



# Regulation, International Cooperation and Trade Governance

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## Plan of the talk

- Brief recap on the rationale for regulation
- Implications of global integration/interdependence for regulation
  - International regulatory cooperation
- Increasing salience of domestic regulation for trade
- (Nascent) trends in addressing trade effects of regulatory heterogeneity
- Open questions for policy relevant research

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## Why regulate? Market failures and “non-economic” objectives

Rationale	Regulatory instruments	Activities/sectors/products
Asymmetric information	Licensing; product standards; prudential supervision; information disclosure (transparency)	Finance Professional services Distribution
Negative spillovers (e.g., environment; climate change)	Tax/subsidies; prohibitions/bans	Forestry; Transport; R&D; Knowledge and information
Network externalities	Price regulation; compatibility standards; access regulation; measures to reduce switching costs	Electricity markets; telecommunications credit cards
Competition/market power	Pro-competitive regulation; universal services requirements; subsidies; antitrust; workers' rights	Collusion; activities with large economies of scale
Public goods/services	IPRs; Government provision Subsidies	Infrastructure; Education; Health; Defence, police

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## Three trends in regulation practice (1)

1. Increased focus on governance and effectiveness:
  - ‘Good regulatory practices’: transparency; consultation; ex ante impact assessment (cost-benefit); monitoring; ex post evaluation and review
2. Public vs. private standards
  - Public: legislated; mandatory/enforced by the state
  - Private: set by non-governmental actors: firms – e.g., large retailers and NGOs (Fair Trade; GlobalGap etc.)
  - Public (compulsory) regulation addresses more general notions of the public interest
    - May increase private costs – but with offsetting social benefits
  - Private, voluntary regulatory standards allow consumers to differentiate between products/firms and firms to signal/establish a reputation

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## Trends in regulation practice (2)

3. Increasing international cooperation – including via international organizations that set standards.
  - This is nothing new
    - ITU (founded 1865): allocate global radio spectrum and satellite orbits; set technical standards for interconnection
    - ISO (founded 1946): Develop voluntary, consensus-based, market relevant standards (22595 standards published so far)
  - Why pursue international regulatory cooperation?
    - Transparency: reduce search costs for firms
    - Learning – enable companies/regulators to share knowledge
    - Address international externalities through joint development/adoption of common norms
    - Reduce costs of regulatory heterogeneity for economic operators

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## Impact of changes in global trade

- Growth of global value chains: cooperation among firms pooling experience and capacities makes production more efficient and innovative
- But also increases uncertainty and risk of coordination failures between links in chains spanning many countries
- Example: drilling-rig contractors, oil-field service providers and energy operating companies involved in Deepwater Horizon blowout/sinking
  - Pharmaceuticals, car safety, food processing, etc.
- GVCs make it harder (impossible) for a domestic regulator acting alone to achieve regulatory goals
  - Example: competition law enforcement against global car parts cartel –13 jurisdictions investigated over 70 companies producing more than 100 products
- Regulatory differences/segmentation can be both a source of production inefficiencies (excess trade costs) and generate adverse regulatory outcomes

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## Regulatory responses to a GVC world

- Traditional regulatory problem: information asymmetry
  - Firms know the risks they generate and have incentives to avoid costs of mitigation
  - The regulator must establish rules to protect public welfare while avoiding capture
- GVCs give rise to co-production of latent hazards by participating firms
  - Uncertainty implies neither the regulator nor firms may know what needs to be done
  - Cooperation to reduce hazards impeded by capacity differences
- The task of regulation becomes organizing/supervising investigation by firms of emergent risks and responses before they cause harm
  - From inspect & detect, correct & prevent to
  - prediction & learning/feedback systems approaches
- Regulator becomes a meta-regulator (Coglianese and Mendelson, 2010)

