

Dadansoddi ar gyfer Polisi



Analysis for Policy



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How do Free Trade Agreements impact the UK and Wales's Ability to Regulate.

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Views expressed in this report are those of the researcher and not necessarily those of the Welsh Government

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Introduction

1. In the context of the UK's exit from the European Union (EU) and the recent proliferation of Free Trade Agreements (FTAs), either signed or under negotiation, this research looks to better understand the impact that new FTAs are having on policy makers working in regulatory areas with devolved competence.
2. After the United Kingdom (UK) left the EU on 31 January 2020, regulatory powers that previously sat with the EU returned to the UK, including to Wales where the policies were part of devolved competence.
3. Following EU Exit, the UK has seen key changes to its international outlook. Firstly, the UK agreed the UK-EU Trade and Cooperation Agreement (UK-EU TCA) with the EU, ensuring that the UK's market remains closely linked to the EU market. Secondly, the UK has embarked on an ambitious and rapid process of FTA negotiations with both bilateral and multilateral partners.
4. Since leaving the EU, the UK is now directly subjected to the full impact of international trade matters. This research reviews some of the effects of this new UK reality and the potential effects it might have on devolved policies and devolved regulatory development.

Methodology

5. The methodology undertaken to conduct this research was in 3 stages:
 - a) A literature review and analysis conducted on the international trading environment and the international dynamics/trends and rules governing regulatory activity making.
 - b) Textual analysis on specific chapters in four of the UK's major FTAs (UK-EU TCA, Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), UK-Australia Free Trade Agreement (UK-AUS FTA) and UK-New Zealand Free Trade Agreement (UK-NZ FTA)) that have the

most relevance to devolved regulatory practice and devolved policy development.

- c) A series of interviews conducted across a wide range of relevant policy areas in the Welsh Government. In total 21 interviews with 25 respondents were conducted. The interviews were semi-structured, lasting for around thirty minutes each. The interviews comprised of questions to get clear answers towards the main research questions but with flexibility to allow further exploration in the practice of policy making within the contemporary environment more broadly.

Findings

Part 1. International rules and dynamics governing regulatory activity and trade

6. The World Trade Organisation (WTO) is the principle international mechanism through which international trade governance is articulated. The WTO has comprehensive global membership with 164 full members and 24 observer states hoping to join. The WTO provides a meeting forum for setting global trade rules. It has an independent institutional structure to oversee trade activity and importantly provides a dispute resolution mechanism.
7. On leaving the EU, the UK now relies on WTO rules to govern trade with WTO member states where there is no active FTA signed with the UK. WTO rules place obligations for the UK in areas such as tariff schedules on goods and rules on services. The WTO also sets international standards in areas such as Sanitary and Phytosanitary (SPS) measures. WTO rules produce obligations and procedural guidelines to inform how regulatory activity is conducted and what types of activity fall within the disciplines of its remit. Welsh Government, as a UK regulatory authority, acts within the scope of these rules.
8. The rules-based setting, institutional mechanisms and baseline international standard setting activity of the WTO provides a key function to government activity in areas that affect and are affected by international trade. However, the initial successes of the WTO in drawing in new members and overseeing the gradual reduction of tariff

barriers has given way to policy gridlock, as members struggle to agree on new progressive measures¹.

9. Having had reasonable success in addressing tariff related barriers, one of the main issues being considered at the WTO now centres around how to deal with non-tariff barriers to trade. The issues here are cross cutting and can provoke disagreement between developed and developing economies.
10. The parameters of global regulatory activity, as set out in the WTO, are that states are allowed to exercise their sovereign rights to regulatory autonomy. These rights can be exercised as long as the regulatory activity is non-discriminatory (i.e., applies to domestic and overseas goods/services), and where the regulatory activity poses a barrier to trade that it is a justified barrier according to the rules allowed.
11. Regulatory barriers to trade can be justified if they are needed for the protection of human, animal, and plant life, or for the protection of the environment in general. These are all areas falling in devolved competence space. Another justification is that the regulatory activity is needed for matters of national security.
12. Looking at the UK setting, the EU still has a large effect on UK regulatory freedom². The UK's dependence on EU export markets, the EU's large market size and the institutional power of EU regulatory authorities put the UK in a weak structural position to radically diverge from EU regulatory norms.
13. Internally to the UK the post EU setting has been characterised by a conflict over the regional distribution of powers returning to the UK³. Following EU Exit, the United Kingdom Internal Market Act (UKIMA) provides a legal resolution to potential trade related issues connected to regulatory divergence within the UK⁴. The use of common frameworks provide a softer cooperative approach to regulatory alignment between the UK and Devolved Governments in the hope that regulatory policy in key areas is developed in unison⁵.

