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Ensuring accountability in modern trade policy

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Ensuring accountability in modern trade policy

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Contents

Executive Summary ................................................................................................................... 3
1. Globalisation discontent puts pressure on trade policy .............................................. 4
2. Relevance of non-tariff barriers and potential benefits of barrier reduction .......... 5
3. Avenues of regulatory cooperation to lower non-tariff barriers ................................... 7
4. Challenges of non-tariff barriers reduction ................................................................... 8
5. Maintaining European standards and guaranteeing democratic legitimacy .......... 11
6. Summary .......................................................................................................................... 14

References ............................................................................................................................... 15

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F6 Economic Impacts of Globalization
E42 Monetary Systems • Standards • Regimes • Government and the Monetary System • Payment Systems
Executive Summary

Attempts to foster trade liberalisation with a new generation of trade agreements aimed at lowering non-tariff barriers face opposition among the general public. Many fear that trade liberalisation risks lowering the level of protection embedded in regulations that are aimed at safeguarding social rights, health and the environment.

Such criticism cannot be ignored. As we argue in this paper, by clarifying its view on this issue, the EU can further strengthen the position in fora like the G7 and the G20 where the topic of trade is currently under discussion. But along which lines?

Regulatory cooperation, in the context of the new generation of trade agreements, is promising, reasonable and controllable. If done correctly, regulatory cooperation will benefit consumers and not threaten consumer protection. However, a regulatory cooperation body needs transparency and a set of rules to be fully accountable to EU citizens.

Looking at the way the same issue was dealt with in the context of monetary policy and independent central banks, we propose a mix of provisions that aim at defining a clear mandate, enforcing transparency of operations and establishing a reputation.
1. Globalisation discontent puts pressure on trade policy

Public sentiment towards free trade and globalisation has deteriorated in recent years. This has been illustrated by the election of Donald Trump, by the Brexit referendum and the very critical debate on the Transatlantic Trade and Investment Partnership (TTIP) in some parts of Europe. Economists continue to believe that the impact of trade is positive for an economy in terms of efficiency and choices for consumers,1 but recent research has highlighted that these gains are not equally distributed in society. Globalisation, together with technological change, has contributed to the increase in income inequality in mature economies. New research also shows that trade between advanced economies, and China in particular, has been a doubled-edged sword for mature economies: on the one hand it contributed to increasing total factor productivity, but on the other hand it had an adverse effect on the labour markets (Ahn/Duval, 2017). Too many low and medium-skilled employees lost out due to globalisation, and economic policy failed to sufficiently compensate people who were made redundant and/or had to cope with lower wages (Autor et al., 2013; 2014).

The negative effects of trade liberalisation explain, to some extent, the resistance towards new broad-based and encompassing trade agreements, such as the EU-Canada Comprehensive Economic and Trade Agreement (CETA), TTIP and the Trans-Pacific Partnership (TPP) that is prevalent in Europe as well as in the USA. Campaigning against TPP helped Trump to win the American presidential election. And in Europe, TTIP generated an unprecedented wave of protest, which culminated in a petition signed by 3.3 million citizens.2

The increase in inequality is not the only criticism of the so-called new generation of trade agreements – those that go beyond just lowering import tariffs.3 Another oft-voiced key concern is the fear of ceding control over standards and regulations to unelected bodies. This concern arises from the fact that the new generation of trade agreements, like TPP or TTIP, go further than earlier ones by aiming to reduce non-tariff barriers (NTBs) to exchanges of goods and services. NTBs can result from

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1 See, for example, the IGM forum (2012) on free trade. To the question ‘Freer trade improves productive efficiency and offers consumers better choices, and in the long run these gains are much larger than any effects on employment’, 85 per cent of the top economists surveyed replied ‘agree’ or ‘strongly agree’. IGM, March 2012 http://www.igmchicago.org/surveys/free-trade.
2 https://stop-ttip.org/?noredirect=en_GB.
3 Another very controversial issue that emerged during the negotiation and signature of respectively TTIP and CETA is the creation of ad-hoc courts to deal with investor-state disputes (ISDS). While this is related to the public concern of losing state control over supranational and potentially obscure groups, we do not cover the issue in this paper as it would require a different set of solutions to the ones we propose.
regulations and standards that a country imposes within its territory to protect its consumers, its environment, financial stability or certain social and cultural values, for example. The list also includes border procedures and the licences needed to operate in a certain market. These NTBs are not trade barriers per se in most cases (Berden/Francois, 2015). Different regulations on sensitive issues also reflect different preferences by voters in different countries.

