

Please cite this paper as:

Czaga, P. (2004-12-15), "Regulatory Reform and Market Openness: Understanding the Links to Enhance Economic Performance", *OECD Trade Policy Papers*, No. 9, OECD Publishing, Paris.
<http://dx.doi.org/10.1787/315070506641>



OECD Trade Policy Papers No. 9

Regulatory Reform and Market Openness

UNDERSTANDING THE LINKS TO ENHANCE
ECONOMIC PERFORMANCE

Peter Czaga

Unclassified

TD/TC/WP(2004)10/FINAL



Organisation de Coopération et de Développement Economiques
Organisation for Economic Co-operation and Development

15-Dec-2004

English - Or. English

**TRADE DIRECTORATE
TRADE COMMITTEE**

**TD/TC/WP(2004)10/FINAL
Unclassified**

Working Party of the Trade Committee

**REGULATORY REFORM AND MARKET OPENNESS: UNDERSTANDING
THE LINKS TO ENHANCE ECONOMIC PERFORMANCE**

OECD Trade Policy Working Paper No. 9

by Peter Czaga

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JT00176034

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ABSTRACT

This study has been prepared by Peter Czaga of the Trade Directorate in consultation with Anthony Kleitz. Charles Tsai made important contributions to the part on regional and bilateral agreements and initiatives. The study has been discussed in the Working Party of the Trade Committee which has agreed to make these findings more widely available through its declassification under the responsibility of the Secretary General. It is available on the OECD website in English and French at the following address: <http://www.oecd.org/trade>

Keywords: market openness, regulatory reform, domestic regulation, regionalism

ACKNOWLEDGEMENTS

This study examines the interconnections between domestic regulatory reform and market openness by drawing on OECD's earlier work on the regulatory aspects of trade. Part 1 considers how domestic regulations and regulatory reform affect market openness. It shows how with the help of advanced regulatory reform tools and approaches governments can create regulations and regulatory procedures that efficiently meet their policy objectives while at the same time supporting market access. Part 2 demonstrates that international market opening can contribute to facilitating domestic regulatory reform. Trade agreements signed on the multilateral, regional and bilateral levels can promote general principles or specific elements of good regulation and help guide or drive countries' individual regulatory reform efforts. Finally, part 3 analyzes the mutual benefits of regulatory reform and an open multilateral system for trade and investment. It is argued that by increasing domestic economic efficiency, raising the international competitiveness of domestic enterprises and reducing barriers to trade and investment, trade-related regulatory reform enables countries to take better advantage of trade liberalization and of open global markets.

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**REGULATORY REFORM AND MARKET OPENNESS:
UNDERSTANDING THE LINKS TO ENHANCE ECONOMIC PERFORMANCE**

Executive Summary

Drawing on OECD's earlier work on the regulatory aspects of trade, the present paper aims to summarize what has been learned through analysis, discussions and national experience in this area. An effort is made to expand the scope to suggest relevance beyond the OECD area by evoking certain regional experiences. The paper is also a contribution to ongoing reflections on an integrated checklist for the APEC-OECD Co-operative Initiative on Regulatory Reform.

With the expansion of economic globalisation and the fall of traditional barriers to trade, the interconnectedness of market openness and domestic regulatory reform issues is becoming increasingly important. This interconnectedness implies, on the one hand, that regulatory reform can play a strong role in ensuring that liberalized conditions for trade and investment bring the expected benefits in trade and economic performance; and on the other hand, that trade and investment liberalisation can be an important factor in successful regulatory reform.

Given the substantial effects of domestic regulations on the openness of economies, it is important that domestic regulatory reform efforts take the market openness perspective into consideration. Regulatory reform is a tool in the hands of governments to enhance market openness through the improvement of existing regulations and the creation of new regulations that are non-discriminatory and efficient. It can help to reduce burdens on the functioning of enterprises including in their trading activities, thereby increasing the flows of trade and investment. With the help of advanced regulatory reform tools and approaches - such as regulatory impact analysis, administrative simplification, consultation procedures, and international harmonization - governments can create regulations and regulatory procedures that efficiently meet their policy objectives but at the same time are supportive of market access.

On the other hand, international market opening can contribute to facilitating domestic regulatory reform. Trade agreements signed at the multilateral or regional levels can promote general principles or specific elements of good regulation and help guide or drive countries' individual regulatory reform efforts. Regional and bilateral trade and economic initiatives use a wide variety of tools to facilitate regulatory reform, such as binding and non-binding principles, technical assistance and capacity building. The incorporation of regulatory issues into international agreements faces important challenges, such as how not to impede into national regulatory sovereignty and how to ensure appropriate domestic capacities for regulatory reform.

Concerning its benefits, empirical analysis suggests that regulatory reform, when well designed and implemented, contributes to an economic environment that improves the efficiency of the domestic economy while increasing the flow of international trade and investment. These benefits suggest that countries that progress simultaneously with market opening and regulatory reform policies are better placed to take advantage of the benefits of trade liberalization.

Introduction

1. The Secretariat's proposal for this paper was agreed by the TCWP at its meeting in October 2003 (see document TD/TC/WP(2003)30, part A). In December 2003, the Working Party discussed a scoping paper *Regulatory reform and market openness: Understanding the links. A scoping paper [TD/TC/WP(2003)38]*, which provided details on the intended purpose, methodology and content of this paper. The Working party agreed to the further development of the proposed paper.

2. The present paper draws heavily on OECD's earlier work on the regulatory aspects of trade. As part of its multidisciplinary Regulatory Reform Program, the OECD undertook a major report on regulatory reform that was presented to Ministers and published in 1997 (*The OECD Report on Regulatory Reform*, 1997). Since then the OECD has reviewed regulatory reform in 20 Member countries, including trade relevant regulatory practices. The Trade Committee has also undertaken the synthesis analysis (*Integrating Market Openness into the Regulatory Process: Emerging Patterns in OECD Countries*, TD/TC/WP(2002)25/FINAL) that takes stock of emerging patterns in trade-relevant best regulatory practices gained from the country reviews conducted so far. This current paper provides a concise and easy-to-understand summary of what has been already learned through previous work in this area, expanding the scope somewhat to suggest relevance beyond the OECD area. It is also a contribution to the ongoing work on an integrated checklist for the APEC-OECD Co-operative Initiative on Regulatory Reform.

3. In recent years several trends have reinforced the link between domestic regulatory policies and market openness:

- *First*, with increased global flows of trade and investment, domestic regulations that are in place in one country influence economic activities internationally.
- *Second*, as customs tariffs have fallen through trade liberalization, national regulations are often left as the biggest impediment to market access. In parallel, some countries also see domestic regulations as new means of protectionism and sometimes replace tariffs with unnecessary or burdensome domestic regulations that limit market access.
- *Third*, while most developed countries are characterised by a fair degree of economic regulation, in many of these countries the stock of social regulations is rising as governments are under pressure to regulate especially in the areas of health, safety and environment to safeguard specific concerns of citizens and enterprises. At the same time, developing countries in general have a less developed social regulatory net, but still many layers of inefficient economic regulation.

4. Given these developments, there is a growing need for policy makers to understand and pay greater attention to the complementarities and the interconnectedness of domestic regulatory reform and market openness. This interconnectedness concerns:

- on the one hand, the importance of regulatory reform for ensuring that liberalised conditions for trade and investment bring the expected benefits in trade and economic performance;
- and on the other hand, the complementary role that trade and investment liberalisation play in supporting successful regulatory reform.