¹ Wilkinson, 2013

² Moretta, Tombs and Whyte, 2022; Sandford and Gormley-Heenan, 2020.

³ Keating, 2022

⁴ Dougan et al., 2020

⁵ Torrance, 2021

14. From a purely Welsh perspective this contextual overview portrays complexities and obligations within which Welsh Government must now articulate themselves. Strong internationalised standards in some areas bind regulators to international norms, and powerful regional trading blocs provide a centre of gravity towards which regulators must respond. WTO rules and FTAs bind regulators into structures that mean that any regulatory activities that have trade effects needs to be justified or risk reprisals.
15. For clarification UKIMA is outside the scope of this research. Therefore, its effect on devolved regulatory activity has not been analysed.

Part 2. Analysis of the FTAs.

16. This research covered four of the UK's main operative FTAs at the time of writing. These are the: UK-EU TCA, CPTPP, UK-AUS FTA and UK-NZ FTA.
17. Four chapters were analysed from each: Technical Barriers to Trade (TBT), Good Regulatory Practice (GRP), Sanitary and Phytosanitary (SPS) and Environment. These last two offer the closest alignment of devolved Welsh policy competence and the terms of FTAs. Other chapters were looked at in the analysis process, but it was determined that these four chapters were the most relevant.

i. GRP

18. The analysis of the GRP chapters shows a common theme amongst the four FTAs. All the FTAs set certain expectations on how regulatory activity should be conducted and clearly pointed towards a more international outlook in terms of how policy is formulated and how impact assessments are carried out. The FTAs (with the exception of the TCA) are geared to only legally apply to the central level of government (i.e., UK government) and there is no clarification within the texts of how the GRP provisions might apply to devolved governments.
19. The texts all seem to transfer the problematic issue of possible regulatory divergence within the UK to the central government (UK government). All of the FTAs equate GRP at the central level of government with a high level of internal regulatory convergence. They also all require the establishment of specific mechanisms to

ensure that internal UK regulatory divergence does not occur, particularly where the regulatory divergence creates negative trade effects.

20. The GRP chapters limit Welsh regulatory freedom in two ways. First the FTAs elevate policy discourse to international platforms, where cooperation around new regulatory activity will be discussed. The FTAs then require that central governments ensure that internal regulatory actors also align with established central regulatory policy which, as can be seen from within the FTAs, could increasingly be determined through internationalised cooperative channels.

ii. TBT Chapters

21. The TBT chapters across all four of the FTAs involve a broadly similar approach but have different degrees to which the approach is applied. All the FTAs refer to international standards building as a way to ensure regulatory alignment. This is either using existing international standards, or ensuring that respective national standards bodies cooperate with the aim of influencing international standards bodies to develop international standards that can be used globally. These international standards can then form the basis for domestic regulatory activity.

22. The idea of equivalence is a key concept in modern FTA documents. Equivalence is established between state regulatory actors and involves recognising that different regulatory coverage produces an equivalent protection to the domestic regulatory coverage. This allows the complex application of regulatory regimes to differ between FTA Parties whilst enabling trade, as each Party recognises that the other Party has ensured that minimum regulatory outcomes have been achieved.

23. If regulators build regulatory policy around established international standards the equivalence process becomes less complex. As a result, there is a large drive within the free trade setting to advance the international standards setting process across all substantive policy fields. The international standards setting process has implications for all state and sub-state regulatory actors as the general scope of regulatory activity becomes increasingly set within the international standards setting field.

24. The FTAs analysed also revealed differences between the approaches to TBTs and regulatory activity in general. The CPTPP, which is more similar to a US style approach to regulation, is less driven by the need for state regulators to apply international standards, and instead is built upon a model of regulatory activity where substantial aspects of regulatory policy setting and compliance are produced by industry actors themselves. This is at odds with the EU style approach to regulation that takes a more state/government backed institutional model to regulatory policy making and enforcement.
25. The UK-EU TCA and the UK-NZ FTA are more forceful in connection to international standards setting and use language like 'convergence' to suggest a strong alignment of FTA partners with international standards setting norms. The CPTPP and the UK-AUS FTA use language like 'harmonisation', indicating a looser approach to establishing equivalence. This also reflects the more limited approach that the state is expected to take in regulatory activity with a large part of regulatory work left to private industry actors.
26. From a UK and Welsh perspective this difference creates a potential future issue. If the UK space moves to align with the CPTPP style approach to regulation, it would potentially move out of line with the UK-EU TCA approach to regulation, and risks causing substantive trade issues. The same would work in reverse if the UK space aligned with the more rigorously state based regulatory model of the EU, which would then create potential issues of alignment with CPTPP. In aligning with CPTPP, the UK regulatory space will look under-regulated and under-protected from an EU perspective creating issues for trade flows in key goods. When aligned with the EU model, the UK looks over-regulated from a CPTPP perspective and questions over unnecessary TBTs emerge.