This discontent cannot be ignored by policymakers, especially at a time when the gains from trade liberalisation are being questioned by the public (European Commission, 2017). We discuss in this paper how policy makers can simultaneously promote trade integration to foster economic growth and at the same time guarantee that the dismantling of NTBs does not lead to the erosion of regulations, while maintaining appropriate democratic control. Having a clear and open view on this issue – which the recent reflection paper by the European Commission (Harnessing globalisation) ignored – can reinforce the position of the EU vis-à-vis its citizens and in the ongoing discussion on trade held in the G7 and G20 fora.

2. Relevance of non-tariff barriers and potential benefits of barrier reduction

Future trade liberalisation, particularly among mature economies, will mainly focus on NTBs, because tariffs have already been reduced to a large extent. The average tariff for trade between the EU and the USA is less than 3 per cent.4 How big an impediment to trade are the NTBs? Attempts have been made to provide an economic quantification of NTBs in the form of an equivalent tariff. Existing studies mostly concern the EU and their USA in relation to TTIP5.

The automotive sector, a key export for European businesses, provides a telling example. NTBs amount to a significant increase of approximately 26 to 27 per cent to the cost of trade and investment between the EU and the USA (in both directions) (ECORYS, 2009). They amount more than 20 percent if the average result of several studies is considered with other sectors being burdened by partly higher or lower NTBs (Figure 1). Sector specific NTBs for the automotive sector are concentrated in the areas of safety and environmental standards, but are also relevant regarding the Buy American Act, support for research and development (R&D) and security

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4 It does not mean that all goods and services are taxed at almost zero across borders. For instance, on footwear and gaiters a tariff is levied of 17 per cent, and on apparel and clothing accessories of 12 per cent.
5 See Berden and Francois (2015) for a detailed review of methods and estimates.
measures, thus limiting trade and investment flows (ibid.). The report also indicates that consumer safety requirements are of similar high standards, but there are differences, for example, in air pollution and noise standards.

**Figure 1: Non-tariff barriers quantification (tariff-equivalent in per cent)**
Average across different estimates

Source: Based on Berden and Francois (2015)

It is important to note that NTBs are likely to be more of a deterrent for the exports of SMEs than for large firms since the costs related to dealing with NTBs will be higher relative to sales for SMEs in comparison to those of large firms (Cernat et al., 2015). A survey of 869 EU companies by the European Commission revealed that access to information is the single most important barrier: the smaller the company, the more difficult it is to dedicate resources to finding information on regulation and regulators.
3. Avenues of regulatory cooperation to lower non-tariff barriers

The idea of lowering NTBs is difficult to put in practice. Several options are available but each has its own set of pros and cons (Table 1).

Table 1: Schematic overview of selected approaches to reduce NTBs

<table>
<thead>
<tr>
<th></th>
<th>Harmonisation</th>
<th>Cooperation on new issues</th>
<th>Mutual recognition</th>
</tr>
</thead>
<tbody>
<tr>
<td>PRO</td>
<td>Most far-reaching approach</td>
<td>Works well with new technologies</td>
<td>More realistic, also covers existing regulations/standards</td>
</tr>
<tr>
<td>CON</td>
<td>Not in line with national preferences</td>
<td>Does not deal with existing regulations and standards</td>
<td>Often very complex and cumbersome</td>
</tr>
</tbody>
</table>

Source: Authors’ elaboration

The first option, the harmonisation of existing trade-relevant regulations and standards (in bilateral or even multilateral trade agreements) would be the most far-reaching, but least likely to be agreed upon. Harmonisation would entail that country A adopts the standards of country B (or vice versa) or that both agree on the same standard. Firstly, progress in this direction is impeded by different national regulatory traditions and bureaucratic vested interests. Secondly, in bilateral trade agreements, it would have to be decided which nation would have to adapt its standards to the other nation’s, with the risk of provoking a race to the bottom. Establishing internationally agreed standards can mitigate the second problem to some extent, but the first issue will remain an impediment. While the EU has to some extent tried to go for international standards, the USA tends to resist this approach. Cooperation on international standard harmonisation also takes place outside trade agreements and is in part driven by private sector initiatives, such as the technical standards of the International Organisation for Standardisation (ISO) (Chase/Pelkmans, 2015).

