeping markets open. In 1973 the United Kingdom joined the European Economic Community, and had to accept the supremacy of EC (later EU) law. Under the devolution settlements, which were introduced from

1998, it was necessary to create a system which kept the UK Internal Market open, and which was compatible with the supremacy of EU law.

64. Under the devolution settlement, the devolved legislatures and administrations cannot act incompatibly with EU law. This meant that EU laws (rather than UK law) provided the common UK-wide approaches and rules for market access. This will remain the case until the end of the Transition Period, which will end on 31 December 2020.

# Part 1. Introduction to the Internal Market today – supporting an integrated economy

## Introduction

65. The UK is a highly integrated, yet diverse economy, reflecting the historic and complex links between England, Scotland, Wales, and Northern Ireland. These connections support businesses, workers and consumers, ensure the free flow of capital, labour, goods and services, and facilitate our everyday lives in a way that we take for granted.
66. Essential to the integration of the UK economy is our shared regulation, which provides economic stability and certainty to UK citizens, facilitates frictionless trade, and creates opportunities for people to shop, work and innovate across the country. This shared UK marketplace facilitates trade and investment, allows exploration of new technologies, and drives productivity and growth while benefiting consumers. It also helps professionals move across the UK with ease so that they can provide services closer to their customers and develop business in those parts of the UK that offer the best conditions.
67. Much of the recent regulation in the UK has been shaped through our membership of the EU, creating a high degree of uniformity<sup>8</sup>. Following the end of the Transition Period, powers previously exercised at EU level are flowing back to the UK Government and the devolved administrations in line with the devolution settlements. Each devolved administration will therefore be gaining the ability to regulate in new areas such as agri-food, chemicals, waste and fisheries<sup>9</sup> (see diagram on page 17). As a result, the UK will now have the opportunity to develop an alternative regulatory system supporting the free flow of goods and services through the whole economy.

## Previous stakeholder engagement

68. The Government has engaged a number of stakeholders throughout the policy development process. This engagement has included businesses and representative organisations from the many sectors and industries across the UK, as well as consumer groups and academics. The policy set out here has benefitted hugely from their insights on how the UK Internal Market contributes to the effective operation of UK businesses, and on the potential effects of the regulatory landscape on the wider economy and civil society. Input from international policy experts, from governments and academia, in other nations

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<sup>8</sup> Not all areas have been shaped to the same degree, with services regulation generally less closely harmonised than goods regulation for example.

<sup>9</sup> Throughout this paper we use the term 'devolved' as shorthand to mean 'devolved' in Scotland and Wales and 'transferred' in Northern Ireland. We also use the term 'reserved' as shorthand to mean 'reserved' in Scotland and Wales and 'excepted' in Northern Ireland.

who have faced similar policy challenges, has also been incorporated, including from Spain, Canada, Germany and Switzerland.

69. From stakeholder engagement to date, the Government is aware that businesses are anxious to avoid supply chain and logistical disruptions, which may emerge as a result of multiple parallel regulatory regimes, presenting particular challenges for SMEs. Stakeholders have consistently emphasised how the smooth operation of the UK marketplace is critical for their operations. For example, businesses in ‘just in time’ parts of UK supply chains, such as manufacturing, retail, parts, textiles, agri-food, defence and chemicals, rely on the rapid movement of goods within the UK. These businesses highlighted that delays impact the whole supply chain network through increased costs and loss of end customers. Increased costs either must be absorbed by the supply chain, challenging the operability of those businesses operating on smaller profit margins, in particular SMEs, or be passed onto consumers, with a knock-on effect on the wider economy at a time when many businesses and citizens are still struggling to recover from the impact of COVID-19. The Government has drawn on this and other evidence whilst preparing its legislative proposals.

## This White Paper

70. The purpose of this White Paper is to set out the Government’s plan for the key objectives and application in UK of our Internal Market system for the whole of the UK, and to seek additional stakeholder views on some of the details of how this system should function. In the chapters that follow, we explain how the UK’s Internal Market is currently organised, including the evidence for a high level of interconnection across the UK, and the benefits this gives us all for trade. We then examine the proposed aims of the UK Internal Market system and set out its targeted scope. This includes describing the legislative underpinning for the Internal Market to provide a legal safety net to business, professionals and consumers, which cannot be provided through purely administrative channels. Finally, the White Paper sets out the Government’s stance on the formal reservation of subsidy control as this power returns from the EU.
71. There are three annexes:
- **Annex A** – providing the relevant analysis and evidence on the UK Internal Market.
  - **Annex B** – exploring the known international models for managing regulatory difference.
  - **Annex C** – summarising recent and current inquiries relevant to UK Internal Market policy.

## The present and the future of the UK's Internal Market

### What is the Internal Market?

72. The UK's Internal Market is the set of rules which ensures there are no barriers to trading within the UK. Like any market, the way these relationships work is closely connected with our shared institutions and practices – including those linking up governments, business, consumers, and wider stakeholders.

### How does the UK Internal Market operate currently?

73. Stakeholder engagement has been largely reflective of the data that evidences our economic integration, referred to throughout this paper. For example, a Scottish agricultural organisation stated that the UK market remains the most significant interest for Scottish agriculture and highlighted the need to ensure that the Internal Market continues to operate as an open economy. Similarly, a Welsh agricultural organisation commented that smooth cross border trade is essential for Welsh farmers.
74. Census data focused on the numbers of commuters across the UK mentioned earlier in this paper indicates a real integration rather than the presence of a dominating employer or cluster of economic activity on one side of the border. Regarding more permanent movement of people, according to the ONS, all devolved administrations are net recipients of migrants from the rest of the UK combined.
75. It is worth noting that the integration of the UK economy does not seem to be driven by geographical closeness: BEIS analysis<sup>10</sup> shows that even after accounting for geographic distance, whether regions have a shared border, economic size and a range of cultural factors, we see more trade within the UK compared with other regions and countries, indicating lower trade costs within the UK.

### Benefits of an integrated Internal Market

76. The Government's stakeholder discussions have revealed the importance of a seamless Internal Market to allow business to develop efficient supply and distribution chains for goods. Having consistent regulation throughout the UK was seen as a way of reducing business complexity and cost and unlocking efficiencies and economies of scale, which in turn increases international competitiveness. The inverse is also true: a Scottish food manufacturer observed that, changes and additional regulatory burdens could reduce their competitiveness against businesses in the rest of the UK and potentially against EU businesses as well.
77. Recognising the greater possibilities for regulatory barriers post-Transition Period, stakeholders in multiple goods sectors raised concerns that regulatory barriers could increase operating costs in necessitating adaptation to multiple regulatory regimes. For example, future divergence in packaging regulation in the pursuit of differing policy ambitions was highlighted as a risk by manufacturing

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<sup>10</sup> For further detail on results and methodology please refer to the analytical annex to this publication.

stakeholders, in its potential to significantly increase production and transport costs, and compromising supply chain viability. Businesses in goods supply chains across a number of sectors agreed that impacts would be felt across the business base, and particularly by SMEs. A clinical research organisation observed that changes in regulations are more burdensome for a smaller company in terms of learning, reacting and then responding. Similarly, a representative of an organisation in the construction sector raised the concern that larger businesses would be able to adapt while the SME businesses would remain unprepared.

78. The benefits for business of an integrated UK market have important implications for consumers. One consumer group highlighted that, as businesses create efficient supply chains and take advantage of greater economies of scale, consumers gain greater access to products from across the UK as well as reduced prices. A strong UK brand influences consumer confidence in product quality both domestically and abroad and can help improve the volume of UK exports. Research has shown that a 'made in Britain' label has a positive effect on overseas demand<sup>11</sup>, and that customers will, in general, pay a premium for British-branded goods above English, Scottish or Welsh goods (notwithstanding the benefits of national branding).<sup>12</sup> A highly integrated Internal Market plays an important role in protecting consumer interests as well as the general welfare of UK citizens and a strong UK economy that acts as an advertisement for inward investment and export opportunities.
79. In this context, unmanaged regulatory differences can impede business growth and reduce its contribution to the economy, affecting consumer prices. Indeed, consumer groups highlighted that regulatory differences could create consumer confusion and risk loss of confidence for consumers both within the UK and for those consumers overseas who buy into the UK brand. They also highlighted the potential for reduced consumer choice, if businesses were to fail or new barriers were created that prevented the marketing of a product or provision of a service in one part of the UK. This point was also made by businesses: a food sector business observed that if the cost of accommodating regulatory differences in other regions became too high, they would have to withdraw from the market in that region. Consumer groups highlighted that these issues could be compounded by the current consumer landscape where, in their opinion, there is already intensified underrepresentation of Scottish, Welsh and Northern Irish consumers.

### **How does regulatory difference affect business?**

Differences in regulation **can have the equivalent effect of a tax or a tariff on products or services** from other jurisdictions because they introduce an additional cost for producers.

**The OECD identifies three types of direct costs facing businesses as a result of regulatory differences:** specification costs (e.g. modifying products, running separate production lines, or creating different varieties to service

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11 See "the Value of made in Britain", Barclays report, commissioned by the Centre for Economics and Business Research, 2014 <https://cebr.com/reports/value-of-made-in-britain/>

12 See report by Attest on "How British brands are perceived in the UK and USA" <https://www.askattest.com/blog/news-and-trends/british-brands-perception>

different markets), familiarisation costs (e.g. to understand the different regulatory requirements), and conformity costs (e.g. to prove that a product is fit for sale in the other market).

In an international context, the World Bank Technical Barriers to Trade Survey reports that the one-time specification costs – which represent the greatest barrier to market entry – make up 4.7% of the annual value added for the firms in the survey<sup>13</sup>. For example, the Society of Motor Manufacturers & Traders estimates that obtaining whole vehicle approval can take between 6 to 18 months to obtain, and can cost anything between £350,000 to £500,000, without including indirect costs<sup>14</sup>. Certification fees for farming and growing to Soil Association or EU organic standards can cost between £399 to £1,060 depending on the size of the registered land<sup>15</sup>.

80. BEIS economic modelling of new differences in regulation in selected sectors also shows that they could drive an economically significant wedge between producer costs in the ‘home’ UK market and consumer prices in the ‘destination’ UK market.

### **The cost of cumulative regulatory differences, selected sector case studies**

#### **Retail & Wholesale**

A realistic scenario of several small policy differences (modelled through differences in food safety, labelling and product packaging) could result in costs equivalent to a 2% tariff for retailers and wholesalers<sup>16</sup>. For example, if these policy differences were to arise between Scotland and the rest of the UK, Scotland’s retail & wholesale sales to the rest of the UK could initially decrease by 7%, or by £433m<sup>17</sup> based on current annual trade volumes.

Retail transactions totalled £366bn in 2017 and represent approximately 42% of total average household spending across the UK, which means that even small changes in prices might have a significant impact on consumers<sup>18</sup>.

#### **Construction**

Economic modelling of divergence in regulation in the construction sector shows that while individual regulatory differences create only small increases in the costs of trading with the different parts of the UK, in a realistic scenario of several small policy differences, new barriers could create the equivalent of a tariff of 3%, while a moderately more impactful scenario of policy divergence in the construction sector could lead to a cumulative tariff equivalent of over 8%<sup>19</sup>.

13 OECD, International Regulatory Co-operation and Trade. Understanding the Trade Costs of Regulatory Divergence and the Remedies, 2017.

14 Society of Motor Manufacturers and Traders, SMMT Issue Paper, November 2016.

15 Soil Association, Certification fees for farming & growing to Soil Association or EU organic standards, April 2020.

16 These figures are based on modelling estimates and an adapted OECD Regulatory Heterogeneity and Services Trade Restrictiveness methodology. For more details on the results and methodology used, please refer to the analytical annex. See also Nordas, H. Services Trade Restrictiveness Index (STRI): The Trade Effect of Regulatory Differences (2016).

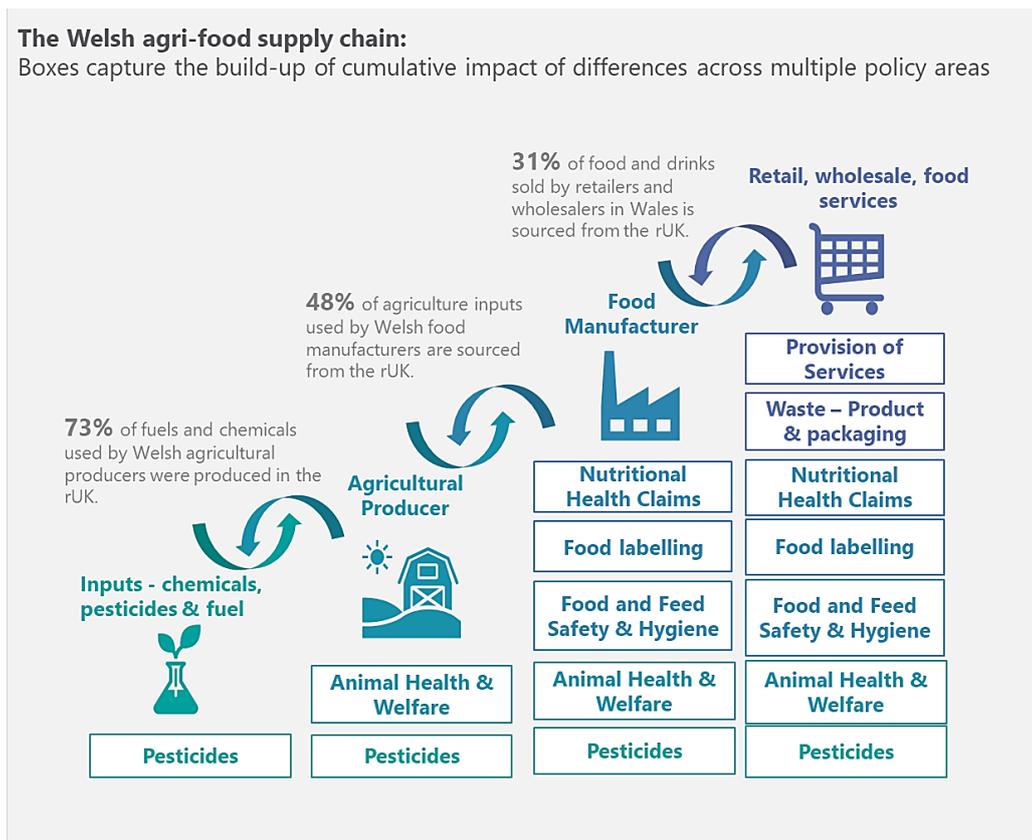
17 We apply the estimated % reduction trade flows to 2018 data from Export Statistics Scotland, using value of Scottish Retail & Wholesale output to the rest of the UK.

18 ONS, Consumer trends time series, 30 June 2019. British Retail Consortium, Annual Payments Survey, 2018.

19 See note 17 above.

81. These costs triggered by regulatory differences can have spill-overs across the highly integrated supply chains that span the UK market, i.e. impacts on others across the economic network. Businesses may be restricted in their choice of suppliers or face higher prices for inputs, which they may pass on to their buyers or consumers. Reducing the number of businesses active in a market can also have large impacts on the degree of competition, potentially increasing prices for the end-consumers or crowding out smaller businesses.
82. The below image (Figure 3) shows the levels of integration of Wales’ agri-food supply chain with the rest of the UK and the large number of regulatory interventions which could impact upon the activities that take place within it. According to the EUREGIO dataset from 2010, Welsh food and drinks manufacturers source 48% of agriculture inputs from the rest of the UK.<sup>20</sup> Food and drink manufacturers often sell their products through retailers in other UK markets. Approximately 31% of food and drink sold by Welsh retailers and wholesalers were produced in another part of the UK.

*Figure 3. Mapping of policy areas affecting each stage of a typical agri-food supply chain, on the example of Wales*



83. The image below (Figure 4) highlights the potential costs which could be passed along both to the businesses and customers throughout a supply chain. If uncoordinated, multiple regulatory differences at different stages of the supply chain have the potential to pass excessive and unnecessary administrative and financial burdens to both businesses and consumers.

<sup>20</sup>Defined as inputs from ‘Food, Beverages and Tobacco’ to ‘Distribution’, as defined in the EUREGIO dataset (2010). EUREGIO data is experimental and the granularity of this example means the reliability of such figures should be treated with some caution.

**Figure 4. Illustration of the build-up of direct and indirect costs at each stage of the food supply chain, on the example of ‘the humble sandwich’**

As an example, consider **the humble sandwich** sold in a supermarket or a food outlet. With an average price of £2.00, around 8.2 billion sandwiches are purchased every year in the UK



The final sandwich price on the shelves of a supermarket or a small sandwich shop could reflect:

- **indirect costs** passed on from suppliers such as food manufacturer having to comply with different food labelling and packaging requirements across the UK. The estimated (one-off) cost to relabel per unique product type is between £4,000 - £7,000<sup>1</sup>
- **direct costs** of having different recycling requirements for the packaging across the UK



The sandwich maker's pricing would in turn reflect the:

- **indirect costs** of farmers having to comply with different animal & plant health regimes across the UK for the meat used in the sandwich, or the different pesticides residues in the tomato and lettuce
- **direct costs** of different food safety and labelling for this product



Using pesticides as their inputs, farmers would also need to absorb:

- **indirect costs** of chemicals producers, losing economies of scale as a result of not being able to produce certain bulk chemicals
- **direct costs** of different animal & plant health or pesticides regulations.

1. British Sandwich & Food to Go Association, 2020 2. Campden BRI/Defra (2010). Updated to 2019 prices. *Developing a Framework for Assessing the Costs of Labelling Changes in the UK*

Source: Infographic produced by the Department for Business, Energy and Industrial Strategy (BEIS)

84. If left unmanaged, the cumulative burden of multiple regulatory differences could create significant costs that become a deciding factor in business decisions to produce, trade and invest UK-wide. An inquiry by the Canadian Standing Senate Committee on Banking Trade and Commerce estimated that the effect of eliminating internal trade barriers in the Canadian economy would range between 0.05% and 7.0% of gross domestic product, or between C\$1 billion and C\$130 billion. It should be noted though that Canada was facing a high degree of Internal Market fragmentation, with significant divergence between provinces.<sup>21</sup>
85. While currently the costs of trading between the different constituent parts of the UK are low, an increase would be likely to have a significant impact on GDP. In a modelled scenario where intra-UK trade costs increased to the level seen between German states, UK GDP would reduce by £7.3 billion. If barriers exceeding those found in Germany were introduced the UK GDP loss could be greater.<sup>22</sup> However, these costs would likely not be distributed evenly. Instead, economic modelling shows that, in relation to the size of their economies, the reduction in Scottish and Welsh GDP would likely be nearly 4 and more than 5 times larger, translating into absolute GDP losses of £1.9 billion and £1.2 billion for Scotland and Wales respectively. BEIS analysis of higher potential intra-UK trade costs shows that while local and international consumption would increase in response, this is insufficient to offset the negative impact on trade between the constituent parts of the UK.
86. Impacts such as these show the need to provide a single underpinning for the UK market that will prevent unnecessary barriers and new costs for businesses and

<sup>21</sup> <https://sencanada.ca/content/sen/committee/421/banc/rms/2jun16/Report-e.htm>

<sup>22</sup> While Germany and the UK differ fundamentally in terms of their history and current state of devolution, this example shows the hypothetical economic impact of moving towards a less integrated but nevertheless still highly functioning Internal Market.

consumers. Such an underpinning would provide an essential commitment to all business and consumers that their economic freedoms will be preserved, and with them, a complex web of economic interactions that impact on everyday lives.

