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The Global Value Chain Policy Series was launched in 2018 by the World Economic Forum System Initiative on Shaping the Future of International Trade and Investment. It consists of brief policy papers on various aspects of global value chains (GVCs). The aim of the series is to stimulate cross-policy discussion and thinking about GVCs and collect ideas from researchers and practitioners on how to help GVCs contribute towards development, sustainability and inclusiveness. These ideas can then be examined in more depth in the context of particular value chains, regions or public-private initiatives. The World Economic Forum is working to bring the relevant actors together to facilitate this multistakeholder, cross-policy undertaking, aimed at catalysing partnerships for impact.

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# Introduction: GVCs and regulatory heterogeneity

In a world economy characterized by the fragmentation of production processes across different countries through global value chains (GVCs), misaligned or redundant regulations can become a key source of transaction costs. For supply chains to work efficiently, inputs need to be sourced expediently and reliably across multiple markets. Any delays or frictions from diverse domestic standards or inspection processes can generate disruptions that reverberate across an entire regional or global production network. This results in accumulated transactions costs. It adversely affects not only the parent company but a range of other businesses in upstream and downstream activities, particularly small and medium-sized enterprises (SMEs). Ultimately, the costs also affect consumers through higher prices for final goods, reducing real purchasing power and overall living standards.

In addition to and interlinked with trade, the operation of supply chains invariably entails foreign direct investment (FDI) by multinational enterprises (MNEs) across the various countries where the different segments of an integrated production process are located. Since investment is by definition a behind-the-border transaction, the quality and predictability of domestic regulations greatly affect investment decisions and overall market access. Given that MNEs establish manufacturing affiliates across multiple markets and regions, the convergence of regulatory processes across countries reduces search and transaction costs, increasing efficiency. Improving regulatory frameworks can therefore help countries become more competitive in attracting “foreign factories” linked to GVCs, bringing important employment opportunities and associated spillover effects.

Overall, the increased awareness of the interdependency between trade and FDI brought about by GVCs implies that transaction costs for divergent or opaque regulatory measures do not just affect trade flows but have important effects on investment as well, particularly FDI linked to GVCs. In this context, GVCs heighten the importance of reducing transaction costs from domestic regulations, without compromising the achievement of legitimate public policy goals. Generally, trade and FDI costs from domestic regulation stem from two factors: how restrictive regulations are and the extent to which they differ across the markets in question. This paper focuses on the latter, discussing the benefits of and avenues for promoting regulatory convergence from a GVC lens.

# Effects of regulatory heterogeneity: Why it matters

## Non-tariff measures have become increasingly burdensome for businesses engaged in GVCs

The success of the multilateral system, as well as the supporting development of preferential trade agreements (PTAs),<sup>1</sup> has led to a massive reduction in the levels of tariffs and the use of quotas in the trade of goods worldwide. Since the establishment of the World Trade Organization's forerunner, the General Agreement on Tariffs and Trade (GATT), tariffs among early GATT parties have fallen by around 30%.<sup>2</sup> While tariff reductions continued to be the primary focus of negotiations within the World Trade Organization (WTO), other issues, such as technical barriers to trade (TBT), sanitary and phytosanitary (SPS) issues, services and intellectual property, as well as specific sectoral issues such as textiles and agriculture, began to be addressed.

Indeed, the very success of the WTO in reducing tariffs has led to the growing dominance of these other, non-tariff barriers, as one of the primary issues for trade negotiators. For example, during the Uruguay Round (1989-1994), 22 countries, including the United States, the then European Communities, Australia, Canada and Switzerland, negotiated the *Pharmaceutical Tariff Elimination Agreement*, agreeing to virtually eliminate tariffs on pharmaceutical products.<sup>3</sup> Despite this development, trade in the pharmaceutical sector is still very costly. Recent studies have shown that non-tariff measures (NTMs) in pharmaceuticals created a trade cost of 19% on imports into the United States in 2009.<sup>4</sup> Today, NTMs are considered the most important source of trade costs in the world economy, and most NTMs stem from domestic regulation.