5. By examining concisely the experience in OECD and in some non-OECD countries from both perspectives, the present analysis aims to raise awareness of the interconnectedness of domestic regulatory reform and market openness and the importance of taking this into account in the policy-making process. Section 1 of the paper will consider how domestic regulations affect market openness and in particular – on the basis of experience in OECD countries -- how certain promising regulatory practices can help ensure that domestic regulations positively contribute to market openness. The purpose of this part is to provide evidence why regulatory reform, which aims at the improvement of regulatory quality and methods, is an essential approach to raise the level of market openness. Following this, Section 2 will consider how market opening policies agreed on the international level can play a complementary role in facilitating domestic regulatory reform. Examples will be provided of ways in which international trade agreements, on the multilateral, regional and bilateral levels, prescribe and support regulatory change and also of the challenges encountered in this process. Finally, Section 3 will analyze and illustrate the mutual benefits of regulatory reform and an open multilateral system for trade and investment. Drawing on empirical analysis, it will be argued that by increasing domestic economic efficiency, raising the international competitiveness of domestic enterprises and reducing barriers to trade and investment, trade-related regulatory reform enables countries to take better advantage of trade liberalization and of open global markets. It must also be noted that the effect of market openness on regulatory objectives other than strengthened competition and economic performance is beyond the scope of the present analysis.

6. The paper points clearly to the importance of closer contact and co-ordination between trade officials and regulators. It aims to facilitate the dialogue between these policy communities by setting out clearly the stakes and useful tools for ensuring greater coherence between regulatory and trade policies. Trade and regulatory officials will also be able to use the arguments presented in the paper in their dialogue with the business sector and civil society about trade and regulatory policy issues of concern. Recognizing national differences in legislative and political systems, as well as in cultural and historical backgrounds, the paper intends to avoid advocating particular solutions but rather aims to enhance awareness of the links between regulatory and trade issues.

Box 1. What are Regulation, Regulatory Reform and Market Openness?

Regulatory measures are understood as the diverse set of instruments by which governments set requirements on enterprises and citizens. Regulations include all laws, formal and informal orders, subordinate rules, administrative formalities and rules issued by non-governmental or self-regulatory bodies to which governments have delegated regulatory powers.

Regulatory reform concerns changes to improve regulatory quality, that is, to enhance the performance, the cost effectiveness or the legal quality of regulations; or to improve processes for making regulations and managing reform.

Market openness policies aim to ensure that a country can reap the benefits of globalisation and international competition by eliminating or minimising the distorting effects of border as well as behind-the-border regulations and practices. These policies influence the range of opportunities open to foreign suppliers of goods and services to compete with domestic counterparts in a particular national market (e.g. through trade and investment).

1. How are domestic regulations important for international market openness?

7. Domestic regulations play an important role in influencing the level of market openness as they can facilitate or restrict the free flow of goods and services and of investment. The non-discriminatory nature of regulations and regulatory efficiency are important determinants of market openness.

8. Non-discriminatory and efficient regulations contribute to the creation of a level playing field and an efficient business environment for enterprises and, therefore, facilitate the flow of international trade and investment. First, non-discriminatory regulations ensure formally equal treatment and opportunities for all enterprises to enter and compete with each other in a given market. Second, regulatory efficiency ensures the extent to which these enterprises can gain and maintain access to different markets. Effective regulations often share several features and characteristics: they are able to secure their main objectives efficiently, and, at the same time, impose the minimum burdens on economic activity and the least possible negative effects on the achievements of other policy objectives. Firms are more likely to enter and succeed in new markets with good regulatory environment. Efficient regulations bring benefits for enterprises, whether they are foreign or domestic, by creating conditions for easy access to new markets and help to maintain profitable economic activities by keeping regulatory costs low and providing a secure and efficient business environment.

9. At the same time regulations can have a restrictive effect on market openness when they are discriminatory or inefficient. Openly discriminatory regulations restrict access to markets either by directly prohibiting the entry of certain firms or the practice of certain activities, or by indirectly placing additional burdens on selected enterprises. Such regulations entail additional costs that create a competitive disadvantage vis-à-vis other firms. In addition, regulations that place unnecessary burdens and therefore extra costs on market participants negatively affect economic performance. Enterprises find it difficult to sustain a profitable business activity on poorly regulated markets. By creating high risks and costs and low returns on business investment or commercial presence, such environment discourages the economic activities of foreign and domestic enterprises alike and has a negative effect on international trade and investment.

10. The restrictive effect of domestic regulations on market openness can be intentional or unintentional. On the one hand, discriminatory regulations can be adopted explicitly for the purpose of creating effective trade barriers and can be consciously designed as a means to protect domestic actors from international competition. On the other hand, inefficient regulations usually create an indirect and unintentional trade barrier, more as a by-product of the failure to give due consideration to alternative, but effective, approaches.

11. It is important to underline that the efficiency of regulations affects not only market access but also the performance of the domestic economy as a whole. Regulations can either place restrictions or facilitate the functioning of all enterprises whether the latter are foreign or domestic. Lengthy and unpredictable administrative procedures, extensive red tape, gaps in regulation, complex and contradictory technical regulations that are difficult to comply with, and unpredictable judicial enforcement represent burdens on the activity of any enterprise, let it be foreign or domestic.

12. Regulatory reform is a tool in the hand of governments to enhance market openness through the improvement of existing regulations and the creation of new regulations that are non-discriminatory and efficient. Reform should be considered for the improvement of regulatory institutions and methods that are used to produce, review and implement regulations. Regulatory reform can help to reduce burdens on the functioning of enterprises including their trading activities, and in this way it can contribute to better economic performance and to the increase of the flows of trade and investment. From a trade perspective a specifically important aim of regulatory reform is to create regulations that achieve regulatory objectives in ways that are no more trade-restrictive than necessary. It is important that regulatory solutions adopted serve to achieve regulatory objectives while minimizing the barriers to trade and investment.

13. The rest of this section will review the benefits of market openness arising from “high quality” regulatory reform, characterized by adherence to six principles of efficient regulation for market openness. This analysis draws on recent experience in OECD countries and elsewhere.

Transparency and openness of regulatory decision-making

14. The transparency and openness of regulatory decision-making is a fundamental factor facilitating participation in a market. Three particular aspects can be identified: 1) access to information about regulations; 2) the openness of the rule-making process to stakeholders through public consultations; and 3) effective access to appeals procedures.

15. Transparency in its most basic form means easy and open access to information. Every firm operating in the market, should have information about regulations, procedures, and other measures that affect its interests and indicate the conditions, constraints and risks that firms will encounter on the market. Having all this information reduces uncertainties over applicable requirements, helps companies to better foresee the costs and returns of their trading activities and investments and thereby facilitates access to markets.

16. Access to information is critical for any enterprise, domestic and foreign, operating in the market. It is particularly relevant for foreign firms and new market entrants as being unfamiliar with the given regulatory, but also economic, political, social and cultural environment, these firms might have to overcome extra difficulties to obtain crucial information regarding the actual functioning of regulations.

17. A second fundamental aspect of transparency refers to the openness of the regulation-making process: in particular the opportunity provided for all stakeholders to participate in formal or informal consultations. Consultations and the equality of access to them have important effects on the quality and enforceability of regulations in general, on the efficiency of economic activities and on the level of market openness.

18. First, consultations that lack transparency and are not open for all stakeholders create opportunities for specialised interests to capture the regulatory process. For example, regulatory consultations held only with selected enterprises runs the risk of putting forward regulatory measures that favour specific interest, disadvantage others and restrict competition. Regulations that are biased towards certain interests not only restrict market openness but also create economic inefficiencies or weaken societal objectives (environmental, health and safety, consumer protection, social cohesion, etc.). A further disadvantage of discriminatory consultations is that they deprive regulatory authorities from the expertise of the regulated entities. The consideration of the views of all market participants allows regulatory authorities to benefit from the experience of different actors that in turn can help to avoid regulatory inefficiencies and to create regulations that are the least restrictive of market access. The participation of foreign parties may also assist in disseminating international best practices and provide early warning of any trade dispute that may arise as a consequence of the regulation. The use of the regulatory expertise of enterprises might be especially important for developing countries that often lack administrative or technical capacity to design efficient regulations. Finally, another important benefit of open and transparent consultations is that they provide time and flexibility for firms to adjust to potential changes in regulation and this in turn helps to increase compliance rate or reduce compliance costs. These opportunities reduce uncertainty and therefore help companies to stay competitive in and also to enter different markets.