## Managing regulatory difference: the need for a UK model

87. In light of such impacts, there already exists a recognition that regulatory coherence is an important part of the UK's overall economic prosperity. This is why the UK Government, jointly with the devolved administrations, are looking to agree a UK-wide, sector-by-sector approach to certain policy areas currently governed by EU law and that intersect with areas of devolved competence.
88. The Common Frameworks programme developed jointly between the UK Government and devolved administrations will create an intergovernmental policy development and decision-making process, and provide high levels of regulatory alignment in specific policy areas along with roles and responsibilities of each administration. All Frameworks will adhere to the principles agreed between the UK Government and Scottish and Welsh Governments at the Joint Ministerial Committee (European Negotiations) (JMC(EN)) in October 2017, and later by the Northern Ireland Executive. These include the principle that frameworks should be created where necessary to '*enable the functioning of the UK Internal Market whilst acknowledging policy difference*'.
89. Common Frameworks will support the devolution settlements and the democratic accountability of the devolved legislatures and will therefore be based on established conventions and practices. Frameworks will also maintain, as a minimum, the same degree of flexibility for tailoring policies to the specific needs of each territory as was afforded by the EU rules. In some policy areas, Common Frameworks will aim to establish and maintain common standards in order to maintain our high regulatory standards. Frameworks will be the vehicle for discussing and maintaining standards in relevant policy areas.
90. Common Frameworks will also ensure that officials work closely across participating administrations to design policy that benefits all parts of the UK and avoids disruptive divergence. This will still enable administrations to innovate but in discussion with other administrations and ensure that new regulations are interoperable. The Scottish Government officially withdrew from the UK Internal Market project in March 2019 but remains an active participant in the Common Frameworks programme. This has driven further the need to legislate to protect the areas that the Frameworks are not designed to cover.
91. Depending on the nature of the powers transferring from the EU, Frameworks may facilitate the setting up of new bodies and forums to take on functions previously captured through EU structures. There is a range of powers returning from the EU which will intersect with devolved competence<sup>23</sup>. This will directly impact on some Common Frameworks more than others. For example, DEFRA has placed multiple policy areas which are the subject of returning powers within

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<sup>23</sup> Cabinet Office, Revised Framework Analysis: Breakdown of areas of EU law that intersect with devolved competence in Scotland, Wales and Northern Ireland [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/792738/20190404-FrameworksAnalysis.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/792738/20190404-FrameworksAnalysis.pdf)

the scope of the Animal Health and Welfare Frameworks. This means that these Frameworks will be the vehicle used by the UK Government and devolved administrations to discuss with one another any potential introduction or changes to the regulation within scope. The Company Law Framework, however, will only allow the UK Government for Great Britain, and the Northern Ireland Executive for Northern Ireland, to do this for a few regulations. The Common Frameworks therefore vary greatly in the numbers of returning powers they cover.

92. Common Frameworks constitute a valuable mechanism to ensure all parts of the UK agree common approaches where possible. The additional cross-cutting measures set out in this White Paper, will be, however, necessary to complement them. This is for a number of reasons.
93. Firstly, Frameworks are not able to assess the wider economic impacts or knock-on effects of regulatory divergence, including how regulatory differences in one sector affects other sectors (the so called 'spill-over effect'). Secondly, Common Frameworks do not address how the overall UK Internal Market will operate once the UK has left the overarching EU system at the end of the Transition Period. Lastly, as Frameworks are limited to a specific number of policy areas, they will not account for the full UK economy across goods and services, and therefore will not be able to provide a comprehensive safety net for businesses and consumers.
94. As a result, in order to ensure that a post-EU UK Internal Market delivers continued fair, coherent, frictionless trade across all parts of the UK, these gaps need to be addressed through a more robust legal architecture.

## Trade in services: the need to understand the context of the wider ecosystem

95. Given the potential for different regulation across the UK to impact on the provision of services, it is important to also maintain coherence across services provision as the Transition Period concludes.
96. Intra-UK regulatory differences could create barriers to services trade. For example, construction projects across the UK are influenced by the regulation of construction professions in the 'destination' market. These might differ to those in the 'home' market of a construction firm. Economic modelling of regulatory differences in the regulation of construction professionals between the 'home' and 'destination' market suggest that these could build up to a cost equivalent of a 5% tariff if these differences were left unmanaged<sup>24</sup>. UK construction accounts for 6% of total UK annual GVA, or £116 billion<sup>25</sup>.

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<sup>24</sup> The reported ad-valorem tariff equivalents are based on modelling realistic divergence scenarios in selected services sectors, using the OECD's Services Trade Restrictiveness Index and gravity modelling. The number reported here corresponds to the STRI 'Restrictions to the Movement of People', where we attempt to capture the effects of uncoordinated policymaking over regulation and recognition of professional qualifications in the construction sector. For a more detailed discussion of the methodology and scenarios, please refer to the analytical annex.

<sup>25</sup> ONS, Regional gross value added (balanced) by industry: all NUTS level regions, 2019, 2016 price base.

### UK internal services trade

The UK Internal Market plays an equally big role for **services** as for goods. For each of Scotland, Wales and Northern Ireland, a large proportion of total services production and consumption is destined for, or originates in, another part of the UK, similar to the case with intra-UK trade in goods. In contrast to goods, where a relatively greater proportion of trade occurs internationally, services are more likely to be traded within the UK Internal Market. According to Export Statistics Scotland, the value of Scotland's services exports to the rest of the UK has consistently outpaced its international exports by around 2.4 times over the last ten years, while in Northern Ireland, official statistics show that 3 times as many services are purchased from Great Britain compared with international imports.

97. Separately, the UK Government plans to review the objectives for regulating professions and recognising international qualifications. The Government wants to make sure that professional qualifications support a productive economy and help maintain workforce supply after the end of the Transition Period. These findings will be implemented alongside, and will work together with, the approach to professional qualifications in the UK Internal Market.

## Scope of the Government's response to the evolution of the UK Internal Market

98. One of our key objectives for the UK Internal Market is to ensure the protection of intra-UK trade by avoiding the creation of unnecessary barriers caused by regulatory differences between the UK Government and devolved administrations (see below for a more detailed explanation of proposed Internal Market objectives). Given that we are looking to address the impacts of regulatory difference, we will be excluding areas of regulation in which the UK Government can set common rules within the UK. The scope of the UK Internal Market proposals will therefore exclude reserved/excepted areas to the extent they are reserved/excepted within each devolution settlement<sup>26</sup>.
99. Potential regulatory differences for goods in reserved/transferred areas due to the Northern Ireland Protocol will be considered separately, as outlined in Part 2.
100. As set out in preceding sections, the UK Internal Market system should be broadly focused on regulatory requirements that impact on the provision of goods or services. Given the wider effect of returning EU law, this is the area where the potential for new divergence will be most apparent, and where the impacts of divergence will be most costly without a market access commitment. The

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<sup>26</sup> Each devolution settlement is unique and the distinction between reserved and devolved powers (or reserved, excepted and transferred powers in Northern Ireland) can be complex – for example, policy areas can be devolved/transferred for one nation but not others. The scope of the UK Internal Market proposals will therefore exclude reserved/excepted areas to the extent they are reserved for each devolution settlement. Using the example of a policy area that is reserved for Wales but devolved/transferred for Scotland and Northern Ireland: the impacts of UK Government regulation on barriers between England/Wales will not be within scope, as UKG will be regulating across this territory. However, the impacts of UK Government regulation on barriers between England/Wales on the one hand and Scotland and Northern Ireland on the other would be within scope, as would the impacts of regulation by the Scottish Government and Northern Ireland Executive on barriers between each other and on England/Wales.

complexity of supply chains in the UK Internal Market means that differences across a wide range of regulation can create 'grit' to trade flows, often where it is not immediately obvious. The legislative system set out in this paper will therefore cover a wide range of regulation, with more detail on the specific scope of the legislative model provided later in this section.

101. It is important to recognise that most potential barriers to internal trade can come from differences in regulation which do not take the form of primary legislation. To preserve the UK Internal Market as an integrated trading space, the Internal Market system will cover wider regulatory powers, such as secondary legislation and regulation made, not just by governments, but also by other regulators concerned with regulating professionals and service providers. This should be in scope where it could significantly impact the UK Internal Market as a whole.
102. In the area of services, factors that impede trade flows will affect both industry and individual lives. With the UK being a services-based economy, but with a strong interaction with goods and production, consistency and certainty are vital. It is therefore important for the UK Internal Market system to facilitate the provision of services throughout the UK, whether they are based on professional qualifications, licensing or other authorisation schemes.

## The objectives for the UK Internal Market

103. The main objective of a UK Internal Market system is to guarantee the economic interests of business, consumers and workers, working with the grain of the UK's constitution to support devolved decision making. This means ensuring a robust and prosperous Internal Market that creates opportunity, maximises choice and best value for consumers, with decisions made as close to the businesses and citizens they affect as possible.
104. The three overarching objectives for the UK Internal Market system are therefore:
  - a) to secure continued economic opportunities across the UK;
  - b) to continue to increase competitiveness and enable citizens across the UK to be in an environment that is the best place in the world to do business; and
  - c) to continue to support the general welfare, prosperity and economic security of all our citizens.
105. In addition to these overarching objectives, there are three supporting aims:

### **Supporting aim 1: Maintain frictionless trade between all parts of the UK**

106. A key objective for any model of Internal Market should be to continue to protect the interests of businesses and consumers by ensuring they can continue to do business in all parts of the UK without unnecessary barriers. Such barriers, if allowed to emerge, could increase business costs, in some cases passed onto consumers, or reduce consumer choice. In some instances, they could add up if multiple areas of regulation are affected.

### **Supporting aim 2: Maintain fair competition and prevent discrimination**

107. Any Internal Market system should avoid economic protectionism. We should ensure that business or consumers in one part of the UK are not favoured over others, and that one part of the UK cannot create the potential to undercut businesses from a different part. Considerations of fairness are fundamental to a viable Internal Market system, not allowing for one part of the UK to discriminate against businesses from another part.

### **Supporting aim 3: Continue to protect business, consumers and civil society by engaging them in the development of the market**

108. Inclusion of business and consumer voices in regulatory policy making lies at the heart of the Government's vision for the UK Internal Market. This means a system that gives business, consumers and civil society a voice (a key aspect of an open government) within the regulatory regime that is likely to affect them, opening up the decision-making process and encouraging involvement in designing key features of regulation. This emphasis on inclusion aims to achieve greater responsiveness of a regulatory regime to the needs of those it is meant to work for.
109. Finally, the UK Internal Market will also have the following two design rules:

#### **Design rule 1: Foster collaboration and dialogue**

110. Any market system should encourage good intergovernmental relations by creating opportunities for different levels of government – central, devolved, local – to collaborate and engage in constructive dialogue, including increased transparency between the UK Government and devolved administrations, early discussion and parity of participation. It should also facilitate joint action on matters of mutual benefit between administrations in emerging and existing policy areas.

#### **Design rule 2: Build trust and ensure openness**

111. The system should embody the principles of open government and transparency towards stakeholders. This not only gives stakeholders a voice but also makes it easier to balance the needs of businesses and consumers. It should also provide channels and mechanisms to build trust between all involved parties, including between those advising (experts) and making regulation (legislatures) as well as between governments, and governments and stakeholders.

## **The case for a legislative underpinning as a Market Access Commitment**

112. As we move away from the system and rules of the EU Single Market, it is imperative that UK business and citizens are provided with a fundamental, legal commitment of continued market access to all of the UK. As some powers will be held by the devolved administrations, a Market Access Commitment will update fundamental economic protections and provide businesses with greater certainty as to the legal landscape.

113. The absence of such a market commitment would bring a number of significant challenges. Firstly, an increased unpredictability in the potential for regulatory differences will emerge between parts of the UK as we exit the Transition Period. While cooperation between governments will be key to a well-functioning Internal Market, it will not, on its own, provide the certainty that businesses need to operate smoothly across the UK. The change in legal context following the exit from the Transition Period is likely to impair the speed and clarity with which businesses make investment and supply chain decisions, including product requirements.
114. Secondly, we need to be able to address the barriers that could arise from regulatory differences. Trade frictions not only risk undermining economic freedoms, but also bring wider impacts for the welfare of citizens and the economy, set out in Part 1 above. The costs accrued as a result of trade frictions are likely to be passed onto consumers.
115. Thirdly, the experience of other countries such as Australia and Switzerland show that a legal underpinning can increase certainty for businesses and governments. Including this in legislation provides the greatest degree of protection against harmful barriers, and the greatest degree of clarity to businesses and consumers of their rights when trading across the Internal Market.

## Northern Ireland and the UK Internal Market

116. The free flow of goods and services within the UK Internal Market is of critical importance to Northern Ireland's economy and people. The Government remains fully committed to safeguarding Northern Ireland's rightful and essential place in this market as the Transition Period ends. Our approach to the implementation of the Northern Ireland Protocol, as set out in the May 2020 Command Paper on 'The UK's Approach to the Northern Ireland Protocol', and to a wider UK Internal Market system, as set out in this paper, demonstrate this commitment.
117. The arrangements agreed through the Northern Ireland Protocol reflect the unique circumstances of Northern Ireland, including the need to protect the Belfast (Good Friday) Agreement in all its dimensions. These arrangements will ensure that a hard border is avoided on the island of Ireland whilst preserving the integral place of Northern Ireland within the UK Internal Market. However, the Protocol is not codified as a permanent solution; it is designed to solve a particular set of problems and can only do this in practice as long as it has the consent of the people of Northern Ireland.
118. The Northern Ireland Command Paper sets out how we will implement the Protocol in a way that protects the economy of Northern Ireland and its place within the UK Internal Market. The paper sets out a four-point plan to ensure:
  - a) unfettered access for Northern Ireland's businesses to the rest of the UK;
  - b) no tariffs on internal UK trade;
  - c) no new customs infrastructure in Northern Ireland; and
  - d) Northern Ireland benefits from UK trade deals.

119. It should be noted that this White Paper does not set out the Government's approach to implementing the Protocol or delivering unfettered access, which have been covered in the May Command Paper. Nonetheless it does address, where appropriate, interactions with these Northern Ireland specific considerations.
120. As outlined in the scope section, this White Paper is focussed on the increased potential for regulatory barriers to the trade of goods and services within the UK as the Transition Period ends. Within this scope, there are some considerations for Northern Ireland that the legislative proposals set out below will take into account. Firstly, Northern Ireland will continue to apply a subset of EU goods rules for the purposes of avoiding a hard border on the island of Ireland. This means that any goods being placed on the Northern Ireland market will need to comply with those rules. Secondly, as set out in the Northern Ireland Protocol Command Paper, we will ensure that where Northern Ireland traders gain product approvals and certification for the Northern Ireland market from EU authorities and bodies, the UK will recognise those for the purpose of placing goods on Great Britain's market. Further guidance will be provided for Northern Ireland traders placing certain highly regulated goods on Great Britain's market.
121. The Internal Market proposals set out in this Paper will therefore provide the overarching architecture for the Internal Market, with some necessary adaptation to take into account the requirements of the Protocol and commitments on unfettered access. However, as mentioned in Part 1 'Northern Ireland and the UK Internal Market', the Protocol is built on the consent of the people of Northern Ireland and its alignment provisions might therefore only be temporary. The adjustments to the UK Internal Market system that are necessary to reflect the Protocol will therefore fall away if the alignment provisions in the Protocol cease to apply.
122. The chapters that follow provide more detail on Northern Ireland's role within the proposals. All of these will be shaped around the Northern Ireland-specific considerations outlined above, with more complex interactions for the legislative underpinning for goods than for services.

## International trade

123. As reflected in the devolution settlements, the UK Government is responsible for international relations of the whole of the UK and alone has the power to enter into international agreements binding on the whole or any part of the UK. The devolved administrations have competence to observe and implement international obligations that relate to devolved matters. The UK Government is responsible, as a matter of international law, for compliance with those obligations.
124. To ensure such compliance, however, consideration must be given to the important interactions between a well-functioning Internal Market in the UK and the implementation of future trade deals. As the arrangements in other countries demonstrate, the introduction and maintenance of collaborative relations to deal with regulatory barriers within a country helps its ability to develop and implement

ambitious trade deals that can deliver UK-wide benefits and prosperity to businesses and citizens. In the same way, the existence of an easily explained system for managing the Internal Market supports the ongoing attractiveness of a country for foreign direct investment; this view was echoed during the Government's engagement with stakeholders. An organisation representing the energy sector asserted that businesses like regulatory simplicity and stability and that companies invest in the UK because it is a highly stable market.

125. A coherent UK Internal Market that facilitates frictionless provision of goods and services will also support the UK's exporting ambitions. A system that helps our businesses to thrive domestically will drive businesses' ability to place their products and services on international markets. Reduced burdens and innovative regulation will be key to this, enabling high-performing companies to become more competitive and productive, and boosting the UK's already strong trading reputation around the world. These, and other impacts on the UK's trading relationships, will therefore feature as an important consideration in designing our Internal Market mechanism.

## Securing investment

126. The UK is already recognised as a top destination for international investment with the UK's total inward FDI stock at approximately £1.6 trillion in 2019, greater than that of France and Germany combined<sup>27</sup>. However, this investment is often unevenly distributed across the UK. The Government will consider which spending powers it needs to enhance the UK internal market, to help people and businesses in each nation to take advantage of it, and to further its ambition to level up every part of the UK. In exercising any such new powers, the government will provide funding fairly across the nations.

## Preserving the integrity of the UK Internal Market

127. Given these measures are intended to preserve the integrity of the UK Internal Market on an ongoing basis, the Government will look to build on precedent to ensure the continuity of the most effective mechanisms to deliver that objective. We will also seek to ensure that there is widespread public understanding of the benefits of the UK Internal Market as an integral part of the Union. The Government welcomes thoughts and ideas on the best way to ensure that this message is effectively communicated.
128. In addition, to ensure the continued success of the UK Internal Market following the Transition Period, the UK Government will seek to clarify the use of spending powers to support and promote the functioning of the Internal Market. This will provide certainty and transparency to help channel private and public investment to all parts of the UK.

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<sup>27</sup> UNCTAD country fact sheet: United Kingdom, data in USD converted at rate 1 USD = 0.783652 GBP.

## Part 2. Mutual recognition and non-discrimination

### The legislative underpinning for the UK Internal Market

129. The Government believes that a system of mutual recognition supported by a non-discrimination principle will provide an effective legislative means to deliver a smooth and fair trading space within the UK.
130. The fundamental aim of all mutual recognition systems is to ensure that compliance with regulation in one territory is recognised as compliance in another. This is useful to prevent discrimination against businesses from other parts of the UK, and to ease the burdens associated with complying with two sets of requirements. Mutual recognition is a known and well-tested system, used in countries such as Australia and Switzerland.
131. The experience of mutual recognition in other countries shows that it can provide a low-cost and decentralised way of dealing with differences in regulation. A mutual recognition system does nevertheless protect the ability of administrations to regulate domestically produced goods, professionals and services originating from their territory, while ensuring that any differences in regulation that emerge *between* jurisdictions do not result in unnecessary barriers to trade.
132. A requirement not to discriminate (a 'non-discrimination principle') provides additional support to mutual recognition. This makes it unlawful for a government to regulate in any way that affords less favourable treatment to *goods, professionals or service providers originating in or from another territory* to that afforded to its own goods professionals or service providers. This principle forms an essential part of the Internal Market legislation of other countries, including Canada.
133. A mutual recognition system tailored to the UK's unique circumstances will encompass three areas of regulation, and reflect the different ways goods and services are currently treated under UK law:
  - a) **Goods** – mutual recognition of goods means that a good which can be lawfully sold in one territory, can be lawfully sold in other territories without having to comply with that other territory's requirements (that would otherwise apply). Mutual recognition will cover mandatory requirements relating to lawful sale, i.e. product requirements and their related processes and production methods (for example, requirements on production, composition, quality, packaging or labelling). Other types of requirement not directly related to lawful sale will be excluded e.g. conditions on transport, disposal or the manner of sale of goods. These will instead be covered by the non-discrimination principle. As noted earlier, goods being placed on the Northern Ireland market will have to comply with the arrangements set out in the Northern Ireland Protocol The mutual recognition principle will also take account of our commitments to ensure that Northern Ireland goods will have

unfettered access to the rest of the UK Internal Market. Northern Ireland's specific role within a legislative underpinning for goods is addressed in detail below.