The second avenue is cooperation on co-writing regulations and standards. This especially applies to new technologies (e.g. smart cars) and it is a realistic and promising option. However, it is only relevant for future issues.

For existing regulatory provisions, the most promising option is the third option: mutual recognition. Under certain (important) conditions, a product admitted to the market in country A would also be permitted to enter country B’s market. This is the
principle that governs the Single Market in the EU, in combination with a high degree of harmonisation.\(^6\) Should the UK leave the Single Market, mutual recognition in the industrial goods trade could also be an option as the UK has been part of this harmonisation and might be prepared to adapt its product standards to EU standards in many cases in the future (Matthes/Busch, 2016). Apart from this, the delays in starting the Brexit negotiation show how undoing integration is generally even more difficult than doing it.

Determining the eligibility for mutual recognition poses difficult technical and legal problems that are dealt with in the following section.

4. Challenges of non-tariff barriers reduction

The negotiation of TPP took eight years and CETA took seven. The duration of the negotiation gives a clear idea of the challenge diplomats are confronted with when discussing the possibility of lowering NTBs.

Moving the trade liberalisation discussion from tariffs to standards and regulations creates two sets of issues. The first is related to the way negotiations are conducted and the problem of secrecy. Katt (2006) looks at negotiations and the need of a balance between transparency and secrecy. He argues that the latter is necessary to allow for frank discussions and flexibility in positions, both important ingredients for the successful conclusion of a trade agreement. But such secrecy is also prone to possible abuses that undermine the legitimacy of government action in the public eye. Tung (2014) notices how an increasingly networked world characterised by the explosion of online information make opaque practices less and less tolerable.

The second issue concerns the implementation of trade agreements that involve harmonisation or at least cooperation on regulations and standards. Writing about the USA and the trade negotiations of the Uruguay Round in the mid-1990s, Shapiro (2002) observes that the replacement of existing regulatory standards with international standards adopted without public participation can generate frustration. When a regulation is fully national, citizen groups have the opportunity to monitor the

\(^6\) However, large differences exist between the Single Market and traditional trade agreements, or even the new generation of EU bilateral trade agreements (including CETA), where mutual recognition is hardly applied at all (Busch/Matthes, 2016). This is due to the fact that in the EU mutual recognition is allowed only because regulations and standards have been harmonised to a considerable degree among Member States. As another distinguishing factor, the creation of the Single Market went hand in hand with the reinforcement of supranational common institutions (the European Commission and the Court of Justice of the European Union) and a certain degree of democratic control via the European Parliament.
rulemaking process and discuss it, formally or informally. And taking decisions in supranational fora makes it more difficult for citizen groups to participate. Public engagement in the drafting of regulations brings two key advantages: first, it increases the democratic legitimacy of the regulation and second, it helps to improve the quality of a proposal, thanks to rounds of discussion. This is particularly true in the case of the EU where the existence of the Union adds extra levels to the decision-making. ‘It is becoming even more difficult to draw dividing lines between legal orders: international law is increasingly coming to play a role in national (and EU) legal orders, whereas national (and EU) legal developments are exerting a bottom-up influence on the evolution of the international legal order’, according to Wessel and Wouters (2008). For the same reason the EU uses the precautionary principle as a guide: ‘… if there is the possibility that a given policy or action might cause harm to the public or the environment and if there is still no scientific consensus on the issue, the policy or action in question should not be pursued’.7

The lack of proximity to the rule-makers creates two types of fears:

- The fear that the possibility to influence the negotiations and the implementation is skewed towards business lobbies, leading to decisions that are only in the interest of some and not the whole society.8
- The risk of lowering standards in the interest of facilitating exchange of goods and services.