19. A third important aspect of transparency is the openness of appeal procedures. Market participants who have concerns about the application of existing regulations find it important to have appropriate access to appeal procedures. Regulations are better accepted and work more efficiently if both domestic and foreign economic actors have access to remedies when they are confronted with overly burdensome or unclear regulatory requirements or unsatisfactory results. These remedies can be included in formal legislation, or they might be part of effective informal channels for lodging and advancing complaints that are open to domestic and foreign parties. In either case there should be clearly defined time limits for appeals processes, and adequate explanations, for example when requests are denied.

Box 2. Regulatory transparency in OECD countries

United States - The basic rulemaking process to be followed by all agencies of the US Government is set out in the Administrative Procedures Act (APA). The APA sets a high standard of transparency and opportunity for comment by any interested parties - national or non-national. Foreign traders and investors are thus well positioned to participate actively at various stages of the rulemaking processes. At a minimum, the APA requires that in issuing a substantive rule an agency must 1) publish a notice of proposed rulemaking in the Federal Register, 2) provide all interested persons - nationals and non-nationals alike - an opportunity to participate in the rulemaking by providing written data, views, or arguments on a proposed rule, and 3) publish a notice of final rulemaking at least 30 days before the effective date of the rule.

Mexico - Prior consultation occurs at two stages; an initial consultation to determine general views prior to the development of proposals, followed by consultations on a more detailed draft of a proposed measure. At the initial stage, ministries are expected to consult with strongly affected parties prior to the drafting of new regulation. The consultation also includes communication with foreign firms, for example, through foreign trade associations, to ensure non-discrimination. The Administrative Procedure Law requires pre-announcement of measures, including enactment, amendment or abolition of legislative measures and subordinate measures. Except in cases of urgency or damage to the public interest, the regulatory authorities shall preannounce the draft measures and grant requests to view the full text of proposed measure. The length of pre-announcement periods must be a minimum of 20 days.

Non-discrimination

20. Domestic regulations affect market openness in the most direct way when they are explicitly or implicitly biased against goods and services of certain domestic or foreign origins. In such cases regulations reduce market access by restricting these products and services to enter and compete with other products. Such discrimination is generally inefficient because in this case product characteristics are associated with their source instead of their quality or price. In contrast, regulations that are non-discriminatory provide for a better equality of competitive opportunities between like products and services irrespective of their origin, and therefore increase market access.

21. The principle of non-discrimination involves both national treatment (i.e. equivalent treatment to national as well as foreign suppliers) and most favoured nation (MFN) treatment (i.e. no difference in treatment among foreign producers). In most countries commitment to these principles flows from WTO membership, so that respect for both is broadly ensured through adherence to international trade obligations. For this reason, explicit references to discrimination in national legislation are relatively rare among OECD countries.

22. Rules and regulations governing foreign investment are often areas where countries maintain some nationality-based restrictions. This typically happens in the form of foreign ownership limitations or through the use of special and burdensome notification and review provisions that intend to put foreign investment under heavy scrutiny. These restrictions are most commonly observed in certain key sectors such as telecommunications services, financial services, air transport, and the so-called cultural industries (e.g. broadcasting, book publishing and distribution, and film distribution).

23. In recent times, in many countries restrictions on foreign investment have given way to more liberal policies seeking to attract investment. Many countries tend to compete for investment through the use of investment incentive and related attraction schemes. In certain cases regulatory approaches may actually reflect “reverse” discrimination, whereby foreign parties enjoy additional advantages over

domestic firms. However, such policies often generate negative effects as they present large budgetary burdens and create artificial gaps in profitability between domestic and foreign firms.

Avoidance of unnecessary restrictiveness for trade and investment

24. Even when regulations are applied in a non-discriminatory manner, market openness can still deviate from its optimal level if regulatory measures are more restrictive for trade and investment than is necessary for the achievement of intended policy goals. In these cases the objectives, design or implementation of regulations may be set in a way that creates unjustified difficulties to the free flow of goods, services or investment. These negative effects originate from poor regulatory quality and often from the lack of assessment of the impacts of regulations on market openness. Unnecessary restrictions on trade may be reduced if regulators examine the trade effects of proposed and existing regulations and give preference to regulatory measures and solutions that lead to the achievement of economic and societal objectives but at the same time create the least disturbance for the flow of trade and investment.

25. Governments most commonly employ the following tools and mechanisms to ensure that regulations effectively avoid unnecessary trade restrictiveness:

26. *Use of performance based regulations and consideration of regulatory alternatives* - Enterprises generally find it easier and less costly to comply with regulations that specify product requirements in terms of performance rather than design or descriptive characteristics. Such regulation is based on an underlying recognition that enterprises should have the flexibility to meet a regulatory objective in any way that achieves the desired outcome without being told exactly how they have to do it. In this way, enterprises have incentives to develop efficient design standards including ones that may be applicable across different markets. This arrangement contributes to innovation and improved efficiency and can reduce unnecessary high costs originating from divergent regulatory requirements in different countries. Similarly, different regulatory and non-regulatory alternatives, (e.g. self-regulation) when used and implemented with careful consideration, can also help keep compliance costs low for business engaged in international, as well as, in domestic activities and therefore can facilitate competitiveness and market openness.

27. *Regulatory impact analyses (RIA)* - RIA is a systematic process of identification and quantification of important benefits and costs likely to flow from the adoption of a proposed regulation or a non-regulatory policy option under consideration. It may be based on benefit/cost analysis, cost effectiveness analysis, business impact analysis etc. RIA can also be used as a tool to examine some of the impacts of regulations on market openness- which can be an additional consideration when assessing the overall cost and benefits of the proposed regulatory measure - and therefore to minimise the trade restrictiveness of the regulations. RIA could provide policy makers with additional information that enables them to choose among the array of equally efficient regulatory alternatives available for attaining a particular regulatory objective the one that causes the least distortions to trade.¹

¹ For more on RIAs see OECD, *Regulatory Impact Analyses: Best Practices in OECD Countries*, Paris, 1997.

Box 3. Measures to reduce unnecessary trade restrictiveness in OECD countries

Canada - The requirement to prepare a Regulatory Impact Analysis Statement (RIAS) was first introduced as part of the federal government's 1986 Regulatory Reform Strategy, making Canada one of the world's most experienced practitioners of regulatory impact analysis. The Federal Regulatory Policy requires all federal regulatory authorities to prepare a RIAS for each proposed regulation using uniform, government-wide criteria. Guidance for RIA writers states that impact assessment should clearly assess "impacts that may affect a region, business and trade, and competitiveness" and that quantitative measures are "desirable" for assessing direct and indirect economic impacts, such as on employment, operating costs, international trade, global competitiveness, and distribution of income. Additional guidance on cost-benefit analysis requires that regulations minimize impediments to Canada's competitiveness. To reach this determination, regulators are encouraged to consider whether the regulatory proposal would affect imported and domestically produced goods or services in the same manner or degree and whether the proposal would discourage foreign firms or individuals from investing in Canada.

United Kingdom – The UK places a special emphasize on reducing administrative burdens on small and medium-sized enterprises. Formalities for setting up a new firm are very light, and since 1979 no prior authorisation to invest in the UK is needed. The UK also has a specific government body, the Small Business Service (SBS) with a mandate to assist small businesses. The main objectives of the SBS are to provide a strong voice for small firms within government, and to simplify and improve the quality and coherence of support to small firms. It also helps small firms deal with regulation and ensure that small firms' interests are properly considered in the making and implementation of regulations.

