

## **New Approaches to Support Transatlantic Trade Integration**

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### **Introduction**

One of the distinctive features of the post Second World War period has been the steady and sustained increase in international commerce, which, with the exception of a few episodes when the world went into recession (most notably in 2008), has grown more rapidly than output year in, year out. The extent to which world trade has grown since the 1950s is striking, especially when put in historical perspective. The volume of trade increased 27-fold between 1950 and 2008, three times more than the growth in global GDP. The value of global trade in goods and services passed the US\$20 trillion mark in 2011 or 59 percent of global GDP, up from 39 percent of GDP in 1990.

This growth in global trade was driven by lower trade costs, the result of technological change, trade reforms and the pursuit of outward-(export-)-oriented policies. Technological changes include advances in information and communications industries that led to a sharp drop in the costs of international telecommunications, and containerization and other improvements in logistics that led to a steep fall in unit transport costs. Average import tariffs have fallen to the 5–10 percent range. Tariffs confronting many firms are often zero as a result of the complete elimination of tariffs for the products they import. This is not just a phenomenon that is limited to high income economies. China has implemented a major trade and investment liberalization program in the last 20+ years, with average applied tariffs post-accession to the WTO having declined to less than 7 percent. Similarly, the average applied most-favored-nation tariff in India is now around 6 percent.

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Much of the recent growth in world trade comprises intermediate inputs, components and services of various kinds. The decline in trade and information and telecommunications costs has permitted firms to geographically splinter their “production lines,” designing international supply chains that allocate different parts of the production process to firms in different countries. International supply chains and production networks are the mechanisms through which this process of specialization is organized, with goods being processed—and value being added—in multiple countries that are part of the chain. By locating (sourcing) activities and tasks in different countries as a function of their comparative advantages, total costs of production can be reduced. The growth in supply chain trade (SCT) has been supported by—indeed, is dependent on—cross-border movement of capital and knowledge (as the technology and know-how needed to undertake the various activities is often firm-specific). The global value of the stock of foreign direct investment (FDI) rose more than 6-fold in the last decade or so; local sales by foreign-owned firms (foreign direct investment) was some US\$26 trillion in 2012, as compared to \$18 trillion for world merchandise trade.

### **1. Harnessing Supply Chain Trade Opportunities**

Developing countries in Asia, transition economies in Europe and a number of countries such as Mexico have become active participants in SCT. The share of manufactures in total exports of developing countries has increased from just 30 percent in 1980 to over 70 percent today, with a substantial proportion of this comprising intra-industry trade—the exchange of similar, differentiated products. This trend is a reflection of the increase in the intensity of SCT, with lower wage economies importing parts and components and processing them into products that are exported for further processing elsewhere or for final consumption.

SCT has numerous implications for economic policy. One is that it facilitates the entry of low-income countries into manufacturing. Through “vertical specialization” (focusing on specific tasks that are part of an international supply chain) even very poor countries can engage in manufacturing for the global market. SCT allows firms to locate labor-intensive and relatively unskilled tasks in poor countries. While the share of the total value of a final

product that is added by the processing activities located in a low-income developing country will generally be small, the employment and income that are created as a result of SCT participation may generate significant indirect benefits through greater demand for local goods and services. Over time, as countries increase their experience in SCT, firms may be able to increase the share of total value that is generated locally. Since 2002, China and other developing countries that have engaged intensively in SCT have more than doubled the value added produced locally in manufacturing activities (Timmer et al., 2013).

There is substantial variation across countries in SCT participation. Sub-Saharan African countries in particular remain heavily dependent on natural resources and agricultural products. To date most of Africa and much of Latin America and the middle East have not seen the shift towards intra-industry trade, vertical specialization and SCT that has been a driver of trade growth in East Asia, Mexico, Turkey, and Central and Eastern Europe. Fostering greater diversification and participation by African, Latin American and Middle Eastern economies in SCT is a major challenge for governments of the countries concerned.

