Catalyst? TTIP's impact on the Rest

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Must TTIP-induced regulatory convergence benefit others?

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One of the central objectives of the negotiations for a Transatlantic Trade and Investment Partnership (TTIP) is to foster a convergence in business regulation between the EU and the US. Negotiators recognise that convergence will not lead to widespread harmonisation of regulatory standards. Rather, they hope that over time firms on one side of the Atlantic will find it less costly to meet regulatory requirements on the other side. In an era when tariffs are either very low or, in many cases, zero for goods imported by the EU and US, it is often argued that the costs of meeting regulatory requirements are, relatively speaking, now the larger barrier to international trade.[1]

A longstanding concern about regional trading arrangements (RTAs) is that they introduce discrimination against third parties. Since Viner's pioneering research, economists have analysed the effects of tariff-based discrimination created once a RTA comes into force. When it comes to so-called behind-the-border regulatory provisions of RTAs, however, there is a strong presumption in the 'multilateralising regionalism' literature that RTAs introduce at most limited discrimination and, in some cases, no discrimination at all (Baldwin et al. 2009). Recently, Baldwin (2014) concluded an

1 Erikson (2014) has argued that "[t]o deliver sizeable economic benefits, the EU and the US have to agree on a package of changes to regulatory policies and practices that are to some extent unknown but that still will be controversial. According to an impact assessment from CEPR (2013), 80% of the potential economic gains from TTIP would be generated by changes in non-tariff barriers and regulations, including service liberalisation and greater openness in public procurement."

assessment of the potential for discrimination in the non-tariff provisions of RTAs with the following remarks:

> *A key lesson from the above discussion is that discrimination is difficult with regard to many 21st century trade disciplines–rules of origin either make no sense, or are 'leaky' since nationality is difficult to pin down when it comes to services, companies and capital. This 'leakiness' of the rules of origin dilutes the discriminatory effects of RTA provisions. (p. 33)*

Given the prominence of regulatory convergence in the TTIP negotiations, whether or not this conclusion is the correct one assumes greater importance, in particular for third parties. The purpose of this chapter is revisit these claims.

This chapter complements that of Mattoo's in this volume. Regulations differ markedly across sectors of the economy. Some regulations must be met before a product or service can be sold in a jurisdiction and, as Mattoo argues, TTIP could result in regulations being adopted on both sides of the Atlantic that are more costly or harder for exporters from third parties to meet.[2] If TTIP-induced regulatory convergence amounts to convergence to higher standards, then Mattoo is concerned that this may become another barrier to entering markets on both sides of the Atlantic.

Other regulations concern the conduct of firms after their entry into a market. A point of departure between this chapter and Mattoo's is that we consider the enforcement associated with the regulation of conduct. For completeness sake, it should be noted that neither Mattoo nor we consider the effects of privately imposed and administered standards. This is not to imply that the latter are unimportant – indeed, many firms exporting from developing countries contend that they are. Rather, the point is that

2 Once one allows for the possibility the lobbying by domestic firms can influence the direction of regulatory change, then TTIP (and RTAs in general) can be used by such firms to raise their foreign rivals' costs by more. Those familiar with the industrial organisation literature will be aware of this 'raising rivals costs' argument (Salop and Scheffman 1983).

private standards are unlikely to be the focus of the TTIP and are therefore outside of the scope of this short analysis.

The remainder of this chapter is divided into three parts: some reflections on so-called leaky preferences created by provisions on regulatory matters in RTAs; identification of six potential sources of discrimination in regulatory enforcement; and some concluding remarks.

Leaky preferences can still harm third parties

The argument is often made that, as far as many behind-the-border provisions in RTAs are concerned, subsidiaries of companies that are owned by third parties that operate inside an RTA are treated similarly to those firms that are owned by citizens of the nations that signed the RTA.[3] In RTAs signed by the EU and the US, provisions with this characteristic can be found. Since precedent tends to matter in trade negotiations, the inclusion in TTIP of behind-the-border provisions that do not discriminate on the basis of the nationality of a foreign invested subsidiary cannot be ruled out. Are such provisions harmless to third parties?

Sometimes it is argued that discrimination on the basis of nationality of ownership is either harder or costlier to implement than discrimination on the basis of origin of imported goods. On other occasions, it is argued that discrimination is not necessary to meet the public policy objective of the regulation.

Either way, so the argument goes, the strongest possible preferences (on the basis of nationality of ownership) are eschewed and the benefits of any RTA-induced regulatory change are enjoyed by all firms operating inside the RTA, irrespective of nationality. As a result the benefits are said to 'leak' to certain commercial interests of third parties.

3 We leave to one side the interesting question as to whether, in an era of cross-border shareholdings and the like, it makes sense to refer to the nationality a firm.

But this is not the end of the story. The symmetric treatment within the RTA will induce firms from third parties to view more favourably supplying customers located in the RTA through commercial presence inside the RTA rather than outside the RTA. Consequently, leaky preferences could alter investment flows, potentially to the detriment of third parties.

The net effect on a third party is, therefore, going to be determined by the benefits arising to its existing subsidiaries operating inside the RTA in question and the loss of investment, value-added, and jobs (in the sector in question and among the suppliers to that sector) as firms relocate commercial activities from outside the RTA to inside the RTA. The *absence* of certain preferences does not necessarily imply the absence of losses by third parties.