United States – With an aim to minimise administrative burdens, the government offers legal protection to citizens if agencies attempt to enforce unnecessary paperwork requirements on them. The Paperwork Reduction Act (PRA) requires federal agencies to request the approval of the Office of Management and Budget (OMB) before collecting information from the public. The PRA, through a combination of OMB review, self-enforcing sanctions, and government wide reduction targets, seeks to minimize the amount of paperwork the public is required to complete for federal agencies. At the same time, however, the PRA also recognizes that good information is essential to agencies' ability to successfully serve the public. To that end, the PRA gives OMB the responsibility to evaluate the agency's information collection request by weighing the practical utility of the information to the agency with the burden it imposes on the public.

28. *Administrative simplification* - The simplification initiatives that aim to reduce administrative burdens on enterprises are also important ways for governments to minimise the trade restrictiveness of regulations. Too much red tape is one of the most common complaints from businesses, as filling out forms, asking for permits and licences are often extremely complex and cumbersome activities, which often result in delays, uncertainties and high costs for business. Even when international players in principle encounter the same administrative requirements as domestic players, the administrative burden deriving from it can be higher in their case. Firms that operate in a variety of markets will find it more difficult and costly to collect information, understand and comply with administrative requirements that differ from country to country. Strategies to make administrative regulations simpler and less burdensome to comply with, such as one-stop shops, simplification of license and permits procedures, time limits for decision-making, and the use of IT-driven mechanisms can all contribute to efforts to reduce the restrictions on the flow of trade and investment.²

² For more on administrative simplification practices see OECD (2003) *From Red Tape to Smart Tape – Administrative Simplification in OECD Countries*, OECD, Paris.

29. *Trade facilitation* - The simplification and harmonisation of international trade procedures offers another important tool for governments to minimise unnecessary trade restrictiveness. Procedures relating to customs clearance can often impose significant delays and costs on traders. Regulatory reform covering this area intends to reconcile the efficient pursuit of different social and economic objectives (such as revenue collection, health and safety protection and prevention of illegal practices) with a simplified way of doing business, streamlining documentary requirements and accelerating product clearance.³

Use of internationally harmonized measures

30. Domestic regulatory frameworks generally reflect individual national characteristics and policy objectives that often result in different regulatory arrangements. Enterprises that operate in more than one country have to face the challenge to adjust to and bear the extra costs of meeting these distinct national requirements. Regulatory diversity in most cases is justified by the different choices in preferences and objectives that countries make. However, unnecessary costs originating from regulatory diversity can appear when the chosen regulatory solutions do not serve any clear public interest, or when they are consciously designed in a particular way in order to fit the strengths and peculiarities of the domestic industry.

31. Unnecessary costs associated with regulatory diversity can be reduced by favouring the use of internationally harmonized measures. Typically such measures include the use of international standards as the basis of domestic regulations and the acceptance of regulatory measures of another country as equivalent to domestic measures. By adopting and harmonising with international standards when appropriate, economies are able to achieve regulatory goals while minimising unwanted impediments to international trade. These approaches can increase the similarity of regulatory environments and thus can facilitate the access and presence of firms across international markets. The positive benefits will apply to domestic firms as well by helping their international trade activities. Firms will find it easier to export products and services or to make investments in foreign markets where they encounter a regulatory environment that is largely similar to their domestic one.

32. To achieve maximum results, national authorities should systematically examine whether a relevant international standard exists when proposing a new regulation, and if so, whether it would be effective and an appropriate basis for the new regulation. National efforts to encourage the adoption of regulations based on harmonised measures, procedures for monitoring progress in the development and adoption of international standards, and incentives for regulatory authorities to seek out and apply international standards are all possible approaches to ensure the appropriate use of internationally harmonised standards.

³ *Quantitative Assessment of the Benefits of Trade Facilitation*, OECD, Paris, 2003.

Box 4. Regulatory harmonisation in OECD countries

Germany - Currently about 75 per cent of the standards published in Germany are elaborated at the European and international level. The amount of purely national standards has continuously decreased. The German economy is highly committed to global trade, and thus needs international standards. Furthermore, the completion of the European Internal Market has promoted the development of European Standards and has limited the need for national standards. At the domestic level the German Institute for Standardisation (DIN) is in charge of standardisation. DIN develops standards of interest to industry, business and other interested parties (e. g. public authorities, consumers), and provides a range of related support services. DIN is a private association and not a government institution. Membership in the DIN is voluntary, open to “the ability to pay”. When DIN adopts European or international standards as national standards it withdraws all conflicting national standards. Purely national standardisation only takes place in domains where harmonised standards are not available.

Korea - The Korean government has engaged an active policy in favour of enhanced transparency of the standardization and certification system and of increased use of internationally harmonized standards. The reforms started in 1998 have been driven by trade talks and also by the need to improve the business environment for local firms. Legislation recommends that regulatory authorities adopt relevant international standards when drawing up or modifying technical regulations and voluntary standards. A co-ordination body, the National Standards Council, has the mission to review all standards with the view to promoting co-ordination of different standards and international standards.

Quality of conformity assessment processes.

33. Conformity assessment refers to measures taken to assess the conformity of products, processes and services to specific requirements or standards. These procedures may have the effect of facilitating trade, or they may create a technical barrier. On one hand, public objectives like health, safety and environmental often require rigorous and careful conformity assessment procedures. When done without the involvement of excessive costs and time, these procedures can facilitate market openness by increasing consumer confidence in imported products. Firms are likely to regain the invested costs, as their ability to demonstrate that their products and services met these strict requirements can lead to high consumer confidence and increased sales.

34. On the other hand, conformity assessment procedures can place unnecessarily high burdens on firms and, therefore, can negatively affect market openness. First, conformity assessment can cause duplicative costs for firms when different markets require the repetition of essentially identical tests against the same or equivalent standards. Recognising the equivalence of the results of an assessment performed elsewhere can greatly contribute to reducing costs. Mutual recognition agreements (MRAs) signed by two or more countries on the acceptance of conformity assessment procedures is one possible approach to formalise this process. However, given the complications frequently encountered in negotiating such agreements, attention has recently focused on alternative approaches. Progress towards a more efficient system can also be made through the recognition of supplier’s declaration of conformity, unilateral recognition of conformity assessment results reported in other countries, or through voluntary arrangements between conformity assessment bodies in different countries. In addition to the possibility of duplication, conformity assessments procedures can also cause unnecessary burdens when they are designed in a way that the high cost of meeting them and their rigour does not contribute to the achievement of regulatory objectives. Finally, these procedures are often open to abuse in the implementation stage. Complex, slow, non-transparent and arbitrary assessments mean increased costs, delays and may discourage or prevent manufacturers from introducing products in the market. A conformity assessment that is proportionate, streamlined and well implemented can save time and money,

support larger scale production and economies of scale, and simplify purchasing, thus reducing costs for companies.

Incorporation of competition principles into domestic regulatory practices

35. Anticompetitive practices of private firms can present difficulties for the efficient functioning of international markets. Some of these practices include hard core cartel conduct, abuses of dominant position, or attempts to monopolise a given market. These activities can restrict market access by seriously undermining the efforts of firms to enter new markets. For this reason, a commitment to sound competition principles is crucial in providing the appropriate conditions for genuine market openness.

36. It is important to point out that regulatory reform generally reduces constraints on the activities of firms, thus often leading to more vigorous competition. However, such developments might be prevented in practice by anticompetitive behaviour of firms once regulations are removed. The initial phase of deregulation might be characterised by few players and high market concentration in which abuse of a dominant position or horizontal collusion might occur. Therefore it is important that competitive markets be recognized as a key goal of regulatory reform. Competition and regulatory authorities should be on the lookout for anticompetitive practices post-deregulation and should have mechanisms in place that enable them to consider complaints from consumers and new or potential entrants, whether they be foreign or domestic, about such practices.

2. *How does market opening affect domestic regulations and regulatory reform?*

37. Against the background of the effects of domestic regulations and regulatory reform on market openness, this section intends to explore the reverse impacts, namely how market opening affects domestic regulations and regulatory reform.