- b) **Professional qualifications** – mutual recognition of professional qualifications means that compliance with regulation required to access a profession in one territory can be used to demonstrate compliance towards the access of that profession in another territory. Where access requirements in the other territory differ, a process will be implemented to enable professionals to demonstrate compliance. In addition, other profession-specific regulatory requirements needed to practise the profession will be included as part of this process.
  - c) **Services** – the effect of mutual recognition is already in place for most services authorisations within the UK through the Provision of Services Regulations 2009<sup>28</sup>. These regulations have broad application and areas out of scope of this regime (such as financial, healthcare and transport services) are also out of scope of the UK Internal Market proposals. The Provision of Services Regulations 2009 set out that any authorisation scheme provided for by a UK competent authority must be justified and the objective not attainable in a less restrictive manner. The scheme itself must be based on criteria that prevent arbitrary assessment. Additionally, an authorisation issued by an authority with functions covering less than the whole UK generally permits exercise of the relevant activity throughout the whole UK. This system will be explicitly brought within the Internal Market system.
134. The non-discrimination principle will be a requirement not to discriminate between individuals or businesses based on residence or origin within the UK. Direct discrimination is where an individual or business is treated differently and unfavourably by another administration, in an explicit manner, compared with local operators when operating in another part of the UK, expressly on the grounds of residence or geographical origin. The non-discrimination principle will allow scope for such differential treatment where this is necessary, for example, to address a public, plant or animal health emergency.
135. The Government holds that it should also protect against instances where an economic operator is not directly discriminated against but is nevertheless treated in a substantially unfavourable way by another administration compared with local operators when operating in another part of the UK, and where for example, this is not justifiable on the grounds of a clearly stated policy objective.
136. This obligation on administrations and regulators not to discriminate in a way that affects trade will provide an additional safeguard for the UK Internal Market in areas where mutual recognition is excluded. For example, if Wales specified that milk cannot be transported more than a certain distance which meant that in effect most milk from England, Scotland and Northern Ireland could not be sold in Wales, this could be viewed as a case of indirect discrimination. This kind of discrimination should be prohibited as it has equivalent effect to direct discrimination.

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<sup>28</sup> The Provision of Services Regulations 2009, <https://www.legislation.gov.uk/ukdsi/2009/9780111486276/contents>. These Regulations apply to UK nationals and establishments.

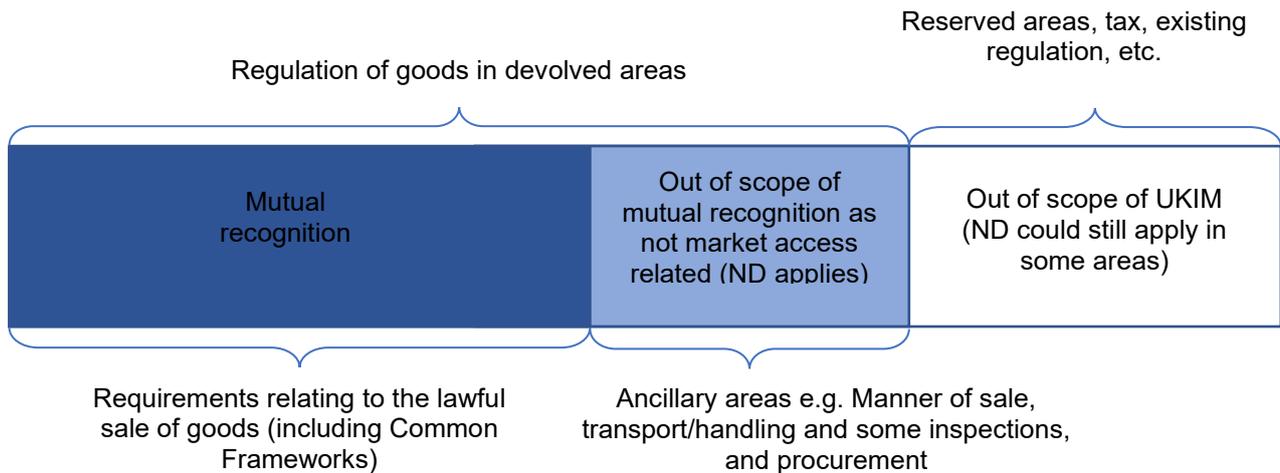
137. It will be necessary to decide whether indirect discrimination in this context should be prohibited at the outset in legislation as a justiciable right for business, or after a period of monitoring and assessment. Another option would be for this element of the non-discrimination principle to be given effect by other means, such as via robust administrative or intergovernmental processes.

**Question 1: Do you agree that the government should seek to mitigate against both 'direct' and 'indirect' discrimination in areas which affect the provision of goods and services? Could you provide examples of indirect discrimination that would affect the functioning of the Internal Market?**

## The scope and operation of the legislative underpinning: how mutual recognition and non-discrimination elements will combine

138. Mutual recognition and non-discrimination will operate together to ensure both smooth and fair trade within the UK. For goods, a UK-specific mutual recognition principle will be introduced. Mutual recognition will be the default presumption but there are areas where mutual recognition will not be appropriate ("*exclusions*"). As set out before, there have always been areas out of scope of the UK Internal Market, such as the Scottish legal system.
139. For services, the effect of mutual recognition is already provided through the principles applied to authorisations under the Provision of Services Regulations 2009 and this effect will be retained explicitly as part of the system.
140. For both goods and services, these provisions will be supplemented by the non-discrimination principle. For goods, non-discrimination will apply within certain excluded areas such as procurement.
141. For services, the non-discrimination principle will contribute to preventing unnecessary barriers to service provision within the UK. For professional qualifications, a system will be introduced to ensure that professionals regulated in one part of the UK will be able to seek recognition of their qualifications in another, allowing them to provide services. As with goods, the principle of non-discrimination could apply in certain areas of professional regulation that are exclusions from the core approach.
142. As set out below, the non-discrimination principle will also take account of obligations that apply under the Northern Ireland Protocol and legislative provisions on unfettered access for Northern Ireland businesses. Stakeholders are invited to comment on the scope of non-discrimination in Question 2 below.
143. Figure 5 below illustrates the application of both mutual recognition and the non-discrimination principles.

Figure 5. Scope of mutual recognition and non-discrimination for goods



144. Some areas will be excluded from mutual recognition and non-discrimination. Exclusions will be defined from the outset in legislation and will not be expected to change. If the UK Government or a devolved administration introduces new regulation that falls within an exclusion, then the mutual recognition system will not apply to all or part of it as appropriate. The excluded categories will likely include:
- areas out of scope of the UK Internal Market model as set out above, i.e. UK Government regulation in reserved areas, existing regulatory differences (which remain unchanged), tax and fiscal matters, and the provision of goods and services by public authorities (market activity from economic operators and professional qualifications would be covered);
  - regulation necessary to implement some international obligations.
145. The Government envisages that non-discrimination will apply to the ancillary areas of regulation which are not directly related to the lawful sale of goods, (i.e. requirements on transportation, disposal, or the manner of sale of goods); and is considering whether and to what extent it should apply to public procurement, in particular for above-threshold procurements<sup>29</sup>. Stakeholders are invited to comment on the application of non-discrimination to public procurement. In addition, the Government is keen to obtain views on which other areas which have the potential to affect goods or services but are not covered by mutual recognition should also be covered by the principle of non-discrimination.

**Question 2: What areas do you think should be covered by non-discrimination but not mutual recognition?**

<sup>29</sup> Procurements which have a contract value equal to or greater than the thresholds set out in the WTO Government Procurement Agreement.

## Legislative underpinning and Northern Ireland

146. The system outlined above is intended to provide the underpinning legislation for the whole UK Internal Market – including Northern Ireland. At the same time this legislative underpinning will need to take account of the Northern Ireland Protocol, and of the UK Government’s clear commitments on unfettered access for Northern Ireland goods to the whole of the UK market. As set out below, a legislative underpinning based on mutual recognition and non-discrimination will sit alongside separate legislative provisions on unfettered access for Northern Ireland goods. Together, they will ensure that new barriers to trade in goods and services within the UK are avoided as the Transition Period ends.
147. Goods moving into Northern Ireland from Great Britain will also need to meet the specific requirements set out in the Northern Ireland Protocol. However, where the Northern Ireland Executive sets regulatory requirements outside of the scope of the Protocol, these requirements will be subject to the principles of mutual recognition and non-discrimination as set out above.
148. With respect to goods moving from Northern Ireland to Great Britain, the Government has committed, in the *New Decade, New Approach* deal to restore the Northern Ireland Executive, to legislate to provide Northern Ireland business with unfettered access to the Internal Market and to ensure that this legislation is in force by 1 January 2021. These commitments were reiterated in the UK Government’s Northern Ireland Command Paper on 20 May<sup>30</sup>.
149. As outlined in the Command Paper, unfettered access legislation will ensure that where Northern Ireland traders gain product approvals and certification for the Northern Ireland market from EU authorities and bodies, the UK will recognise those for the purpose of placing goods on the Great Britain market. These commitments will complement the broader legislative system for the Internal Market, as they will ensure recognition for Northern Ireland goods on the Great Britain market, while also ensuring that Northern Ireland’s goods are not subject to discriminatory requirements in Great Britain.
150. For services and professional qualifications, the system outlined above will apply across the UK, including to Northern Ireland.

## Conclusions

151. The two principles set out above – mutual recognition and non-discrimination – together constitute in the Government’s view a legislative framework that will preserve the fundamental market access rights of businesses and citizens across the UK Internal Market. This system will replace the effect of the rules and

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<sup>30</sup> “The *New Decade, New Approach* agreement recognised the need to implement the Northern Ireland Protocol in a way that works for the restored Executive and Northern Ireland’s businesses. This included a firm commitment from the UK Government to exploring additional flexibilities and sensible practical measures across all aspects of the Protocol to maximise the free flow of trade. It guarantees that the Northern Ireland Executive will be invited to attend any Withdrawal Agreement Joint Committee or Specialised Committee meetings where Northern Ireland is being discussed and when the Irish Government are in attendance. The UK Government also committed to legislating by 1 January 2021 to guarantee unfettered access for Northern Ireland’s businesses to the whole of the UK Internal Market”. The UK’s Approach to the Northern Ireland Protocol, May 2020, page 6. <https://www.gov.uk/government/publications/the-uks-approach-to-the-northern-ireland-protocol>

mechanisms of the EU Single Market had within the UK. Mutual recognition will ensure that goods and services are recognised across the UK without the need to comply with unnecessary additional requirements imposed by any part of the UK. Non-discrimination will ensure that no individual or business faces discrimination in a different part of the UK based on origin or residence.

## Part 3. Governance, independent advice and monitoring

### Securing governance, independent advice, and monitoring

152. While Part 2 of this White Paper sets out the Government's proposals for the core legal underpinning for the UK's independent Internal Market, this part considers in more detail the institutional arrangements necessary to ensure its smooth operation on an ongoing basis. In order to ensure a well-functioning Internal Market, the Government intends to build on existing governance arrangements between the UK Government, devolved administrations and UK Parliament and the three devolved legislatures and that this should be transparent and beneficial to businesses, workers and consumers. Such provisions will be an important component of our economic response to COVID-19.
153. Governance arrangements will seek to build on the existing collaboration between the UK Government and devolved administrations, ensuring a strong basis for political decision-making, oversight, and dialogue in relation to the Internal Market. These arrangements will require a close relationship with Common Frameworks, as set out earlier in the White Paper, and will also need to account for the Review of Intergovernmental Relations. Finally, future governance arrangements will need to ensure that any existing dispute avoidance and resolution mechanisms can address potential disagreements on the Internal Market. This will also mean intergovernmental collaboration in communicating and resolving issues from stakeholders facing potential barriers to intra-UK trade.
154. In this White Paper the Government has made clear that the evolution and overall shape of the UK's Internal Market will be overseen by the UK Parliament, and that key decisions will be put to the UK Parliament for approval, rather than resting exclusively with the UK Government. It is also clear that in order to give fullest effect to the system as described, certain supporting functions should be carried out at arms' length from the UK Government in a way that is both visibly and practically independent.

### Independent functions in the Internal Market

155. As the UK transitions from membership of the European Union and the close supervision that the European Commission applies to its own Single Market, it is not the Government's intention to replicate that institution within the UK Internal Market. However, the Government does recognise that there remains an important role in relation to the Internal Market for independently-delivered functions removed from its own political influence and that of the devolved administrations. Such independent bodies are common among partners around the world, whether Australia's Productivity Commission or Switzerland's Competition Commission, with functions and governance as varied as the

markets and governance arrangements that they support, albeit in federal contexts.

156. Adapted to the UK's own unique context, these two independent functions should: support the smooth running of the legal underpinning described in Part 2; guard against the growth of fragmentation and indirect discrimination; and ensure expert reporting to the UK Government, devolved administrations and legislatures. The carrying out of these two functions will not lead to third-party determinations that directly overturn the actions of elected administrations.

## Monitoring and advising on the health and evolution of the Internal Market

157. Assessing the likely costs and benefits of policymaking is standard practice, with the UK Government and devolved administrations each implementing some approach to 'Better Regulation', in part through formalised impact assessments. But no administration currently explicitly considers the impact of their regulatory decisions on other parts of the United Kingdom on an individual or collective basis, including whether their proposals may be discriminatory.
158. It is the Government's position that independent expert advice should be available on the potential impact of a proposal on the Internal Market, including to legislatures, rather than being isolated to individual administrations. As well as shaping the policy-making process and encouraging stakeholder input from across the UK, these assessments will contribute to a stronger evidence base both within and between administrations. Such assessments will cover not only local and community effects, but also cumulative and cross-UK supply chain implications.
159. Independent advice should be available to support the gathering of necessary evidence and analysis, as well as reviewing its comprehensiveness when requested. Expert economic and scientific advice, based on a growing evidence base on the Internal Market, as well as analytical capability will help all four administrations through the process of accounting for the need to manage the Internal Market. Such advice will be vital in ensuring that different regulatory approaches can be accommodated across the UK whilst ensuring protection of the Internal Market and the free flow of goods across the nations.
160. In addition to providing necessary independent advice, the Government believes expert monitoring and updating of the health and growth of the UK's Internal Market will be vital. This monitoring will cover the 'health of the market', as well as adaptable reporting of economic trends across the UK Internal Market, including its impact on competition. This reporting will ensure that any cumulative difference in regulation is tracked over time. Effective monitoring of this sort will allow a wide view of the impact of the development of standards across the UK on its wider business environment. This will support the Government's commitment to ensuring the UK Internal Market remains a high-value market with high regulatory standards.

161. The monitoring mechanism could see specific reporting into impacted sectors or UK regions and could also include local-level divergence within England, particularly in response to future English devolution. The functioning of the UK Internal Market architecture itself will also need to be reviewed at intervals to make sure legislation is still serving developments in the market and whether legal principles are being adhered to and utilised effectively by stakeholders.
162. This monitoring function would provide administrations, legislatures and external stakeholders with reporting into the functioning of the UK Internal Market. However, the independent monitoring function will also be made available for specific requests for advice or research from any UK administration or legislature. Insights from external stakeholders will be gathered to support this function and outputs will be made available for businesses and consumers to consider and utilise. In this regard, the monitoring function could include the option for making recommendations about minimum standards.
163. Independent monitoring and reporting will not generate any binding recommendations, though monitoring could nevertheless explicitly note particularly distortive or discriminatory actions by any administration.

## Capturing business and consumer insight into the development of the Internal Market

164. In the course of stakeholder engagement to date, businesses, trade associations and consumer groups have all consistently emphasised concerns around multiple regulatory environments developing within the UK following the Transition Period in a way that lacks transparency and leads to increased costs. Business stakeholders of all sizes have expressed interest in the Government facilitating ways to meaningfully raise enquiries about and their experience of harmful regulatory divergence, barriers to trade and impacts on competition between devolved administrations.
165. The views of business and consumers will be actively and systematically gathered on an independent basis, in part to support advice provided and monitoring. Stakeholders will be able to submit evidence of potential regulatory distortions through an online interface. An independent assessment of this evidence could support reporting on whether a regulatory measure was causing businesses significant costs more generally and discouraging intra-UK trade. This could include professionals who are facing barriers in having their qualifications recognised across the UK.

## Delivery and implementation of independent functions

166. As detailed above, the Government intends to supplement the smooth operation of the principles outlined in Part 2 with two functions delivered independently: monitoring of the Internal Market and business and consumer engagement. The Government believes two of these functions are best housed in the same vehicle, in recognition of the mutually reinforcing role they will play in the wider system.

This would also ensure the functions are implemented with adequate authority and necessary flow of information happens seamlessly.

167. The UK Government recognises the range of potential vehicles for the two independent functions that could be explored including an independent body with close links to the UK Parliament and devolved legislatures; an expert committee; or a body accountable directly to the UK Parliament. The design of the vehicle and its governance will have implications for the way advance notification, oversight and dispute resolution are conducted, as well as how wider intergovernmental collaboration on and accountability for the Internal Market is ensured.

**Question 3: What would be the most effective way of implementing the two functions outlined above? Should particular aspects be delivered through existing vehicles or through bespoke arrangements?**

**Question 4: How should the Government best ensure that these functions are carried out independently, help the smooth functioning of the internal market and are fully representative of the interests of businesses and consumers across the whole of the UK?**

## Part 4. Subsidy control

### Introduction

168. A subsidy is, broadly speaking, support in any form (financial or in kind) from any level of government – central, regional or local – which gives an advantage to a business that it could not obtain otherwise. This advantage could be in any form, including a grant, a tax break, a loan or guarantee on favourable terms or use of facilities below market price. Subsidy control is an area where a coherent UK regime is key to our ability to remain a thriving and competitive economy, and achieve both our national and global economic ambitions.
169. Matters which require a coherent approach to ensure the integrity of the UK Internal Market, such as the regulation of anti-competitive practices and agreements, are already reserved. The existing areas that have been reserved to the UK Parliament in respect of each of the devolved nations (or are either reserved or excepted in Northern Ireland) are set out in the three main devolution Acts:
- [Scotland Act 1998](#) (Schedule 5).
  - [Northern Ireland Act 1998](#) (Schedule 2 excepted matters and Schedule 3 reserved matters).
  - [Government of Wales Act 2006](#) (Schedule 7A).

### A coherent approach to subsidy control

170. As part of our approach to ensuring benefits for businesses across the UK Internal Market, it is important that we continue to have a uniform approach on the rules that will govern the way public authorities, including local authorities, support businesses.
171. The UK has until now had a single subsidy control regime as it has been subject to the EU rules on State Aid regulated by the European Commission. The UK Government remains committed to maintaining open and fair competition between businesses in all parts of the UK and it will do so by clearly moving away from the EU's State Aid rules to create our own, sovereign subsidy control regime. This will build on our obligations under the WTO and other trade agreements.
172. A single, UK-wide regime will provide certainty and clarity for businesses and protect them from unfair competition whilst allowing the Government to focus on the delivery of wider strategic priorities. It will help to mitigate the risk of harmful subsidy races between nations, regions and cities, whilst promoting a dynamic and competitive market economy throughout the UK. We will set out our policy for this new domestic regime separately in due course, but remain committed to developing an open, fair, and transparent subsidy control mechanism. In addition, the UK's domestic subsidy regime will take account of the provisions of the

Northern Ireland Protocol. The Government's approach to this is set out in more detail in 'The UK's approach to the Northern Ireland Protocol'<sup>31</sup>.

173. The Government has previously stated its view that the regulation of State Aid is a reserved matter<sup>32</sup>. However, while this reservation would be sufficient to encompass an approach to subsidy control that mirrored the EU State Aid regime in the UK, the existing devolution settlements do not contain any general reservation for subsidy control. To guarantee that a single, unified subsidy control regime could be legislated for in the future, we will legislate to expressly provide that subsidy control is a reserved matter (or 'excepted', in line with the terminology used in Northern Ireland). The UK as a whole has an interest in ensuring that there is legal certainty, and that the UK Internal Market can continue to function without barriers. Given this, the future subsidy control mechanisms should be the responsibility of the UK Parliament to determine.
174. The devolved administrations will remain responsible for their own spending decisions on subsidies (how much, to whom and for what) within the architecture of any future subsidy control mechanism. We will continue to work closely with all the devolved administrations to seek to agree the shape of a UK-wide domestic subsidy control regime.

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<sup>31</sup> <https://www.gov.uk/government/publications/the-uks-approach-to-the-northern-ireland-protocol>

<sup>32</sup> Frameworks Analysis: Breakdown of areas of EU law that intersect with devolved competence in Scotland, Wales and Northern Ireland.