The term "non-tariff measures" covers a diverse set of processes in terms of purpose, legal form and economic effect. Given their increasingly important role in global commerce, the quantification of NTMs has been the object of substantial academic and policy attention. However, because of the diversity of the types of NTMs, any consistent or global analysis is challenging.<sup>5</sup> NTMs may be defined as all policy measures outside of tariffs and tariff-rate quotas that have a more or less direct impact on international trade, either through their effect on the price of traded goods and services, the quantity traded, or both.<sup>6</sup> Generally, such measures aim to overcome or reduce the impacts of perceived market imperfections, such as those related to negative externalities, risks for human, animal or plant health or information asymmetries.<sup>7</sup> While often addressing legitimate public policy concerns, they tend to increase production and trade costs and may affect, positively or negatively, the development of new technologies or production methods.

International regulatory cooperation (IRC) refers to rule-making that involves consideration of the international

environment.<sup>8</sup> It entails including an international dimension in the design and development of regulation, as well as in its implementation and enforcement. Regulatory cooperation can take many forms. Figure 1 illustrates the 11 mechanisms identified by the OECD. These range from the most binding, namely the harmonization of rules via joint institutions, to the lightest form of cooperation, the exchange of information among regulators. Despite growing interest in regulatory cooperation, a clearer understanding of these options' costs, benefits and determinants of success is required.

Figure 1: The many forms of international regulatory cooperation

Integration/harmonization through supra-national institutions (EU)	Specific negotiated agreements (treaties/conventions)	Formal regulatory co-operation partnerships (US-Canada Regulatory Cooperation Council)
International organizations (OECD, IMO)	Regional agreements with regulatory provisions (RTAs, FTAs)	Mutual recognition agreements
Trans-governmental networks of regulators (International Laboratory Accreditation Cooperation)	Formal requirements to consider IRC when developing regulations	Recognition of international standards (ISO, International Technical Commission (IEC) standards)
Soft law (principles, guidelines, codes of conduct)		Dialogue/informal exchange of information (dialogues through Transatlantic Economic Council)

Source: OECD, *International Regulatory Co-operation: Addressing Global Challenges*, 2013, pp. 23-25.

## Servicification and digitalization heighten the importance of effective regulatory approaches

Driven by technology, countries' interconnectedness has increased dramatically over the past 30 years, with a corresponding increase in the amount and frequency of exposure to other regulatory regimes. Between 1990 and 2015, global trade intensity (measured as the share of the total volume of exports and imports of goods and service in world GDP) doubled.<sup>9</sup> Data on financial flows on PayPal's payment system illustrate the significant cross-border financial transfers the internet enables on a daily basis across the economic development landscape. Indeed, by

2011, a third of US exports had become digitally deliverable services, while EU and US exports in general incorporate significant amounts of digitally deliverable services as intermediate inputs.<sup>10</sup> This rapid growth in the flow of goods, services, people, transport and communications is testing the limits of effective domestic regulatory frameworks, as jurisdiction and levels of responsibility become increasingly opaque. As a result, consumers and businesses (especially SMEs) are increasingly faced with regulatory requirements outside their traditional markets. Understanding and appropriately adjusting behaviour in light of this web of regulation increase the cost of cross-border commerce and can have a dampening effect on its growth. The costs of dealing across multiple regulatory regimes can be substantial for GVCs.

To counteract these costs, countries must act in a coherent manner as regards developing regulations. Regulatory barriers can inhibit firms, particularly smaller players, from engaging in commerce, especially digital commerce, as they lack the resources to address complex regulatory burdens across multiple jurisdictions. For example, effective and secure payment systems are essential to facilitate digital transactions. The spectrum of payment methods has expanded significantly as a result of technological developments. Access to different payment settlement methods, including electronic ones, is crucial for firms to reach a broader consumer base and provide a wider variety of services. At the same time, appropriate security measures are needed to prevent fraudulent transactions and identity theft. Security measures also foster trust and confidence among users and create an environment that is conducive to digital transactions. The coherence of standards and regulation is seen increasingly as a critically important way forward for international commerce, digital and otherwise.

