Karmakar, Suparna

Research Report
Prospects for regulatory convergence under TTIP

Bruegel Policy Contribution, No. 2013/15

Provided in Cooperation with:
Bruegel, Brussels

Suggested Citation: Karmakar, Suparna (2013) : Prospects for regulatory convergence under TTIP, Bruegel Policy Contribution, No. 2013/15, Bruegel, Brussels

This Version is available at:
http://hdl.handle.net/10419/106310

Terms of use:
Documents in EconStor may be saved and copied for your personal and scholarly purposes.
You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.
If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.
PROSPECTS FOR REGULATORY CONVERGENCE UNDER TTIP

SUPARNA KARMAKAR

Highlights

• An ambitious, comprehensive and high-standard trade and investment agreement between the European Union and the United States is feasible, but a key concern is whether the transatlantic trade partners will succeed in creating a meaningful agreement within the tight timeline of the Transatlantic Trade and Investment Partnership (TTIP) negotiations. The target of a ratified pact before a new European Commission takes office in November 2014 is an objective that is likely to conflict with the level of ambition on the substance.

• Regulatory congruence would require the unilateral and unconditional recognition by the TTIP partners of each other’s standards, procedures and conformity assessment tests. The way forward is to create a ‘living’ (or progressive commitment) agreement on regulatory cooperation with a horizontal template for coherence and conformity assessment and a detailed monitoring mechanism, with implementation starting immediately for a few selected sectors.

• Regulatory harmonisation under TTIP may not lead to emerging markets automatically upgrading to the higher TTIP standards. Domestic priorities and the high demand from a rising price-sensitive group of consumers will likely result in a dual regulatory regime in emerging markets in the medium-term.

Suparna Karmakar (suparna.karmakar@bruegel.org) is a Visiting Fellow at Bruegel. This Policy Contribution was prepared as written evidence to the UK House of Lords European Union Committee (Sub-Committee on External Affairs) enquiry into the Transatlantic Trade and Investment Partnership, which started in October 2013. The author gratefully acknowledges comments and helpful suggestions from André Sapir and Guntram B. Wolff.
PROSPECTS FOR REGULATORY CONVERGENCE UNDER TTIP

SUPARNA KARMAKAR, OCTOBER 2013

THE EU-US TRANSATLANTIC TRADE AND INVESTMENT PARTNERSHIP (TTIP) NEGOTIATIONS are aimed at concluding an ambitious, comprehensive, and high-standard regional trade and investment agreement that offers significant benefits in terms of promoting international competitiveness, jobs, and growth in the partner countries. TTIP would seek to liberalise, as much as possible, trade and investment between the two blocs in the 20 areas that the agreement is expected to cover. The negotiations started in February 2013 and the negotiating parties completed a first round of talks in Washington in early July. The second round of negotiations was scheduled to be held in Brussels in the second week of October.

A CEPR study estimated that an ambitious and comprehensive agreement could bring significant economic gains for the EU as a whole (approx. US$88.7 to $155.1 billion a year until 2027, depending on the level of ambition of the negotiated agreement) and the US ($US64.4 to $123.5 billion a year), while also increasing global income by almost US$130 billion annually as a result of increased bilateral trade. If an ambitious and comprehensive agreement that reduces behind-the-border impediments to trade and investment is concluded, it is likely to increase the annual GDP of both parties by 0.5 to 3.5 percent, depending on the degree of integration. Together, the US and the EU already account for almost half of global GDP and a third of world trade; each day, goods and services worth US$2.7 billion are traded bilaterally. The stock of shared direct investment adds up to more than US$3.6 trillion.

KEY CHALLENGES AND CONCERNS

As much as 80 percent of the total potential gains from the TTIP would come from cutting costs that arise from administrative procedures and divergent regulations (so-called non-tariff barriers or NTBs), as well as from liberalising trade in services and public procurement. Although tariffs between the US and the EU are already low (on average 4 percent), the cost of dealing with unnecessary bureaucracy can add a tariff-equivalent of 10-20 percent to the price of goods, which (although usually borne by the consumer) affects the competitiveness of domestic producers and exporters in highly cost-sensitive modern global value chains. ECORYS estimates that eliminating even half of the NTBs caused by regulatory divergence could increase transatlantic GDP by half a percent, or US$150 billion. But tackling the NTBs is not easy. The two trade partners have been discussing regulatory harmonisation in key traded products/sectors for nearly two decades, since the adoption of the Transatlantic Declaration in 1990. Furthermore, as most of the gains are expected to emerge from eliminating bilateral regulatory and beyond-the-border barriers (the impact of which on increased trade flows is both difficult to measure and attribute), the inability to reduce the NTBs implies that a large part of the projected trade gains may remain unrealised.