## Part 5. Conclusions

175. The purpose of this White Paper has been to set out the Government's vision for addressing the gap that the removal of the EU Single Market rules creates on the UK market, in a way that reconciles the need for ongoing economic cohesion with scope for regulatory difference.
176. As the EU superstructure falls away, a coherent approach to market access will drive efficient supply chains and opportunities for business growth, and ensure fair price distribution for consumers. It maintains business certainty and the clarity needed for investment decisions, also protecting consumer prices and increased choice. A well-functioning Internal Market plays a key part in the development of a durable and successful constitutional model, one which recognises the value of devolved powers and the benefits they offer to local populations.
177. Smooth trading arrangements across the UK constitute a key factor in the UK's ability to implement international trade deals, a building block of the UK's economic future. They not only ensure we can realise the benefits of a reciprocal trading arrangement, but also increase the UK's attractiveness to future trade partners and foreign investment. As the UK embarks on a new ambitious trading agenda, the relevance of a strong Internal Market mechanism to these economic goals should not be underestimated.
178. While many of these benefits are recognised already through the Common Frameworks mechanism, a legislative underpinning provides a safety net based on the principles of safeguarding the rights of our businesses and citizens, supporting a thriving and cohesive economy, and protecting general welfare, prosperity and economic security. Together, they are supported by the objectives of preserving frictionless trade, fair competition, innovation and business and citizen participation.
179. The Government considers that the best way to address the gap resulting from the removal of the EU market ecosystem is to enshrine in law the principles of mutual recognition and non-discrimination. These will ensure goods and the services covered are recognised in all parts of the UK without the need to comply with additional requirements, and without business facing discrimination based on its origin. The Government will also seek to work with the devolved administrations to improve collaboration on regulation and ensure impacts on businesses in all parts of the UK are understood as regulation is implemented. In addition, it will consider delivering independent monitoring and reporting on the health of the Internal Market as it grows and evolves, and considering the views of businesses and consumers when it carries each of these functions out.
180. The White Paper recognises the essential importance of ensuring that Northern Ireland remains a full member of the UK Internal Market. Northern Ireland will therefore be incorporated into the UK-wide Internal Market legislative system. At the same time, this system will take account of the requirements of the Northern Ireland Protocol for as long as its alignment provisions apply.

181. The UK's Internal Market will continue to evolve and respond to the changes required by the UK's constitutional and economic development. As this happens, the Government's aim is to ensure that the way we trade in the United Kingdom remains fair and free, that barriers are minimised, and that businesses and individuals genuinely shape the market rules that are meant to serve them. This is key to ensuring that we remain a dynamic economy, and a thriving United Kingdom.
182. This White Paper also highlights the need for certainty and transparency to encourage private and public investment to all parts of the UK. This includes clarifying spending powers of all levels of Government and for the UK Government to construct replacements of EU programmes.

# Consultation questions

1. Do you agree that the government should seek to mitigate against both 'direct' and 'indirect' discrimination in areas which affect the provision of goods and services?
2. What areas do you think should be covered by non-discrimination but not mutual recognition?
3. What would be the most effective way of implementing the two functions outlined above? Should particular aspects be delivered through existing vehicles or through bespoke arrangements?
4. How should the Government best ensure that these functions are carried out independently, ensure the smooth functioning of the Internal Market and are fully representative of the interests of businesses and consumers across the whole of the UK?

## Next steps

183. The Government is keen to engage a wide range of stakeholders on the questions indicated above, and invites views from industry, civil society, think tanks and academics, and from the devolved administrations. The Government will also consider the interests of the Crown Dependencies and Overseas Territories.
184. The consultation **on the questions highlighted above** will begin on 16 July 2020 and close on 13 August 2020. The Government will then publish the response to this consultation on the GOV.UK website, [indicate timeframe], summarising the received responses and setting out the actions that will be taken in developing our final proposals.

# Annex A – Analysis and evidence of UK Internal Market

## Introduction and executive summary

### Overview

The UK Internal Market policy largely considers economic challenges. In light of this, BEIS and HMT have conducted a comprehensive programme of analytical work to support the policy development process.

The findings of this work programme are summarised in this document, alongside which related outputs from an externally commissioned research project are also published.

The focus of the analytical work has been on three broad strands, with the third one concerning operational considerations for future policy implementation:

- **Status quo – How does the UK Internal Market currently operate?**

How do the parts of the UK currently interact in economic terms? How much do economic goods and services cross the UK and is the UK Internal Market integrated?

- **What if – How would economic activities be affected by changes to the status quo?**

Would there be any detriment from changes to the regulatory landscape? Would greater divergence have operational implications for UK businesses?

- **Forward look – How could the development of the UK Internal Market be assessed in practice in the future?**

How could benefit and cost implications of future divergent policy proposals be systematically considered before and after implementation? How could the overall performance of the UK Internal Market be assessed and monitored over time?

### Status quo analysis – key findings

A range of available data sources has been considered to generate insights into the current operation of the UK Internal Market. Most data sources suggest economic relationships with other parts of the UK are currently more important for the devolved administrations than relationships with the EU and the rest of the world. Key findings include:

- A high degree of integration in terms of movement of goods and services exists, with other parts of the UK being more significant trading partners to all devolved administrations than the EU, and in some cases, the rest of the world combined.

- We find empirical evidence of a high degree of mobility of people (human capital being a critical factor of economic activity) through significant flows both on a permanent and temporary basis.
- While the data availability for capital and knowledge flows is more limited, there are clear indications of deep connections and mutually beneficial relationships between the parts of the UK, displayed in business ownership data and citation metrics of academic co-authorship.
- Additional analysis has been carried out to directly assess the regulatory landscape for service providers intra-UK. For these, we have found a high degree of regulatory alignment in the UK, without instances of overt discrimination.
- An experimental dataset of subnational flows of goods and services has also enabled econometric comparison of costs of trading between parts of the UK and costs of trading with third countries, while correcting for external factors such as distance. The data shows a significant cost advantage of trading within the UK, in comparison with trading internationally.
- A range of case studies sheds further light on the current operational realities of the UK Internal Market and brings to life the integrated nature of UK businesses.
- Lastly, the empirical evidence was complemented by a theory-based approach: a review of academic trade literature identified a range of key societal benefits of economic openness and integration.

## What if analysis – key findings

Structured engagement has been conducted with businesses from a range of sectors and across all jurisdictions of the UK. Qualitative interviews have been carried out based on hypothetical policy divergence scenarios, to explore the operational implications in the real world. While the engagement should not be seen as covering a representative sample of the overall economy, it has emphasised some considerable efficiency implications that are likely to affect any company that operates under multiple regulatory regimes:

- Duplicative costs and loss of economies of scale from market fragmentation.
- Loss of attractiveness to enter markets (applies equally to foreign investors).
- Logistical challenges, not just at point of production but throughout the entire supply chain (e.g. haulage and distribution centres for differentiated product lines).
- Reputational risk from fraud, grey imports<sup>33</sup> and inadvertent non-compliance.
- Loss of planning certainty for longer term business decisions (e.g. investment, crop cycles) – even the theoretical risk of future divergence has real world implications.

Like for the analysis of the status quo operation, quantitative analysis has been conducted to underpin these qualitative findings. Methodological approaches developed for the first strand of the analytical work have been built on and enhanced to be useful for this:

- Modifying the regulatory analysis and building it into a scenario-based modelling tool has been used to establish implications of different hypothetical service regulation divergence scenarios in terms of increases in trade costs between

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<sup>33</sup> Goods that have been imported from another country and are outside of the manufacturer's authorised trading channels.

parts of the UK. Unmanaged divergence could, over time, result in tariff equivalents that are comparable in magnitude to barriers observed in trade with third countries.

- Building on the experimental subnational trade data set, a full intra-UK gravity model has been developed and used to assess general equilibrium outcomes<sup>34</sup> of a scenario with higher assumed intra-UK trade costs. Results indicate that not only there would be a loss to overall UK welfare (i.e. higher intranational trade costs could not be offset by increasing international trade) but also that the devolved administrations would be significantly more negatively impacted than England in such a scenario (although even England would suffer an economic loss).

## Future assessment – key considerations

An important operational consideration arising from the first two areas of analysis has been the assessment of benefits and costs to the UK Internal Market, from diverging policies that might be implemented in the future. Assessing UK Internal Market impacts from future diverging policy proposals can fundamentally happen in two ways – before implementation (ex ante) and after implementation (ex post). Both approaches have strengths and weaknesses and would work best in conjunction with each other. Initial exploration of a possible methodology has identified a range of key considerations:

Impact assessments at the policy design stage (ex ante):

- Provide a structured way of considering and capturing UKIM impacts before policy proposals are implemented.
- In conjunction with public consultations provide an opportunity for stakeholders to input, in line with general good policy making principles (applies to businesses and consumers, but also to policy makers in other governments).
- Support informed policy decision-making – systematically and comprehensively capture all costs and benefits so advantages and disadvantages are weighed up at the decision stage.
- If successfully applied in decision-making, create a safeguard that identifies divergent policies with undue detrimental UKIM impacts before they are implemented. This gives an opportunity to reconsider and adapt these policies before implementing them.
- Any approach will have resource implications in all governments and processes need to factor in capacity development to ensure robust assessments.
- There are likely efficiencies from coordinating data collection and management for fundamental evidence that is likely to be equally required in all administrations (e.g. business population characteristics, intra-UK trade flows).

Monitoring and evaluation after policy implementation (ex post):

- Policy-specific evaluation will likely present significant implementation challenges, given interlinkages through supply chains and the resulting difficulty to isolate impacts of individual policies. Such an evaluation approach is also unlikely to shed light on cumulative effects of divergence over time.

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<sup>34</sup> The behaviour of supply, demand, and prices in a whole economy, considering multiple interacting markets.

- A more macro level and cross-cutting assessment of the performance of the UK Internal Market over time is potentially a promising route to overcome such challenges. A cross-cutting approach should however be designed in such a way that it still facilitates assessments at sectoral and regional levels.
- Constructing metrics that provide meaningful insights into the performance of the UK Internal Market presents a significant data and evidence challenge and coordination across UK parts is likely to unlock efficiencies.
- Consideration should be given to conducting the monitoring function universally across the whole of the UK and whether this could be delivered independently of government.

## Part 1: Status quo analysis – How does the UK Internal Market currently operate and what are the benefits to this?

### Why maintaining our Internal Market matters

The benefits of open and integrated markets for goods, services and labour have long been discussed in the economic literature. Openness to trade brings benefits to the entire economy, businesses, and consumers. While discussions in the literature generally refer to the openness of the flow of goods and services *between* countries, the main findings identified hold equally true for considerations *within* national geographies.

An open market is characterised by low trade costs. Trade costs capture all costs incurred by a business in getting a good or service to a final consumer (other than the cost of producing the good itself). They include transportation costs, local distribution costs, contract enforcement costs as well as the cost of complying with regulation and regulatory barriers (Anderson & Van Wincoop, 2004).

Low trade costs create economic benefits by allowing countries to specialise in sectors and products that have a relative cost advantage (Costinot & Donaldson, 2012). Similarly, in the intra-UK context, low trade costs between the four parts allow regions of the UK to specialise according to their comparative advantage. For example, compared to the UK as a whole, Scotland specialises relatively more in agriculture, oil and gas extraction and food and drink manufacturing<sup>35</sup>. Similarly, Wales has a specialisation in agriculture and manufacturing.

At the same time, an integrated market provides the opportunity for the best match between buyers and suppliers. A good or a service can be easily moved to the location where it generates the greatest economic benefit. This so-called allocative efficiency holds equally for workers and jobs. If workers can move freely between the different parts of the UK because, for example, their qualifications are recognised UK-wide, there is likely to be a better match of job searchers and vacancies according to their strengths and skills (Heinz & Ward-Warmedinger, 2006)<sup>36</sup>. This is likely to lead to higher productivity for businesses and higher wages for workers than would otherwise be the case (Meager & Speckesser, 2011).

In addition, higher intra-national trade costs would limit access of firms to some markets, because servicing the higher cost market becomes unprofitable. This would reduce the number of producers in each market and would lower the level of competition. At the same time, crowded out producers could no longer supply the entire UK market and would not be able to take advantage of economies of scale, thereby increasing their unit costs (OECD, 1998). This would be a detrimental outcome for consumers in both markets, since competition and efficiencies are key to keeping prices low, not just along the supply chain, but all the way to the end user (RBB Economics, 2014).

High levels of integration can also have important impacts on innovation. In an international context, the literature suggests that the degree of integration, particularly of less productive with more productive regions, allows for knowledge sharing between

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<sup>35</sup> Based on [ONS analysis of location quotients and geographic concentration of industry employment](#).

<sup>36</sup> There are of course a range of factors affecting the mobility of workers, not all of which fall under the scope of the UK Internal Market architecture, such as the quality of public services and infrastructure, among others.

firms. This can happen along the supply chain between firms in similar sectors (Isaksson, Simeth, & Seifert, 2016). Furthermore, increased competition from firms across the UK is likely to incentivise firms to innovate in order to increase their productivity (Syverson, 2011).

Human capital and the transfer of employee knowledge and skills is also beneficial. Evidence suggests that these can be transferred when workers are able to switch between businesses (Trippi & Maier, 2011). Evidence further shows that such knowledge spillovers between regions translate into increased productivity (Fischer, Scherngell, & Reismann, 2009).

The role of productivity is particularly important in the case of the UK, which has a significant productivity gap with its major competitors and disparities between the productivity of its regions<sup>37</sup>, with Greater London and the South East being substantially more productive than the rest of the UK. However, there are several factors which may affect the UK's productivity beyond the UK Internal Market and other interventions are better suited to address this inequality of productivity.

Overall, the UK Internal Market plays an important role in supporting firms in increasing their productivity through relocation of capital, labour and inputs towards more productive firms, as well as through innovating or adopting existing technologies. This brings key benefits to consumers through lower prices and more variety, and to workers through higher wages. It is also key for the UK's international competitiveness, increasing exports as well as making the UK more attractive for foreign direct investment (Goodwin & Pierola, 2015).

While there are clear benefits of a highly integrated Internal Market, not all these benefits are immediately visible to policy makers. A high degree of integration across the UK Internal Market has beneficial spillover effects or externalities that fall to entities outside of each part of the UK and are therefore "invisible" to decision makers when considering impacts on their own administrations alone. Conversely, the introduction of regulatory divergence is likely to have negative externalities in other geographies that are not immediately obvious or the focus of policy makers in a jurisdiction. There is therefore a policy intervention case to ensure due consideration is paid to any spillover effects that might arise.

### Current levels of integration of the UK economy

The complex linkages between the four parts of England, Scotland, Wales, and Northern Ireland are reflected in strong economic ties, spanning outputs as well as all factors of production. This section provides evidence that the parts of the UK are highly integrated in terms of the flow of goods and services, labour, knowledge, and capital (both physical and human).

In considering the operation of the UK Internal Market it is important to bear in mind the distribution of economic size between the constituent parts. The economy of England is significantly larger than any of the other parts of the UK and generates around 87% of total economic activity (ONS, 2019). The remainder is split between the other parts of the UK, with Scotland contributing 8%, Wales generating 3% and Northern Ireland being

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<sup>37</sup> See [ONS analysis of sub-regional productivity in the UK](#).

responsible for 2% of overall output<sup>38</sup>. Given the material difference in size, different dynamics apply to England than to the other regions, with generally a higher degree of integration with the rest of the world observed for England.

## Trade flows

Deep linkages are clearly present in the flow of goods and services. Export Statistics Scotland 2018 (Scottish Government, 2020) suggests that Scottish sales to the rest of the UK (rUK) are worth £51.2 billion, 1.5 times as large as its EU and rest of world (RoW) exports combined.

Similarly, according to the Northern Ireland Statistics and Research Agency's Broad Economy Sales and Exports Statistics 2018 (NISRA, 2020), external sales from Northern Ireland to Great Britain are worth around £10.6 billion, around 50% of total external (outside of NI) sales and exports, and around 1.6 times its total EU exports. Data for previous years indicates an even higher importance of sales to GB, with these exceeding exports to all the rest of the world combined<sup>39</sup>. The picture is similar for imports, with NI purchases of GB goods and services valued at around £13.4 billion, 63% of all purchases from outside NI, and 2.5 times as large as imports from the EU.

*Figure 6 – Northern Irish and Scottish external sales by trading partner (% value GBP) – source: NISRA Broad Economy Sales and Exports Statistics (2018), Export Statistics Scotland (2018)*

Country	Rest of UK	Rest of EU	Rest of World	rUK : rEU	rUK : International
Northern Ireland	49%	31%	21%	1.6x	0.9x
Scotland	60%	19%	21%	3.2x	1.5x

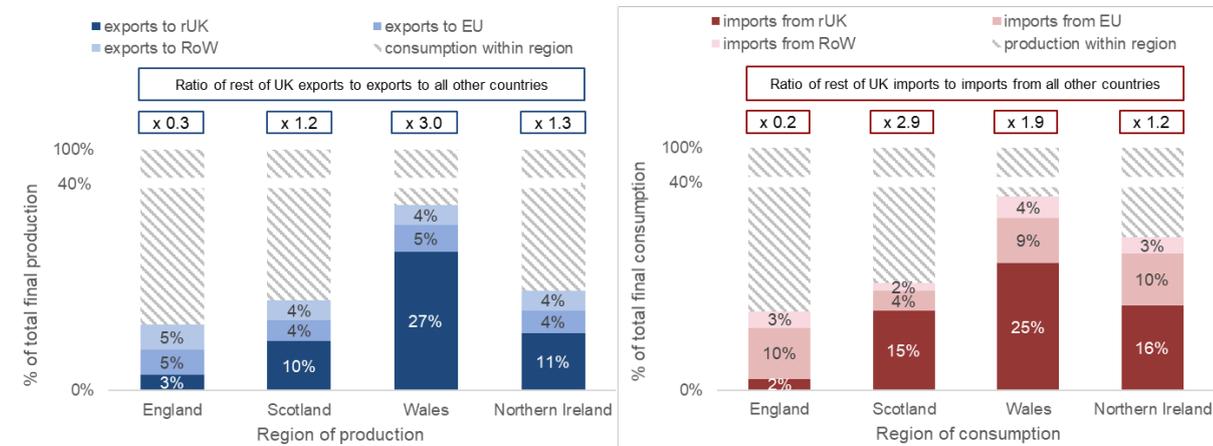
Equivalent official statistics do not exist for Wales or England. Therefore, further sources of information were explored to supplement the statistical publications by Scotland and Northern Ireland. One particularly useful dataset was the EUREGIO dataset, published by the PBL Netherlands Environmental Assessment Agency (Thissen & al., 2018). This data models trade flows between some 250 subnational regions within the EU, including the four parts of the UK. While the official Scottish and Northern Irish statistics estimate exports based on survey data, this data set models subnational flows in a top-down approach by decomposing international trade flows as captured by the World Input-Output Database (WIOD, 2013).

For the most recent available year of 2010, this data confirms a significant amount of trade between constituent parts of the UK. While for all parts of the UK, most goods and services are produced and consumed within each region, in Scotland, Wales and Northern Ireland trade in final goods and services with the UK exceeds trade with the EU. Intra-UK trade is especially significant in Scotland and Wales; Scotland imports three times as much final goods and services (by value) to other parts of the UK as it does from all international trading partners combined. Similarly, Wales exports three times as much final goods and services from other parts of the UK as it exports internationally (Figure 7).

<sup>38</sup> This is of Gross Value Added, which is a measure of the increase in the value of the economy due to the production of goods and services. Calculated from provisional 2018 figures, total excludes economic activity that cannot be assigned to regions.

<sup>39</sup> According to NISRA, in 2016, NI sales to GB exceeded international exports by 1.5x.