In thinking about the new generation of trade agreements, these fears have to be regarded not as black or white but with many shades of grey, based on who is the partner in the trade agreement. Negotiating between advanced economies, where levels of protection for consumers, workers and the environment are relatively close, is not the same as negotiating NTBs with emerging markets or developing countries where standards can be significantly lower.

However, considerable differences in regulatory protection can also exist among advanced economies, as for example in the chemical sector between the EU and the USA. The EU has established strict and costly procedures for registration and licensing for chemical products in the context of the REACH regulation, while the USA (which does not follow the precautionary principle to a comparable extent) is

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8 The European Consumer Organisation writes: ‘While more transparency will in principle also benefit public interest lobbyists by opening more possibilities to bring their perspective to decision makers, a reality check leads to the conclusion that NGOs just do not have the resources to compete with corporates when it comes to multiplying presence and influence.’
more generous in this respect and relies on the threat of litigation in case of damages. Another area where preferences and regulations diverge considerably is the food sector, specifically regarding genetically modified organisms (GMOs) or hormone-treated beef. If mutual recognition was applied to such fields, the fear of lowering standards would be clearly justified. From a purely economic perspective, an item produced in a country with lower health and environmental standards would be less costly as a rule.

**BOX: Learning from monetary policy: mandate, credibility and communication**

In 2004, Finn E. Kydland and Edward Prescott were awarded the Nobel Prize for Economics for highlighting a specific failure of economic policymaking: the role of expectations and time consistency. Barro and Gordon (1983) carried the work further and applied it in particular to monetary policy. Their work highlighted the need to delegate monetary policy to independent bodies constrained by a mandate so as to avoid the inflation bias of a monetary policy managed by government in a discretionary way.

‘Independence requires accountability to those who granted independence, i.e. to the democratically elected representatives of the citizens of the euro area’ explained a member of the executive board of the European Central Bank (ECB) in 2001\(^9\). To ensure accountability, a number of measures exist to safeguard the transparency of the goals and the means used by the ECB. The list includes, for example, the quarterly testimonies of the ECB’s President before the Committee on Economic and Monetary Affairs of the European Parliament, where the President explains the ECB’s policy decisions and answers questions posed by Members of the European Parliament (MEPs); and the publication of statements and regular publications, such as the Monthly Bulletin\(^10\). To this one has to add the issue of a clear mandate: maintaining price stability in the euro area, quantified by the Governing Council as a year-on-year increase of close to but below 2 per cent in the Harmonised Index of Consumer Prices (HICP). The clarity of the mandate, combined with transparent communication, is key to ensuring the credibility and trustworthiness of the Central Bank vis-à-vis the citizens and economics agents.

The implementation of the new generation of trade treaties needs to follow similar rules to ensure transparency and accountability, comparable to monetary policymaking. Rules need to be created to define a clear mandate, foster credibility and better communicate decisions. It is worth clarifying that the parallel with monetary policy refers not to the content, but to the process. More precisely, this is an example of how the need to manage a specific policy in a technocratic manner can be framed in such a way that accountability is established.

Source: Authors’ elaboration

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\(^10\) Economic bulletin, since 2015.
Thus, it could outcompete goods produced in the country with higher standards. As a result, consumers in the latter country would suffer from lower standards in this product group and the producers from competition unrelated to efficiency. In such cases, the barrier should not be lifted unless action was taken by the other country to increase the standards. However, at the same time, producing for a smaller market can be expensive. What multinational companies often do, especially in Europe, is manufacture or provide ingredients that meet the strictest regulation so that they can export to the entire region. The additional cost of meeting the toughest standards can be less onerous because some costs are gained back in scale. Such a dynamic might also apply in the case of trade agreements.

5. Maintaining European standards and guaranteeing democratic legitimacy

Can NTBs be lifted without lowering standards and respecting the will of society? This is possible under the condition that mutual recognition is limited to those products where different national regulatory provisions lead to similar outcomes regarding safety or other relevant regulatory objectives. For example, this could be true of automobiles in the EU and the USA because, overall, the level of safety achieved by regulations on both sides of the Atlantic appears rather similar, despite the recent controversies about environmental and emission standards. However, determining whether regulatory outcomes are sufficiently equivalent is a highly complex and painstaking task that requires the involvement of highly qualified experts.

