Business and Transatlantic Trade Integration

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Trade and investment flows across the Atlantic market are extensive and barriers to such exchanges are low on average. Indeed, many of the tariffs that are applied to trade flows are now so low that the administrative cost of collecting them may outweigh the revenue that is collected. Remaining trade and investment barriers are concentrated in sensitive sectors where there are longstanding concerns on both sides about liberalization – such as audio-visual and broadcasting industries, maritime cabotage, agricultural products, or issues that surround financial services and e-commerce. However, to a significant extent, the policies that inhibit the transatlantic flow of goods, services, knowledge and professionals are increasingly regulatory in nature – generated by differences in product and market regulation (Francois *et al.* 2013; Amcham 2013; Vogel 2012). The associated policies are motivated by a raft of objectives, including human and animal health and safety, national security, consumer protection, attenuating environmental spillovers, macro-prudential goals and a variety of other possible market failures.

Successful international cooperation to reduce the market segmenting effects of regulatory policies is very difficult to achieve because of worries regarding their possible impact on the realization of regulatory objectives. Matters are complicated by the fact that multiple agencies with different mandates, objectives and approaches to enforcement frequently play a role in setting and ensuring compliance with product and process regulations and overseeing the operation of the markets they are responsible for. Differences in approaches reflect variations in institutional organization, legal regimes, attitudes towards risk, etc. as well as differences in the ability of national industries to ensure that regulation is tailored so as to increase the costs for foreign competitors of contesting 'their' domestic or regional market. In the EU-US context matters are complicated even further by the fact that many of the policies that impede the ability of foreign providers to contest markets are at the state level (28 national governments in the EU, the 50 states in the case of the United States). Although the EU has a common external trade policy, which now also encompasses foreign investment policy, much of the regulation pertaining to services markets and taxation/incentive policies is applied at the national level. The same is true in the United States.

Research on the potential gains from regulatory cooperation aimed at further integrating the transatlantic marketplace suggests that this can generate substantial benefits for both sides. Equally as important, if not more so, is the potential for identifying and putting in place mechanisms and processes that reduce the market segmenting effects of regulatory barriers without undermining the achievement of regulatory objectives. A key question confronting both sides is what could be done through cross-Atlantic cooperation to realize these potential gains. This question boils down to whether EU-US cooperation can be an effective mechanism to drive the *domestic* policy initiatives that are needed to enhance the ability of foreign providers to contest markets – or put differently, for consumers and firms to be able to source goods and services that best meet their needs at competitive prices, whether from the EU or the United States or other countries, while ensuring that regulatory objectives are realized.

Past experience has shown that this will be anything but easy. A necessary condition for reducing regulatory compliance costs and eliminating duplicative and redundant requirements is mutual trust and understanding of regulatory systems and compliance mechanisms. This requires interaction and information exchange between regulatory authorities in order to achieve a measure of acceptance that norms and processes are 'equivalent enough'. This has been recognized by both sides. Thus, the 2007 Framework for Advancing Transatlantic Economic Integration stresses dialogue: the establishment of joint mechanisms

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and processes to assess the impact of regulatory regimes and to enhance timely access to information on proposed regulations, and a Transatlantic Economic Council to guide the process and review progress.

The Transatlantic Trade and Investment Partnership (TTIP) negotiations offer a new opportunity to put in place mechanisms to address regulatory sources of market segmentation. Analyses of the potential impact of a TTIP conclude that the near-term gains are likely to be limited as a result of the difficulty in addressing the regulatory agenda that generates excess trade costs across the Atlantic. The most careful and comprehensive economic analysis to date suggests that a TTIP will increase real aggregate incomes in the EU and the United States by no more than 0.5 percent (Francois *et al.* 2013). One reason for such relative small estimates of potential net gains is that the study assumes (realistically) that it will not be feasible to make significant progress in addressing many of the regulatory sources of transatlantic trade costs. This is consistent with the views expressed by the European Commission, which has indicated that agreements with the United States on regulatory matters will be of a 'living nature', involving gradual progress in convergence and mutual acceptance of regulatory norms and approaches that is conditional on the operation of new cooperative mechanisms that are created as part of the TTIP (European Commission 2013). What follows discusses a possible procedural approach to address the trade-impeding effects of regulation that builds on this recognition.

The Transatlantic Trade and Investment Partnership

The goals of the TTIP initiative are ambitious. A major objective is to achieve greater regulatory coherence and to agree on approaches to address policy matters that have not been dealt with in trade agreements outside of the European Union to date. An example is to agree on disciplines on the behaviour of (towards) state-owned or controlled enterprises. A stated aim is not just to further integrate the transatlantic marketplace, but to develop rules and approaches that are globally relevant and that could become a template for future multilateral norms (Eizenstat 2013; Akhtar and Jones 2013).