One reason for the skewed pattern of SCT participation is that although barriers to trade have fallen dramatically, the costs associated with international transactions remain much higher than those that arise within countries, and average trade costs are much higher for low-income countries than richer ones. In the last 15 years trade costs have fallen much more in richer nations. Trade and information/coordination costs help explain why a large share of global SCT is in fact regional—centered on three “international factories:” Europe, East Asia and North America (Baldwin and Lopez-Gonzales, 2013).

## **2. Implications for policy and international trade cooperation**

From an SCT participation perspective reducing trade costs and improving “connectivity” to regional and global markets is a precondition for attracting SCT investments. This is a policy agenda that goes far beyond trade facilitation—improving the efficiency of border management—to include policies ranging from regulation of transport-related infrastructure services, e.g., ensuring there is competition in road, rail, maritime, and air transportation markets, to the types of safety or security and other product standards that apply. Product standards-related regulation can have a major impact on SCT as it can

impede the ability of firms to realize economies of scale and source inputs—whether parts or services—from just a few locations around the globe.

The expansion of SCT, in conjunction with the associated flows of FDI into developing countries, has greatly attenuated the incentives to use traditional trade policy instruments like tariffs. Being able to compete in a specific niche or value-adding activity requires that firms integrate into the relevant production networks. Significant levels of import protection would impede their ability to do so as it would increase the cost of inputs. Gawande, Hoekman and Cui (2011) show that the intensity of a country's vertical specialization helps explain observed trade policy responses to the 2008 crisis as well as the level of trade protection pre-crisis. The major emerging economies did not utilize the "policy space" they have to raise barriers in an attempt to protect domestic industries in part because of the incentives created by participation in SCT.

This does not mean there are no incentives to use traditional trade protection. Recent experience has shown that governments continue to be inclined to use measures that restrict exports of natural resources and agricultural products that are upstream inputs into global value chains. This acts as a subsidy to domestic processors. It may make the chains they connect to more competitive, but if domestic processors are less efficient than competitors in the rest of the world, such policies will negatively affect SCT participation. SCT increases incentives for government to use "behind-the-border" policy instruments to support domestic economic activities. Analogous to tariffs and import protection these may create negative international spillovers—e.g., subsidies and similar policies to attract SCT-linked FDI that generates incentive competition between governments. Alternatively, policies (or an absence of policy) may negatively affect the efficiency of supply chains or impose costs on firms in other countries that are located either "upstream" or "downstream" along the supply chain. If the policy environment is too restrictive there will be little SCT.

Governments are not necessarily aware of the impacts of prevailing policies on SCT investment incentives and operations. Moreover, existing trade agreements and similar forms of international cooperation usually are not designed with a view to minimize

negative SCT spillovers. Nor are they designed to assist governments to put in place a policy environment that will support SCT specialization and greater use of SCT opportunities. These considerations have implications for the design of trade agreements and international trade cooperation, whether this involves high- or low-income countries. While specific priorities for action will differ, all nations have an important stake in SCT and further exploiting the opportunities that exist for greater specialization at the firm-level. Hoekman and Jackson (2013) and World Economic Forum et al. (2013) advocate a “whole of the supply chain” approach to assessing and addressing the effects of regulatory policies on trade costs. They argue that this could increase the effectiveness of international cooperation by identifying those policies that matter most in terms of impacts on businesses involved in supply chains. The basic idea is that by organizing negotiations and agreements around a “bundle” of policies that may range from the contestability of transport services markets to the ability to apply new ways to distribute products, governments will be able to better use the commitment technology offered by trade agreements to reduce domestic supply chain constraints as well as barriers that are created by what trading partners do. But a “supply chain approach” can also be used as a mechanism to address the market-segmenting effects of differences in regulation, which is increasingly the main source of trade and investment barriers among high-income countries.