### Regulatory differences are a key source of trade costs, particularly for SMEs

Regulatory differences can have adverse effects on trade, particularly raising the cost for foreign suppliers wishing to export to other (differently) regulated markets. Regulatory differences may give rise to one or a combination of three specific cost elements:

1. Information costs – identifying and processing the information on relevant requirements in the target market
2. Specification costs – the need to adjust the product or production process to the requirements of the importing country
3. Conformity assessment costs – verifying and proving that these requirements have actually been met.<sup>11</sup>

These costs have long been recognized by policy-makers. Over time, a number of international legal agreements and cooperative arrangements have been introduced to discipline domestic regulation and promote regulatory coherence and cooperation. WTO rules encourage domestic regulation to be based on accepted international standards for further coherence across markets. The WTO's TBT and SPS committees act as fora for members

to discuss measures, including product regulations and conformity assessment procedures, maintained by others and encourage the adoption of best practice.<sup>12</sup> Such cooperation can have a significant impact on trade costs. Studies have shown that trade agreements that include SPS coordination reduce the costs associated with these provisions by 0.6 percentage points (from around 3% to just over 2%)<sup>13</sup> and that including transparency provisions in trade agreements increased trade in agricultural products by 1.6%.<sup>14</sup>

However, regulatory heterogeneity remains a significant barrier to trade. Regulations may differ across jurisdictions as a result of diverse public policy and national objectives or due to regulators from different countries pursuing the same public policy objectives with different regulatory approaches.<sup>15</sup> Technical standards set by international bodies such as the International Organization for Standardization (ISO) for payment cards (such as ISO/IEC 7816 for electronic identification cards with contacts and ISO/IEC 14443 for contactless integrated circuit cards) help to create common standards across countries, increasing transparency and lowering costs. This, in turn, can help establish a path to coordinated regulatory approaches.

The rise of GVCs has created opportunities for SMEs and developing country firms to better integrate with the global economy. They participate as important suppliers of goods and services in international supply chains. To gain the benefits of learning-by-exporting, it is preferable to be exporting multiple products to multiple markets.<sup>16</sup> This is difficult if the regulations that have to be met in each jurisdiction are very different. The burden of regulatory heterogeneity on SMEs is disproportionately high. Indeed, the International Trade Centre has shown that a 10% increase in the frequency of regulatory or procedural trade obstacles encountered decreases the export value of large firms by 1.6% and of small firms by 3.2%.<sup>17</sup>

Regulators often do not consider the trade implications of their regulations. According to the OECD, good regulatory practice (GRP), including regulatory impact analysis (RIA), faces limitations when trying to mainstream trade considerations into the analysis.<sup>18</sup> Research on the use of GRP and RIAs indicates that an important gap may exist between theory and practice when it comes to trade. Though many countries formally commit to assessing social and environmental impacts, for instance, the assessment is often inadequate and fails to feed into the policy-making process.<sup>19</sup> The key is the ability to gather relevant information. There are challenges related to identifying and measuring the trade impacts and costs of regulatory action, especially heterogeneity across trading partners. While businesses perceive regulatory differences across countries as a significant source of trade costs,<sup>20</sup> regulators need a precise and measurable understanding of these costs to balance them in the welfare-maximizing exercise. This is often quite difficult to achieve.