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## Meta-regulation

- Pre-approval/ex-ante the meta regulator sets initial thresholds for risk reduction and requires firms to systematically canvas their practices and identify potential hazards by:
  - presenting plans specifying the risks of proposed operations;
  - how those risks will be mitigated;
  - the tests by which the mitigation’s effectiveness will be verified;
  - the methods for recording test results
- Example: Hazard Analysis of Critical Control Points (HACCP)
  - Operating unit—firm, farm, etc.—identifies critical control points where pathogens or non-conformities can enter the system, and defines methods to prevent this
  - Regulator verifies the effectiveness of plans and measures, and ideally pools information

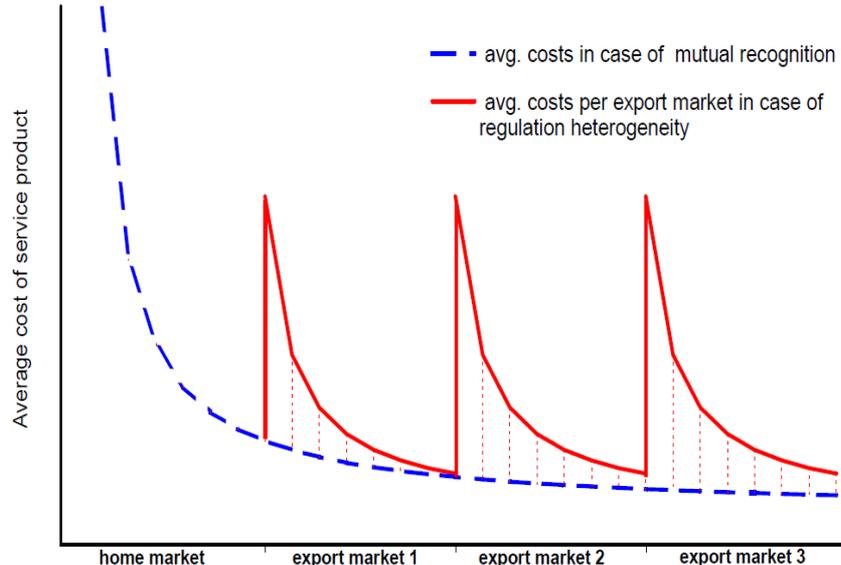
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## Increased incentives for international regulatory cooperation (IRC)

- Different dimensions/paths
  1. International standardization. Many examples – telecoms; food; financial services...
  2. Cooperation on conformity assessment – mutual recognition of certification
  3. Equivalence agreements: continuing mutual (reciprocal) scrutiny and evaluation of systems & exchange of information to improve risk-based regulatory decisions
    - Canada-US Food Safety Systems Recognition Agreement – FDA, Canadian Food Inspection Agency and Health Canada determination food safety regimes, hazard detection and response systems are equivalent
    - EASA (EU) – FAA (US) FAA bilateral air safety agreement (BASA): mutual acceptance of certification systems based on shared information on quality assurance, reporting & standardization activities

## The trade (negotiator) perspective: reduce trade costs

- Two dimensions:
  - Traditional agenda: reduce/remove discriminatory policies
  - Reducing costs of regulatory heterogeneity—'trade facilitation'  $\equiv$  IRC



Nordas (2016): Countries with a common legal origin trade about 30% more services with each other and about 50% more business services

On average a 0.05 points reduction in the heterogeneity index would increase services trade by about 2.5% ;  
The impact depends strongly on the level of regulation

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## Regulatory cooperation: is market access linkage helpful?