### **3. Regulation as a Trade and Investment Barrier**

The policies that restrict (raise the cost of) the international flows of goods, services, knowledge and professionals—all core elements of SCT—are increasingly of a regulatory nature—so-called nontariff measures. Examples are product regulation (to achieve health, safety or security objectives), licensing requirements, and certification and conformity assessment procedures. Successful international cooperation (agreements) on regulatory policies confronts significant difficulties because of concerns by regulators regarding the implications of efforts to reduce the market segmenting effects of regulation on the realization of regulatory objectives. Matters are complicated by the fact that frequently multiple entities with different objectives have a role in setting and enforcing product and process regulations. In general, the design of regulations does not consider how taken together they may impact on SCT.

In the EU-US context, for example, abstracting from policies that restrict foreign ownership of—or even participation in—specific sectors (such as air transport and maritime cabotage in the US), many of the policies that increase the costs of contesting markets are at the state level (28 national governments in the EU, the 50 States in the case of the US).<sup>1</sup> Although the EU has a common external trade policy, which now also encompasses investment policies, much of the relevant regulation of services activities is still applied at the national level. The same is true in the US for many services activities. Research on the potential gains from further regulatory reform and harmonization/mutual recognition initiatives in the EU and the US services relationship concludes that in principle there is a significant incentive to pursue such reform—e.g., OECD (2005) estimates that comprehensive services reforms could raise per capita GDP by over 3 percent in the EU and US. A key question however is what could be done through international cooperation to realize these potential gains—i.e., to implement the needed reforms. This question boils down to whether EU-US cooperation can be an effective mechanism to drive the *domestic* policy reforms that are needed to enhance the ability of foreign providers to contest markets—or put differently, for consumers and firms to source the goods and services that best meet their needs at competitive prices.

Past experience reveals how difficult it is to achieve this. In the case of the EU and the US, remaining barriers are to some extent in sensitive sectors where there are long-standing concerns on both sides about liberalization, in part reflecting differences in cultural (on the EU side) and security (on the US side) objectives, as well as the strength of specific lobby groups (e.g., farmers). Insofar as strongly held non-economic preferences enter into the equation—as is the case in a number of regulatory areas relating to privacy and public health for example, where there are major differences in risk attitudes—making progress in moving towards greater mutual recognition and/or approximation of regulatory norms/standards is a huge challenge.

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<sup>1</sup> Noteworthy in this connection is that databases that measure the prevalence and magnitude of product market regulation such as that compiled by the OECD indicate that there are very large differences *across* EU member states in the type and restrictiveness of regulatory measures, especially for services. The EU is in that respect still far from a single market (see OECD, 2011 and Messerlin and van der Marel, 2012). The same is true of the US. For example, pressure equipment in the US is regulated at the State level, implying that a firm must deal with 50 regulators. Licensing of certain professional services—e.g., legal and medical service providers—is also at the State level.

Attempts to reduce regulatory barriers to transatlantic trade and investment flows in recent decades have had disappointing results. Mutual recognition agreements have had limited impact (Vogel, 2012). Harmonization of norms is extremely difficult to achieve for regulatory measures that are already in place even if the focus is limited to regulations that apply within the EU and the US, let alone seeking to harmonize rules across the Atlantic. A necessary condition for moving forward in reducing regulatory compliance costs and eliminating duplicative and redundant requirements is mutual trust and understanding of regulatory systems and compliance mechanisms—matters that cannot be legislated but require communication and cooperation 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 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.

#### **4. The Transatlantic Trade and Investment Partnership**

The recently launched Transatlantic Trade and Investment Partnership (TTIP) negotiations offer another opportunity to put in place mechanisms to address regulatory sources of market segmentation. Analyses of the potential impact of a TTIP conclude that the gains are likely to be limited—at best increasing real aggregate incomes by perhaps 0.5 percent. One reason for this is that it is considered unrealistic (infeasible) to make significant progress in addressing many of the regulatory sources of higher transatlantic trade costs. The European Commission recognizes that any agreement with the US on regulatory matters will have to be of a “living nature,” involving gradual progress in convergence and acceptance of policies that results from the operation of specific institutional mechanisms that will need to be put in place (European Commission, 2013). What follows discusses a possible approach that builds on this recognition, motivated by past efforts to reduce transatlantic trade and investment barriers. While the discussion focuses on the TTIP, the challenge confronts all governments, and some of the suggestions that are made can be applied in other contexts as well—including the WTO.