**Figure 7 – UK market for final goods and services; proportion of final goods and services produced in each part of the UK split by region of consumption (LHS); proportion of final goods and services consumed in**

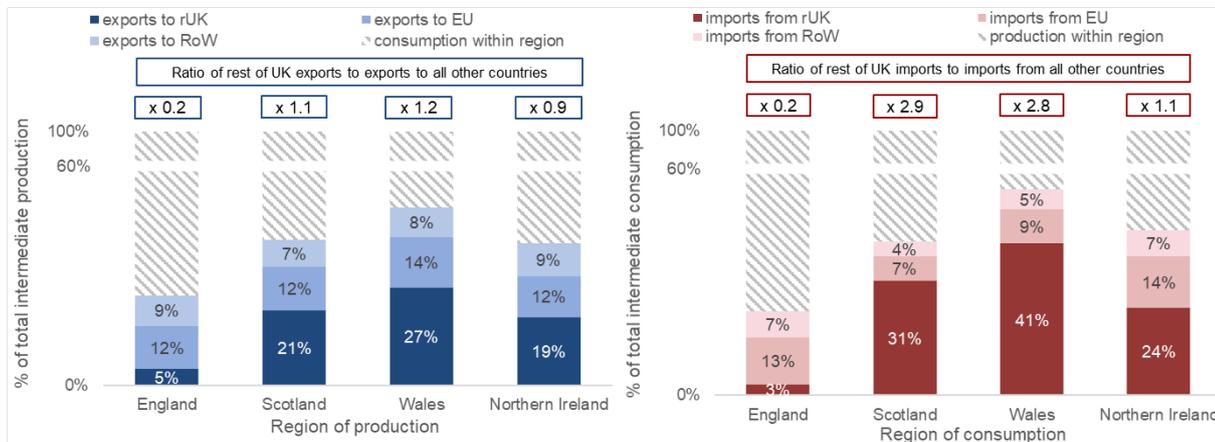


*each part of the UK split by region of production (RHS). Data sourced from the EUREGIO dataset (2010).*

Services trade is particularly significant within the UK Internal Market. According to the EUREGIO dataset, services trade with the UK forms a significant proportion of each of the devolved administrations' overall production and consumption. For example, almost a third of all services consumed in Wales were from the rest of the UK. Furthermore, the data show that each part of the UK trades more in services with the rest of the UK than with the rest of the world. Official statistics from Scotland and Northern Ireland corroborate this finding. For example, in 2018, Scotland exported 2.4 times as much in services to other parts of the UK as to the rest of the world, while Northern Ireland imported almost 3 times as much in services from GB compared to the rest of the world.

The UK Internal Market is equally important for supporting intra-UK supply chains. The reliance on other parts of the UK for trade in intermediate goods and services is even higher than for final goods and services. In Wales and Scotland, for example, almost three times as many intermediate inputs used by businesses come from other constituent parts of the UK as from all international markets combined.

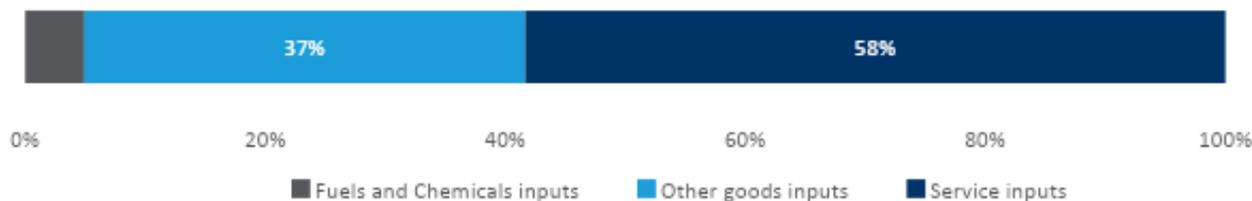
Figure 8 – UK market for intermediate goods and services; proportion of intermediate goods and services produced in each part of the UK split by region of consumption (LHS); proportion of intermediate goods and services consumed in each part of the UK split by region of production (RHS). Data sourced from the EUREGIO dataset (2010).



Looking at supply chain flows at a more disaggregated level, we can see how these links are driven predominantly by cross-sectoral connections. For example, Scotland’s fuels and chemicals sector sources 61% of its total inputs from the rUK. Among these, only around 5% of its inputs come from within the sector, with the significant remainder of 95% stemming from other sectors and around 60% of the value of rUK inputs coming from service sectors (Figure 9 – Rest of UK intermediate inputs into the Scottish Fuels and Chemicals sector, split by type of input. Data sourced from the EUREGIO dataset (2010)).

This integration of supply chains across the UK Internal Market demonstrates the complexity and multi-layered nature of the connection of the parts in the UK economy. It also highlights the possibility of spillover effects along the supply chain arising from regulatory divergence and the risk of cumulative effects from differences in multiple sectors.

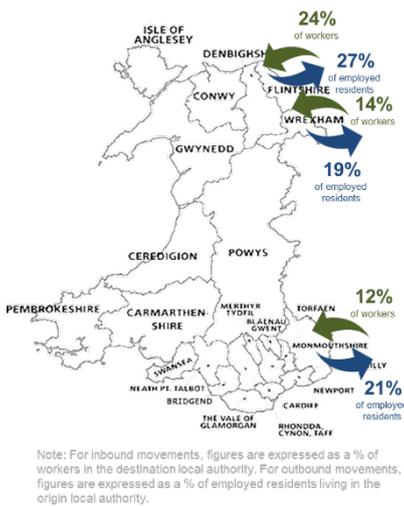
Figure 9 – Rest of UK intermediate inputs into the Scottish Fuels and Chemicals sector, split by type of input. Data sourced from the EUREGIO dataset (2010)



### Mobility of people & Human Capital

However, the UK Internal Market is not only characterised by large flows of goods and services, but we equally see a high degree of integration in terms of other factors of production.

For example, we see significant movement of people (labour) on both a temporary and more permanent basis. Census data (ONS, 2011) shows that a large number of people move between the UK nations on a day-to-day basis for work (“cross-region



**Figure 10 – Cross-region commuting between England and Welsh local authorities**

commuting”). Cross-region commuting is most prevalent close to the England-Wales and England-Scotland borders in both directions, where in some Welsh local authorities up to 24% of workers come from and 27% of employed residents commute to England. In total, in 2011, over 170,000 workers commuted from one part of the UK to another.

A similar picture emerges for more permanent migration. Data from the labour force survey (ONS, Social Survey Division, 2017) indicates that around 1.4 million individuals live in a different part of the UK than they were born. This implies that nearly 7% of all public sector employees and more than 5% of private sector employees were born in a different part of the UK than they work now. Higher Education Student Statistics (HESA, 2019) show that around 130,000 students in total per year move to a different part of the UK to attend

university. Over a quarter of Welsh and Northern Irish students studying in the UK study outside of their home region. 13% of all students in Scottish higher education institutions come from the rest of the UK.

## Knowledge and capital

The UK Internal Market also plays an important role in facilitating the exchange of knowledge across the UK. Patent data shows that across-constituent part collaboration is equally if not more important than international collaborations (slight variation in year on year time series data by the OECD). This holds true for all devolved administrations as well as England. We also see that science research collaborations across the UK seem more impactful than research collaboration between any of the parts of the UK and international partners, as measured by publishing and analytics company Elsevier through a field weighted citation index (Elsevier, 2016). Such collaboration has proved significant in the fight against COVID-19 as one of the largest research projects is a joint project between researchers at Imperial College London, the University of Liverpool, and the University of Edinburgh (UK Research and Innovation, 2020).

Finally, we observe indications of significant capital flows between the parts of the UK. While the data on capital movement is less comprehensive than for other factors, we nevertheless see that firms owned by a party from another part of the UK contribute to 17% of employment in Scotland (Scottish Government, 2019) and 11% in Northern Ireland (NISRA, 2019). The data from Scotland further suggests that they contribute to 19% of revenues earned.

## Case Studies of integrated business models in operation

### Case Study 1: Rolls Royce (Rolls Royce, n.d.)

The picture painted by the aggregate data is supported by several case studies, such as **Rolls Royce Holdings**. Rolls Royce is one of the world’s leading aerospace companies (placing 10<sup>th</sup> worldwide in terms of revenue) in a sector that employs 95 000 people across the UK.



*Figure 11 – Locations of Rolls Royce's manufacturing, repairs, and research & development facilities*

Currently Rolls Royce derives more than 50% of their revenue from services. Rolls-Royce pioneered servitisation as a key part of their business model and takes almost complete responsibility for ongoing maintenance provision of engines sold. These services need to be provided close to the customer and Rolls Royce provide on-site maintenance in all parts of the UK. This geographic spread indicates the ease and lack of barriers with which Rolls Royce can move professionals and goods around the UK. It also indicates that its customer base is truly UK-wide in addition to global.

Alongside benefiting from the high integration of the UK Internal Market in the provision of services, they also make use of different specialisation across England, Wales and Scotland for manufacturing, repairs/overhauls, and research & development facilities. For example, Rolls Royce has established 19 research centres at 14 UK universities across Scotland, England, and Wales.

Each centre focuses on a specific aspect or technology, together forming a cohesive and comprehensive knowledge and innovation base. In this way, Rolls Royce takes full advantage of the UK Internal Market, providing unified services in all regions while also taking advantage of regional specialisations. Internal barriers to the movement of goods and services would be highly disruptive for this network.

#### **Case Study 2: Summer Harvest Oils** (Scottish Government, 2016)

Another example shows the importance of the UK Internal Market not only for large high-tech manufacturing firms but also highlights the importance in the agri-food sector, where one might assume more localised production processes. While **Summer Harvest Oils**, a rape seed oil producer, has most of its production in Scotland it nevertheless relies heavily on integrated UK supply chains for its business.

Oilseed rape along with wheat and barley are the most popular crops grown in Scotland. Summer Harvest Oils produces in Scotland but sources its inputs, such as packaging, from England and Wales and distributes its products through independent retailers in Scotland, Wales and England. In 2015 the company began to expand its business into the overseas market using an export and consolidation firm based in the West Midlands to co-ordinate orders and ship.

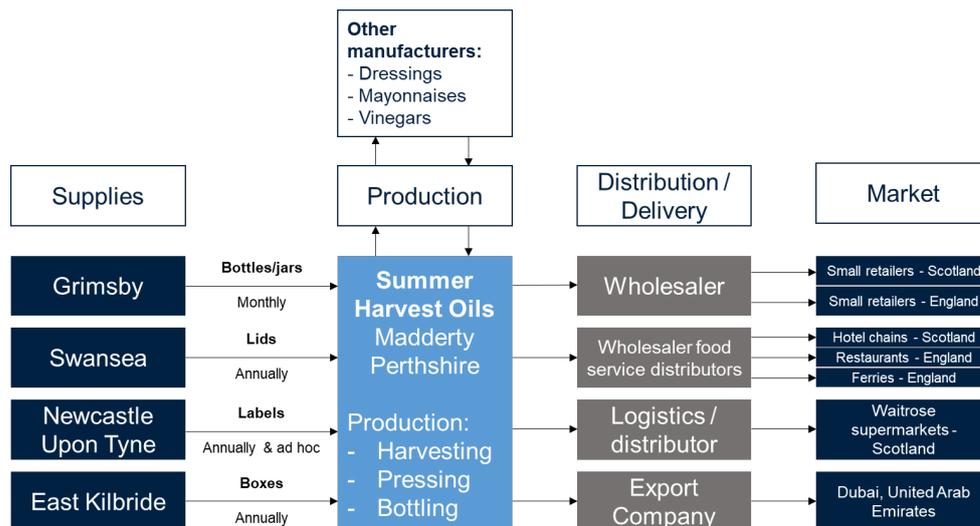


Figure 12 – Supply chain flow chart of Summer Harvest Oils

## Part 1.1 Current degree of regulatory alignment

The previous section showed that there are significant flows of goods, services, and factors of production between parts of the UK. In addition to analysing trade and mobility patterns empirically, we also look at regulation in the UK geographies and the resulting trade costs faced by UK buyers and sellers and compare these to international benchmarks.

The drivers of trade costs are diverse. These include geographical (such as distance), cultural (such as language) and historical factors (for example a colonial connection), as well as non-tariff measures. In an international context, non-tariff measures (NTMs) are defined as policy measures – other than ordinary customs tariffs – that can potentially have an economic effect on trade in goods and services, changing quantities traded, or prices or both (UNCTAD, 2010). Discriminatory treatment in law and regulatory differences are two potential sources of non-tariff measures between trading entities and have been considered in detail in the current context of the UK Internal Market.

### Intra-UK restrictiveness of services markets

Externally commissioned research into UK Internal Market services trade restrictions has evidenced a high degree of regulatory alignment across all four parts of the UK. The research found that UK services providers do not face any discriminatory treatment in law, indicating an open and fair competitive environment for businesses across the UK.



#### Methodology Note: The UK Internal Market Services Restrictiveness project

The UK Internal Market research catalogues services trade restrictions applied by each of the four parts of the UK (the full research report is published alongside this document). We apply the OECD’s Services Trade Restrictiveness Index (STRI) methodology and adapt it in several ways.

As devised by the OECD, the STRI framework provides a regulatory questionnaire to capture restrictions to the provision of services in national markets. The presence of barriers is translated into a numerical index value ranging between zero (most open) and one (most restrictive). The methodology has been developed under close consultation with the business community and is a well-established framework.

In a novel approach, the OECD methodology is applied at the intra-national level. For this, the country coverage is expanded to cover services regulations applied by England, Scotland, Wales, and Northern Ireland, capturing the regulatory measures service providers need to comply with to sell their services into each of the four parts of the UK.

For each part of the UK, the research also compares how services regulations are **applied to** four levels of origin of service providers (or four types of regulatory treatment): providers from within the UK constituent part, the rUK, EEA service providers, and WTO service providers trading on most-favoured-nation (MFN) terms. For each **bilateral pair of parts of the UK**, we also identify differences in services regulation to design Regulatory Heterogeneity Indices. We follow the OECD methodology outlined in (Nordas, 2016).

We use an econometric model to translate the index scores generated through the STRI framework into trade costs. These are expressed as ad valorem equivalents (AVEs), or tariff equivalents. The AVEs represent the wedge that services restrictions drive between the price paid by the consumer in the 'importing' part of the UK, and the price received by the producer in the 'exporting' part of the UK. If it costs £10 to produce one unit of a product but the final consumer price is £20, trade costs due to services restrictions are £10 per unit, or 100% in AVE terms. In interpreting tariff-equivalent costs it is important to note that a relatively integrated Internal Market does not translate into AVEs of zero across sectors; indeed, even trade within a single geographical location is subject to an AVE of greater than zero: it is always necessary to incur some level of cost in order to connect buyers with sellers. Rather, we would expect to see AVEs that are substantially lower than MFN AVEs.

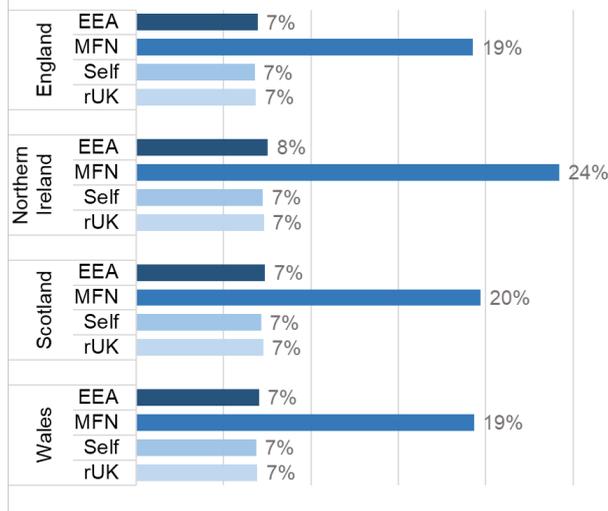
The high degree of regulatory alignment translates into low trade costs for UK businesses, compared to their rest-of-world counterparts. As shown in Figure 13, the tariff-equivalent costs faced by a "most favoured nation" service providers (i.e. from another WTO member country) range between 19% and 24% across the 14 sectors covered in the research – much higher than the 7-8% for EEA service providers and 7% for rUK service providers. There is a clear cost advantage to UK firms from dealing with customers in a relatively integrated market, the most beneficial being the UK Internal Market.

The research also highlighted that Internal Market treatment is typically very close or identical to EEA treatment, indicating the structuring role that the EU ecosystem has played in ensuring regulatory alignment to date, further strengthening the case for policy intervention now that the relationship between the UK and the EU is changing.

There are also only very limited instances of differences in regulation between the four UK constituent parts. Differences in regulation – especially against a backdrop of low restrictiveness found for the four parts of the UK – could significantly affect trade costs, by making it necessary for firms to adopt different production processes for different types of transactions (domestic versus cross-border with international partners).

Using England as the anchor point and comparing its regulations with those in other UK constituent parts, we find that regulatory heterogeneity is only present in a limited number of services sectors: legal services (AVE of 5%) with Scotland and Northern Ireland, distribution services (1%) with Scotland, and air transport services (1%) with all three other constituent parts.

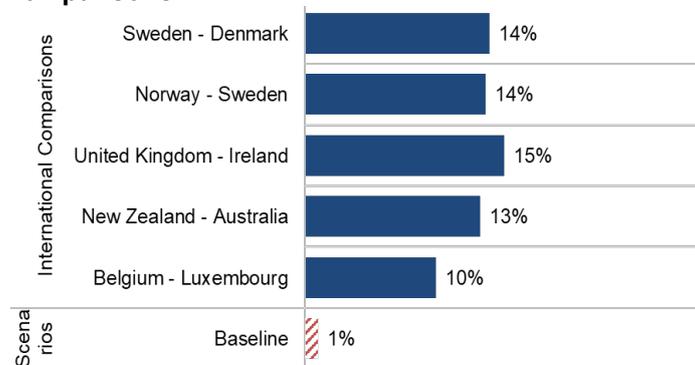
**Figure 13 – Tariff equivalents of service sector restrictions**



Given the lack of regulatory heterogeneity data for other Internal Markets, it is impossible to conduct a direct international comparison. But we can put the UK results in context by looking at the degree of regulatory heterogeneity between countries with very close historical, cultural, and economic ties. For instance, the degree of heterogeneity between England and Scotland in distribution services (retail & wholesale) is equivalent to a 1% tariff on intra-UK imports, while for intra-EEA policies between Belgium and Luxembourg it is 10%, or between Scandinavian countries it is 14%. Retailers and wholesalers in Australia

and New Zealand also experience higher trade costs, equivalent to a 13% tariff. This comparison suggests that the degree of heterogeneity among UK constituent parts is substantially less than that observed between EU member states, Scandinavian countries or the Trans-Tasman trading space with close historical connections.

**Figure 14 – Retail & Wholesale (Distribution) Regulatory Heterogeneity AVEs: International Comparisons**



## Trade costs for goods and in aggregate

### Methodology Note: Our approach to goods trade costs

For goods markets, an index-based approach such as the STRI approach was not suitable – most regulatory barriers in goods sectors are at the product level and currently, no intra-UK product-level trade data exists. Therefore, we used economic modelling to estimate trade costs.

We drew again on the experimental EUREGIO data on intra-UK sales in goods markets to construct all-inclusive measures of trade costs<sup>40</sup>. We estimate a gravity model of regional trade (at the NUTS 2 level), controlling for the effect of distance, economic size, and average trade costs on trade between regions. We also ensure that we capture the effect of a good moving between parts of the UK. In other words, we introduce a variable that indicates, for example, exports from England to Scotland or from Northern Ireland to Wales.

Therefore, we can reasonably expect that the reported trade cost reduction (between parts of the UK vs. crossing an international border) would be caused by factors other than distance, economic size, and average trade costs alone. In other words, we can proxy the cost advantage for businesses trading within the UK in comparison to international trade.

Economic modelling in goods sectors indicates that intra-UK buyers and sellers also benefit from an integrated Internal Market in agricultural and manufactured goods in terms of reduced trade costs. Trade costs between UK constituent parts are 51 percentage points lower than international trade costs in agriculture and 22 percentage points in manufacturing.

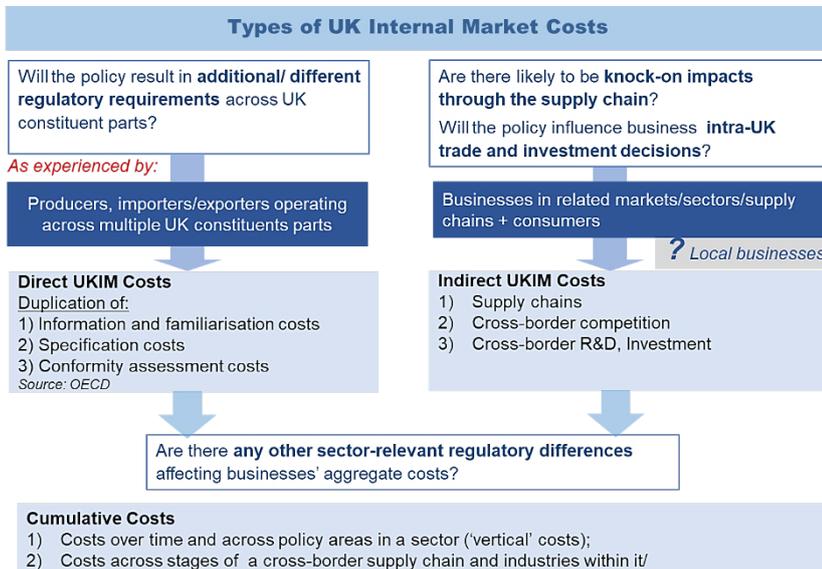
In addition, we analyse whether there are significant ‘border effects’ across all sectors between the different parts of the UK. While there is no physical border between the parts of the UK, there may be additional costs of goods being traded between the different parts, therefore changing trade similar to the effect of a physical border. To quantify these effects, we developed a so-called general equilibrium gravity model using regional data in the UK, the rest of Europe and several other countries. Using the gravity model allows us to isolate the effects of goods moving between parts of the UK on trade costs from the confounding impacts of distance, economic size and cultural factors.