However, more recently, policy-makers have been focusing on the reduction of regulatory trade barriers as a priority of

foreign and economic trade policy. Research on potential gains from improving regulatory performance concludes that the savings in compliance costs can be substantial. Focusing on trade facilitation measures is a good first step. Indeed, improving performance in border administration and transport and communications halfway to global best practice could increase global GDP by an average of 5%.<sup>21</sup> In a similar vein, the potential gains from going beyond the adoption of best practice to actual convergence are considerable.<sup>22</sup> For instance, extending the EU level of regulatory convergence to trade between the EU and the US would increase real incomes by 6%<sup>23</sup> and regulatory convergence in services sectors would raise per capita GDP by some 3%.<sup>24</sup> The services trade costs associated with the average score on the regulatory heterogeneity index (0.26) amounts to an *ad valorem* equivalent trade cost of between 20% and 75%, depending on the service sector.<sup>25</sup> Estimates show that reducing this regulatory heterogeneity by 0.05 points is associated with 2.5% higher services exports and that the impact is larger the lower the level of trade-restricting regulation.<sup>26</sup>

## Multiple approaches exist for addressing regulatory heterogeneity

The degree to which policy-makers can cooperate to achieve these gains runs along a continuum. “Shallow” approaches include holding policy dialogues and improving transparency, which may involve instituting consultation procedures prior to adopting new regulations. Examining SPS provisions, for example, only 65 of the 280 plus PTAs notified to the WTO contain a transparency provision in their SPS chapters, and almost 70% of those that do have come into effect in only the past 10 years. Very few PTAs contain provisions for mutual recognition within their SPS chapters. More recent trade agreements have embedded deeper

commitments in terms of both harmonization and mutual recognition. While no legal obligation is imposed on WTO members to harmonize or recognize, there are references across WTO agreements to these efforts. Indeed, both the TBT and SPS Agreements recognize the benefits of harmonization and require, for example, that members base their technical regulations on international standards unless the latter are ineffective or inappropriate to fulfil the legitimate objective pursued.<sup>27</sup>

Economists Bernard Hoekman and Petros Mavroidis outline four degrees of international coordination on regulatory matters: competition; coherence (adoption of common principles of due process); consultation; and deeper forms of cooperation, such as mutual recognition, harmonization or acceptance of international standards in domestic regulation.<sup>28</sup> These different approaches to regulatory cooperation depend critically on the degree to which trading partners share underlying public policy goals, and the degree to which the consideration of international market performance factors into those goals.

Nowhere is a lack of a coherent, multilateral regulatory structure felt more keenly than in the context of GVCs, where this additional trade cost accumulates at various stages of the production process as parts and components cross borders multiple times. Delays and uncertainty over whether particular products or their conformity assessments will be accepted by trading partners can prove particularly costly. Conversely, regions and sectors with developed value chains often see regulatory cooperation. For instance, mutual recognition agreements, which have become more sector-specific since the late 1990s, are seen in the electronic goods and telecoms equipment sectors in East Asia.<sup>29</sup>

Table 1: Alternative types of regulatory coordination across country groups

	Global	High-Income	North-South	South-South
Competition	Baseline situation	Baseline situation	Baseline situation	Baseline situation
Coherence	Some WTO agreements: non- WTO sectoral initiatives	Core area of focus (e.g. OECD)	Elements of some PTAs; APEC	Limited to date
Consultation	Some WTO agreements: non-WTO sectoral initiatives	Frequent; networks of sectoral regulators	Elements of some PTAs; TPP	Limited to date
Cooperation	Sectoral examples: Codex Alimentarius, FSB	Examples in Some PTAs: CETA, CPTPP	Limited to date	Limited to date

Notes: FSB: Financial Stability Board; CETA: Comprehensive Economic and Trade Agreement; CPTPP: Comprehensive and Progressive Agreement for Trans-Pacific Partnership; APEC: Asia-Pacific Economic Cooperation; TPP: Trans-Pacific Partnership.

Source: Bernard Hoekman and Petros Mavroidis, “Regulatory Spillovers and the Trading System: From Coherence to Cooperation”, ICTSD and World Economic Forum, 2015.