The goals of the TTIP initiative are ambitious. A major objective is to achieve greater regulatory coherence and to agree on approaches to address so-called 21<sup>st</sup> century policy matters that to date have not been dealt with in trade agreements outside of the European Union. An example is to agree on disciplines on the behavior of (towards) state-owned or controlled enterprises. A stated aim is to develop rules and approaches that are globally relevant and that could become a template for future multilateral norms (Eisenstat, 2013; Akhtar and Jones, 2013).

Efforts to address regulatory spillovers (regulations that create barriers to trade and investment) tend to focus on regulators—creating mechanisms through which regulatory authorities from different countries interact and putting in place consultation and information exchange-cum-notification systems through which other parties are made aware of proposals for new regulation. While such mechanisms are critical in establishing the data and information flow needed to build trust and understanding of the operation of counterpart regulatory processes and norms, the impact of such types of cooperation in lowering trade costs is often limited. One reason is arguably that regulatory cooperation often follows a “silo approach:” the focus is on a specific policy area such as health or safety standards, with an emphasis on technical matters such as what constitutes equivalence, or on certification and conformity assessment procedures. These are undoubtedly necessary dimensions of any effort to address regulatory barriers to trade. But 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 “their” 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 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 underlying norms and preferences of the countries involved are similar enough that they should be regarded as equivalent. In many cases it is also likely to be the case for the EU and the US. The question then is how to move in this direction on a transatlantic basis. A premise of the suggestions that are made below is that progress in this direction could be facilitated if those most concerned by the impacts and effects of specific regulatory regimes are made an integral part of the process of deciding where an unconditional approach to recognition is feasible and appropriate.

As mentioned, deliberations on regulatory regimes tend to be largely technical in nature. Limited attention is given to explicit consideration of net economic effects. Assessments and analysis of how specific forms of regulation interact with each other and jointly impact on business and international trade opportunities is generally not undertaken. Indeed, it is striking that in contrast to other areas of government policy, no use tends to be made of mechanisms to identify what stakeholders actually want or what their true priorities are when it comes to trade-related regulation.<sup>2</sup> This contrasts with other areas of public policy. E.g., municipal governments sometimes make use of instruments such as deliberative polling to overcome the problems of “rational ignorance” and bias in responses by stakeholders to surveys, opinion polls or their views on alternative public policies or investment projects. Deliberative polling involves a random, representative sample of stakeholders participating in a “poll” on a policy issue. This group is subsequently brought together to deliberate on the issue in small groups that are facilitated by trained moderators, informed by accessible expert briefing materials that provide balanced information on the matter at hand. Following this process of informed deliberation the group is asked to respond again to the original question. As long as the sample is indeed representative of the relevant stakeholder community, the end result should much better reflect the conclusions that would be attained if the population as a whole were able to become more informed and more engaged by the issues (see Fishkin, 2009, for an overview). A variation of this process could help overcome entrenched differences between

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<sup>2</sup> See Halle and Wolfe (2007) for a discussion of practices in a number of countries.

regulators by bringing in the stakeholders in whose name the regulations are set and defended.

There is a disconnect between the way that business today operates internationally and the way that governments pursue international trade agreements. The former “think supply chains” whereas the latter tend to focus on specific policy instruments that are under the control of a particular regulatory authority or government body. Making progress in addressing regulatory barriers to trade may be facilitated if the disconnect is recognized and the two communities do more to get on the same page. One way to attempt to do this is to complement the policy-specific (“silo”) approaches that have been the standard to date in trade agreements with mechanisms that are centered on – anchored in – the conceptual frameworks that are used by international business to organize production and utilize techniques developed by political scientists to better identify what the true preferences of stakeholders are when it comes to regulatory policies and approaches. Involving all stakeholders in international cooperation aimed at reducing regulatory trade costs could help to generate the engagement by industry and consumer groups that is needed to mobilize the political support required for passage of an agreement through national legislatures and in the case of the EU, the European Parliament. Greater involvement by key stakeholder groups can also help ensure that the TTIP achieves the stated objective of making progress on “21<sup>st</sup> century” regulatory policies and provides a template for doing so that could be emulated by or at least inform multilateral efforts or trade cooperation in other parts of the world.