Reducing the remaining tariffs will be harder than imagined: the reason why high tariffs on sugar, textiles and garments, steel, and trucks have existed for so long is because of powerful vested interests that are loathe to relinquish their advantages; tackling these interests would require a political appetite to challenge key constituencies in a time of weak economic prospects. Finally, the TTIP negotiations are not all encompassing; they will not cover agricultural subsidies, subsidies to aircraft manufacturers, or movement of temporary workers. Nor will they comprehensively cover IP rules and financial sector regulation. Therefore, notwithstanding the different studies that have outlined the economic and strategic benefits of TTIP, the debate on the feasibility of a deep trade agreement and even its desirability is still open.

More critically, the TTIP has rather ambitious nego-
Despite the growing exchange of information and the increasing cooperation between transatlantic regulators on standards-related issues, experience in important sectors indicates that the long-delayed, much-needed standardisation is not easy to achieve.
An ambitious WTO-plus chapter on Sanitary and Phyto Sanitary (SPS) and Technical Barriers to Trade (TBT) measures, monitorable disciplines on regulatory coherence and transparency, and regulatory compatibility in specific, mutually agreed goods and services sectors will turbo-charge regulatory cooperation and enhance the two trade partners’ competitiveness relative to other emerging market competitors, in particular China. However, the problem lies in identifying the mutually acceptable binding capacity of such cooperation and coherence. Industry (and consumers) are keen to see regulatory standardisation and mutual recognition in key traded sectors, not from deregulation and the lowering of standards, but through the elimination of wasteful and inefficient rules – both existing and future – by sensibly recognising each other’s standards and procedural streamlining where possible, but never at any cost to safety. In the contentious auto sector for example, there is an industry-led call for mutual recognition, which would ostensibly be some kind of reciprocity agreement under which the US and EU would accept vehicles built to either standard.

In light of the past interaction between the EU and US, and drawing on Europe’s internal market experiences, it is clear that dramatic change in legislation (which would be entailed in case of harmonisation or convergence of existing regulations) on either shore of the Atlantic is not feasible. However, meeting the rather over-ambitious timeline and the scope of negotiations is possible if the partners agree to recognise unilaterally and unconditionally the other’s standards, procedures and conformity assessment tests; there is strong evidence that US and EU product safety regulation is likely to be deemed ‘compatible’. European Commission negotiators agree that although the two sides have different but similar safety requirements when it comes to lights, door locks, brakes, steering, seats, seatbelts and electric windows, many of these could be formally recognised as providing the same level of safety. But attaining it calls for a regulatory cooperation agreement that goes further than statements of ‘intentions’ and outlines ‘best practice objectives’.

What is needed is a ‘living’ (as in progressive and not a one-time commitment) agreement on regulatory cooperation with a horizontal [cross-sectoral] template for coherence and conformity assessment and a detailed monitoring mechanism, with implementation started immediately for a few selected sectors. An agreement to avoid further fragmentation will require cooperation when setting new rules, by motivating regulators to cooperate at an early stage as well as throughout the life-cycle of a regulation. The Ecorys (2009) study finds that 75 percent of total potential TTIP benefits [combined cost reductions for the EU and US by reducing divergence and partially aligning regulatory regimes] are in four sectors: motor vehicles (31 percent); chemicals, cosmetics, and pharmaceuticals (19 percent); food and beverages (14 percent) and electrical machinery, including medical devices (11 percent). Evidence also indicates that regulatory regimes and sectors that have the potential to provide the highest level of benefits and cost savings are likely to be

---


14. The estimated increase in the US-EU bilateral auto trade associated with the elimination of tariffs and NTBs alone accounts for more than one third of total estimated increase in bilateral trade flows associated with a successful TTIP negotiation. Source: Francois et al (2013), see footnote 2.


16. Based on 20 case studies and 3,000 observations of risk-reducing regulatory decisions in the US and EU, it is concluded that overall risk stringency is about the same, with several of the case studies showing divergence explained by protectionism and local rent seeking. See Jonathan B. Wiener, Michael D. Rogers, James K. Hammitt and Peter H. Sand (eds) (2010) The Reality of Precaution: Comparing Risk Regulation in the United States and Europe, RFF Press.

17. This also calls for easier rules of origin in MRAs. Excessively constraining rules of origin have proved problematic for some of the EU’s previous recognition agreements.

---

‘What is needed is a “living” agreement on regulatory cooperation with a horizontal [cross-sectoral] template for coherence and conformity assessment and a detailed monitoring mechanism, with implementation started immediately for a few selected sectors.’
regulatory regimes in the product safety area. Having corresponding regulatory agencies in both regions undertake Transatlantic Regulatory Impact Assessments (TARIA) on significant existing and pending product safety regulations in these sectors, will further help in attaining regulatory coherence 18.