# International regulatory cooperation (IRC) for GVCs: Synergies between trade and investment

## Trade and investment are intertwined: Implications for IRC agenda?

A key area of regulatory coherence for GVCs is the mutually dependent areas of trade and investment. This area remains critically under-examined in the literature and among policy-makers. Regulatory disparity not only affects trade flows but has important knock-on effects on FDI through the activities of MNEs involved in global production sharing. Recent research increasingly confirms the interdependency of trade and investment as complementary activities of MNEs operating GVCs. Although traditional models held trade and investment as alternative modes of entry into foreign markets, GVC research suggests that outward FDI and exports are far more often complements than substitutes.<sup>30</sup> Richard Baldwin crystallized the notion that in “21st century commerce”, where products are made across several countries and sold all over the world, there is a “trade-investment-services” nexus.<sup>31</sup> Trade and investment are still substitutionary modes for some types of firms, sectors and markets, but they are less prevalent in global production sharing strategies. An integrated IRC agenda both for the trade and investment activities of MNEs can therefore help create a more uniform regulatory backbone for the expansion of GVCs.

Most normative frameworks for investment, including the OECD Policy Framework for Investment, recognize the role of good regulatory governance as an underpinning of a sound investment environment.<sup>32</sup> As investment is a behind-the-border transaction, the weight of domestic regulatory barriers is arguably greater, spanning competition, employment and administrative regulations. A key challenge is that many of the barriers that affect foreign investors are non-discriminatory in nature, that is, they are domestic regulations that apply *de jure* to both foreign-owned and domestic enterprises operating in the market. Yet, they often add more hurdles to foreign providers, and can therefore have a *de facto* discriminatory impact. For example, licensing procedures, while often applying both to domestic and foreign operators, can have a deterrent impact on foreign investors due to asymmetries in information and language, with cultural barriers and the absence of equivalent criteria when the exact requirements are difficult for a foreign operator to meet. In addition, investment in production facilities is a long-term activity with higher sunk costs than trade, often entailing several years of search costs before the investment is made. Whereas an export or import activity can be discontinued in the short term, it is harder to reverse such an investment decision. This implies that the regulatory consistency over time is important for investment, in addition to the regulatory coherence across countries.

As in the case of trade policy, traditional barriers to investment such as foreign equity restraints have been widely liberalized in many sectors and countries. This is

largely the case for manufacturing, while limitations remain in the primary and a number of services sectors, such as transport and energy. Though many more sectors are open to capital, other measures, such as regulatory approval mechanisms and licensing procedures, can deter FDI flows and impair the benefits from liberalization. Hence, there is a need to pay greater attention to identifying and monitoring non-equity measures for FDI, akin to NTMs for trade. It is also necessary to balance the welfare benefits from new measures against possible efficiency losses. The 18th OECD-WTO-UNCTAD report on G20 trade and investment measures highlights that the scope of transactions seen to impair national security is widening.<sup>33</sup> While legitimate when confined to genuine national security concerns, these policies should not be used as disguised restrictions to international investment.<sup>34</sup> It is important to invigorate an IRC agenda that can bring down the costs of unnecessary regulatory procedures, while at the same time ensuring the ability of governments to regulate for legitimate public policy objectives.