## **5. Operationalizing a “supply chain approach”**

A supply chain approach to the design of policy commitments and disciplines would not be product, sector or policy instrument-specific but focus on how various policy areas—tariffs, border management procedures and requirements, product standards, different domestic agencies responsible for regulatory policies, access to transport and distribution (logistics) services, and so forth—jointly impact on international production, trade and investment. The objective would be to cut across the prevailing policy silos in government and regulatory agencies, with an explicit focus on how the existing combination of applicable regulation/policies affect key dimensions of supply/production chains and reduce

efficiency/raise costs. E.g., World Economic Forum et al. (2013) notes a case involving a chemical company that imports acetyl, used in aspirin and paracetamol, into the US. The company must, on average, comply with similar regulations from five different agencies that often fail to coordinate and communicate effectively with one another, resulting in delays for one out of three shipments, with each day of delay costing the firm US\$60,000.

The average car has thousands of components that are produced by hundreds of suppliers located in dozens of countries. A Volkswagen Polo might have an engine made in Germany; a wiring harness from Tunisia, and an exhaust filter system from South Africa. Differences in standards and in testing procedures imply that components as well as the final product are not interchangeable—a catalytic converter that complies with EU norms may not be accepted in the US and vice versa. Akhtar and Jones (2013) cite the example of a U.S. light truck manufacturer that wanted to sell a model in Europe—which “required 100 unique parts, an additional \$42 million in design and development costs, and incremental testing of 33 vehicle systems ... all without any performance differences in terms of safety or emissions.” There are many more examples in the trade press and industry literature. Regulatory recognition would allow firms to realize supply chain efficiencies by sourcing parts and components from the lowest cost/best location for them as opposed to having to produce intermediates to different standards in different locations.

How might a supply chain approach be designed to address regulatory barriers to trade?

**1. *Select a number of supply chains or trade lanes.*** 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 (or in the context of the specific set of countries that are seeking to remove regulatory barriers to trade). Business needs to be an integral part of this process in a way that goes beyond “consultations” and “dialogue” as governments generally will only have a very incomplete understanding of how supply chains work and how they operate and are designed. It will be impossible to consider dozens of supply chains so a first challenge will be to determine which to choose. Government and other stakeholders have an important role to play here, by e.g., suggesting or introducing criteria that will ensure that broader national welfare considerations are introduced. E.g.,

given that international trade flows and supply chains are often dominated by very large companies and industries it will be important control for possible biases that can result from simply focusing on existing trade and investment flows.

It is important to consider how regulatory policies impact on the ability of small and medium-sized enterprises (SMEs) to exploit new technologies to sell more internationally.<sup>3</sup> SMEs are an important source of employment. Generally they will be suppliers to lead firms, contract manufacturers and multinational service companies but they also can use the internet and business-to-business market platforms to sell their products internationally. Taking actions to facilitate greater international participation by SMEs is a priority for all governments, but often they will be unaware of how extant policies impact on the ability of SMEs to expand their international operations. An example is the cost hurdle imposed by security or privacy-motivated regulations such as a requirement to locate servers in the country of the consumer/client. Such regulations are much easier for a large firm to overcome than an SME. In practice SMEs will be more difficult to identify and to engage than large firms and industry associations. This may not be too much of a constraint in identifying and addressing regulatory barriers however as these apply to all firms independent of size.