We find that ‘border effects’ exist but are low in international comparison: The model finds that trade between parts of the UK is 24% lower than trade within those parts, once distance and other factors have been accounted for. The equivalent measure for Germany shows that inter-state trade is 65% lower than within states. This means that the costs of trading between German states is significantly higher than trading between the parts of the UK, showing the high levels of integration of the UK Internal Market.

<sup>40</sup> This effect is found to be statistically significant at the 10% level. Note that if stricter significance cut-offs are applied the border effects are even lower for the UK, implying that there are no significant border effects between the four parts.

## Part 2: Costs of regulatory divergence

### What costs can result from divergence?



Differences in regulation could introduce direct costs for businesses and consumers with activities across parts of the UK (such as producing, buying, or selling). There are also indirect costs borne by businesses via sector linkages and integrated intra-UK supply chains. Such differences in regulation can have the equivalent effect of a tax or a tariff on products or services imported from other parts of the UK. The

**Figure 15 – Typology of UK Internal Market**  
 The balance of UK Internal Market costs and benefits should therefore be taken into account when considering divergent policy proposals.

### Direct costs of regulatory differences

The OECD has published extensive material on the topic of (international) regulatory cooperation and identifies three types of direct costs facing businesses as a result of regulatory differences: specification costs (e.g. modifying products, running separate production lines, or creating different varieties to service different markets), familiarisation costs (e.g. to understand the different regulatory requirements), and conformity costs (e.g. to prove that a product is fit for sale in the other market) (OECD, 2017).

#### Specification costs

Specification costs represent the largest costs driver associated with regulatory differences. They are incurred by exporters, importers or producers when adapting their products and services as well as their business models to the requirements of a given market. They are also referred to as **substantive compliance costs** (OECD, 2014).

Product and process specification costs can be an obstacle to market entry, in particular for small and medium-sized enterprises when the required changes significantly alter the production technology and business models of firms (such as the mode of supply, distribution and sale of goods/services). In an international context, the World Bank Technical Barriers to Trade Survey reports that the one-time fixed costs – which represent the greatest barrier to market entry – make up 4.7% of the annual value added for the firms in the survey (OECD, 2017).

#### Information and Familiarisation Costs

When regulatory requirements in the home and the destination market are different, firms incur additional one-off information costs to familiarise themselves with local

regulations and adjust their compliance systems. There are also recurring information costs associated with monitoring information about the different regulatory requirements in markets across the UK.

### Conformity assessment and qualification costs

Conformity or qualification costs are incurred by firms for verifying and demonstrating to the authorities or intermediate customers that their products meet the regulations of the destination market. The OECD finds that conformity costs are particularly cumbersome in complex value chains and can negatively influence value chain participation.

Conformity assessment trade costs stem from additional fees for laboratory testing in the destination market, certification costs, licensing fees, or additional monitoring and checking systems to observe relevant regulatory requirements.

For example, the Society of Motor Manufacturers & Traders estimates that obtaining whole vehicle approval can take between 6 to 18 months to obtain, and can cost anything between £350,000 to £500,000, without including indirect costs (Society of Motor Manufacturers and Traders, 2016). Certification fees for farming and growing to Soil Association or EU organic standards can cost between £399 to £1,060 depending on the size of the registered land.

### “Hassle” and Complexity Costs

These costs are more difficult to operationalise (either quantify or monetise) as they are normally felt by business when dealing with overlapping and unnecessary regulatory requirements resulting in additional waiting times, delays, and duplication of the administrative burden. There may also be second-order effects associated with increased regulatory complexity such as accidental or inadvertent non-compliance due to supply chain complexities, resulting in fines and reputational damage.



#### Different recycling regimes for single-use drinks containers

In the future, different constituent parts may adopt different policy approaches to the recycling of single-use drinks containers covering different materials – for example, a Deposit Recycling Scheme (DRS), plastic bottles recycling target, or a system of kerbside collection.

Creating multiple plastic bottles recycling regimes in the UK could result in additional costs for businesses with operations across different parts of the UK. Directly affected businesses are faced with several choices:

- a) Withdrawal from a market, resulting in opportunity costs from loss in market share and economies of scale (as well as reduced choice for consumers),
- b) Investment in compliant packaging and labelling.

#### *Drinks manufacturers or retailers could incur:*

- **Specification costs** – drinks manufacturers may need to produce separate bottles, using different materials to be able to place drinks on each of the UK markets. They would need to run separate production and logistic lines to ensure continued access. Alternatively, they could change the use of inputs used in packaging (depending on types of materials covered by each scheme), resulting in input substitution.

- **Information and familiarisation costs** – additional costs connected with participating in a different recycling scheme, including understanding producer and retailer responsibility.
- **Conformity and compliance costs** – additional costs connected with participating in a different take-back scheme (e.g. changes in raw materials to ensure compliance and bottles collection infrastructure).
- **Hassle/complexity costs** – drinks manufacturers may also incur costs due to accidental non-compliance by placing bottles containing materials not accepted by one UK regime. There is also the risk of fraud, resulting from criminal intent to reclaim deposit from bottles that origin from other parts where no deposit payment had been collected upon sale.

*'We would need to produce different store and customer communications. Customers shopping across the border, in England, purchasing a bottle with a deposit may try and redeem the deposit in Wales despite the deposit the scheme not being live there. Consequently, there will be policy decisions to take to ensure customer understanding. This takes management time in store and results in additional costs.'*

**Major UK retailer**



#### **Food Labelling: Illustrating all trade costs**

At the end of the Transition Period, powers related to both food labelling and nutritional health claims will return to UKG (acting for England), Scottish Government, Welsh Government, and the Northern Ireland Executive. Using these powers, one administration could introduce a more stringent labelling regime, mandating a new front-of-pack nutritional labelling requirement. The additional requirements for the consumer information provided on labels could apply to all food and drink products sold on to the market of that administration (including both packed processed food and non-prepacked food prepared in store).

*Food manufacturers producing or selling across multiple UK constituent parts could incur:*

- **Information and Conformity Assessment (Fixed Costs)**  
Additional investment to design all labels to the higher standard and calculate Nutri-scores in order to maintain access to the more stringent market. They would then incur various forms of specification costs like R&D, marketing and familiarisation costs, as well as costs of demonstrating compliance of their labels to regulators.
- **Specification Costs – printing product labels. Variable costs influence the price**  
The estimated cost to relabel per unique product type is between **£4,000 - £7,000** depending on the regulatory requirement, good and firm size. A medium-large firm is estimated to have a few hundred unique products requiring new labels (Campden BRI, 2010). This could impact businesses' access to that part of the UK's market, product competitiveness, and compliance costs for businesses – which could in turn get passed on to consumers.

Our engagement with business also identified specification costs as an issue.

*'This [different food labelling regimes] would make it not viable to run separate labelling schemes. So, for example in Scotland we have 65-70 stores. To do specific print runs for Scottish requirements – we could do this for products only sold within Scotland, but then you can't export that product south of the border.'*

**Major UK based retailer**

A change in food labelling has a range of 'hidden' specification costs; past industry experience indicates that it takes industry time to adjust.

*'I think from a cost point of view, to get the traffic light system that is currently used standardised, took years and years of effort and energy and in the end the individual retailers drove that through, and retailers are generally working across the UK so wouldn't want different nutritional labelling standards across the UK. It's not just the cost of producing two designs of packaging – also, extra safety checks, audits every time, more labour too.'*

**English agricultural producer**

**Direct cumulative costs: multiple regulations (over time) in a sector**

Finally, it is also important to consider the accumulation of direct costs over time and across policy areas, in a sector.

**Case Study: Food Manufacturing Supply Chain:**

*We will use this hypothetical case study as we move along types of cumulative costs, illustrating the accumulation of costs at each stage of the supply chain*

Building on the case study on Food Labelling above (see case study box above), Figure 16 illustrates (via a hypothetical example) other areas of regulatory difference which could affect the food manufacturing sector. In this example, as well as adapting to differences in food labelling, the food manufacturer needs to comply with different food hygiene and plastic recycling regimes across the UK.

Business told us that different regulatory requirements could disrupt integrated supply chains, especially those of perishable agricultural produce.



**Figure 16 Illustration of direct cumulative costs for food manufacturers**

Therefore, the cumulative costs businesses face in a sector could influence their response to new regulatory differences and affect their decisions to produce, trade and invest UK-wide (see Figure 17 for further information on other factors). Direct costs also accumulate over time and if left unmanaged, could add significant costs to businesses with activities across UK geographies.

**Channels of direct impact based on business and consumer characteristics**

The direct costs of differences in regulatory regimes across the UK may affect the behaviour of different categories of stakeholders differently, which would in turn

determine whether the direct costs identified above will be incurred by businesses with activities across parts of the UK.

As illustrated above, a relatively small increase in cost can have very different (marginal) impacts on businesses depending on the existing build-up of intra-UK regulatory differences affecting the factor as well as business-level factors such as overall financial health/ competitiveness position. In the diagram below, we illustrate the range of possible channels of impact.

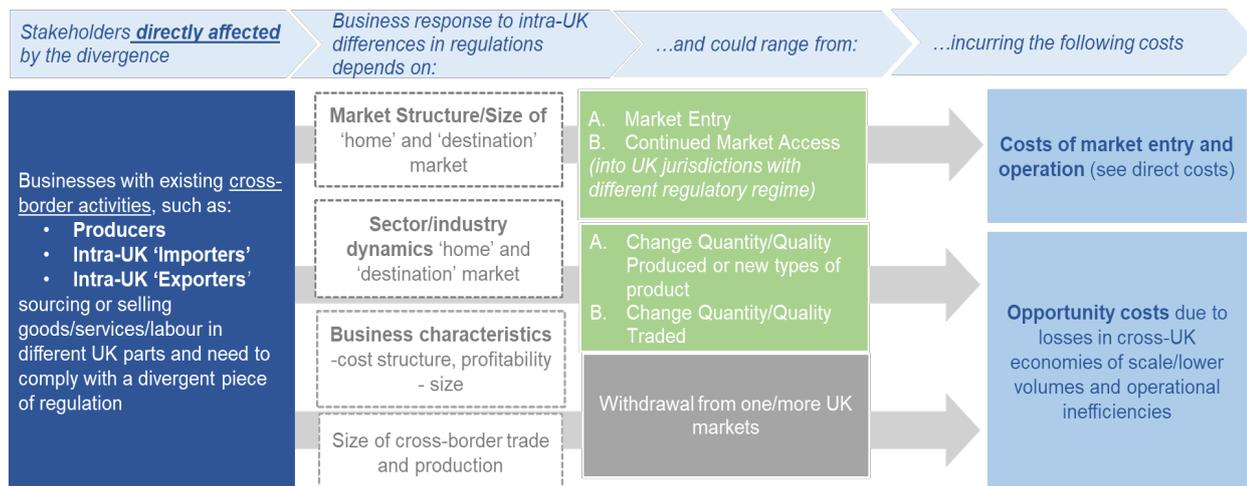


Figure 17 – How do direct costs translate into business production and investment decisions? Impact channels

### Indirect costs of an inconsistent Internal Market

Indirect Internal Market costs are incurred by businesses in related markets, supply chains and sectors, not directly affected by the differences in regulations across the UK.

Figure 18 – How do direct costs translate into indirect impacts for businesses and consumers? Impact channels below provides more detail behind the link between direct costs, business behaviour and indirect impacts.

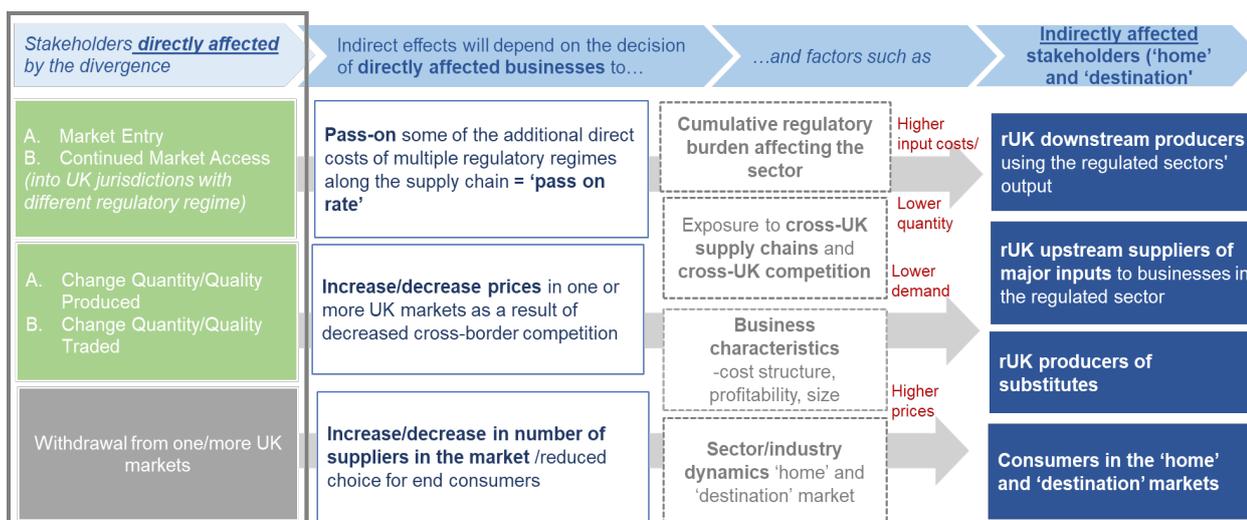
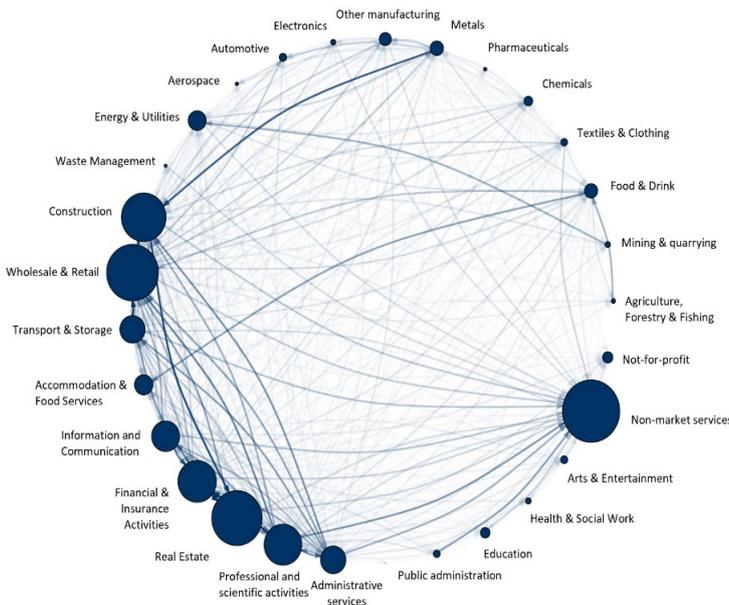


Figure 18 – How do direct costs translate into indirect impacts for businesses and consumers? Impact channels

### Indirect costs within sectors

These impacts are usually transmitted via price changes (or more directly supply and demand changes), quality changes or changes in the availability of goods/services in the home and domestic markets. For example, it is conceivable that businesses not directly engaged in intra-UK trade (i.e. not buying from or selling to entities in other parts of the UK) could still be affected via indirect channels such as increases in the price of their inputs further upstream or changes in the competition landscape.

Figure 19 Sectoral linkages. ONS



### Indirect costs across sectors

In Part 1, we demonstrated the close economic linkages underpinning the UK Internal Market. This further represents the UK Internal Market as a network of sector supply chains, drawing on UK input-output data (ONS, 2019).

Therefore, the effects of regulatory divergence can reach farther than directly affected businesses. Suppliers, intermediate and final customers could face additional costs via their supply chain and sectoral

linkages to directly affected businesses.



### CONTINUED: Case Study: Food Manufacturing Supply Chain

To continue the example of the food manufacturer in the previous section, directly affected businesses may choose to withdraw from one or more markets in the UK, reduce their production volumes or increase their prices to reflect increase in direct costs. These decisions might affect their suppliers upstream (e.g. agricultural producers) and their customers downstream in the supply chain (e.g. retailers and wholesalers).

Business engagement highlighted the complex commercial decisions facing business:



Figure 20 – Supply chain impacts of differing regulations on food manufacturers

*‘With regard to retail supply, there are also further questions on how this would be delivered. For example if Wales is served by depots that also serve English stores: how would a retailer deliver legal produce unless there was a default to the most stringent: which then runs the risk of increasing resistance, impacting sustainability*

*and overall increase in cost meaning more resources are used to produce less food which cannot be the overall aim.'*

**Major UK retailer**

**Indirect costs: Competition and R&D effects**

The indirect effects of multiple regulatory regimes within the UK can also transmit via linkages between businesses in a 'competitive relationship' across UK geographies.

For example, directly affected businesses may choose to withdraw from one or more markets in the UK, with the indirect effect of limiting the number or range of suppliers in the home/domestic market. A diverging UK constituent part could increase regulatory requirements, imposing significant market-specific sunk costs<sup>41</sup>. This in turn might discourage suppliers from the rUK to enter or remain in the market. Regulatory measures can also directly reduce price competition or restrict advertising (e.g. rules that prohibit sales below cost or set minimum prices); or deprive market players of their minimum efficient scale by imposing market fragmentation. Other regulatory restrictions could limit the free movement of professionals, indirectly reducing the availability of firms to acquire labour across parts of the UK and therefore increasing their operating costs. As generally recognised in the economic literature, reduced competition results in consumer detriment through higher prices or reduced quality and choice (or both).

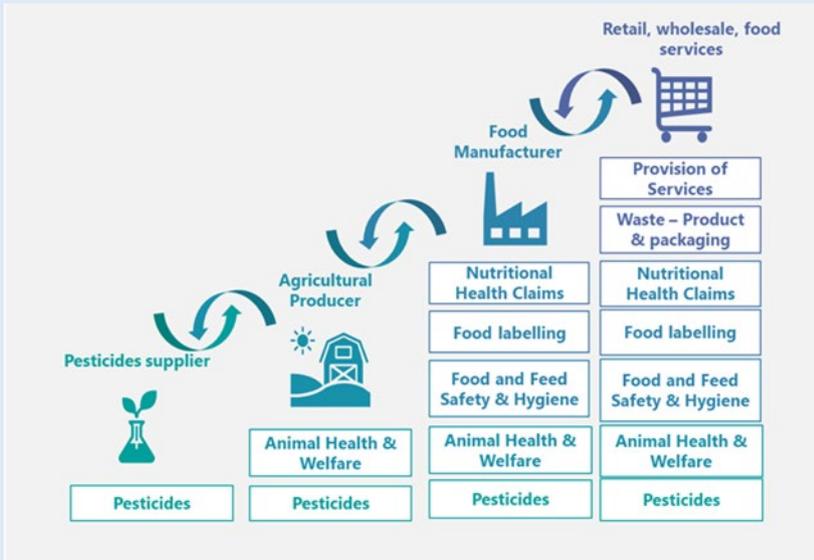
**The overall combined impact: the compounding effect of differences across supply chains and across multiple regulatory areas over time**

As we have shown in the previous sections on direct and indirect costs, differences in regulation could accumulate over time, across policy areas and stages in the supply chain. They could affect businesses directly or indirectly, depending on their embeddedness in intra-UK supply chain, links to other sectors, and stages of trade and production.



