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Regulatory Protection in the New World of Trade: When is it Legitimate?

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Pascal Lamy, the former Director General of the World Trade Organisation (WTO), argued in his Jan Tumlir Lecture that we are moving from an old to a new world of trade. While the old world of trade was about the administration of 'protection' against foreign competition, Lamy argued, the new world of trade is more about the administration of 'precaution', i.e. the protection of consumers rather than producers. This is certainly true for the EU's attempts to negotiate new so-called second-generation trade agreements. And those agreements raise a key question: What is legitimate and what is non-legitimate regulatory protection? While traditional economic analysis can indicate the economic costs and benefits of non-tariff measures, other analyses are needed to estimate their social and environmental impacts. Only then can we determine if a regulation is legitimate or not. Absent such analyses, the public debate revolving around regulatory protection gets based on subjective assumptions and best guesses. Trade policy can thereby learn from non-trade analyses employed in the domestic regulatory sphere.

For regulatory protection it is important to distinguish between non-tariff measures (NTMs) and non-tariff barriers (NTBs). Key WTO Agreements (such as the GATT, Sanitary and Phyto-Sanitary (SPS) and Technical Barriers to Trade (TBT) Agreements) provide legal rules to evaluate the legitimacy – in this case the WTO compliance – of a regulation. Accordingly, regulations are illegitimate or protectionist NTBs if they are (i) not 'necessary' to achieve one of the listed policy objectives like protecting human, animal or plant life or health, (ii) discriminatory or (iii) if they restrict trade more than necessary. In contrast, NTMs are generally perceived by WTO Agreements to be legitimate measures pursuing legitimate policy objectives. Nevertheless, NTMs are also trade-restrictive if they differ across countries as diverging regulations in export markets require producers to adapt products to different requirements which increases their market entry costs.

However, even if NTMs pursue legitimate policy objectives, another question is if they are also legitimate from a national welfare perspective. Does a regulation render overall welfare benefits for society that justify regulatory protection? Or to put it more precisely: Are the social and environmental benefits that a regulation might render higher than the economic costs resulting from its trade-restrictiveness? If we want to have a well-informed public debate about regulatory protection and constructive trade negotiations about how and which regulatory barriers to reduce, we need a thorough analysis of these regulations and their impacts on our society.

The focus of most NTM analyses has so far been on the economic impact of NTMs. Economic costs of NTMs result from their trade-restrictive effects. Economic benefits, in contrast, result from the 'reduction' of NTMs achieved by elimination, harmonization or recognition of equivalence. However, particularly technical regulations can have social or environmental benefits. For instance, the restriction of potentially hazardous product ingredients or a labelling requirement for ingredients are technical regulations (i.e. SPS measures or TBTs) which can reduce negative health impacts and pursue a public policy objective – the protection of public

health. In this case technical regulations render social benefits for society that may outweigh the economic costs created by their trade restrictiveness.

It is complicated to analyse these social impacts of NTMs and above all to analyse them quantitatively. Yet, NTMs are de facto domestic regulations that affect trade in goods. And the domestic regulatory framework provides instruments to analyse the non-trade impacts of regulations, for example cost-benefit analyses. The objective of a cost-benefit analysis is to determine if a policy is worthwhile from a national welfare point of view and whether it should be implemented or not. Therefore, a cost-benefit analysis aims to calculate the overall net impact of a policy on national welfare by monetising all the negative and positive impacts of a policy on the society. If the value of the benefits exceeds that of the costs, the implementation of the policy leads to a welfare increase and vice versa.

A major challenge of a cost-benefit analysis is to compare non-economic impacts of a regulation with economic impacts. For such a comparison all the costs and benefits need to be expressed in one common measurement unit. This means that all impacts, whether positive (benefits) or negative (costs), need to be monetised. The economic impacts of NTMs can be determined by estimating the price effects of NTMs and calculating ad-valorem equivalents (AVEs). AVEs express the trade-restrictiveness of NTMs in a percentage change of the price of the good similar to tariff rates. However, social impacts such as the described health benefits usually do not have a market price. Hence, to estimate health benefits of a regulation resulting from the reduction of health risks, two main approaches are used in regulatory impact assessments: cost-based and preference-based calculations. A cost-based approach is, for example, the human capital approach where the value of the foregone earnings of a dead person is calculated. Preference based approaches estimate the value of people's preferences for a non-market good like health.

Consequently, approaches to assess overall welfare impacts of regulations do exist. In fact, the European Commission has assessed and quantified the social impacts of several EU regulations, for example of the REACH Regulation concerning the use of chemicals. An impact assessment was carried out for an amendment to the REACH Regulation prohibiting the use of cadmium in jewellery products. This impact assessment also included a calculation of the health benefits and costs of such a prohibition. Thus, EU impact assessment guidelines provide information about the use of cost-benefit analyses and how to monetise social impacts like health impacts. The OECD has even developed an NTM specific cost-benefit framework for agricultural goods.

As we need a more thorough analysis of NTMs, these approaches could be used to assess regulations for trade policy purposes and could help to determine the legitimacy of regulatory protection. Due to their technical complexity and data-intensity the use of these methods might be difficult on a large scale, but they can be useful to assess selected NTMs that are of particular importance for society. The results of such assessments can contribute to a more facts-based public discussion with the civil society and more transparent policy-making. At the same time, such assessments can foster evidence-based decisions about whether and how to address specific NTMs in trade negotiations and strengthen the EU's negotiating position.

The European Commission can foster a more comprehensive assessment of NTMs via three possible channels. First, it can include an obligatory quantitative assessment of non-economic impacts of prioritised NTMs in impact assessments of trade agreements. Second, it can require a comprehensive assessment of trade impacts as part of general regulatory impact assessments if regulations are expected to play an important role for trade. Third, it can go beyond the existing impact assessment frameworks and create an independent body specialised in research and advice on issues affecting national welfare like the Australian Productivity Commission. Such initiatives at the EU level could, furthermore, be accompanied by promoting cooperation at the international level. Assessment frameworks, guidelines and best practices for such assessments could, for example, be developed under the auspices of the WTO, OECD or UNCTAD. Increased transparency of trade and regulation will not just lead to more thoughtful decisions; it will also invite greater trust from the public in efforts to reduce unnecessary or illegitimate trade effects of regulation.