**2. Identify the “cluster” of policies that matter most.** Once a set of supply chains/production networks has been selected, the various supply chain platforms—“councils” in what follows—would seek to identify the most binding regulatory policy constraints that impact negatively on the operation of the chain by generating costs that are in excess of what is required to satisfy the norms that apply. Here again the active involvement and participation by business is critical as such costs 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. As in the first step—selecting what supply chains or production networks to

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<sup>3</sup> SMEs tend to face proportionally greater barriers to engaging in international trade, as the fixed costs of understanding and satisfying regulatory requirements in different markets weigh much more heavily on a unit cost basis than for large firms with much larger turnover and capacity to cover the costs of dedicating personnel to dealing with the different agencies concerned in multiple foreign markets.

focus on—this process of “mapping” supply chain trade costs and inefficiencies to regulatory policies 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 good rationale—such as addressing market failures, ensuring human health and safety, etc. But in practice it is often the case that there is redundancy in the sense that very similar but slightly differentiated 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).

**3. Agree on an action plan.** Another essential task for supply chain councils is to propose and agree on an action plan to address those regulatory policies that most detrimentally impact on the operation of international production networks. Here again the public-private partnership nature of the councils is important. The participation/representation of both the relevant regulatory bodies and those in government who are responsible for economic policy more generally is necessary to be able to decide 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 identification of approaches that lower compliance costs without putting into question the rationale for regulation. In practice it is likely that action agendas will require contributions by governments and stakeholders: business, consumer groups and legislators. A deliberative polling approach could be used to determine specific areas where upon reflection (i.e., a process of explicit deliberation by a representative sample of stakeholders that is informed by a balanced synthesis of extant evidence on—and assessments of—the economic and noneconomic consequences of alternative proposed solutions) there is a sufficient degree of “comfort” in proposing a specific way forward.

**4. Set performance indicators.** Measuring and quantifying the “performance” of the supply chain networks that are the subject of deliberations in ways that can be monitored over time. The aim should not be to restrict attention to identifying the most binding constraints (sources of trade costs) but to set specific targets for improvement. What such key performance indicators may be will depend in part on the type of activities or products involved. Establishing numerical baselines will help both to motivate the need to pursue reforms and is a critical ingredient in determining whether progress is being made over time to reduce trade costs. One reason why metrics are critical is because of the scope for policies to substitute for each other—removing one source of redundant or duplicative regulatory cost may not have an effect if other policies continue to impose excess costs.

**5. Monitoring, learning and accountability for results.** A final element of the “terms of reference” of supply chain councils would be to contribute actively to monitoring and reporting on progress and results. This should be public (published) both to ensure transparency and to increase the incentives of those who are tasked with taking actions to do so. This is a function that will depend importantly on having established a quantitative baseline and collecting the data that are required to determine if performance on the chosen metrics is being made. While the analysis of progress made (or not made) and reporting should be done by independent entities to ensure that conflicts of interest do not arise, business again has a critical role to play as often it will have the best access to the requisite data. If for example, the performance indicators are centered on the time it takes for consignments to satisfy all border management processes, or the share of transactions that are physically inspected, or the variance in the average time that is required for regulatory approval to be obtained, data on the outcomes that are realized on these metrics will need to come from the business community.

**6. Institutional design issues.** A number of challenges may arise in operationalizing the approach. Firms may have a vested interest in providing biased data; may not want to provide relevant data even if they have it because of competitive concerns or worries about potential liability; and in general will be disinclined to incur additional costs associated with

a need to collect data that they do not already compile as part of managing their supply chains. The more that the performance indicators can be measured using data that is either readily available or is already being compiled by firms for their own purposes the easier it should be for the councils to monitor outcomes over time. Thus, one of the tasks for the councils is to determine what data already exist that can be used for purposes of establishing a baseline and monitoring performance over time.

A potential problem in this regard is that governments may not trust the data that is provided and firms may not trust the governments with data or be worried about providing information that can be used by competitors. This calls for aggregating and anonymizing data so that individual businesses need not be concerned about “retaliation” by regulatory agencies or releasing commercially sensitive information. There are good practice models, such as those that have been developed for firm- and household-level survey data that can be used to address such concerns. A necessary element is that the data are compiled and processed by an organization that is technically competent and independent of individual enterprises. An example of a possible entity that could play this role is the US International Trade Commission; alternatively this task could be performed by a well-established policy research institute or network.