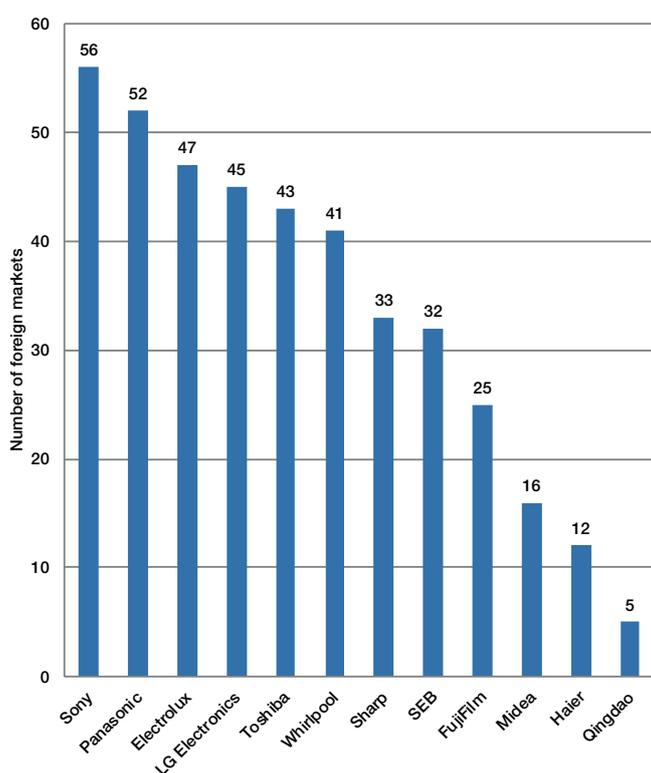
## Regulatory heterogeneity affects the operation of global factories

There is no denying that investment is sensitive to differences in regulations across countries. MNEs engaged in GVCs locate different parts of the production process in different countries, through direct investment in foreign affiliates abroad. The level of regulatory coherence or compatibility across markets where they establish their “world factories” affects their overall operating costs. Given that investment requires market presence in a foreign country – physical and legal – the consistency and predictability of domestic regulations is critical. In addition, MNEs involved in GVCs need to source inputs for production from multiple countries and typically sell intermediate or final goods to a wide array of countries. For this reason, non-tariff measures on trade also affect FDI.

A recent OECD firm-level analysis encompassing 147 multinationals across 13 sectors sheds light on how firms combine trade with FDI, as well as a range of strategic partnerships.<sup>35,36</sup> The study maps the great extent to which the supply relationships of MNEs span across multiple countries and regions. In the electronics sector, for example, key players in the sector – 12 MNEs representing 55% of the market share – have market access and/or market presence in 5 to 56 countries (see Figure 2). This market presence comprises direct investment (ownership of equity shares in foreign affiliates), as well as non-equity modes (contract-based control of foreign firms, such as contract manufacturing, licensing, research collaboration). Moreover, the study shows across all sectors in the sample that MNEs tend to have FDI links in a greater number of countries than trade links, so the geographical dispersion of FDI appears to be greater than for trade.

Notwithstanding, the same OECD study shows that the FDI operations of MNEs remain largely concentrated among OECD countries, whereas their trade partners span a more diversified group, including developing countries. This may be partly explained by the higher institutional and regulatory predictability and coherence required for long-term investment activities. OECD concentration is even higher for strategic partnerships than for FDI. Strategic partnerships are generally associated with sectors where innovation, flexibility and speed are important, such as pharmaceuticals and the digital economy (internet services, information and communications technology). Research has shown that the greater the sophistication of the production process and the reliance on complex contracts involving intangible assets, the greater the need for sound institutional and regulatory mechanisms.<sup>37</sup> Hence, IRC efforts can be particularly important for enabling the expansion of high-technology, knowledge-oriented activities that are subject to higher regulatory complexity.

Figure 2: Number of countries in which MNEs operate in the electronics sector (55% of market share)



Note: The market share is based on the revenues provided by companies and reported by FactSet Supply Chain Relationships. Given that FactSet only includes listed companies, this market share could be overestimated.

Source: OECD, based on FactSet Supply Chain data.

