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STRENGTHENING TRANSATLANTIC COOPERATION

VIRTUE FROM NECESSITY

Why the EU and U.S. should strengthen regulatory cooperation

Richard Salt, January 2009

Regulation, of products, services and markets, rarely sets pulses racing – and when it does, it tends to be for the wrong reasons. Yet cross-border differences in the way markets are regulated represent a growing challenge for the global economy, and demand greater cooperation from the world's economic powers. Nowhere is this demand for engagement greater than in the transatlantic economic relationship.

At heart, the challenge is that our economies are increasingly integrated, while our regulatory and legal systems are not. Goods, services, people and information increasingly flow across easily national borders, but the standards and rules that help protect consumers and investors, that help ensure stable and transparent markets, and that help maintain national security, do not. Regulatory systems are brought, through globalization, more and more closely into contact with one another – but because they have traditionally been the outcome of domestic politics and designed to achieve domestic objectives, there is little guarantee that any two countries' regulations will be compatible with one another. Worse, they may even work to undermine each other.

Regulatory inter-dependence is growing. And as a result, it is now widely understood that means that regulation, however inadvertent, can create barriers to international trade and investment. This seems to imply a trade-off: between regulatory sovereignty, on the one hand, and open markets on the other; or, that sovereignty and independence can somehow be bought at the expense of some trade openness. For many countries this may seem an acceptable price to pay as they seek to achieve their domestic policy goals.

But it is, ultimately, a false choice – if countries and their regulators avoid working with international partners, regulating entirely without consideration of the outside world, trade frictions may be the least of the problems. They will also be unable to achieve fully the domestic objectives they seek, including the preservation of national security, or even maintain a stable international economy.

When it comes to international regulatory cooperation, the question is not if, but how. European Commissioner Charlie McCreevy has said that the EU and U.S. are condemned to cooperate on regulation. But being condemned to do something is not the same thing as embracing it. It is not simply a question of what needs to be done, but about doing it as well as we are able. Regulatory cooperation is something that both sides of the Atlantic can benefit from; and, rather than approaching the subject with reluctance, the EU and US should make virtue out of necessity.

ARGUMENT OUTLINE

For many years, regulation was a largely domestic policy concern. Countries faced choices over how to protect the interests of consumers and investors, whilst ensuring stable and competitive markets. They chose rules and systems of regulation to protect the environment, ensure minimum labor standards, and achieve a range of other economic and social objectives. In many cases, they also set rules for the functioning of markets that specified which businesses could compete, and on what terms.

Countries still face those same choices, but increasingly face a different challenge. International partners, with whom our economies are more and more closely integrated, make their own choices about how and what to regulate – and the choices made by different countries, often grounded in specific national values and politics, do not necessarily coincide with each other. Globalization, while by no means unique to recent years, has deepened significantly, giving rise to a growing inter-connectedness borne out of deep trade, investment and financial ties, from developments in transport, and from technological advances that make cross-border communication and commerce cheaper, quicker and easier. With people, goods, services and information crossing international borders at rapidly growing rates, these differences between national regulations are brought more sharply into perspective, particularly insofar as they hinder, or put a brake on, economic integration.

Related to this, a number of other events have served to illustrate the potential challenges that this integration poses – perhaps most notably the financial crises of the late 1990s and now 2008, the threats to national security posed by cross-border terrorism (often funded by international flows of finance) and the growing challenge posed by environmental problems such as climate change. Within borders, regulation is one tool for dealing with problems like these. But the more that we have understood that these 21st century problems are transnational, the more we understand that a purely domestic regulatory response becomes insufficient, and the more that foreign regulation becomes a key concern of domestic policy makers.[1]

Despite this, countries continue to disagree on the appropriate way of regulating markets; they disagree on the role of testing of products and who should bear the risks associated with new technologies (e.g. as we see with disputes over genetically modified organisms); they disagree on the protection and privacy that should be afforded to individual's personal data (e.g. as with recent transatlantic disputes over airline passenger data). Yet this is hardly surprising. For entirely legitimate reasons, each country's approach reflects national preferences (including such fundamental political choices as the appropriate role for government in the economy), history, and culture; in some cases it may also reflect specific features of the domestic economy or political process - one might think here of U.S. regulation of insurance, which even in an integrated global economy, continues to take place at the state, rather than federal level.