The institutional framework for the proposed supply chain councils and related processes and mechanisms can build on those that have been put in place already in the transatlantic context. The Trans-Atlantic Business Council (TABC) – established in January 2013 and combining the Trans-Atlantic Business Dialogue (TABD) 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 as far as business engagement is concerned. Together with the Transatlantic Legislators Dialogue and the Transatlantic Consumers Dialogue, the TABC 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.

## **6. Participation by other countries: supporting “open regionalism”**

Most EU- and US-based firms will be engaged in supply chains that involve third countries. Even though SCT is mostly regional in volume terms (Baldwin and Lopez-Gonzalez, 2013), there will be very few supply networks that do not involve tasks and products produced in other parts of the world. Any approach to addressing regulatory barriers that is strictly delimited to a bilateral setting is unlikely to be optimal even for 2 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 SCT. Indeed, the same applies to countries that are not (yet) part of SCT. Agreements between the EU and the US to reduce duplicative regulatory costs may have the effect of facilitating participation of third country firms in SCT. 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 preferential removal of transatlantic tariffs are likely to be limited because average tariffs in the EU and the US are low—although there are significant exceptions, e.g., import duties in the EU on light trucks. There is greater potential for greater discrimination against third countries resulting from measures that have the effect of reducing the market segmenting effects of differences in regulatory policies. Much 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 cannot be extended so as to allow 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.<sup>4</sup>

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<sup>4</sup> The literature investigating the effects of regional harmonization of standards has found that this may benefit excluded countries, but that this is conditional on the capacity to satisfy the norms and mechanisms that are adopted by the countries that are member of an agreement. See, e.g., Chen and Mattoo (2008) and Shepherd (2007).



The suggested process sketched out above will by its nature identify which countries need to be part of the equation. Ultimately, what is needed is a true multilateral approach where all countries are part of the process, but there are practical constraints in applying the proposed approach multilaterally given the preconditions for the unconditional equivalence concept to be feasible to apply. For countries characterized by large differences in per capita incomes, regulatory regimes, and enforcement capacity the approach may be less applicable or only be feasible for certain types of regulatory issues. But whatever the case may be, it is important that the mechanism not be exclusive but is open to participation by other countries. This is especially important given the stated intention that the TTIP is aiming to identify “21<sup>st</sup> century” models and approaches that are of relevance to other countries as well.

## **7. Conclusion**

Supply chain trade offers new opportunities for firms to specialize and become part of the “global factory.” Facilitating such trade requires more than reducing domestic trade costs, although that is critical precondition for participation in many types of SCT. A “supply chain approach” offers a potential instrument to identify and address the broader set of policies that are implemented across different government agencies and that taken together generate significant SCT costs (Hoekman and Jackson, 2013). But it also offers a framework to reduce the trade-impeding effects of differences in regulatory policies, even if these are motivated by very similar objectives, if combined with techniques such as deliberative polling to define areas where it is feasible to adopt what Messerlin (2013) has called “unconditional” equivalence in norms and enforcement procedures.

The Transatlantic Trade and Investment Partnership offers an opportunity to launch new approaches to address long-standing constraints to transatlantic trade and investment. The EU and the US have an opportunity to demonstrate that progress on 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 “21<sup>st</sup> century” trade and investment agreement. The suggested approach should be open to participation by third countries. But the large differences in per capita

incomes and social preferences that characterize many country-pairs suggests that the approach proposed here to address regulatory differences will be more feasible to implement among countries that are relatively similar in terms of regulatory capacity and objectives. This is not to imply that a supply chain approach to international cooperation more generally cannot be useful to encourage SCT in low-income countries. To the contrary—as argued above it can do much to identify priority areas for reform, including in the context of a trade agreement.

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