## Expanding IRC efforts to investment: Regional and multilateral opportunities

While it is evident that trade and investment go hand-in-hand in business, they are not always conjoined in policy. Unfortunately, the interactions between the trade and investment policy community have generally been sparse. This is also true for most regulatory cooperation initiatives, which tend to address goods, services and investment in separate realms. Until now, most advances in IRC have been on trade in goods, with more limited strides on services, confined to a few sectors such as telecommunications and financial services. Multilateral provisions on regulatory procedures under the General Agreement on Trade in Services (GATS) have remained weaker than corresponding provisions on NTMs in goods, such as those provided under the TBT and SPS Agreements. As an example, in contrast to TBT and SPS disciplines, the opportunity for comment is not mandatory across services and is only provided for in a best-endeavour form for the consultancy sector under the Disciplines on Domestic Regulation in the Accountancy Sector.<sup>38</sup> Given that services are often delivered through the establishment of a commercial presence abroad, they have a strong link with FDI. IRC for investment operations has hardly been entertained as such, although issues such as balancing the right to regulate with investor protection, among other regulatory concerns, are prevalent. Overall, this pattern of progress of IRC discussions – notably in PTAs – mirrors the WTO, where regulatory provisions under the GATS or the Agreement on Trade-Related Investment Measures (TRIMS) are considerably less developed than in the GATT.

Yet, new developments open a window of opportunity to bridge the gap and create greater synergies between regulatory cooperation efforts covering trade and FDI, both at the regional and multilateral level. One of the positive advances is that investment is increasingly included in PTAs that contain transversal disciplines on regulatory cooperation and transparency. Over 70% of 21st-century PTAs contain comprehensive coverage of investment, in stark contrast with less than 30% of PTAs signed prior to the launch of the Doha Development Round of trade negotiations in 2001. Moreover, 9 out of 10 PTAs with coverage of investment since 2001 involve at least one non-OECD party, reflecting the growing interest in investment from emerging economies that have become exporters of capital. This has created a complementary instrument to bilateral investment treaties (BITs), which have traditionally dealt with a narrower set of investment measures, primarily focusing on investment protection. Moreover, a novel element that has emerged in recent years is that some countries are introducing more detailed investment facilitation measures in BITs, Brazil's Cooperation and Investment Facilitation Agreements being notable examples. Still, the scope of regulatory disciplines covering investment is wider in PTAs, with much greater attention to market access, where restrictive regulatory measures are addressed. Moreover, the treatment of investment in PTAs interacts with relevant regulatory domains, such as competition and state-owned enterprises, or intellectual property rights, providing the opportunity for a

coherent “bundle” of relevant regulatory measures. Finally, the regulatory transparency and regulatory coherence chapters in PTAs are transversal to trade, services and investment, unlike in the WTO framework. This provides a platform for thinking about the effectiveness of these provisions in contributing to greater regulatory predictability and compatibility across the various modes of international business operations.<sup>39</sup>

Beyond regional and bilateral fora, international initiatives on investment have placed a strong accent on the importance of efforts related to IRC. The G20 Guiding Principles for Global Investment Policymaking, which were adopted in 2016,<sup>40</sup> include several principles explicitly referring to the promotion of transparency and coherence in policies, both at the national and international levels. For example, principle IV states that “regulation relating to investment should be developed in a transparent manner with the opportunity for all stakeholders to participate, and embedded in an institutional framework based on the rule of law”. In this context, principle VI reaffirms governments’ “right to regulate investment for legitimate public policy purposes”. Other principles refer to the importance of predictable conditions and the coherence of policies at the national and international levels. It should be noted that these principles are non-binding and, therefore, only constitute a reference for national and international investment policy-making. Yet, extensive references to facilitating good regulatory procedures for investment policy-making reveal the desirability of cooperation in this area.

At the multilateral level, recent efforts to advance cooperation on investment issues at the WTO have largely focused on regulatory transparency and related issues. One of the outcomes of the 11th WTO Ministerial Conference, held in Buenos Aires in 2017, was a Joint Ministerial Statement on Investment Facilitation for Development – co-sponsored by 70 WTO members – which calls for structured discussions with the aim of developing a multilateral framework on investment facilitation. In this initiative, members explicitly recognize the dynamic links between investment, trade and development in today’s global economy. The initiative is centred on the following key pillars: “improve the transparency and predictability of investment measures; streamline and speed up administrative procedures and requirements; and enhance international cooperation, information sharing, the exchange of best practices, and relations with relevant stakeholders”.<sup>41</sup>