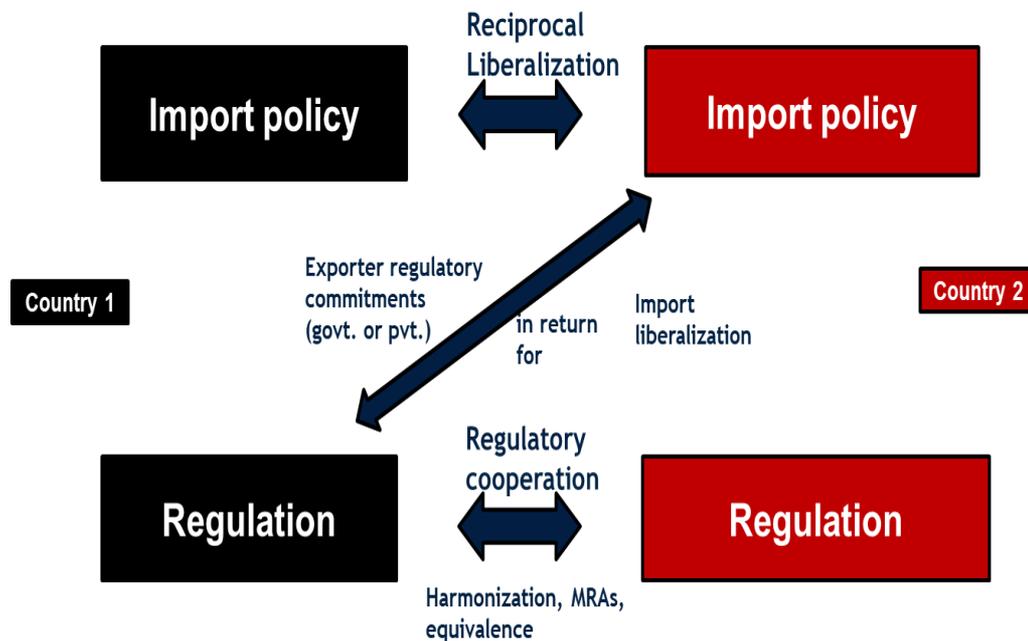
- If aim is reducing regulatory heterogeneity without undercutting achievement of regulatory goals, how could a trade agreement help? For what issues?
  - Need clarity re: why pursue IRC in a trade agreement context?
  - Narrative of trade community: to reduce regulatory costs (“behind the border” barriers)
    - This may be (i) inappropriate and (ii) counterproductive in generating opposition by regulatory constituencies
  - Better answer: to help regulators do their job and improve regulatory performance
  - Question then is how it will do so
  - Open question – limited research on this
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## Types of trade agreements

- Preferential trade agreements (PTAs)
  - Discriminatory (bad); deeper rules (potentially good)
  - Fragmentation (accession generally impossible; CPTPP notable exception)
- Plurilateral Agreements under the WTO (note the caps)
  - Main example: Government Procurement Agreement
  - Permits discrimination; requires consensus
- Open plurilateral agreements (no caps): critical mass agreements
  - Information Technology Agreement, Telecom Reference Paper (GATS)
  - Groups discussing four subjects post MC11, incl. e-commerce
  - Key feature: nondiscrimination rule applies
- Bilateral regulation for market access deals: e.g., EU data adequacy decisions

## Three possible types of cooperation



Source: Mattoo (2019)

## Types of cooperation: market access vs. regulatory policies

	Main issue	Approach	Type of spillover	Characteristics of cooperation	
				MFN (critical mass)	Discriminatory (exclusive club)
<b>Trade agreements:</b> Binding State-to-State multi-issue package deals with fixed terms and binding, self-enforcing dispute resolution	<b>Market access</b> ("terms of trade spillovers")	Cross-issue linkage	Market access effects of discriminatory trade/industrial policies	Multi-issue multilateral agreements (E.g.: Uruguay Round)	Reciprocal PTAs (E.g. CETA, CPTPP, etc.)
		Enforcement linkage	Market access effects of domestic regulatory policies	Single issue, critical mass agreements (CMAs) (e.g. GATS Telecom Reference paper; ITA)	Issue-specific clubs (Art. II.3 WTO Plurilateral Agreements— e.g. GPA)