iii. Sanitary and Phytosanitary (SPS) Chapters

27. There is very little divergence between the SPS chapters of the FTAs. The main aspects of the SPS chapters relate to the international standard setting bodies that operate with a good degree of international consent.

28. Standard setting in the SPS field is heavily science led and for the most part there is a strong scientific consensus around what is and is not good for human, animal, and plant health. As such, Welsh regulatory authorities working in the SPS area are strongly limited by the international scientific consensus that drives strong international standards setting in the SPS field.
29. The SPS chapters in all four FTAs do allow for the state regulators to set regulatory protections above international standard norms. However, should any regulatory activity in the SPS sphere create a barrier to trade, then a high level of scientific and technical evidence is required in order to justify their legitimacy (i.e. to ensure that they are not trade barriers to promote domestic industries disguised as regulations).
30. In this respect, Welsh Government is at a disadvantage in their ability to effectively exercise their regulatory autonomy. The issue here is connected to the high burden of scientific proof needed and the relatively weak institutional capacity of on them to operationalise an effective scientific justification against powerful actors like the EU, which has very powerful institutions acting in this area.
31. Welsh Government is also bound into various UK, GB and Welsh-English structures that have a key role in SPS fields such as the Food Standards Agency (FSA) and the Department for Environment, Food & Rural Affairs (DEFRA). Therefore, Welsh Government will have potential issues with independent regulatory activity both within the UK setting and by extension with FTA partners.

iv. Environment Chapters.

32. The environment chapters across of the FTAs are less focused around international institutions and international standards. This reflects the more politically sensitive and contested nature of policy in these areas. All the FTAs accept that the environment and climate change are big policy issues and there is latitude given towards regulatory activity in these areas. In general, states are allowed to exercise regulatory autonomy regarding environmental and climate objectives, with a lower justificatory burden applied (when compared to SPS for example). States are allowed to pursue legitimate objectives even if policies in this area are trade restrictive and can even be discriminatory towards FTA partners interests.

33. The FTAs in theory allow a great deal of freedom for the UK and Welsh Government to extend proactive and extensive regulatory activity into the environment and climate change policy areas. From a Welsh perspective the CPTPP, UK-NZ FTA and UK-AUS FTA are problematic as they omit any reference to the application of the environment chapters to the UK regulatory space. It is not clear yet if these freedoms apply to the devolved regulatory level, or whether the chapters on TBT and GRP override significant internal divergence in this policy area. The UK-EU TCA does offer a recognition of devolved regulatory divergence and sets out the areas within which UK internal divergence is acceptable.

34. The UK-EU TCA is more restrictive when it comes to environmental protection. The UK-EU TCA requires parties to not weaken or reduce their level of environmental protection below those in place at the end of 2020 (non-regression). Existing commitments and ambitions on climate change, in particular on climate neutrality by 2050, are to also remain in place. This produces potential issues for UK and Welsh regulators if, for instance, particular policies that were in place prior to the UK-EU TCA being in force, start having adverse effects to their industries / environment. Under the terms of the UK-EU TCA, the removal of regulations that were designed to protect the environment is very difficult to legitimise and could constitute a breach of the UK-EU TCA terms, especially if they offer UK businesses an advantage over their EU counterparts.

Part 3. Findings from the Interviews

35. The interviews were conducted across a broad range of relevant policy areas across the Welsh Government. The interviews were designed to determine both the awareness of FTAs and to understand if FTAs were having a material impact on how regulatory policy making is being conducted within the terms set by the UK's reserved powers structure.

36. In total, interviews were conducted across 21 policy areas with 25 respondents. Eleven policy areas reported a good knowledge of FTAs, 8 reported some knowledge of FTAs and 2 reported no knowledge of FTAs. On further questioning very few

respondents had a knowledge of all the UK's active FTAs. In most cases respondents had specific knowledge of one or two FTA texts.