There are also, of course, less desirable causes of regulatory divergence – not least if it results from misguided public policy objectives or regulators are 'captured' by those who have a significant economic interest in the sector. The resulting regulation

[1] See Salt (2008) places this argument in the context of the 2008 global financial crisis.

may unduly favor incumbent firms, protecting markets against competition from other domestic or foreign entities.

Yet national regulators and supervisors will almost certainly know, and understand, the specific needs of the domestic market – and its key actors – better than those of other states. When one also considers the fact that it is national governments who are responsible for picking up the pieces after any failure in regulation, the foundation for much regulation continues to lie quite clearly in domestic politics. And no state's view is inherently right or wrong, or superior to that of any other.

Economic integration brings those different approaches and systems into contact, and occasional conflict; economic inter-dependence begets regulatory inter-dependence. In this way, globalization challenges policy-makers by raising questions that get to the very heart of how we regulate. And together, these challenges mean that there a series of reasons for why cooperation between regulators is essential.

What do we mean by cooperation?

It will be apparent, through this paper, that policy-makers have a range of tools at their disposal with which to address the challenges described above. These tools range from what might be described as the 'hard' to the 'soft': I use the description 'hard coordination' for approaches including harmonization of regulations or common standards because they impose relatively tough obligations on the part of domestic regulators; I use 'soft coordination', by contrast, to describe approaches including advance consultation and dialogue before regulation takes place, or the sharing of best-practice approaches to regulation – which impose little firm obligation on regulators. In between, other forms of coordination can be identified – including those that seek to reconcile differences, minimizing their costs, as well as information sharing.

The chart below illustrates a range of approaches according to a rough spectrum running from soft to hard cooperation.

Soft Coordination

- **Procedural transparency** – Policy-makers allow, and are receptive to, input from foreign actors when developing regulatory policy.
- **Consultation and dialogue, early warning** – policy makers actively share information/thinking on regulatory policy to maximize effectiveness and provide early warning of potential new frictions between regulatory regimes.
- **Best-practice exchange, staff exchange** – policy makers look to foreign regulatory practice for lessons or expertise that can benefit the domestic regime.
- **Accommodation** – faced with regulatory divergence, policy makers adopt measures (such as regulatory interfaces - see Newman 2007) that leave differences intact, but which minimize their costs – in particular by addressing and solving questions of jurisdiction, thereby allowing multinational firms to comply with regulations in foreign markets not required at home.
- **Convergence** – faced with regulatory divergence, policy makers take steps to bring regulatory systems more closely – but not totally - into line with each other.
- **Mutual recognition and equivalence** – despite regulatory divergence, policy-makers acknowledge a broad equivalence in the outcomes of their different approaches, and agree to accept another states' regulatory regime in parallel to their own. In practice, a determination of equivalence between states is likely to be conditional and subject to periodic review.
- **Harmonization of approaches/rules** – policy makers agree to eliminate regulatory divergence in a given area, making their approaches or standards identical.

Hard Coordination

NB. Nothing in this ranking should be taken to imply relative ease or difficulty in implementing cooperation.

It is frequently impossible to say, ex ante, what approach should be taken, i.e. whether it is better to harmonize, converge or, perhaps, accept divergence in approaches and minimize the negative impacts thereof. There is, however, likely to be value in all forms of coordination, even at the softest end of the spectrum described above – though for reasons outlined in this paper, the benefits of softer forms of cooperation are often overlooked.

For these reasons, I've chosen to talk about cooperation in its broadest sense – that it is constructive engagement, without prejudice to the final solution countries adopt.

What do we mean by regulation?

Likewise, I also take a broad definition of the term regulation – to mean any government-imposed rule, legislation or standard that aims to guide the performance of markets. As such, it covers some issues not always considered regulatory in nature – such as legislation that limits or otherwise discriminates against foreign ownership of firms. Neither does it distinguish between market regulation imposed directly through legislation and that imposed through delegated policymaking authority by agencies (as in the U.S. system, wherein Congress legislates and delegates rule-making to Executive Branch agencies or Independent Regulatory Commissions).[2]

Regulation and Trade – the link with economic openness

The most widely understood reason for regulatory cooperation is the impact that regulation can have on openness to trade and investment.