38. The most important impact of market opening on regulatory reform arises through the obligation of individual countries undertaken in international agreements to introduce changes to domestic regulation. Inevitably, countries that join these trade agreements undertake the obligation to introduce changes into their domestic regulations.

39. Thus trade liberalisation involving regulatory reform can contribute to more efficient regulatory systems that underpin strengthened competition and economic performance. Such conditions are arguably propitious for the achievement of other regulatory goals e.g. in the social or environmental policy fields; however, that issue is beyond the scope of the present analysis.

40. The negotiation of regulatory issues on the international level is a challenging process. Difficulties mainly arise from the wide variation of regulatory needs and objectives across countries and from the fear over the loss of regulatory sovereignty and the weakening of regulatory objectives. The choice between developing regulatory principles and establishing uniform standards or benchmarks for domestic regulations is a central issue in this context. Agreements signed to date aim to reach an understanding on generic principles for good regulation to help guide countries' individual regulatory reform efforts but not to encroach on the regulatory sovereignty of governments. These principles are usually general in nature, and they leave the choice of the particular type of regulatory practice to implement them to the respective national authorities.

41. Another problem arises from the fact that there is a disparate experience with regulation among different countries. While some countries have long experience and strong political commitment in designing and implementing efficient regulations, others, particularly developing countries, may lack such experience, as well as resources and expertise. For this reason, assistance in capacity building concerning

regulatory issues could prove highly beneficial to the promotion of market openness and further trade liberalisation globally.

42. Trade agreements incorporating regulatory provisions can have positive effects on domestic regulatory change. They can prevent countries to introduce regulations that have a direct discriminatory affect or through the declaration of principles can guide countries' efforts to improve the general efficiency and specifically the trade friendliness of regulations. If regulatory policy is decided primarily in the domestic policy process in such an environment well-organized private as well as public interests could negatively impact the process of reforms. Commitments to increase market openness undertaken on the international level can help to overcome the resistance of domestic economic actors or of government administrations to regulatory change. Similarly, multilateral agreements can also help to lock in domestic reforms to limit possible backsliding by governments in the future. In this way, trade liberalisation can create important pressures and impetus for regulatory reform. Reforms when well implemented can reduce unnecessary and burdensome regulations and therefore contribute to the domestic and international competitiveness of local firms, as well as, can increase the openness of the economy.

43. The following sections will provide some examples how, given the challenges mentioned above, international agreements address regulatory issues first on the multilateral and then on the regional level.

2.1 Regulatory issues in multilateral agreements

Manufacturing sectors

44. The multilateral trading system incorporates key elements of good regulatory practice in the manufacturing sectors. The goal of the WTO agreements is primarily to lay out a framework in which regulatory measures can be formulated and implemented in the least distortive manner, while leaving countries to pursue their chosen policy goals. It is important that this perspective does not question the objectives of the regulations themselves.

45. The relevance of good regulatory policy is stressed when addressing many of the negotiating topics under the current Doha Development Agenda. Several issues are linked either explicitly or implicitly to regulatory issues. In particular, this is the case for trade in services but also in issue areas such as trade and environment, and trade facilitation. In addition domestic regulations also figure in various ways in the negotiations on market access for industrial and agricultural products.

46. The following regulatory principles are reflected in WTO agreements:

47. *Transparency* – Requirements to ensure transparency – *e.g.* making trade-related rules and regulations publicly available, or informing other WTO Members via notification to the WTO – are included in WTO agreements, and are an important pillar of the system itself. TBT and SPS agreements establish the system of prior notification and comment on proposed technical regulations or measures that may affect international trade. These agreements require that a reasonable period of time should be provided between the publication of measures and their entry into force in order to give time for trading partners to adapt to the changing regulatory requirements.

48. *Non-discrimination* - Another important principle is non-discrimination to which two disciplines apply: most favoured nation (MFN) treatment and national treatment (NT). MFN requires that WTO Members cannot normally discriminate amongst each other, This means that treatment granted to one WTO Member must be extended to all. National treatment requires that imported and locally-produced goods should be treated equally — at least after the foreign goods have entered the market. The same should apply to foreign and domestic services, and to foreign and local trademarks, copyrights and patents.

MFN and national treatment principles are set out in the main provisions of the General Agreement (GATT Articles I and III), but are also underlined in the TBT (Article 2.1), SPS (Article 2.3).

49. *Least trade restrictiveness* - The concept of least trade restrictiveness is found throughout the WTO Agreements and is a key to ensuring that any restrictions on trade imposed for what are considered legitimate reasons are kept to the minimum necessary to carry out those legitimate objectives. Article XX of the GATT states that nothing in the Agreement could be interpreted to prevent the adoption of measures necessary to protect human life or health, relating to the conservation of exhaustible natural resources and necessary to attain other legitimate objectives listed in the Article. Article XX also requires that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade. Technical Barriers to Trade (TBT) provisions, in order to ensure that technical regulations do not create unnecessary obstacle to trade, require countries not to use regulations that are more trade restrictive than necessary to fulfil the legitimate objective. Similarly the SPS Agreements requires WTO members not to impose Sanitary and Phytosanitary (SPS) measures that are more trade restrictive than necessary to achieve their appropriate objectives.

50. *Harmonized standards* – Several multilateral agreements encourage the use for regulatory purposes of internationally harmonized measures whenever such measures are available. While avoiding direct involvement in setting national standards and regulation for trade in goods, the WTO has specified that the rules and procedures for standards or regulations have to be consistent with the maintenance of market access commitments. With the exception of the Trade Related Aspects of Intellectual Property Rights Agreement (TRIPs), which establishes “positive” standards, the WTO generally applies “negative” standards, that is, members are not required to adopt standards or regulations, but if they do so, certain rules are to be followed in order to minimize trade disruption and the possibility of disguised protection.

51. WTO rules, Article 2.4 of the TBT Agreement, Article 3 of the SPS Agreement, clearly exhort Members to rely on relevant international standards as the basis of domestic regulations wherever possible and appropriate. As set out in the TBT Annex 3 Code of Good Practice for the Preparation, Adoption and Application of Standards, standardising bodies within the territory of a WTO Member are also encouraged to use international standards, or relevant parts of them, as a basis for the standards they develop, except where doing so would be ineffective or inappropriate.

52. *Acceptance of foreign measures* - WTO rules also encourage the acceptance of foreign measures as equivalent to domestic measures. Article 2.7 of the WTO TBT Agreement requires Members to give positive consideration to accepting as equivalent technical regulations of other Members, even if these regulations differ from their own, provided they are satisfied that these regulations are efficient and adequately fulfil the objectives of their own regulations. Article 4 of the WTO SPS Agreement requires Members to accept the sanitary or phytosanitary measures of other Members as equivalent, even if these differ from their own or from those used by other Members trading in the same product, if the exporting Member objectively demonstrates to the importing Member that its measures achieve the importing Member’s appropriate level of sanitary or phytosanitary protection. Article 4 further stipulates that “reasonable access” shall be given, upon request, to the importing Member for inspection, testing and other relevant procedures.

Services sectors

53. In comparison to the manufacturing sector, service sector markets are often less exposed to international competition. Restrictions on trade in services usually take the form of domestic regulation, as services tend to be highly regulated, reflecting a variety of important public policy objectives. In this context, the WTO Agreement on Trade in Services (GATS) has been designed to allow for progressive and

flexible liberalisation. Under the GATS, Members are free to choose whether or not to open a given service sector (or sub-sector), and, if they choose to do so, they can limit the extent and type of market access and national treatment granted.