Type of cooperation	Main issue	Approach	Type of spillover	Characteristics of cooperation	
				MFN (unconditional application)	Open club (conditional application)
<b>Open plurilateral agreement (OPA):</b> Open, non-binding (severable); issue-specific	<b>Regulatory heterogeneity</b> (e.g., product markets; competition policy)	No linkage or "within" issue linkage	Pecuniary or non-pecuniary spillovers	International product or process standards (e.g., Codex Alimentarius)  Identification of good regulatory practices (OECD, APEC)  WTO Trade Facilitation Agreement	Mutual recognition agreements  Regulatory equivalence regimes (BASA; EU adequacy regime (data protection);  Exporter commitments to apply importer country standards (EU Forest Law Enforcement, Governance and Trade regime)

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## Open plurilateral agreements (OPAs)

- Cooperation among a group of countries
  - Means to address consensus / development constraints
  - But also means to recognize differences in priorities and preferences
- Aim: reduce trade costs and better realize regulatory goals
- Flexibility in how this pursued: recognition / equivalence / international standards
- Open to all WTO members, ex ante and ex post
- Goes beyond good practice principles – substantive agreements that address specific problems relevant to the trading system
- May be severable – i.e., non-binding. Sovereignty is retained; agreements need not constitute hard law
- Build on sectoral examples of deep regulatory cooperation: e.g. sustainable forestry

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## Why pursue this in the WTO?

- WTO is the global apex trade organization
  - Regulatory cooperation already happening but is piecemeal, not necessarily transparent, and often closed (e.g., bilateral MRAs, PTAs)
- Regulatory differences are a trade issue—and WTO OPAs can reduce trade costs...in ways that addresses sovereignty concerns
- Secretariat support:
  - Transparency in process and implementation—incl. for non-parties
  - Ensure that accession/multilateralization is real, not just talk
  - Technical assistance (on request) (build on TFA precedent)
- OPAs as a tool to revisit existing conflict resolution/enforcement technologies
  - E.g., require reason-giving; third party review (TFA precedent)
- OPAs as a mechanism to re-vitalize the WTO

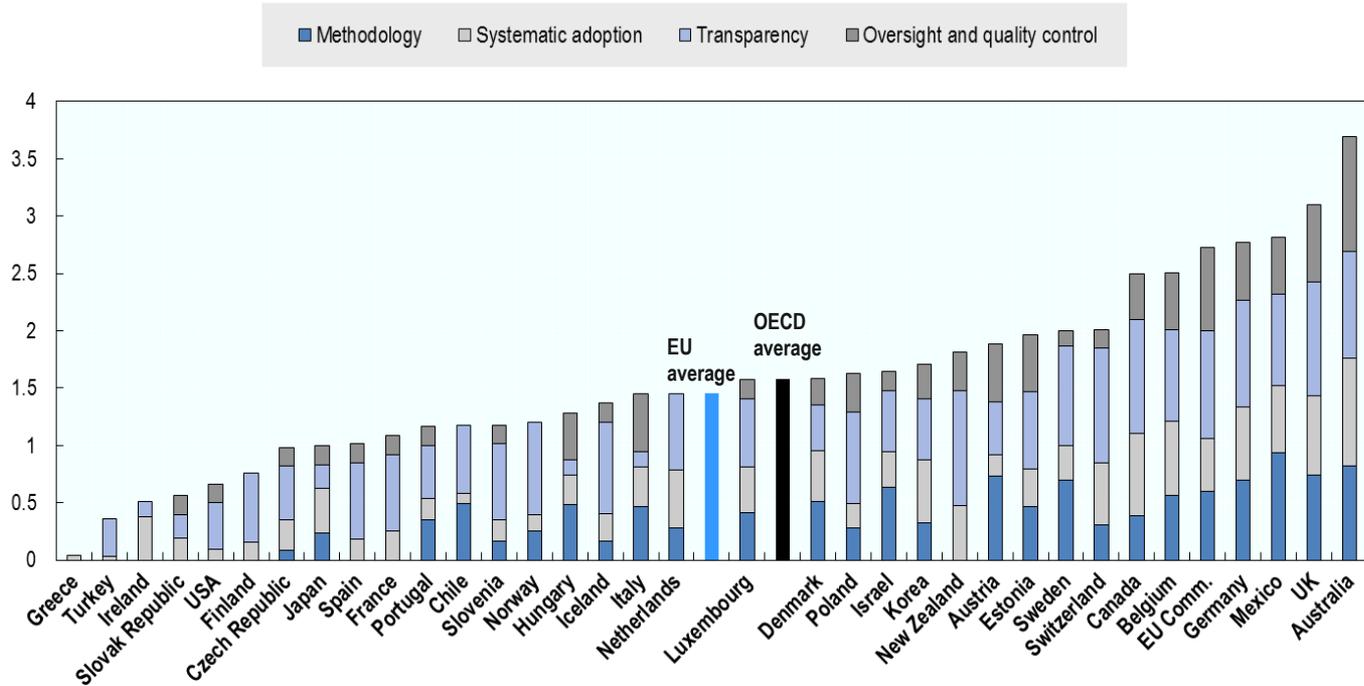
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## What policy areas could OPAs be used for?