Furthermore, the fact that discrimination on the basis of nationality of ownership is not happening at a point in time does not mean that circumstances (economic, political, or technological) cannot change and that discrimination won't occur in the future. For foreign investments with a long payback period, this consideration may be relevant and could raise risk premia. One way to limit such uncertainty would be to ban in an RTA such nationality-based discrimination against foreign investors (for more on this see the concluding remarks.)

Potential sources of discrimination in regulatory enforcement

There are also ways, sometimes subtle, in which RTAs can introduce discrimination in the enforcement of regulations on commerce within a jurisdiction. Since one stated purpose of TTIP is to reduce regulatory burdens on firms operating in the US and EU, then one might ask why US and EU negotiators would not ask for preferential treatment in the implementation of certain regulations compared to third parties? There is nothing preventing them from asking.

There are six ways in which RTAs can result in discrimination against third parties in regulatory enforcement. These are:

1. *Exemptions from a regulation for parties to an RTA*. A weaker variant is when the thresholds that trigger regulatory action are more favourable to RTA parties than to non-parties. Australia, for example, has granted certain RTA partners higher thresholds before transactions are referred to its Foreign Investment Review Board for examination. Of course, fully-fledged mutual recognition accords amount to an exemption from a trading partner's regulation so long as the counterpart regulatory standard is met at home.
2. *More favourable statutory tests and evidential standards for parties to an RTA*.
3. *In regulatory matters where time-to-market is commercially significant, parties to an RTA may receive faster (expedited) reviews.*
4. *Less invasive remedies or punishments for firms from parties to an RTA*.
5. *More expansive rights of appeal for firms from parties to an RTA*.
6. *Shifts in enforcement resources away from parties to an RTA to non-parties*. Should TTIP result in greater confidence in food safety standards implemented on the other side of the Atlantic, independent regulators in the EU and US might shift more of their enforcement resources to inspecting agricultural products and processed food from third parties. Such a shift might not be mentioned at all in any legal text for the TTIP.

Contrary to some assertions in the literature, it is possible to have a single regulator implement different regulatory rules depending on the location of the firm whose matters are before it. Those differences may be of considerable commercial importance to firms inside the RTA and could affect their competitive position vis-à-vis firms outside the RTA. For sure, such privileged treatment could be 'leaky' in the sense described in the previous section, but as argued there, that does not mean there are no adverse effects on third parties.

Should the TTIP negotiations be concluded, third parties may wish to check the provisions relating to regulatory matters to see if they contain any of the six forms of favouritism outlined above. That there are six highlights a key point, namely, that regulatory processes can be reformed through trade agreements in ways that introduce discrimination against third parties. TTIP-related preferences, and more generally RTA-related preferences, need not be confined to traditional border measures such as tariffs and quotas. Indeed, the prominence given to regulatory convergence in the TTIP could spawn a new generation of preferences that harm the commercial interests of third parties. Vigilance on the part of the latter would seem prudent.

Concluding remarks

One of the reasons why the effects of TTIP's provisions on third parties matter is the central role that discrimination is said to play in inducing those third parties to accept the 'multilateralisation' of the provision at the WTO or to seek to join this RTA. It is worth recalling that the essence of 'domino regionalism' was that third parties were harmed by tariff discrimination and to avoid these losses would have an incentive to join the club.[4] Whether the same logic applies to non-tariff measures is therefore important for assessing the likely future course of trade agreements, regional and multilateral, in the 21st century.

The purpose of this chapter has been to challenge the rather benign view of behind-the-border provisions in RTAs that has arisen in the 'multilateralising regionalism' literature. This benign view sits oddly with the pronounced goal of the EU and US to induce the spread of their regulatory norms to other countries once TTIP is concluded. In this chapter we have argued there are several sources of discrimination in regulatory

4 In the case of TTIP, however, we have argued elsewhere that third parties have alternatives to seeking to accede to TTIP (Aggarwal and Evenett 2015).

enforcement that are neither costly nor difficult to implement. Our findings then align with those of Mattoo in his chapter in this volume.[5]

The actual degree of discrimination against third parties from the behind-the-border provisions of any TTIP accord cannot readily be assessed before the terms of such an accord are made known. Even then, reallocation of enforcement effort from parties to TTIP to third parties may not be apparent until years after TTIP has come into force. For these reasons, it would seem unwise to dismiss out of hand the potential for discrimination in non-tariff measures. Experience may well lead us in the years to come to the conclusion that such discrimination is as bad as, and possibly worse than, more traditional tariff-based discrimination against third parties.

Balance also requires us to state that, in principle, TTIP could include provisions on regulatory matters that explicitly rule out discrimination on the basis of nationality during any stage in the administration of a regulation. This would be not dissimilar to the provisions[6] in the North American Free Trade Agreement that ban the use of performance requirements on foreign investors from any country not just investors from Canada, Mexico, and the US. Even if such provisions were included in TTIP – and to date there are no indications that they will be – then questions would still arise as to whether third parties or their commercial interests could enforce any ban on nationality-based discrimination.

5 And, for that matter, also with Winters (2014), who has argued "[t]he rhetoric surrounding TTIP is to create a framework for the gradual harmonisation of regulations, first across the Atlantic and then generalising out for the global good; this view is accepted by many of my colleagues and indeed sounds quite benign. The problem is that, while a benign outcome cannot be guaranteed, one can guarantee that the countries that are outside the club will perceive it quite differently and may act accordingly."

6 In particular, Article 1106.

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