54. The GATS finds it important to recognize the right of Members to regulate and to introduce new regulations on the supply of services to meet national policy objectives. The GATS does not prescribe the type of regulations that governments should enact; rather it seeks to ensure that Members do not use regulations as disguised restrictions on trade. Efficient regulation principles applied to domestic regulations are also generally weaker in most areas of services as compared to the manufacturing sectors. For example, in contrast to agreements covering trade in goods, GATS provisions do not specifically encourage the use of harmonized regulations, nor do they subject new regulations to close international scrutiny through prior notification and comment period. An important discipline present in GATS agreements is to meet the minimum requirements of transparency. See Box 5 below for more details.

Box 5. Some key GATS disciplines and agreements

Members are required (*Article III Transparency*) to publish promptly and, except in emergency situations, at the latest by the time of their entry into force, all relevant measures of general application which pertain to or affect the operation of the GATS. They must also promptly and at least annually inform the Council for Trade in Services of the introduction of any new, or any changes to existing, laws, regulations or administrative guidelines which significantly affect trade in services covered by its specific commitments. Members are also obliged to establish one or more enquiry points to provide specific information to other Members, upon request. (Other specific transparency requirements relate to notification of, for example, mutual recognition and regional trade agreements).

Article VI (Domestic Regulation) provides that, in sectors where they have made commitments, Members are required to ensure that all measures of a general application affecting trade in services are administered in a reasonable, objective and impartial manner. Each Member must also have procedures for prompt, objective and impartial review upon request of, and appropriate remedies for, administrative decisions affecting trade in services (although this does not require any member to institute tribunals or procedures which would be inconsistent with its constitutional structure or legal system). Where authorization is required to supply a service subject to a specific commitment, the competent authorities are obliged to inform the applicant of the decision within a reasonable period of time, and to provide, on request and without undue delay, information concerning the status of an application. Where specific commitments for professional services are undertaken, Members are required to provide for adequate procedures to verify the competence of professionals of any other member.

Article VI.4 mandates the development of any necessary disciplines for measures relating to qualification requirements and procedures, technical standards and licensing requirements to ensure that such measures do not constitute unnecessary barriers to trade in services and are, *inter alia*, based on objective and transparent criteria, not more burdensome than necessary to ensure the quality of the service and not in themselves a restriction on the supply of the service. Such disciplines would only apply to non-discriminatory measures; discriminatory measures can be maintained if they are scheduled. There is yet no agreement as to the scope of measures falling under VI.4.

2.2 Regulatory issues in regional and bilateral agreements and initiatives

55. A number of regional and bilateral initiatives for economic cooperation and preferential trade agreements incorporate regulatory disciplines or orientations into their agreements. This is based on the understanding of participating countries that the effectiveness of the economic integration envisaged within regional economic agreements will be dependent upon genuine regulatory reform for market openness at the national level. Regulatory issues are addressed in a great variety of ways ranging from agreements that impose domestic regulatory change that go beyond multilateral approaches, through the endorsement of binding or non-binding principles, to capacity building or networking programs that aim to facilitate domestic regulatory reform. Below are examples from some cooperation initiatives of the ways regulatory issues are incorporated into their agenda.

Progress on transparency

56. Several initiatives provide for transparency through obligations to publish existing and notify new measures as well as through promoting advanced approaches (IT based or physical one-stop-shops) to the dissemination of transparent information about regulations. For example, the Individual Action Plan (IAP) of APEC (Asia-Pacific Economic Co-operation) member economies provide transparency about existing domestic regulations affecting trade, and plans for reforming them in line with APEC objectives.⁴ Additionally, APEC also works on e-government with the intention to share experience and knowledge on how IT can enhance transparency in government regulations and regulatory processes.

57. In the **European Union**, in order to avoid erecting new barriers to the free movement of goods which could arise from the adoption of technical regulations at the national level, Member States are required by to notify all draft technical regulations on products, to the extent that these are not a transposition of European harmonised directives. In order to bring draft national technical regulations to the attention of the European industry and consumers the Commission publishes regularly a list of notifications received in the Official Journal of the European Communities. The value of the system for private operators has been enhanced with the initiative of the Commission in 1999 to publish notifications on the Internet. A searchable database of notifications (Technical Regulations Information System -TRIS)⁵ going back to 1997 gives access to the draft text and the notification itself, including the rationale of the regulation and the status of the proposal.

Progress on non-discrimination

58. The principle of non-discrimination forms a basic building block of many RTAs. Although their scope is limited in principle to the members of the RTA, nevertheless, discrimination *vis-à-vis* non-RTA members can be mitigated through the practice of “open regionalism”. Under open regionalism, liberalisation commitments negotiated at the regional level are applied on a multilateral basis at the implementation stage. For example, a member of over thirty RTAs, **Mexico** has multilateralised liberalisation and regulatory reform in the areas of investment, customs procedures, intellectual property rights (IPR), and some services. Such actions can have trade-creating effects for third economies and minimise the drag on economic efficiency caused by distortions in trade liberalisation.

⁴ IAPs are available on the Internet at (www.apec-iap.org)

⁵ Available online at http://europa.eu.int/comm/enterprise/tris/index_en.htm

Progress on avoidance of unnecessary trade restrictiveness

59. In several regional initiatives, there are efforts to reduce the unnecessary trade restrictiveness of regulations. For example, **APEC** has developed a number of initiatives for trade facilitation with a declared aim of reducing unnecessary impediments to trade and investment. In APEC terms trade facilitation refers to the simplification of procedural and administrative impediments to trade, such as customs administration, standards and technical regulations, and barriers to the mobility of business people. The major tools used by APEC in trade facilitation are the development of principles and functional agreements in key areas of regulatory and administrative reform that acts as a framework for networking and exchange between practitioners, and the provision of technical assistance in helping less-developed economies implement facilitation measures.

60. On the regional level, probably the most advanced results have been achieved in the simplification and modernisation of customs procedures. In this area, **APEC** pursues several capacity building and technical assistance initiatives, such as projects in enhancing customs-business partnership, building capacity of APEC economies to implement WTO customs-related agreements such as Customs Valuation, Rules of Origin and TRIPS. **ASEAN** (Association of Southeast Asian Nations) is also involved in the process of harmonising customs procedures. ASEAN Agreement on Customs signed in 1997 stressed the principles of consistency, simplicity, efficiency, transparency, access to appeals and mutual assistance in the conduct of customs. Significant items in this text include: agreement to create an ASEAN harmonised tariff Nomenclature; support for adoption of the WTO Customs Valuation Agreement; work to simplify customs procedures in line with the Kyoto Convention, and encouragement of cooperation and consultations with the ASEAN private sector.

Progress on harmonisation and mutual recognition

61. In theory, the achievement of regulatory harmonisation or mutual recognition in the framework of RTAs can be enhanced by geographic proximity as well as similar cultures and histories. It may also be easier for smaller groupings of economies (in comparison to the WTO) to reach agreement.

62. To start with, some RTAs focus on encouraging MRAs. This approach can be seen in the Japan-Singapore and the **EU-Mexico** bilateral trade agreements. Other RTAs actively facilitate dialogue among members in the area of mutual recognition as in the case of the **New Zealand-Singapore** trade agreement. Another initiative, the **APEC Mutual Recognition Arrangement (MRA)** for Conformity Assessment of Telecommunications Equipment when fully implemented will streamline trade in telecommunication products as well as cutting the costs of telecommunications devices. The purpose of the MRA is to reduce the need for multiple testing of products, through the mutual recognition of standards and tests in participating economies. Implementation of the MRA began in July 1999 with nine participating economies involved in Phase I (mutual recognition of test results).⁶ There are also examples of regional MRA agreements focusing on professions. MRAs have been reached among **NAFTA** (North American Free Trade Agreement) economies for engineers (signed 1995) and legal services (1998). **ANZCERTA** (Australia-New Zealand Closer Economic Relations Trade Agreement) presents a more comprehensive approach through the Trans-Tasman Mutual Recognition Arrangement which has been in force since 1998. This Arrangement allows the practice of many occupations in both members.