- Issues where free riding is not a binding concern.
- Trade/transaction costs of regulatory differences
  - Product standards – e.g., a code of conduct for private standards
  - Rules of origin
  - Domestic regulation of services (ongoing WTO discussion)
  - Data privacy / adequacy
  - E-commerce (plurilateral negotiations commenced in early 2019)
  - Multilateralize mutual recognition agreements
  - Sectoral equivalence regimes (e.g., bilateral air safety agreements)
  - Transparency in public procurement
  - Competition law and policy

# Example: commitment to evaluate regulations *ex post*

2015 Indicators of Regulatory Policy and Governance (iREG): *Ex post* evaluation for primary laws



Note: The vertical axis represents the total aggregate score across the four separate categories of the composite indicators. The maximum score for each category is one, and the maximum aggregate score for the composite indicator is four. The EU average is for the 21 EU member countries that were also members of the OECD at the time of survey in 2015.

Source: OECD (2015), OECD Regulatory Policy Outlook 2015, <http://www.oecd.org/gov/regulatory-policy/indicators-regulatory-policy-and-governance.htm>.

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## OPAs and democratic legitimacy

- Rodrik's trilemma: globalization—regulation—sovereignty:
  - Global markets require global regulation which we don't have. Even if we had it – or pursue it – and create a global regulator responsive to a global polity this is incompatible with nation state sovereignty and democracy
- Implication: return to GATT-type “thin” rules that assures “policy space” – focus only on non-discrimination, not IRC
- But “thick,” discursive rules that bolster regulatory capacity by continuous monitoring are what is needed given GVCs/production fragmentation
- If this proceeds along sector-by-sector regulatory equivalence lines through OPAs there is no “global regulator” but does generate global regulation that is democratically legitimate (regulators remain accountable at national/regional level)

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## Further reading

- This presentation draws on the following papers:
- Hoekman, B. 2019. “International Regulatory Cooperation and Trade Agreements,” in Eric Brousseau, Jean-Michel Glachant and Jérôme Sgard (eds.), *The Oxford Handbook of Institutions of International Economic Governance and Market Regulation*. Oxford University Press.
- Hoekman, B. and C. Sabel, 2019, “In a World of Value Chains: What Space for Regulatory Coherence and Cooperation in Trade Agreements?” in Benedict Kingsbury, Richard Stewart, Paul Mertenskötter, and Thomas Streinz (eds.), *Megaregulation Contested: Global Economic Ordering after TPP*, Oxford: Oxford University Press
- Hoekman, B. and C. Sabel, 2019, “Open plurilateral agreements, international regulatory cooperation and the WTO,” EUI Working Paper RSCAS 2019/10. (Forthcoming in *Global Policy*)