Efforts to address regulatory spillovers (regulations that create barriers to trade and investment) tend to focus on regulators and regulatory processes. An example is to create processes for agencies from the relevant jurisdictions to establish consultation and information exchange-*cum*-notification systems through which all sides are advised of proposed changes to policies and drafts of new regulatory measures. While such processes are important to building up the mutual trust and understanding of the operation of counterpart regulatory processes and norms, their effect in lowering trade costs may be limited. Regulators may not have the mandate or autonomy to allow them to accept foreign regulatory mechanisms as equivalent to their own. They also may have little incentive to go beyond dialogue if this were to result in even a small increase in the probability that noncompliant products would circulate in their markets. Interaction and a better understanding of norms and certification and conformity assessment procedures are necessary elements of any effort to reduce redundant regulatory barriers to trade. However, as experience has shown, they are not sufficient: the results of such mechanisms in the context of EU-US economic relations have been disappointing (Vogel 2012; European Commission 2013).

It is difficult to establish 'equivalence' because agreement is conditional on determining that norms and conformity assessment procedures are similar enough to permit mutual recognition. This conditionality-based approach to mutual recognition and acceptance of foreign norms and processes seems logical, but runs into the sand as a result of strongly held views on each side that a given approach is superior and/or fundamentally different. A better approach is arguably embodied in the EU's Services Directive (Messerlin 2013), which is based on the unconditional acceptance of foreign norms. This can be subject to exceptions and exclusions for sectors or products that are deemed too sensitive to allow such acceptance, but the basic principle of the approach taken in the Services Directive is that the underlying norms and preferences of the countries involved are similar enough that they should be regarded as equivalent. In many cases this is also likely to be the case for the EU and the United States. The question then is how to move in this direction?

One element of a way forward could be to go beyond efforts centering on regulators and the technical aspects of regulatory norms and to focus more attention on the effects of regulatory differences as opposed to the differences themselves. International business increasingly involves the participation in and the man-

agement of cross-border production networks and supply chains. The design and operation of any supply chain is influenced by a variety of government policies and the efficiency with which these policies are implemented. Policies may generate high costs without governments being aware of the fact – for example, by causing unpredictable delays and uncertainty. Governments do not 'think supply chain' when considering regulatory policies – instead they pursue international trade cooperation by negotiating specific rules of the game for distinct policies. Greater progress in reducing the trade costs and market segmenting effects of differences in regulation might be achieved if more effort were to be made on focusing negotiations and agreements on initiatives that would enhance the ability of firms to operate their supply chain networks more efficiently. Incorporating a 'supply chain approach' (Hoekman and Jackson 2013) into the design of the regulatory cooperation mechanisms foreseen in European Commission (2013) could complement disciplines that center on specific policy areas – tariffs and other market access restrictions – with a process that identifies how a variety of relevant policies *jointly* impact trade and investment flows. The goal would be to consider how prevailing policies affect the operation of international value chains and impact their efficiency. World Economic Forum (2013) provides a number of case studies of the potential fruits of such an effort.

Operationalizing a supply chain approach

What could a supply chain approach to address regulatory barriers to trade look like? A first step in operationalizing the idea of a supply chain approach would be to select a half-dozen or so trade lanes/production networks that are important in transatlantic exchange and/or where there is significant potential for growth. Given that there are hundreds of 'types' of supply chain networks the choice of which to choose for the purpose at hand will inevitably be somewhat arbitrary, and determined partly by which industries are most interested in engaging in the envisaged process. This is something that could be done through existing mechanisms that have been created by business such as the Transatlantic Business Council.

Once a set of supply chains/production networks has been selected, the various supply chain platforms – 'councils' in what follows – would identify instances where differences in regulatory policy measures impact on international business operations. The active involvement of business is critical as the costs that arise from such differences may not be evident, given that they will often be reflected in delays and other sources of uncertainty that give rise to a need to hold excess inventory stocks and engage in other forms of self-insurance that increase costs. This process of documenting the effects of regulatory policies on international supply chains will require inputs from other (non-business) knowledge providers. Supply chain managers within firms may not understand or be interested in determining the contributions of various sources of costs and uncertainty and which specific policies have the greatest effects, implying a need for collaboration with researchers and analysts.