**CONTINUED: Case Study: Food Manufacturing Supply Chain**

Taking the example of the food manufacturing and food supply chain even further, we now introduce regulatory differences at every stage of a (conceptual) food supply chain – i.e. agricultural producers are now not only indirectly affected by divergence in food labelling and nutritional health claims, but also experience the direct impacts of divergence in pesticides regimes across the UK. There is now also



**Figure 21 – Cumulative supply chain impacts of difference multiple regulatory frameworks**

<sup>41</sup> In economic terms, sunk costs represent costs which have to be incurred (in this context to enter the market) but cannot be recovered, either through increased production or trade volumes for that destination market.

an upward feedback loop with the food manufacturer – if agricultural producers are able to pass on the direct costs of adapting to multiple regulatory regimes, their customers in the food manufacturing industry would face an increase in their input costs.

The UK food and drink manufacturing industry accounts for around £28.6bn (Defra, 2020) of UK GVA every year and around £6.5bn worth of food and drinks products are bought by UK wholesalers and retailers every year (ONS, 2019).

These supply chain links cut across UK constituent parts. For example, according to the EUREGIO data from 2010 (Thissen & al., 2018), Welsh food and drinks manufacturers source 48% of agriculture inputs from the rest of the UK.

Food and drink manufacturers often sell their products through retailers in other UK markets. Approximately 31% of food and drink sold by retailers and wholesalers in Wales was produced in another part of the UK<sup>42</sup>.

Divergent agricultural regulations could also interrupt the £600m (Scottish Government, 2019) worth of agricultural goods flowing from the rest of the UK to Scotland each year, or the over £800m vice versa (Scottish Government, 2020).

This case study above illustrates that – given the significant degree of the economy’s sectoral and supply chain interconnections – there is an overarching risk that the total or cumulative effects felt through supply chain networks could introduce a significant amount of grit into the operation of the UK Internal Market. Even small changes could have material effects, for example if they mean that companies have to comply with multiple regulatory regimes in the UK in parallel – this removes efficiencies and the potential for economies of scale. In extreme cases this could mean that operating in certain parts of the UK is no longer commercially viable for some businesses. An enquiry by the Canadian Standing Senate Committee on Banking Trade and Commerce estimated that the effect of eliminating internal trade barriers in the Canadian economy would range between 0.05% and 7.0% of gross domestic product, or between C\$1 billion and C\$130 billion (The Standing Senate Committee on Banking, Trade and Commerce, 2016). It should be noted though that Canada was facing a high degree of Internal Market fragmentation, with significant divergence between provinces.

## Real-world impacts of cumulative divergence

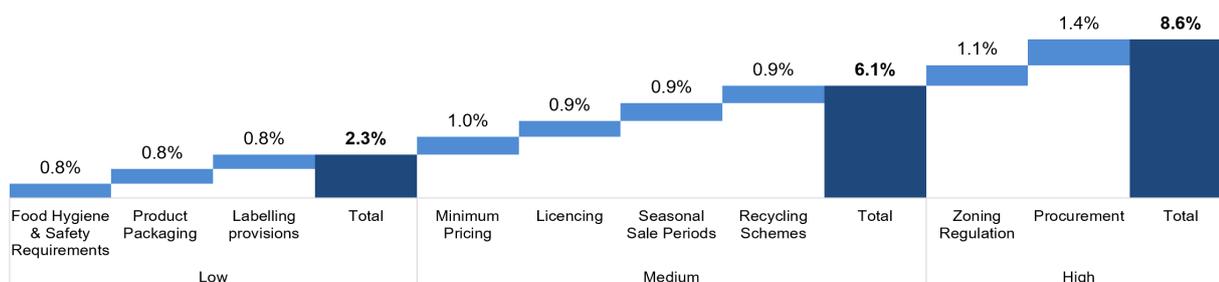
In this section, we supplement the conceptual findings above with more quantitative analysis in order to understand the magnitude of the impact on specific sectors and the economy as a whole. The STRI methodology introduced in this document, in Part 1.1 Current degree of regulatory alignment, has been developed further for the application of a scenario-based analysis. We model different degrees of regulatory divergence between any pair of UK constituent parts, by introducing policy divergence and quantifying the impact using firstly the STRI regulatory questionnaire and secondly the gravity-derived tariff equivalent cost. It is important to note that we do not model the ‘compounding’ effect of divergence across policy areas.

Our ‘Low’ scenario represents the tariff-equivalent cost of regulatory difference across a limited set of policy areas (one or two). In the ‘Medium’ scenario, we attempt to capture

<sup>42</sup> Defined as inputs from ‘Food, Beverages and Tobacco’ to ‘Distribution’, as defined in the EUREGIO dataset (2010). EUREGIO data is experimental and the granularity of this example means the reliability of such figures should be treated with some caution.

the effects of uncoordinated policymaking over time – i.e. pursuing the same policy objective but through different means. Looking through the sectoral lens, our ‘Medium’ scenarios illustrates **direct cumulative costs** on a business in a specific services sector outlined in the section on Direct Costs. In our ‘High’ scenario we build in the impact of intentionally protectionist measures which favour local suppliers vis-à-vis suppliers from the rUK.

We report results for the Construction and Distribution (Retail & Wholesale) sector.



*Figure 22 – Tariff equivalent costs of divergence in modelled policy areas in distribution – internal BEIS modelling of divergence scenarios using the OECD’s STRI framework*

Figure 22 shows that a supermarket operating across the UK could face tariff-equivalent costs of 2.3% due to differences in food labelling, product packaging and food hygiene regimes across the UK. For example, if these policy differences were to arise between Scotland and the rest of the UK, Scotland’s retail & wholesale sales to the rest of the UK could initially decrease by 7%, or by £433m based on current annual trade volumes<sup>43</sup>. This decrease only captures the initial shock of regulatory difference to trade and excludes dynamic economic effects, such as trade diversion or reallocation across sectors. According to ONS data, retail represents approximately 43% of total average household spending across the UK, which means even small changes in prices might have a significant impact on consumers (ONS, Household Expenditure, 2019). The BRC in their 2018 Annual Payments Survey (British Retail Consortium, 2018) found that the average transaction value (ATV) in the UK was £22.57, and with around 20 billion transactions in 2017, totalling £366 billion, retail is a significant proportion of our economy.

Businesses may choose to respond to asymmetries by complying with the highest regulatory standards to ensure continued market access. In the short term, this response translates into upfront cost (for example, changing their operating model and complying with higher regulatory requirements) and compliance costs. Depending on the differences in the regulations (e.g. incompatibility or mutual exclusiveness) such an approach might not always be possible.

More severe knock-on effects might result in decreases in competition – this and most other changes are ultimately likely to feed through to end consumers in the form of higher prices.

For both the distribution and construction sectors, Figure 22 – *Tariff equivalent costs of divergence in modelled policy areas in distribution* – and Figure 23 – *Tariff equivalent*

<sup>43</sup> We apply the estimated % reduction trade flows to 2018 data from Export Statistics Scotland, using value of Scottish Retail & Wholesale output to the rest of the UK.

costs of differences across modelled policy areas and processes in construction – show that low levels of regulatory divergence between a pair of UK constituent parts could create the equivalent of a tariff of between 2-3%, reducing internal UK trade by 7-8% in those sectors. Over time and if left unmanaged, regulatory differences in areas of devolved decision-making could accumulate a cost equivalent to a tariff of between 6-8%.

Figure 23 shows that differences in building regulations and the process of granting construction permits could introduce a 2.8%-equivalent wedge between construction costs and final construction contract price (in this case both public sector organisations and private households). An increase in the bid price for construction contracts could be significant in monetary terms.

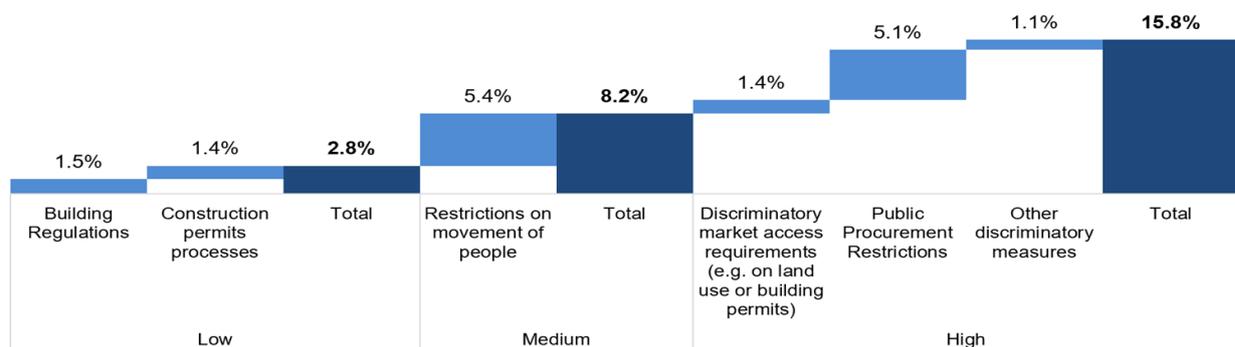


Figure 23 – Tariff equivalent costs of differences across modelled policy areas and processes in construction – internal BEIS modelling of divergence scenarios using the OECD’s STRI framework

### How do these costs compare to international benchmarks?

The tariff equivalent impact of regulatory heterogeneity in our ‘High’ scenario is similar, and in some instances higher, than what is seen internationally. This is a significant increase, compared to the current baseline of limited heterogeneity (resulting in a 0-1% tariff equivalent cost to businesses).

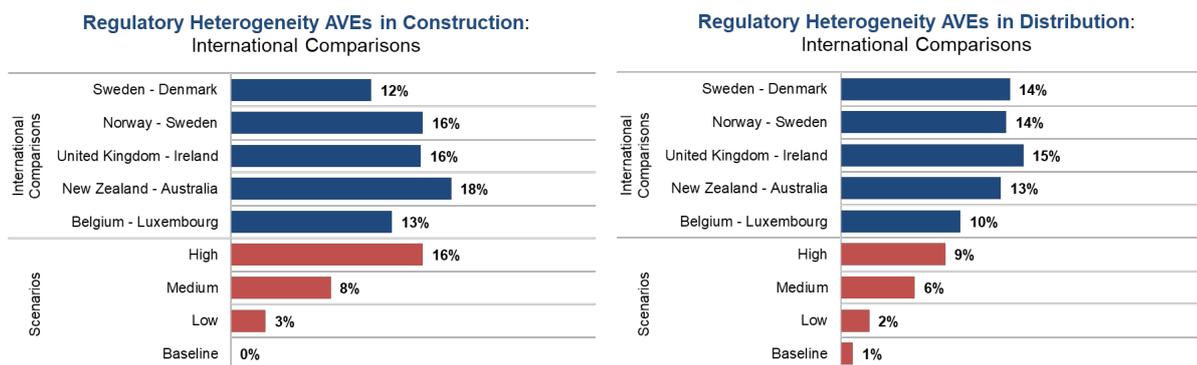


Figure 24 – International comparisons with scenarios of tariff equivalent costs for both construction and distribution

**Methodology Note: Ad-valorem tariff equivalents estimation**

The results above are based on a limited number of sector-specific scenarios and as such, the values reported are not representative of all services sectors. Converting index scores (STRI and Regulatory Heterogeneity) into ad-valorem tariff equivalent requires the use of an international gravity model. The modelling estimates are derived using international trade data and international STRI and heterogeneity

index scores. We also assume that intra-UK trade is equally sensitive to changes in policy as international trade.

We perform sensitivity analysis around key elasticity parameters (for further discussion please see the detailed report and methodological annexes). The AVE values reported throughout the report are based on the midpoint of the range recommended by the OECD for services (Benz, 2017)<sup>44</sup>.

The use of AVEs – while the standard in the international literature – involves an assumption that services policies can be properly understood as primarily affecting variable trade costs (per shipment). It is likely that many services policies in fact create fixed cost barriers to market entry, in the sense that the cost must be paid once regardless of quantity shipped. Such barriers are likely more distortionary than variable cost barriers because they reduce competition in the importing market. As a result, we believe that AVEs represent a lower bound for the actual level of economic distortion introduced by services policies.

It is important to note that these results only capture the initial shock of regulatory difference to bilateral trade and exclude dynamic economic effects, such as trade diversion or general equilibrium effects (such as reallocation across sectors). These effects are outlined in Part 2.1 What would the real-world implications be?

### Minimising UK Internal Market costs and maximising benefits: models of regulatory cooperation

Improved understanding of the types of UK Internal Market costs and benefits is central to informing approaches to managing regulatory coherence in the UK.

Below we summarise and adapt the typology of approaches to promoting regulatory coherence and minimising trade costs, developed by the OECD:

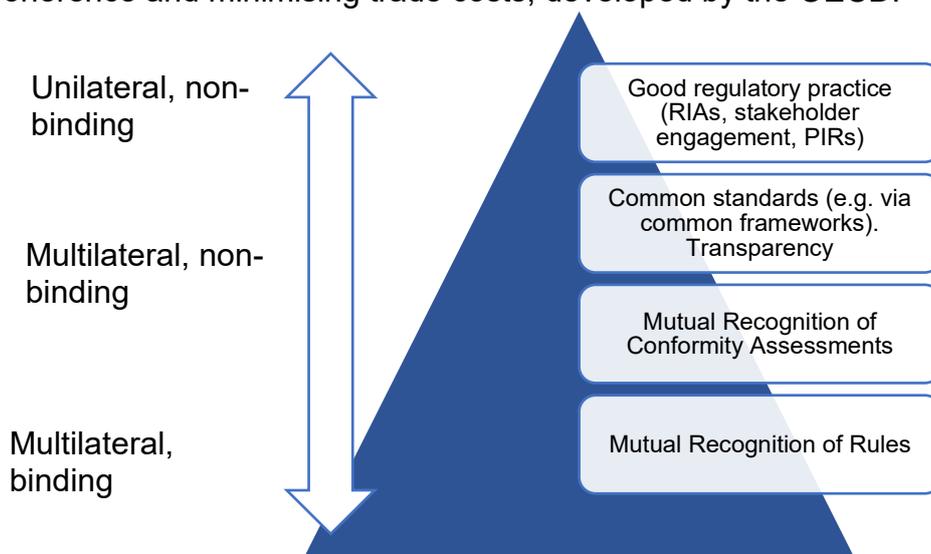


Figure 25 – Options for regulatory coherence and minimising trade costs. Adapted from OECD (2017)

A more detailed discussion on all three aspects of OECD’s good regulatory practice approach – Regulatory Impact Assessments, stakeholder engagement and Post-

<sup>44</sup> Benz (2017) recommends a range for import demand elasticity of between -1.5 to -5 for services.

implementation review – and their application in a UK Internal Market – can be found in Part III. In the table below, we explore the extent to which regulatory cooperation options – if applied in full by economic actors and regulators – remove the range of UK Internal Market costs identified in the previous section.

	Good Regulatory Practice (RIAs, stakeholder engagement and PIRs)	Common standards and transparency requirements	Mutual Recognition of Conformity Assessments	Mutual Recognitio n of Rules
Specification Costs	<i>Depends on regulatory action taken</i>	✓		✓
Information Costs	✓			✓
Conformity assessment/ qualification costs	<i>Depends on regulatory action taken</i>	✓	✓	✓ Partially for Services
'Hassle' and Complexity Costs	<i>Depends on regulatory action taken and enforcement</i>		<i>Partially (only reduces testing delays)</i>	✓
Direct supply chain costs	<i>Depends on regulatory action taken</i>	<i>Partially, through prevention of direct costs arising up – and downstream across stages of the supply chain</i>		
Indirect supply chains costs				
Indirect competition costs				<i>Only partially, depending on standards and business behaviour</i>

Specification costs can be addressed via better regulatory cooperation. At the international level, agreeing a common set of technical product specifications is well-established through international agreements on Technical Barriers to Trade and Sanitary and Phytosanitary Standards. However, there are limitations to the application of common standards. Based on a pilot study of three sectors (domestic electrical appliances, natural gas, and telephone handsets) and five OECD members (including the UK) Fliess et al. (2010) finds that it is difficult to identify a link between standards and a specific regulatory objective, including the policy objectives pursued through the adoption of specific standards.

Binding systems of mutual recognition of technical rules are also effective at eliminating specification costs. In a general sense<sup>45</sup>, Mutual Recognition (MR) implies that goods or services produced under a regulatory regime or rules in one nation enjoy unhindered market access in the destination nation, even if rules are different. Mutual recognition thus removes the need to comply with duplicative product rules and production processes in different markets.

Mutual Recognition of conformity assessment is a more limited version of MR, and only ensures that the conformity assessment bodies (CABs) in one nation can test or certify goods from another market, following local testing rules and procedures, and vice versa. OECD's review of the economic literature on Mutual Recognition concluded that 2 out of 3 of the econometric studies and 6 out of 9 of the qualitative studies find a positive effect of mutual recognition of conformity assessments on trade (Brito, Kauffmann, & Pelkmans, 2016). The others find minor effect or no effect. It is identified by some of these studies that it is the reduction of fixed costs of exporting enabling more firms to export which is at the heart of this. The fixed costs reduction is associated with the removal of the need for duplicate assessments through mutual recognition of assessments. Mutual recognition of rules removes the need for an assessment altogether, so it is possible that the effect would be similarly positive, if not even more so.

Such mutual recognition principles allow for product innovation and differentiation, but well-established MR systems are also underpinned by a common baseline of 'minimum technical standards' or a system of co-regulation with market participants (Pelkmans, 2012). They also reduce the risk of accidental non-compliance or fraud.

Only some information costs can be addressed via better regulatory cooperation, including systems of mutual recognition. An evaluation conducted by the European Commission of its Mutual Recognition (MR) system (European Commission, 2015) emphasised that information costs remain as businesses still need to verify which products or product categories are in scope. Pelkmans further elaborates that mutual recognition (of both rules and conformity assessments) is often 'invisible' to economic agents; what they 'see' are the requirements in local laws and there are additional information search costs.

## Part 2.1 What would the real-world implications be?

The previous section outlines numerous benefits of doing things differently at a local level, but also highlights that there are substantial potential costs to businesses and the economy more widely that need to be considered. However, while these exist theoretically, it is important to understand how likely they are to occur and how big their impact would be.

### Qualitative research – scenario-based business engagement

To better understand what the impact of regulatory difference would be on the operation of businesses across the UK, we undertook extensive qualitative research.

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<sup>45</sup> For more detailed definition of Mutual Recognition principle, please see main White Paper body.

We developed a series of hypothetical scenarios of potential differences in regulation between the four parts of the UK that we presented to businesses to understand how their operations may be affected. The scenarios were structured in such a way that they were relatable to businesses and they were able to see how they could impact their operations. Importantly however, these scenarios are not indicative of policy intent by either the UK Government or the devolved administrations, but nonetheless do present credible examples of potential future divergence.

The engagement involved 40 companies of varying size and covered a wide range of sectors (for example, agriculture, food and drink, transport and logistics and advanced manufacturing) to broaden our understanding of intra-UK supply chains. While neither sectors nor businesses present a representative sample and therefore findings cannot be generalised, the work nonetheless provides an in-depth view into businesses' concerns in a selection of key sectors.

Overwhelmingly businesses recognised and reflected on the commercial benefits of operating within an integrated market with as little regulatory differences

*'It is possible that it might only be viable to run say, 4 products for Scotland which would be a disservice to Scottish consumers.'*  
Major UK drinks manufacturer

as possible. Businesses generally felt that any divergence would result in the loss of efficiencies and undesirable additional costs. These costs may end up being passed on through supply chains leading to higher costs for end-consumers. In addition, consumers' access to a large variety of products may be reduced if it becomes no longer economical to supply all four parts of the UK. Finally, consumer confidence may be reduced due to a potential lack of clarity on the differences in standards across the UK.

Stakeholders highlighted that the increased complexity caused by differences in regulation could also introduce additional risks of non-compliance and fraud. If businesses had to comply with multiple regulatory regimes, they may need to develop different layers of production and distribution. In this highly complex environment, they could face a higher risk of accidental non-compliance and therefore of fines or severe reputational damage. Similarly, individuals may exploit differences in regulation for personal and organised fraudulent activities.

All these effects have the potential to impact global trade activities. According to businesses, increased costs and fragmented supply chains would reduce the competitiveness of UK businesses on the international market. In addition, a fragmented UK Internal Market may also become less attractive to foreign investors, as they can achieve less economies of scale.