Sixty years ago, when the global trade regime was in its infancy, tariffs and quotas were the principal barriers to trade. Successive 'rounds' of negotiations helped reduce their impact on trade such that, for some developed world trade and investment relationships, tariffs and quotas are no longer the problem they once were. Like a receding tide exposing rocks, one effect of this shift has been that so-called 'behind the border' barriers to trade, often regulatory in nature, have been revealed as increasingly important. For the U.S. and EU in particular, the 1990s marked a transformation in the bilateral economic relationship as non-tariff barriers became more apparent.[3]

This trend has been complemented by several changes in the nature of trade, which also made regulation grow in international importance:

- Services, which tend to be more highly regulated than manufacturing, have formed a growing share of world trade;
- Concerns over environmental and labor standards have focused attention on the legal and regulatory policies embedded in the production of goods and services (not just the standards of the goods/services themselves); and,
- Higher regulatory standards are often considered a "normal" economic good, such that tighter standards (i.e. intended to provide more environmental or consumer protection) are demanded the richer countries become.

As a consequence, regulatory differences between countries – in approach, in standards or in enforcement – have been brought more sharply into focus. And there's no doubt that such differences have an impact on trade and investment flows between countries.

Depending on how it is designed and implemented, regulation can have significant anti-competitive impacts by reducing market openness. In some cases, rules may prevent cross-border market integration directly, perhaps through restrictions on foreign ownership of assets. In others, the impact on openness may be through creating and maintaining domestic monopolies that are able to resist competition from foreign companies. In passenger air services, for example, rules on foreign investment and control are widespread – as are restrictions on the ability of foreign airlines to operate services within domestic markets, thereby ensuring market

[2] For more detail on the U.S. regulatory system, see Katzen (2008) and Balla (2008).
[3] See, for example, HM Treasury and Netherlands Ministry of Finance (2003).

fragmentation and protection for domestic firms.[4] Indeed, such barriers have tended to be concentrated in specific sectors, like aviation.

Reforming regulation so that it has the least possible impact on external trade and investment openness would have significant economic benefits. The OECD produces regular data that demonstrate the economic costs implied by regulation that inhibits competition in markets for products, energy transport and communications, and professional services. A 2005 report, drawing on these data, provides striking estimates that would accrue to the transatlantic partners if each were to adopt least-restrictive regulatory approaches in a range of sectors. The report finds that this step would (together with the removal of some remaining tariff barriers), help raise incomes by 2 to 3% in Europe and by 1 to 2.5% in the US – the larger figure for Europe arising largely from the fact that the U.S. was, on average, closer to best-practice approaches.[5]

Beyond these market openness effects, divergent regulatory requirements can impose additional costs on businesses seeking to sell goods or services across markets, perhaps even being so high as to deter some companies from selling across borders at all – either because the costs of complying with two approvals or certification procedures are high, or even because different standards can make it impossible to offer the same good to consumers in both markets without substantial product revisions. To take just one example, a recent paper by a U.S. automobile trade association points to one American car, built with export potential to Europe in mind, that incurred over $40 million of additional design and development costs because of differences in European and U.S. regulation - yet the authors contend that the safety and environmental performance of the car was unchanged as a result.[6]

All the same, regulatory differences have to be seen in context. Differences in regulation between the EU and U.S. (or, indeed, any two countries) may well have an economic cost – but it may also have some benefit. Insofar as regulation can vary to cater for specific national circumstances, concerns and values, divergence is a manifestation of national policy autonomy, improving welfare through higher standards of health, safety or environmental protection. And precisely because regulation has a firm foundation in national preferences, this policy autonomy has value. In economic terms, for example, it can allow for regulatory approaches that maximize efficiency given particular features of the domestic economy, including the administrative capacity of domestic institutions. As such, the welfare effects of efforts to converge or harmonize regulation across borders are ambiguous – they can be either positive or negative, depending on the specific issue and sector under analysis.