Of course, the exact contours of the WTO initiative are still being shaped, and it is premature to discuss specific measures that countries might address. Yet, the overlaps and synergies with broader IRC efforts are clear. There is broad consensus on the need to improve regulatory transparency and predictability, where many lessons can be drawn and applied from trade, while possibly leveraging existing institutional mechanisms. Consideration has also been given to streamlining and accelerating approval procedures, such as licensing and qualifications. This has a similar genesis to resolving information asymmetries

in quality standards for trade. Finally, discussions have brought attention to the need to establish mechanisms for exchanges among competent authorities on investment regulations and procedures that pose unnecessary burdens for investors. Here, too, valuable lessons and synergies can be exploited between trade and investment efforts. After all, most regulations pose burdens both for “traders” and “investors,” i.e. for businesses conducting interdependent export, import and FDI activities in the context of GVCs.

A key challenge in the IRC agenda at the regional level is that some regions, including Sub-Saharan Africa, the Middle East and North Africa and South Asia are not forming part of these PTAs that include comprehensive disciplines on regulatory transparency and coherence. Similarly, the G20 discussions involve a limited number of emerging economies. Given that these are important future markets for investment and participants in GVCs, their engagement in IRC efforts would be desirable. Technical assistance and capacity development have an important role to play in this regard. On the other hand, the WTO’s Investment Facilitation for Development initiative does include a considerable number of developing and least-developed countries from all regions. Hence, the WTO initiative provides a good pathway to advance IRC in a manner that is inclusive and calibrated to the capacities and concerns of developing countries.

# Conclusion

The increasingly complex environment of international commerce should convince policy-makers and regulatory authorities of the necessity for a solid foundation for more advanced regulatory governance initiatives, such as increasing international regulatory cooperation in trade and investment. In particular, the need to stabilize the evidence base that supports policy decisions and establish its credibility is urgent. The focus of regulatory policy must be on outcomes rather than process and on the effectiveness of laws and regulations and their expected achievements rather than on burden reduction and cost saving. However, that is not the case and evidence shows that the approaches of process and cost-cutting remain at the fore of regulatory policy development.<sup>42</sup> Regulatory *cooperation*, on the other hand, is all about process: the explicit consideration of the international marketplace in the development and implementation of domestic regulation.

As highlighted in the work of the OECD Regulatory Policy Committee, implementation and enforcement remain the weakest links in the application of regulatory policy, while stakeholder engagement (systematic and consistent feedback from citizens and businesses) in the design of regulations is limited. More meaningful engagement, greater transparency and better communication are needed to ensure that citizens and businesses feel included in the policy-making process. This increases the acceptance of regulatory decisions and ultimately bolsters trust in government.<sup>43</sup>

The internationalization of regulation has not kept pace with globalization and technological advancements. An overview of OECD countries' IRC practices shows that the mainstreaming of IRC in rule-making is only partial and, so far, relatively superficial.<sup>44</sup> To achieve the benefits and cost reductions of international regulatory cooperation, a more consistent approach must imperatively be adopted. In addition, the sharper links between trade and investment that have emerged in international production networks call for more comprehensive approaches to IRC, in order to provide the necessary regulatory backbone for the expansion of GVCs.

Good domestic regulation is necessary to address market imperfections and spillovers. It must take into consideration the unique circumstances and environment of each national entity, and countries need the policy space to ensure their domestic regulation is appropriate. Indeed, governments and populations of major economies have shown a preference for national regulatory autonomy, although it must be balanced with greater coherence and cooperation. An optimal level of coherence exists, taking into account the context. A holistic approach to international regulatory development provides a framework in which these different needs can be appropriately balanced.

# Endnotes

1. Trade agreements have been referred to, often interchangeably, as free trade agreements, regional trade agreements and preferential trade agreements. The term “preferential trade agreements” (PTAs) is used in this text but refers to all trade agreements outside the WTO.
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