This is why the European Commission proposed the establishment of a Regulatory Cooperation Body (RCB) in the context of TTIP, a forum in which experts from both the EU and the US would meet regularly (European Commission, 2015). The reference to TTIP is made here because no other trade agreement goes this far in defining the scope for regulatory cooperation. It is true that Chapter 25 of TPP, for instance, does propose the creation of a Committee on Regulatory Coherence. However, this represents a much less ambitious approach compared to the RCB, due to the composition of the group that negotiated the Treaty and that included the USA as well as less developed countries. Moreover, if anything TPP would improve the standards of middle-income countries, rather than erode those of the USA.

To render regulatory cooperation effective, the RCB would provide for a horizontal framework and would be organised with sectoral subfora (automotive, chemicals, cosmetics, pharmaceuticals, ICT, engineering, financial services, medical devices
and textiles). More particularly, it would be the forum for cooperation on future regulations/standards and would also be responsible for coordinating the decision-making process about regulatory equivalence as a precondition for mutual recognition, according to the European Commission. The RBC would not replace the national (or European) regulators, but would analyse the cases and do the preparatory work for the democratically elected bodies. As the work of the RCB would be ongoing after the conclusion of trade negotiations on a continuous basis, this would imply establishing a kind of ‘living agreement’.

This approach appears reasonable overall and has the potential to become a blueprint for future trade negotiations about the dismantling of NTBs beyond TTIP. However, because it would be composed of experts and technocrats it solicits the question: how can citizens be sure that the members of the body will remain impartial and will not be biased by interests of any sort? There is a legitimate concern that important regulations and standards could be eroded or new provisions prevented in decision-making processes that take place behind closed doors and without sufficient participation of parliaments and Non-Governmental Organisations (NGOs).

Ensuring accountability requires a solid rules-based framework to safeguard the high level of European standards, democratic legitimacy and sufficiently broad participation of various interest groups. Thus, learning from the example of monetary policy (see Box), several preconditions would have to apply to regulatory cooperation in a form similar to the RCB so as to establish its accountability. The mix of provisions should aim at defining a clear mandate, enforcing transparency of the operations and establishing a reputation. Based on these three objectives, we propose the following preconditions (see Table 2 for a summary):

- The RCB should have a very limited decision-making power, enabling it to only take decisions of a very technical nature that do not influence the level of European standards.
- Decisions of greater importance have to be taken by the European Parliament (EP) or national parliaments depending on the respective competencies.
- The distinguishing line between both categories of decisions that limits the realm of the RCB has to be clearly defined.¹¹

¹¹ Concerning the respective competencies of the EP and national parliaments, the ruling by the European Court of Justice on the EU-Singapore agreement provides important insights. According to the Court, national parliaments have to be involved in decisions that concern portfolio investment and Investor-state dispute settlement (ISDS), while the EU retains exclusive competences in all areas which are now pivotal to the global trade agenda, including trade in goods, services, public procurement, competition, foreign direct investment, sustainable development, intellectual property rights and state-to-state dispute settlements (Van der Loo, 2017).
• Representatives from the EP (and possibly also from national parliaments) should be allowed in on all discussions in the RCB to enable full monitoring.
• A broad participation of relevant stakeholders in the RCB’s fora also needs to be guaranteed in order to permit sufficient democratic control. Provisions would have to be established to ensure a balance between corporate interests and other forms of representations (NGOs, consumers’ organisations, etc.). Chase and Pelkmans (2015) recommend the institutionalisation of a process whereby interested parties send a petition to the relevant regulators with the supporting evidence about their case.
• The RCB would have to report quarterly in front of relevant committees of the European Parliament.
• The proceedings of the RCB also need to be transparent. The calendar of meetings, minutes of the meetings, etc. would have to be fully accessible.
• In establishing regulatory equivalence in all relevant product groups, highly reputable independent academic expertise should be consulted.
• A strict code of conduct for the staff and clear compliance rules would have to be established.

Table 2: Necessary preconditions to make the regulatory cooperation accountable

<table>
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<th>Enforce transparency of the operations</th>
<th>Establishing a reputation</th>
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