Moreover, specific regulatory rules or approaches are likely to garner greater political support the more they are seen as the outcome, or reflection, of a political debate in which domestic interests are seen to have been weighed against one another, as opposed to simply being rules imposed from outside.

[4] In the U.S. for example, a minimum of 75% of voting stock must be held by U.S. citizens (other restrictions also apply to the effective 'control' of the airline).
[5] See OECD (2005)
[6] See Wilber and Eichbrecht (2008)

As a consequence, multilateral discussions in the World Trade Organization (WTO) have found it difficult to make progress on regulatory barriers, particularly in the case of services. The traditional approach to trade liberalization (in the GATT) rested on the export-focused, mercantilist approach of reciprocity in negotiated concessions: trade negotiators seek market access for exports by conceding access to domestic markets, which ultimately leads toward free trade. But Hoekman and Messerlin (2000) argue that this rests on two conditions, namely that: tariffs are the main barrier to trade; and, non-tariff barriers are easily quantifiable in tariff-equivalent terms. Since these conditions are not true for many services markets, negotiations have enjoyed only limited success.

A number of strategies have been developed to address the trade/openness impacts of divergent regulation, among them the approaches listed in the earlier box including harmonization, mutual recognition and regulatory interfaces.

Best-practice

It would be foolish for any country to believe that it had a monopoly on good policy-making – a point as true of regulation as in any other area. For regulatory policy, there are payoffs for countries willing to learn from each other, both in terms of how policy is developed, and the specific solutions adopted.

Firstly, countries vary markedly in the administrative and policy processes through which regulation is developed. Procedural differences, in factors such as consultation, judicial review or oversight, transparency and cost/benefit analysis, can have a direct impact on both the efficacy and efficiency of the regulation being developed.[7] Secondly, the regulatory approach taken might vary significantly across countries – including, for example, in terms of how responsibility for regulation or oversight is balanced between the state and the private sector. Thirdly, and perhaps most obviously, the specific regulatory rules are likely to vary widely. But in each case, a country's experience provides evidence and lessons that other states are likely to benefit from, particularly at the regulatory frontier as new products/services enter the market, or new regulatory approaches are attempted.

The OECD work, referred to earlier, provides clear evidence of this. The economic gains they identified from transatlantic cooperation rest simply on a process of regulatory reform, in which each country would adopt international best-practice in pro-competitive regulation. They do not require the harder forms of cooperation such as harmonization. Thus, even within the OECD – even within the EU – there remain significant opportunities to learn from one another.

For emerging markets and developing countries, there is an even greater opportunity to learn. Developing countries, in particular, face a growing need to develop regulatory capacity, so that critical services such as telecommunications, finance and transport can support wider economic development.[8] For resource-constrained

[7] It is worth noting here that some differences reflect different constitutional arrangements. Perhaps most obviously, the US system of administrative law is a specific definition of the powers to regulate (known as rule-making), delegated by the federal government to administrative agencies (such as the Securities and Exchange Commission).
[8] See, for example, Schmid (2008)

countries, it is neither efficient nor feasible to start with a blank regulatory page, but neither do they have to – there is much they might learn from the expertise and experience that already exists. Indeed, the United States' Securities and Exchange Commission (SEC) International Technical Assistance Program has sought to provide precisely this kind of assistance to both developing countries and emerging markets; similarly, the United Kingdom is currently developing a new International Center for Financial Regulation.

Achieving domestic policy objectives

While emerging markets and the developed world have much to gain from such technical assistance, so does the developed world. It is not altruism, but self-interest – because in an integrated global economy, countries increasingly rely on each other's abilities to regulate and oversee markets. Quite simply, it becomes less and less possible to achieve domestic policy objectives without effective cooperation.

There are several broad ways to think about this:

- In one sense, regulators often require assistance from international partners to identify emerging risks or challenges to domestic markets. Domestic markets may be challenged by market innovations or emerging problems that have developed in foreign markets under the supervision of other regulators – particularly in rapidly innovating, highly globalised sectors such as financial services.