37. When questioned about the impact of FTAs on their work, all respondents felt that it was too early to make a judgement. The research found that very few respondents recognised the UK-EU TCA as an FTA text. The explanation for this seems to stem from the endurance of the terms and regulatory practices of the UK-EU TCA from when the UK was an EU member state. The UK-EU TCA as an active FTA has a clear impact on regulatory autonomy at the UK and Welsh level.
38. This research also uncovered some interesting issues that tie into some of the broader international dynamics set out in reference to regulatory activity within the terms of FTAs.
39. In reference to the emergence of a new cooperative platform for international cooperation within FTA partnerships, respondents felt that they were distanced from these international settings with access decided on an ad hoc basis by UK officials. This problem was also identified in relation to Welsh inclusion in FTA negotiation processes, although many respondents reported that more recent and ongoing FTA negotiations were including Welsh officials more consistently.
40. Respondents also reported that there were structural issues regarding justifying divergent policy positions. This issue has two focal points. First, respondents struggle to operationalise the kinds of complex scientific and technical knowledge communities within coherent institutions to produce the necessary evidence that can stand up to established big regulatory players like the EU. Second, in many policy areas, Welsh Government is already tied into large UK, GB, or Welsh/English wide bodies like the FSA and DEFRA. Institutional lock-in to these large powerful actors further limits Welsh independent regulatory capacity.
41. The interviews also highlighted a quite basic structural problem with regards to assimilating the raft of new FTAs coming into effect. This issue was a simple question of the time available to digest the implications of FTAs for their policy area. FTA texts can be complicated, require legal interpretation and as this research found, creates different sets of obligations on FTA partners. Understanding the nuances and

interrelations of each different FTA is imperative to good policy making activity, an issue that will intensify as more FTAs come online in the near future.

42. Although outside the scope of this research, respondents noted that the presence of the UKIMA may constrain future policy decisions.

Conclusions

43. Rules and obligations set out in WTO commitments and in FTAs have created a patchwork of complex, and sometimes contradictory, demands on regulatory actors, including for the Welsh Government.

44. The UK internal setting in the era after EU Exit has created a new level of complexity that Welsh government will now have to work with. UKIMA, common frameworks and the plethora of joint forums through which cooperative regulatory activity and standard setting occurs have added to this complexity.

45. The combination of complex international dynamics alongside new complex internal relations means that Welsh Government will face strong structural limitations in its policy space.

46. In terms of the FTAs, potential issues were raised in relation to clashes in how the CPTPP and the UK-EU TCA articulate deep regulatory activity. The CPTPP model favouring an industry led self-regulatory model in some areas like environmental protection, whereas the UK-EU TCA keeps to a traditional state regulatory model.

47. Despite some key differences in most respects all the FTAs analysed, they did not create any substantial overt limitations on Welsh regulatory independence over and above existing demands of WTO obligations.

48. However, the FTAs were found to create two specific dynamics that would affect Welsh regulatory autonomy. The first effect is more diffuse and latent. This involves the internationalisation of standard setting, and the use of FTAs as a cooperative vehicle towards regulatory alignments. Here the FTAs elevate regulatory decision

making away from the devolved level into an international forum for the creation of harmonised regulatory systems.

49. The second dynamic has the effect of removing the issue of internal regulatory divergence from within the legal scope of FTA provisions and making it a matter for internal politics. In addition to this, the FTAs requires that central governments implement effective mechanisms to ensure the regulatory alignment of internal regulatory actors.
50. The overall effect of FTAs is to subject devolved governments to UK central logics. The UK in turn, under the terms of FTAs, will increasingly respond to international pressures to align regulatory systems. This potential effect is strongest in relation to the UK-EU TCA given the size of the EU's market, the connection of the UK to EU markets and the international force of EU institutions in driving international standard setting.
51. In terms of awareness of FTAs from policy areas, it was found to be a generally good, although in many cases respondents did not have a comprehensive understanding of all active FTAs.
52. In reference to the effects of FTAs on regulatory activity at the Welsh level, it was felt that it was too early to assess their impacts. Several respondents reported that the UK-EU TCA had the most impact on their areas of work with policy needing to align with EU policy objectives and regulatory requirements, often because of the UK's status as a previous EU member state.
53. In relation international standard setting and regulatory convergence, policy areas reported that they did have access to international negotiation processes. However, where they existed, like participation in UK cooperative settings, the participation was often ad hoc and depended on good personal relationships rather than effective institutional mechanisms to provide access.
54. Welsh Government also have significant structural disadvantages when trying to compete with larger, better resourced bodies at the UK and international levels. This

was most evident in relation to accessing institutions and producing scientific and technical knowledge to support regulatory activity.