As noted previously, in many cases regulatory policies will have a clear rationale – such as addressing market failures, ensuring human health and safety, etc. But in practice there may be redundancy in that similar data must be reported to different regulatory entities, or that very similar standards are imposed by agencies that do not communicate with each other. A supply chain focus will help identify such redundancies and possibilities for consolidation in ways that might not be evident if cooperation centers on a horizontal regulatory agency-by-agency approach and efforts to establish when requirements are (approximately) equivalent (enough).

An important contribution supply chain councils could make is to suggest an action plan to address the effects of regulatory differences that have the greatest negative effect on international supply chains. Here again the public-private partnership nature of the councils is important. The participation of both the relevant regulatory bodies and those in government who are responsible for economic policy more generally is necessary to be able to determine what can be done to reduce regulatory compliance costs without detrimentally affecting the realization of the underlying regulatory objectives. At the same time, active engagement by the business community can facilitate the identification of approaches that lower compliance costs without calling into question the rationale for regulation. Establishing numerical benchmarks that can become the baseline (focal point) for efforts to reduce the trade-impeding effects of regulatory differences will help to determine if trade and investment costs are lowered over time. Monitoring and reporting on progress and results is another valuable activity that supply chain councils should engage in. While as-

sessments of the impacts of TTIP initiatives will need to be done by independent entities with the requisite analytical capacity, business can make an important contribution *via* the provision of relevant data (Hoekman 2013).

The institutional framework for the proposed supply chain councils and related processes and mechanisms can build on those that have already been put in place in the transatlantic context. The Trans-Atlantic Business Council (TBC) – established in January 2013 and combining the Trans-Atlantic Business Dialogue and the European-American Business Council, both of which date back to the mid-1990s – is a natural focal point for the proposed supply chain councils. Together with the Transatlantic Legislators Dialogue and the Transatlantic Consumers Dialogue, the TBC is to provide advice and guidance to the governments that are represented in the Transatlantic Economic Council – the highest level political body tasked with making progress in removing barriers to transatlantic trade and investment. The supply chain councils are one way in which the advisory role of these bodies can be complemented with specific proposals for action and active engagement in assessing the effects of prevailing policies on trade and investment, identifying potential solutions and monitoring progress in reducing the trade-impeding impacts of differences in regulatory regimes.

Participation by other countries: supporting 'open regionalism'

Most EU- and US-based firms will be engaged in supply chains that involve third countries. In many cases supply networks will not involve tasks and products produced exclusively in the EU and or the United States. Any approach to addressing regulatory barriers that is strictly delimited to a bilateral setting is unlikely to be optimal even for two blocs that account for some 50 percent of global GDP. The implication is that the processes that are used in the TTIP should be open to participation by other countries that are important in the supply chains that have lead firms based in the EU and the United States. Agreements between the EU and the United States to reduce duplicative regulatory costs may have the effect of facilitating the participation of third country firms in production networks. Such expansion of trade along the so-called extensive margin (new markets, new suppliers) is an important source of trade productivity gains.

Traditional trade diversion costs generated by the preferential removal of transatlantic tariffs are likely to be limited because average tariffs in the EU and the United States are low – although there are significant exceptions, e.g. import duties in the EU on light trucks. There is greater potential for more discrimination against third countries resulting from measures that have the effect of reducing the market segmenting effects of differences in regulatory policies. A great deal depends on whether third country firms will be able to benefit from better access to the larger market created by TTIP as a result of agreement on the equivalence or acceptance of regulatory regimes. If such agreements do not permit firms in third countries to demonstrate compliance with EU or US norms, they will be at a disadvantage and trade diversion costs are likely to arise.

The suggested supply chain process described previously will, by its nature, identify which other countries are important participants in an international production network. In practice, it is likely that there will many such countries. This highlights the need to extend effective processes for addressing the trade-impeding effects of differences in regulatory policies to the world as a whole. Ultimately, a multilateral approach is required whereby any country can be part of the process. This is something that will take time and is, of course, conditional to the EU and the United States first putting in place processes that are effective in addressing regulatory sources of market segmentation. What matters is that in developing approaches to address these issues, European and US officials and policymakers on both sides make allowances for other governments to participate in whatever mechanisms are put in place.

Conclusion

The Transatlantic Trade and Investment Partnership offers an opportunity to launch new approaches to address longstanding constraints on transatlantic trade and investment. The EU and the United States have an opportunity to demonstrate that progress in addressing regulatory sources of market segmentation can be made by putting in place effective public-private partnerships that focus on constructive problem-solving and help define what should be understood by a '21st century' trade and investment agreement.

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