- Regulators also require help from international counterparts through access to more specific information. For example, competition policy decisions relating to large mutli-nationals involve judgments based on activities in markets both at home and abroad. In a similar vein, market integration and communication advances mean that fraudulent activity can more easily be based overseas, helping protect its perpetrators from oversight from domestic regulators that do not communicate with international partners.[9]

- Moreover, since many political and economic issues cross borders, the actions of other regulators may even be a critical part of effective domestic regulation. This is particularly true in areas such as environmental protection – where pollutants or other environmental damages do not respect political borders – or in highly integrated sectors of the economy, where interdependencies mean that the costs of regulatory failure overseas (such as market instability or inadequate consumer protection) can quickly undermine markets and regulatory goals at home.

  One obvious example here is the financial turmoil that has spread rapidly around the globe, but which has its roots in U.S. sub-prime mortgage lending.[10] Among the many contributory factors that help explain the crisis, weaknesses in financial regulation in the U.S. appear to have played a significant role (acknowledged, for example, by former Federal Reserve Chair

[9] For this reason, the International Organization of Securities Commissioners created, in 2002, an information-sharing agreement across securities regulators.
[10] See Salt (2008). For an excellent overview of the crisis and its contributing causes, see Goldstein (2008).

Alan Greenspan[11]): many observers argue, for example, that disclosure and transparency rules did not make the risks of some complex securities sufficiently clear to investors, and capital requirements for banks were too low.

Equally, one might also point to the series of product recalls and warnings since 2007 relating to Chinese exports of tires, toys and pet foods, which raised awareness of the potential risks to domestic consumers from weaknesses in foreign regulation. The United States and China have now signed a number of agreements aimed at increasing regulatory cooperation, to help address precisely these kind of issues.

- Finally, there are likely to be some cases where market regulation and supervision may only ever be as good as the weakest link in global capacity, because global interdependencies mean that even one poor regime offers scope to undermine regulatory efforts the world over. Perhaps the most obvious example here is that of preventing terrorist financing where, because finance can flow around the world with ease, a small number of nations willing to safeguard terrorist assets can undermine the robust regulatory action of many others.

Influencing Regulation – the International Dimension

Policy makers also need to recognize that, in an integrated global economy, the regulatory choices of international partners will influence, and be influenced by, what we do at home. Today, no one regulates in a vacuum.

So far, we've noted two ways in which the regulatory choices of international partners may have an impact on domestic policy: through the adoption of best-practice learned from foreign regulators; and, through direct pressure for convergence or harmonization in order to advance greater trade or market access. But there are also softer ways in which the regulatory choices of others will influence domestic regulation – channels which, it is often argued, the European Union has sometimes proven more adept at utilizing than the United States.

These are often portrayed as constraints imposed by the markets – an argument often premised on a conception of global businesses as foot-loose, seeking out weak regulatory regimes in order to lower costs, and forcing countries to compete for their investment capital. For example, Bayne and Woolcock argue that "[g]overnments are now obliged to consider whether the policies they pursue are 'business friendly'", because of the impact they may have on international investment decisions.[12] But the policy choices of international partners still lie at the root of this effect, because they provide the range of alternatives that markets might choose between.

On the one hand, it is often argued that global integration may exert a downward, de-regulatory pressure on domestic regulation, leading to a 'race to the bottom'. This is known as the Delaware Effect – so-called because within the United States, it is

[11] See Greenspan (2008). According to Greenspan, a: "… surge in global demand for U.S. subprime securities by banks, hedge, and pension funds supported by unrealistically positive rating designations by credit agencies was, in my judgment, the core of the problem."
[12] Bayne and Woolcock (2007), p.346

often argued that Delaware's more company-friendly chartering laws give it a comparative advantage in attracting incorporations relative to the other states. Differences in regulatory requirements between states can facilitate regulatory arbitrage, wherein market participants structure their affairs so as to take advantage of the regime that benefits them most.