⁶ Participating countries are Australia, Canada, Japan, Hong Kong, Peru, Republic of Korea, Singapore, Chinese Taipei, and USA.

63. Concerning standards, **APEC** members have made a commitment to align domestic standards with relevant international standards in four priority sectors by 2005.⁷ Member economies have also agreed to align all electrical safety and electromagnetic compatibility standards by 2008. **ASEAN** work on the harmonisation of standards and conformance can be viewed as a dual track process. The first track is based on a 1998 ASEAN Framework Agreement on Mutual Recognition Arrangements which has set the stage for the negotiation of sectoral MRAs. To date, two MRAs in the electrical and electronic equipment (2002) and cosmetics (2002) sectors have been established and work is under way in an additional three sectors including telecommunications equipment, pharmaceuticals and prepared foodstuffs. The second track consists of a longer term process of harmonizing standards and conformity requirements across the ASEAN membership, which is carried out by the ASEAN Consultative Committee on Standards and Quality (ACCSQ). The Committee's responsibilities include: 1) Implementation of the ASEAN Framework Agreement on Mutual Recognition Arrangements; 2) Harmonization of standards; 3) Enhancement of standards and conformity assessment infrastructure in Member Countries; and 4) Strengthen the transparency of standards, technical regulations and conformity assessment regimes in the region.

64. The **European Union** has a policy in place on technical harmonisation, standardisation and conformity assessments, the "New approach" and the "Global Approach", with the aim to overcome barriers to the free flow of goods posed by diverging rules in Member States. On the basis of the "New Approach", in chosen sectors, harmonisation does not result in detailed technical rules, but is limited to defining the essential health, safety and other requirements which industrial products must meet before they can be marketed. Theoretically, manufacturers are free to use any technical specification they deem appropriate to meet these requirements. The responsibility for the elaboration at European level of technical specifications which meet those requirements has been moved from EU government bodies to three European standardisation bodies.⁸ The "Global Approach" sets out detailed conformity assessment procedures to be used in establishing conformity with the essential requirements. Suppliers may use any notified body within the EU to carry out the conformity assessment, which introduces competition to the conformity assessment market and potentially reduces costs borne by manufacturers in certifying their products. Once found to be in conformity, a product carries the CE marking and can be freely marketed throughout the Single Market without having to undergo additional compliance testing.

Progress with competition policy

65. Competition policy provisions are appearing with increasing frequency in more recent RTAs, but with varying levels of obligation.⁹ In the **European Union** an effective competition policy regime is viewed as a prerequisite to deep integration. Where the EU applies a competition policy on a regional level, **NAFTA** provides that its members "shall adopt or maintain measures to proscribe anti-competitive business conduct" and "recognize that such measures will enhance the fulfilment of the objectives of this Agreement."¹⁰

⁷ The following areas are involved: electrical and electronic appliances, food labelling, rubber gloves and condoms, and machinery).

⁸ European standardisation bodies: CEN (European Committee for Standardisation) CENELEC (European Committee or Electrotechnical Standards) and ETSI (European Telecommunications Standards Institute).

⁹ See more detail in Chapter 4. "Competition Policy" in *Regionalism and the Multilateral Trading System*, OECD, Paris, 2003.

¹⁰ Article 1501:1 of Chapter 15 of NAFTA.

3. How does trade and investment friendly regulatory reform enhance economic performance?

66. Regulatory reform affects and brings benefits to economies in two interrelated ways. Concerning the effects, it determines the functioning of the domestic economy and also it influences the pattern of international trade and investment. Concerning the benefits, regulatory reform, when designed and implemented properly, creates a well regulated domestic environment that improves the efficiency of the domestic economy, and also increases the flow of international trade and investment. The multiple benefits of regulatory reform suggest that countries that progress simultaneously with market opening and regulatory reform policies are better placed to take advantage of the benefits of trade liberalization.

Regulatory reform delivers benefits to a country by improving the efficiency of the domestic economy

67. Good regulatory practices and efficient regulations have a positive effect on the domestic economy as a whole indirectly by improving public governance and directly by increasing the efficiency of economic actors. First, regulatory reform contributes to good governance by improving the quality, objectivity, and professionalism of government regulatory bodies and of reducing the opportunities for corruption and bribery. Concerning the direct economic effects, a fundamental result of regulatory reform is the improvement of the efficiency of national economies and their ability to adapt to change and to remain competitive. Good regulatory quality encourages productivity, investment and innovation, creates new jobs, and boosts growth and competitiveness, while maintaining high standards of consumer and environmental protection. The prospect of these domestic benefits is the basic and indispensable driving force for regulatory reform.

68. A number of OECD studies offer evidence of the negative effects of inefficient or poorly adapted regulations and of the positive effects regulatory reform can deliver both on the sectoral and on the macroeconomic level.¹¹ A first important lesson is that regulatory reform brings to countries economic benefits in terms of improved employment and growth prospects. Elimination of regulatory barriers to competition compels firms to become more efficient and boosts the productivity of entire industries. Better regulations encourage productive efficiency and innovation, as more competitive markets strengthen the incentives to improve productivity and stimulate the adoption of new products, technologies and management methods. Increased efficiency and innovation also brings valuable benefits for consumers through reduced prices, and improved product quality and choices. Second, available evidence shows that regulatory reform, and in particular product market reforms, contributes to gains in employment. Unnecessary burdensome regulations increase production costs, while regulatory barriers to entry reduce competitive pressures on enterprises. In turn these effects can restrain output and lower the number of firms and the level of economic activity in the long run. Regulatory reform that reduces regulatory burdens and facilitates market entry can boost economic activity that can result in higher employment. Third, while improving economic results, regulatory reform can also contribute to maintaining and increasing high levels of regulatory protections in areas such as health and safety, the environment, and consumer protection by introducing more flexible and efficient regulatory institutions and regulatory instruments, such as consultations, regulatory impact analyses, mechanisms to increase transparency, administrative simplification approaches, enforcement mechanisms, etc..

69. Concerning the economic costs of inappropriate regulation, a recent study of the World Bank entitled *Doing Business in 2004: Understanding Regulation* investigated the scope and the manner of

¹¹ *The Economy Wide Effects of Product Market Policies*, SG/SGR(2003)8; *OECD Report on Regulatory Reform I-II*, OECD, Paris, 1997; "Policies and International Integration: Influences on Trade and Foreign Direct Investment", *OECD Economics Department Working Papers*, No. 359; Nicoletti G. and S. Scarpetta (2003), "Regulation, productivity and growth", *Economic Policy*, Vol. 36, 11-72.

regulations that enhance business activity and those that constrain it.¹² The findings reveal that cumbersome and inefficient regulations impose heavy economic costs on enterprises and on the economy as a whole in developing countries. Another World Bank report by analyzing data on the regulation of start-up firms in 85 countries pointed out that countries that regulate entry more heavily have greater corruption and larger unofficial economies, but not better quality goods and better economic performance.¹³

Further benefits are created through greater openness to international trade and investment, including through improved competitiveness in international markets

70. Regulatory reform also affects the economy through facilitating international trade and investment. On one hand, by removing regulatory barriers, it eases the entry of goods and investment originating from foreign markets. On the other hand, by increasing the competitiveness of the domestic economy it improves export performance.

71. To start with, trade friendly regulatory reform can ensure that regulations facilitate the flows of international trade and investment. The increased market openness achieved through such means enables economies to better profit from the opportunities provided by international competition. First, a more open economy brings benefits through the better exploitation of comparative advantage that leads to better resource allocation and through the effect of more competitive markets that act as a stimulus to innovation and efficiency.