As for a viable model of arriving at regulatory coherence, lessons from the EU single market suggest enshrining the need for hard legal oversight and unconditional mutual recognition. Discerning ex-ante the optimality of a regulation would be a complex and perhaps impossible task. Experience from the Australia-New Zealand FTA and the European Union Services Directive's mutual recognition exercises clearly show that unconditional mutual recognition works best in integrating markets with developed standards and consumer expectations/cultural preferences, and that recognition must precede harmonisation efforts. Implementing regulatory coherence in a meaningful way in the near future thus calls for mutual recognition and equivalence that sets clear goals to overcome the [largely known and well documented] differences; the key steps to follow are setting [1] clear equivalence principles, (2) an enforcement mechanism, and (3) transparency of processes. In particular, transparency should be its guiding principle, with strong public oversight and involvement of industry and consumers. Without such legitimacy, it would be hard to guarantee that the application of standards would converge.

Clearly, creating a usable regulatory cooperation template with horizontal elements that can be tested immediately in selected sectors, is where the transatlantic political capital needs to be invested during the next few months; generating early momentum is necessary. To meet the targeted TTIP timeline, without sacrificing the ambition of scope, the regulatory cooperation agreement needs to be ‘living’ and to have ‘unconditional mutual recognition’ as a key pillar of setting equivalence principles. The fact that there is a healthy fear of Chinese standards thwarting future market access prospects and ‘full political support’ across the Atlantic, makes the regulatory cooperation prospects under TTIP brighter than in the past. In the case of TTIP, past preparedness is waiting to be translated into a clear and implementable roadmap.

**IMPACT ON THIRD COUNTRY MARKETS – CONVERGENCE IN EMERGING MARKET PRODUCT STANDARDS**

An important concern is whether regulatory harmonisation under the TTIP will positively influence standard setting in large emerging markets. Assuming that the TTIP (and TPP) implements deep liberalisation and achieves regulatory coherence in the near future, a consequential restructuring and/or fragmentation of global supply chains remains a real threat for the large emerging markets, in particular China and India. These economies may then react in the following ways. First, they could adopt and upgrade to these new rules, regulations and industrial standards, even at some financial and political cost, in order to reduce the business costs of serving a world market. China took this approach when it adopted and pre-committed to stricter WTO disciplines during its accession process, which helped it to become the world’s most competitive economy. Indian exporters treat these costs as fixed before making the decision to export to industrialised country markets, often simultaneously meeting both the US- and EU-led standards’ compliance requirements (that are much higher than domestic standards) in order to avoid rejection of consignments. Chinese and Indian experience of the past decade has shown that pragmatically accepting and adapting to new realities bears fruit. Second, they could selectively refute the rules and production standards, based on domestic interests and the perceived market for their products in the new global economic architecture in which developing countries and their domestic markets account for almost 40 percent of global economic activity at current US$ levels, and more than 50 percent at US$ PPP19. By 2050, it is estimated that six of world’s seven largest economies will be outside the OECD group. A more likely possibility is that emerging markets might operate on a sui generis dual regulatory regime in the medium term in key areas such as product standards and intellectual property (IP). Taking the example of the TTIP negotiations, even if the EU and US manage to harmonise and upgrade

Despite the high growth rates of emerging markets, especially China, it is uncertain that they will be able to entice them into adopting those rules simply out of fear of exclusion.

The compelling reason for these economies to not unilaterally upgrade to the higher standards and rules, albeit harmonised, arises from the medium-term demand structure and purchasing power of the mass consumer in these economies. In 2011 the per capita GDP of Brazil was US$12,594, South Africa US$8,070, China US$5,445 and India US$1,489, while the average per capita GDP in OECD countries was US$41,225, with the US per capita GDP being US$48,112\(^{20}\). The demand pattern is thus necessarily different. Middle-class demand growth is also expected to be higher in the emerging markets in the next few decades. In such a situation, given that the effective demand from the price-sensitive large emerging middle-class is likely to remain high at home and in similar developing countries that they can easily serve, a mass domestic upgrading to the costlier, ‘higher’ regulatory standards, albeit desirable, might not seem optimal to Chinese and Indian policymakers. A more likely medium-term outcome is the possibility of the creation of a dual regulatory regime in emerging markets, with the export-oriented firms in these economies adopting the higher standards, while a large part of the remaining producers servicing the domestic market continue to use the old, less rigorous standards and IP regimes; this will further fragment regulatory regimes across the world. If the emerging market domestic consumer group is significantly large (although difficult to quantify, this share is likely to remain around two-thirds of the total population in China and India for the next decade according to various estimates), the incentive for emerging economy governments to upgrade/sign up to more rigorous regulatory standards will diminish, at least until the majority of domestic consumers can afford to pay the quality-premium on the higher-standard discretionary products and services.

\(^{20}\) Despite the high growth rates of emerging markets, the real wage and purchasing power gap is expected to continue in the medium term, and this coupled with the forecasted exponential growth in the lower-middle classes would in turn reshape the global businesses. See Homi Kharas (2010) ‘The Emerging Middle Class in Developing Countries’, Working Paper No 285, OECD Development Centre.