*'Customers will be looking for the consistency of products across the UK. If the UK system is aligned it will help us develop on the global stage (...). If the home market is aligned it will give us more resources to develop internationally.'*

Major UK drinks manufacturer

In addition, certain businesses highlighted that for their sector's international competitiveness has relied on a reputation of high quality for the "Made in the UK" trademark and differences in regulation could reduce consumer confidence in the UK brand. Businesses stressed that success had previously been reliant on adherence to a single and uniform set of UK standards that has facilitated access to those markets.

Finally, businesses reflected that even uncertainty surrounding regulatory divergence could impact business operations. In many sectors, businesses have to make long term investment and operation decisions, which would likely need to change in the case of regulatory divergence. Therefore, creating maximum certainty was seen as key by the stakeholders questioned.

## Gravity analysis

As mentioned in the previous part, there are few UK Internal Market trade costs between the four parts of the UK and no significant ‘border effect’. These trade costs seem significantly lower than for other de-centralised countries such as Germany. This raises the question what the economic cost would be if the UK Internal Market trade costs increased, for example to the level of Germany.

The usage of intra-German trade costs is purely illustrative and does not indicate a prediction for the UK market. The German market operates within fundamentally different historic, administrative, and constitutional circumstances than the UK and as a result is likely to have very different trade flows between constituent parts. Furthermore, as mentioned above, trade costs may be caused by invisible drivers that are not within the control of policy makers.

Adapting the gravity modelling technique explained in the previous section, we simulate the impact of increasing trade costs, for example to the German level. If UK constituent part ‘border effects’ increased to German levels, the impact would be much larger in Scotland, Wales and NI than for the UK as a whole: Analysis shows that UK GDP could be reduced by 0.34%, while the reduction in Scottish would be 1.18% and for Welsh GDP 1.61%. This reflects the current importance of intra-UK trade relative to international trade in these geographies. Applying these

### Methodology Note:

A standard gravity model captures only direct effects of changing trade costs between a pair of countries. An increase in trade costs between two nations, however, also changes the *relative trade costs* between those nations and any other trading partners as well as their economic size, an important predictor of trade. To overcome this problem, we use a general equilibrium approach: Instead of extrapolating from the coefficients of the regression explained above, we use these coefficients to feed into an iterative simulation. This allows prices, relative trade costs and GDP to adjust in all countries, therefore capturing the general equilibrium effects. For more details of the methodology, see CITATION LAr16 \ 2057 (Larch & Yotov, 2016).

percentages to the most recent GDP figures for 2018 (ONS, 2018), this implies a loss in GDP of £7.3 billion for the UK as whole with a loss of £3.9 billion for England and £1.9 billion and £1.2 billion for Scotland and Wales respectively.

The overall negative effects on GDP are driven by a significant reduction in trade between constituent parts. This reduction is only partially offset by increases in international and within-constituent part trade. England sees a much smaller reduction in GDP due to a fall in its trade with the devolved administrations, which would predominantly be offset by an increase in within-England trade.

This aggregate effect shows the impact of an overall increase in trade costs on GDP. While these are significant and economically large impacts, this is not a prediction of the future of the UK. Firstly, devolution in Germany is fundamentally different to that of the UK and as the result the states have different policy levers at their disposal. In addition, trade costs can be affected by many factors outside of policy makers control, as explained in the previous section. As a result, these figures should not be taken as any

indication of the likely GDP impact of policy divergence by the four parts of the UK after the end of the transition period.

## Part 3 Future assessment – key considerations

The following section reflects a range of high-level considerations that should be borne in mind when considering possible approaches and which will need to be built on further for the potential design of a future UKIM assessment process.

### UK Internal Market impact assessment at policy design stage (ex-ante)

A systematic and comprehensive identification of benefit and cost implications at the policy design stage can fulfil several good policymaking functions.

Within and between the governments of the UK an assessment of expected policy effects before implementation would ensure that impacts not just within the regulating jurisdiction are identified, but that knock-on effects are also brought to light.

A structured UK Internal Market impact assessment (UKIM IA) process would encourage collaboration between different levels of government, to draw on local expertise present there and identify impacts close to where they would arise.

In conjunction with a possible commitment to make UK Internal Market analysis in relevant regulatory impact assessments publicly available – for example as part of a public policy consultation – an opportunity would also be provided for the business community and the general public to provide additional views and evidence, which could feed into further policy refinement.

Such a process would ensure that political decision makers have a comprehensive assessment of all implications – beneficial and detrimental – at their disposal to feed into informed decision-making processes.

It needs to be acknowledged that a UKIM IA approach would have resource implications for policy makers and that the required capability would need to be built up in all administrations. The efforts should be commensurate to the benefit of improved decision making (i.e. the avoidance of undue costs to the Internal Market from harmful regulatory divergence) and focus should fall on such proposals that bear the highest risk of causing material harm to the operation of the UK Internal Market.

Lastly, there are likely data and evidence needs that would be the same across all administrations for which there are likely efficiency gains from centralising the data collection and maintenance processes. Rather than each administration collecting the same data independently there are likely to be efficiency gains to be realised from centralising the function and making the data available to all four administrations.

### UK Internal Market surveillance after policy implementation (ex post)

Evaluation of policies once they have been implemented is a recognised step in policy making guidance and usually done via post-implementation reviews (PIRs). Such an ex post element is likely also to be beneficial in the UK Internal Market context, as it could highlight additional impacts that were not possible to foresee ahead of implementation.

However, as discussed in previous sections of this document, the UK Internal Market is highly integrated across sectors and through supply chains, which creates some

challenges for any evaluation approach that attempts to identify policy-specific impacts only. Due to the high degree of integration, the cumulation of direct and indirect impacts and the compounding effects of feedback loops over time it is likely going to be highly challenging to assess the full impact of any individual regulation in isolation, particularly once it has been in operation for a length of time. Further work is required to explore the feasibility of this approach.

A more aggregate-level and cross-cutting approach to assessing UK Internal Market impacts after regulatory measures have been implemented might be more straightforward to achieve in practice. Such an approach would track the functioning and development of the UK Internal Market over time, through the consideration of a selection of suitable proxy metrics. This approach should be designed in such a way that sectoral and regional assessments are still possible.

The development of suitable metrics and ensuring the availability of data and evidence to track these metrics will provide a significant methodological challenge and will benefit from a collaborative approach with input from all parts of the UK.

Consideration should also be given to conducting the monitoring function universally across all of the UK, rather than replicating efforts in multiple administrations. An independent body might be well placed to conduct this function and to produce UK Internal Market health checks at regular intervals.

### Conclusion

Both broad approaches – ex ante and ex post – have merits on their own, but for a comprehensive ongoing consideration of both policy-specific and cumulative impacts over time a combination of both options would appear particularly effective.

However, further work is required to develop a comprehensive methodology and to create processes and supporting infrastructure to embed the production of UK Internal Market impact assessments in the policy development process.

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## Annex B – International examples of Internal Market systems

### *International Examples of Internal Market systems*

Proposing options to manage an Internal Market is not a novel idea. Research into other countries' Internal Market systems has informed the development of the proposals set out in this paper. Whilst many of the countries studied are federal or quasi-federal, there are still important lessons that can be learnt.

### *Australian Internal Market System / Australian and New Zealand Internal Market System*

In an attempt to fix their fragmented Internal Market, Australia introduced the Mutual Recognition Act 1992 (MRA) which applies to the States and Territories of the Australian Commonwealth. The MRA introduced the mutual recognition of goods and registered occupations between Australian States and Territories. This was fully introduced countrywide in 1995. Under the MRA, goods that can be sold lawfully in one State/Territory can also be sold in another without having to satisfy certain additional requirements. Similarly, registered occupations in one State/Territory may practise the equivalent occupation without having to obtain additional qualifications or experience. The scheme applies only to regulation relating to placing goods for sale and does not impact on the manner of sale requirements, including those relating to the use of goods.

The Trans-Tasman Mutual Recognition Agreement (“the TTMRA”) is a non-Treaty arrangement between the Government of New Zealand and the Commonwealth, State and Territory Governments of Australia (“the Australian Parties”) which introduced mutual recognition of goods and registered occupations between the Australian Parties and New Zealand. It was intended that the mutual recognition scheme created by the TTMRA would, as far as is possible, be consistent with the scheme created by the MRA. The TTMRA was implemented domestically by the Australian Parties and New Zealand in mirror legislation which entered into force in 1998, the Trans-Tasman Mutual Recognition Acts of 1997.

Political governance is utilised as the main decision making and dispute avoidance mechanism, however legal challenges under the MRA have been pivotal in removing barriers to trade. Heads of each state government meet through the Council of Australian Governments, along with representatives from New Zealand where there are TTMRA issues, and ultimately have responsibility for the management of the MRA and the TTMRA, with the monitoring of the mutual recognition systems being undertaken by the Cross Jurisdictional Review Forum (CJRF).

Australian Ministerial Councils, which have representatives from New Zealand when necessary to address TTMRA issues, have an important role in facilitating discussions and decisions on the mutual recognition systems. This can include resolving disputes, the introduction of harmonised standards to replace mutual recognition and the creation of temporary and permanent exemptions. The reviewing of the MRA and TTMRA is undertaken by the external Australian Productivity Commission (APC). The APC's findings, when agreed and deemed necessary, are implemented by the CJRF.

In their 2015 review, the APC found that both the MRA and TTMRA were generally working well<sup>46</sup>. It was also stated that both the MRA and TTMRA schemes allow easier cross border business to take place<sup>47</sup>. However, it was noted that the system worked more effectively for goods than for registered occupations. The MRA and TTMRA are regarded as 'light-handed', decentralised and low-cost modes of dealing with interjurisdictional differences in law and regulation<sup>48</sup>.

### *Swiss Internal Market System*

Like Australia, Switzerland has a federal system, with states known as cantons, but unlike Australia, Switzerland introduced their Internal Market architecture due to external pressures. Following the decision not to join the European Economic Area (EEA), questions were raised about the number of internal barriers within Switzerland, when compared to those across the EEA.

Article 95(2) of the Federal Constitution<sup>49</sup> provides the constitutional basis for the recognition of academic and professional qualifications throughout the 'unified Swiss economic area'. The Swiss Internal Market Act (SIMA) 1995<sup>50</sup> was introduced to improve competition between cantons through the removal of market access barriers.

SIMA introduced a version of the EU Cassis de Dijon mutual recognition principle<sup>51</sup>, for both goods and services. The introduction of the Act gave goods and services across Switzerland the legal assumption of equivalence when traded across cantons. All goods and services are within the scope of the law. Additionally, cantons are not allowed to restrict market access based on the fact that market participants have their place of business or their seats in another canton – local and non-local market participants have to be treated equally. Should a canton wish to derogate a good or service they must be able to show that the regulations of the place of origin provide considerably lower protection of public interests, show that local market participants are also subject to the restriction and justify the derogation as proportionate in protecting the public interest.

Further changes to SIMA were brought about following the 1999 agreement with the EU to allow a form of free movement of citizens between the EU and Switzerland, so giving EU professionals rights in Switzerland. To avoid reverse discrimination<sup>52</sup> the federal government incorporated those same freedoms regarding movement of professionals within Switzerland, so as not to disadvantage their own citizens.

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46 Productivity Commission 2015, *Mutual Recognition Schemes*, Research Report, Canberra, <https://www.pc.gov.au/inquiries/completed/mutual-recognition-schemes/report>

47 Ibid.

48 Page 207, Productivity Commission 2015, *Mutual Recognition Schemes*, Research Report, Canberra

49 <https://www.admin.ch/opc/en/classified-compilation/19995395/index.html>

50 <https://www.admin.ch/opc/fr/classified-compilation/19950280/index.html#:~:text=La%20pr%C3%A9sente%20loi%20garantit%20%C3%A0%20sur%20tout%20le%20territoire%20suisse.&text=Elle%20vise%20en%20particulier%20%C3%A0%3A&text=renforcer%20la%20coh%C3%A9sion%20%C3%A9co>

[nomique%20de%20la%20Suisse.](https://www.admin.ch/opc/fr/classified-compilation/19950280/index.html#:~:text=La%20pr%C3%A9sente%20loi%20garantit%20%C3%A0%20sur%20tout%20le%20territoire%20suisse.&text=Elle%20vise%20en%20particulier%20%C3%A0%3A&text=renforcer%20la%20coh%C3%A9sion%20%C3%A9conomique%20de%20la%20Suisse)

51 The Cassis de Dijon ruling (judgment of the Court of Justice of 20 February 1979, Rewe-Zentral AG Bundesmonopolverwaltung für Branntwein (Case C-120/78) [1979] ECR 649) established the principle that, in essence, products sold lawfully in one Member State may be sold in another. It further held that Member States may only place restrictions on the free movement of goods on certain very specific public interest grounds: in particular to ensure fiscal supervision, the protection of public health, the fairness of commercial transactions and the defence of the consumer. [https://www.europarl.europa.eu/doceo/document/E-8-2016-008884\\_EN.html](https://www.europarl.europa.eu/doceo/document/E-8-2016-008884_EN.html)

52 The term reverse discrimination is used to describe a type of discrimination wherein members of a majority or historically advantaged group are discriminated against based on their race, gender, age, or other protected characteristic. In the Swiss case they did not want to allow workers from outside Switzerland more rights than Swiss workers themselves through the free movement agreement signed with the EU.

In 1996, the Swiss created the Competition Commission (CC) as an independent federal authority, to monitor competition within Switzerland. In relation to the Internal Market, it monitors compliance with SIMA by the Confederation, the cantons and the municipalities. The CC provides informal advice, explanatory reports and non-binding recommendations but has no decision-making powers. Since 2005, the CC has had an independent right of appeal and can obtain a court ruling as to whether a market restriction is inadmissible. The Swiss federal government introduced the Internal Market Authority (IMA) within the CC to strengthen the law and its operational application. Main functions of the IMA are to review all legislative proposals from the cantons and scrutinise proposals, however, they do not hold any power to prevent legislation. The IMA also acts as a contact point for businesses and consumers.

The IMA does not itself resolve complaints from consumers and businesses about Cantonal legislation that infringes the SIMA. Instead, complaints are primarily raised through the courts – but the IMA has rights to appeal court rulings and support consumer cases which have been deemed to be in breach of the Internal Market principles. Unlike the Australian Internal Market system, there is no independent body that reviews the functioning of the SIMA, though the IMA does report on its actions.

Whilst both above systems utilise mutual recognition as the main legislative vehicle, there are countries which have chosen to use different legislation and systems.

### *Spanish Internal Market System*

Spain introduced its Law on the Guarantee of Market Unity in 2013. This set out legal principles to reduce market fragmentation and prevent the creation of trade barriers between regions. The legal principles cover; Non-Discrimination, Better Regulation, national unique validation, and administrative cooperation. The legal principles are applied to all autonomous regions and the central government within Spain.

Non-Discrimination is applied through the Law on Market Unity and all economic operators within Spain are within scope. The principle states that no economic operator can be discriminated against by reasons which would relate to the place of residence or establishment. Through the application of the principle, regions are no longer able to discriminate or create protectionist measures for their own economic operators. The provisions relating to the principle of national unique validation, under which economic operators can provide their services and products outside of the territory of origin provided that the territory of destiny could accept the full validity of the requirements, qualifications, prior inspections or guarantees of the territory of origin, were subsequently cancelled following a ruling by the Spanish Constitutional Court in June 2017.

Spain created the National Markets and Competition Commission (CNMC) alongside the law in 2013. The CNMC has the power to challenge laws it considers to be in breach of the four principles. Businesses and consumers also use the CNMC as the main point of contact when they wish to challenge a law they believe breaches any of the four principles. Such challenges are taken to the courts to be resolved if regions have not been able to find an out of court solution. Most of the cases which have been raised via the CNMC, however, have ended up in court.

Discussion that members of the UK Internal Market policy team held, in July 2019, with Spanish government and business associations, revealed there was a consensus that

the system had brought the regions together and reduced the administrative burdens placed upon businesses trading with Spain. Upon discussion with multiple Spanish business associations, it was relayed, that the reliance upon the courts in solving the disputes, and the time that these resolutions take was seen as the most pertinent issue with the Law on Market Unity.

## Annex C – Recent & current enquiries relevant to UK Internal Market policy

There is ongoing interest in the UK Internal Market for the UK Parliament, the devolved administrations, academia and the third sector.

In March 2020, the **Northern Ireland Affairs Committee** in the UK Parliament launched an inquiry, '[Unfettered Access: Northern Ireland and customs arrangements after Brexit](#)', to “scrutinise customs arrangements for goods moving in both directions between Northern Ireland and Great Britain under the revised Northern Ireland Protocol”<sup>53</sup>. The inquiry includes among its questions: “Whether the revised Northern Ireland Protocol will allow goods produced in Northern Ireland unfettered access to the rest of the UK Internal Market”. Responses to date highlight the implications of the UK Government “allowing part of its Internal Market to be subsumed under a different customs regime and a different single market”<sup>54</sup>, and focus on the potential challenges of administrative burdens, logistics, competition implications and resourcing<sup>55 56</sup>.

The UK Parliament’s **Welsh Affairs Committee** has similarly launched an inquiry into the implications of the UK-EU trade negotiations for Wales, '[Brexit and Trade: implications for Wales](#)'. Part of the inquiry will assess the effects of the Northern Ireland Protocol on intra-UK trade, including whether additional capacity is required at Welsh ports. Respondents were asked to comment on how the revised Northern Ireland Protocol “will affect the access of goods to and from Wales as part of the UK Internal Market, including customs checks, processes and declarations”. Responses published to date have highlighted the need for future regulatory frameworks to take account of the impacts on public health and wellbeing<sup>57</sup>, the potential for “frictions and additional costs to the movement of goods between Wales and Northern Ireland”<sup>58</sup>, the risks of “unfair competition in our domestic marketplace from products produced to lower standards as a result of trade liberalisation”<sup>59</sup>, and a request for the UK “to preserve current standards in alignment with the EU”<sup>60</sup>.

A **Scottish Parliament inquiry**, '[Scotland and the UK Internal Market](#)', is also underway, with the Finance and Constitution Committee launching a review into this area in 2019. The initial inquiry began in response to the Common Frameworks with a preliminary evidence session and commissioned comparative research on how Internal Markets operate within different countries, namely Canada, Switzerland and United States of America. The purpose of that work was to understand how the UK Internal Market might operate post-Transition Period. The call for evidence, which closed on 28 February 2020, posed a broad range of questions, including: “What institutional structures will be required to administer and enforce the UK Internal Market?” and “What should be the role of the Scottish Parliament in relation to scrutinising the UK

53 <https://committees.parliament.uk/work/115/unfettered-access-northern-ireland-and-customs-arrangements-after-brexit/>

54 Written evidence submitted by Katy Hayward, Milena Komarova and

David Phinnemore <https://committees.parliament.uk/writtenevidence/1983/pdf/>

55 Written evidence submitted by the Freight Transport Association <https://committees.parliament.uk/writtenevidence/2279/pdf/>

56 Written evidence submitted by Professor David Widdowson AM <https://committees.parliament.uk/writtenevidence/3837/pdf/>

57 Written evidence submitted by the Welsh NHS Confederation

<https://committees.parliament.uk/writtenevidence/1694/pdf/>

58 Written evidence submitted by NFU Cymru, <https://committees.parliament.uk/writtenevidence/1895/pdf/>

59 Ibid.

60 Written evidence submitted by Universities Wales <https://committees.parliament.uk/writtenevidence/2092/default/>

Internal Market?”. The responses, from different sectors, highlight concerns about divergence, as well as favouring UK-wide approaches based on positive and expanded intergovernmental relations. The UK Government is grateful to those respondents who have generously given their time to input to the UK Internal Market policy development.

In 2017, the National Assembly for Wales’ **Constitutional and Legislative Affairs Committee** launched an inquiry into UK governance post-Brexit. The resulting report published written evidence arguing for a “functioning system of intergovernmental relations” to navigate the complexities of UK constitutional principles<sup>61</sup>. The written evidence also recognised that EU exit would raise significant questions on making UK laws in areas previously covered by EU competence, and highlighted the need to preserve an Internal Market within the UK ‘with due regard for the distribution of powers between the four governments and legislatures to ensure that the economic and political interests involved are factored into “the formulation of policy and legal solutions”<sup>62</sup>.

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61 <https://senedd.wales/laid%20documents/cr-ld11405/cr-ld11405-e.pdf> Accessed 21 May 2020 22:14.

62 Ibid.

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This consultation is available from: <https://www.gov.uk/government/publications/uk-internal-market>

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