72. In addition, regulatory reform also helps to improve the competitiveness of domestic enterprises in international markets. The economic benefits described above work in a closed domestic economy but they are even more reinforced in an open economy. The positive effects become especially important in the case of trade liberalisation, when domestic producers have to compete with firms from abroad and their regulatory burdens matter substantially. When tariffs and quotas no longer significantly limit the potential exports of domestic industry, inefficiencies caused by unnecessarily heavy or divergent regulatory burdens are crucial in determining the success of enterprises both in domestic and in foreign markets. In the local markets, inefficient regulations can benefit foreign firms at the expense of domestic ones and can result in the loss of domestic markets to competitors from countries with better regulatory regime. A firm may have relatively low production costs, but face high costs of complying with inefficient regulations in its home country, and if these costs are high enough they can offset the efficiency and locational advantages and cause the loss of sales to an otherwise less efficient foreign supplier. At the same time, enterprises operating in good regulatory environment in their home countries will be better placed to compete both in foreign and domestic open markets.

73. Furthermore, regulatory reform delivers benefits for the home country by increasing its attractiveness for foreign investors. Foreign and multinational enterprises prefer to choose locations with efficient and transparent regulatory environment and are likely to stay away when confronted with unnecessarily burdensome and unpredictable regulations that can inflict particularly high costs on their business activity.

74. Analytical studies provide some empirical evidence about benefits that accrue to those economies undergoing market opening through regulatory reform measures. An OECD study titled *Quantitative Assessment of the Benefits of Trade Facilitation*, and a World Bank study on *Global Economic Prospects: Realizing the Development Promise of the Doha Agenda*, give analyses of trade facilitation gains globally, while an APEC study, *APEC Economies – Realising the Benefits of Trade Facilitation* examines the

¹² *Doing Business in 2004: Understanding Regulation*, World Bank, Washington, 2004.

¹³ "The Regulation of Entry," *Policy Research Working Paper* 2661, World Bank, Washington, 2001.

impact of APEC's trade facilitation measures on the region.¹⁴ These papers suggest that trade facilitation measures can add significantly to the benefits coming from trade liberalisation. Other studies prepared by OECD and UNCTAD illustrate how regulatory reform in the services sector can bring further benefits through opening up the sector for international competition.¹⁵ Another World Bank report provides evidence how excessively administrative burdens in 32 developing countries discourage inflows of foreign direct investment.¹⁶

When regulatory reform is well-planned and properly implemented its perceived costs can be minimized or are outweighed by its benefits

75. Governments, social groups and enterprises sometimes act as a critic of regulatory reform and market opening. However, given the combined benefits of these processes, increased market openness created by regulatory reform seems not to be contrary to the national interest. Concerns that reforms that ease market access would result only in an increased inflow of goods and services are misplaced. Based on the positive economy wide effects of improved regulations and market openness, reforms can increase the competitiveness of the domestic economy and as a result domestic enterprises will be able to better perform and compete on domestic and foreign markets alike. Some sectors or actors that earlier benefited from the old inefficient regulatory system and from closed markets may be negatively effected, but the benefits for the economy as a whole outweigh costs. Positive effects brought in by increased competition, better governance, innovation and improved specialization spread across the whole economy and benefit the majority of businesses and customers alike. At the same time, there is clearly a role for governments to balance the benefits of regulatory change against its costs and to provide appropriate assistance for a successful structural adjustment to those adversely affected.

76. Further concerns relate to the possibility that trade-friendly regulatory reform can negatively affect the achievement of regulatory objectives. However, regulatory reform that is properly planned and implemented should not mean the weakening of regulatory objectives. The aim of regulatory reform is not deregulation, or less regulation, but more efficient regulation, achieved through improved regulatory institutions and methods to produce, review and implement regulations. Better regulations are more efficient means to safeguard economic and social policy objectives in, for example, consumer and environmental protection, health and safety. From a trade perspective, more efficient regulations can achieve regulatory objectives with no or the least amount of trade restrictiveness. In cases the meeting of regulatory objectives requires restrictions on trade, it is important those regulatory solutions are chosen that secure the achievement of regulatory objectives but at the same minimize the barriers to trade and investment.

Based on their positive effects on economic performance, market opening and regulatory reform are mutually reinforcing.

77. First, based on its effect of increasing the international competitiveness of economies, regulatory reform helps countries to benefit from international trade and investment liberalization and therefore can create a substantial constituency that favours further market opening. Second, increased market openness

¹⁴ *Quantitative Assessment of the Benefits of Trade Facilitation*, OECD, Paris, 2003; *Global Economic Prospects: Realizing the Development Promise of the Doha Agenda*, World Bank, Washington, 2004; *APEC Economies – Realising the Benefits of Trade Facilitation*, APEC, 2002.

¹⁵ "Services Trade Liberalisation: Identifying opportunities and Gains", *OECD Trade Policy Working Paper No. 1*, OECD, Paris, 2004; "Trade in services – market access opportunities and the benefits of liberalisation for developing economies" *Policy issues in International Trade and Commodities Study Series No. 19*, UNCTAD, 2002.

¹⁶ "Administrative Barriers to Foreign Investment in Developing Countries," *Policy Research Working Paper 2848*, World Bank, 2002.

reached through trade liberalization can give an additional drive to the domestic regulatory reform as it increases the awareness about the importance of an internationally competitive regulatory framework. Countries that want to compete in a global marketplace realize that in order to do so they have to improve the regulatory environment so that they gain a competitive edge in global markets.

Box 6. Regulatory reform and market openness in Mexico

Mexico provides a good illustration of how regulatory reform and market openness can strengthen each other. Market opening and regulatory reform have gone hand in hand in Mexico as greater international competition – enhanced by the trade liberalization associated with Mexico’s accession to the GATT as well as membership in NAFTA and other FTAs -- generated a forceful impetus for domestic regulatory reform.

Trade liberalisation and domestic regulatory reform steps taken in Mexico:

Year	Market opening	Year	Regulatory reform
1986	GATT accession	1989	Economic Deregulation Unit
1992, 1999	Chile	1992, 1997	Federal Law of Metrology and Standardisation
1994	OECD membership	1993	International Trade Law
1994	NAFTA	1993, 1998	Federal Economic Competition Law
1994-2000	Several FTAs	1994	Federal Administrative Procedures Law
2000	EU	1995	Agreement for Deregulation of Entrepreneurial Activity
2003	Japan (in process)	2000	Federal Administrative Procedures Law
		2002	Federal Transparency Act

Source: *Market opening, regulatory reform and the Doha Development Agenda* (Presentation delivered by Eduardo Pérez Motta, Ambassador of Mexico to the WTO, at the Global Forum on Governance, Regulatory Issues and the Doha Development Agenda, Geneva, 25 March 2003).

Concluding remarks

78. As this paper has illustrated, there are important political and economic complementarities between free trade and regulatory reform.

79. On the one hand, given the substantial effects of domestic regulations on the openness of economies, it is important that domestic regulatory reform efforts take the market openness perspective into consideration. This requires well-functioning contacts and co-ordination between trade officials and regulators. With the help of advanced regulatory reform tools and approaches - such as regulatory impact analyses, administrative simplification, consultation procedures and international harmonization - governments can achieve the aim of creating regulations and regulatory procedures that efficiently meet their policy objectives but at the same time are supportive of market access. Furthermore, as domestic regulatory reform increases the international competitiveness of economies, countries that reinforce market liberalization by reforms to improve the regulatory environment will be better placed to take advantage of globalised markets. As a consequence, by securing new opportunities for enterprises to expand to new markets, effective regulatory reform can increase domestic political support for further trade liberalization.

78. On the other hand, international market opening can contribute a lot to facilitating domestic regulatory reform. Trade agreements signed on the multilateral or regional levels can promote general principles or specific elements of good regulation and help guide or drive countries' individual regulatory reform efforts. However the incorporation of regulatory issues into international agreements faces important challenges, such as how not to impede into national regulatory sovereignty and how to ensure

appropriate domestic capacities for regulatory reform. Also, appropriate co-ordination with regulatory officials should be organised in the negotiation of international trade agreements, so that their expertise is usefully drawn on in the design as well as in the implementation of the regulatory aspects of these agreements.

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