But this is, in any case, an overly simplistic view; the reality is more nuanced. The financial services industry has not grown in strength in New York, London or Frankfurt because of weak regulation; indeed, the opposite is likely true. These cities have likely grown as centers of finance because they have traditionally been seen as having relatively strong regulatory regimes that enhance investors' confidence in the services and assets being offered in those markets. And while concerns have been raised about the quality of regulatory oversight and supervision in some offshore financial centers that have attracted significant financial capital, the IMF has found that standards have risen in recent years as a result of focused international attention and cooperation.[13]

Meanwhile, David Vogel has argued that there may, in some areas, exist a California Effect – an opposite to the Delaware Effect in that regulatory standards can instead be bid up by international openness and competition. Vogel uses the name California because the state has a record of leading tougher environmental standards, both within the U.S. and worldwide. He cites the example of automobile emission standards, where California chose, in the 1970s, stricter standards than the minimum required of states. Since then, the United States Congress has tightened nationwide standards in line with California; and, in addition, several other states have asked the U.S. government if they too can impose the stricter, Californian approach. As Vogel puts it: "California has helped make American mobile emissions standards steadily stronger."[14]

The logic of the arguments is easy to follow. Firstly, if California imposes a more thorough and more costly form of regulation on a firm that sells across the United States, California's size and economic weight may mean that it is in the interests of that firm to supply all production as meeting the tougher California standards, because the economies of scale that come from meeting one standard exceed the cost savings that might be made by tailoring different products. Secondly, Vogel argues that some domestic firms may favor stricter regulations if, by so-doing, compliance costs will fall disproportionately on multi-national competitors. And thirdly, rich countries have greater power to insist on tighter standards in international treaties or trade agreements

Participation in, and power over, international dialogue and forums highlights a related channel of influence. As Anne-Marie Slaughter has pointed out in her book *A New World Order*, recent years have seen a proliferation of often informal, expert networks in response to global economic integration, that have increasingly began to address, and exert a growing influence over, cross-border issues such as regulation – adding a technocratic channel through which the interests and approaches of other states may influence the regulatory approaches taken at home.

[13] Indeed, a 2005 IMF Report noted: "… on average, [Offshore Financial Centers] meet supervisory standards superior to those of other jurisdictions, though with deficiencies in lower income jurisdictions." – see IMF (2005) pp.5-6
[14] Vogel (1995), p.259

For our purposes, it doesn't really matter whether the net effect is towards stronger or weaker regulatory standards – simply that there IS likely to be influence on domestic regulation beyond the usual domestic political and policy processes. Indeed, regardless of whether there might be a ratcheting up or down of regulation, regulators and legislators need to understand that, in the long run, they are not entirely masters of their own destiny. As a result, they must engage in the debate.

For European and American policy makers, it may be tempting to believe that the sheer size and economic weight of domestic markets will be enough to ensure that they can exert a significant, or even decisive, influence on regulation. Dan Drezner argues bluntly that: "the great powers – defined here as governments that oversee large internal markets – remain the primary actors writing the rules that regulate the global economy".[15] But particularly when viewed through the lens of differences in transatlantic regulation, some limits of this approach become obvious. In terms of trade and economic weight, the EU and U.S. are broadly comparable – from which it follows that, if they hold different views or approaches to regulation, neither would necessarily have good reason to believe that they can dominate the others' influence.

More significant may be recent evidence that suggests market power is not the only decisive factor – instead, the concept of 'regulatory capacity' may also be important.

Bach and Newman (2007) introduce and define regulatory capacity as: "a jurisdiction's ability to formulate, monitor, and enforce a set of market rules." They argue that a state's ability to influence regulation internationally depends on the expertise of domestic regulators (including their experience and the resources at their disposal), the coherence of regulatory authority (all else equal, a specific and centralized authority should have greater influence than when authority is dispersed across bodies), and the power available to regulators to punish non-compliance with domestic rules, perhaps by preventing market entry. Countries with large markets should, in theory, find it easier to employ resources in the name of building regulatory capacity – but whether they do or not is a different matter.

By way of illustration, a recent paper by Newman for the German Marshall Fund (Newman 2007) explains how a strengthening over time in the EU's regulatory capacity helped push the United States into negotiations that resulted in the U.S. accommodating strict data privacy rules. This happened despite the fact that the e-commerce sector, which was heavily affected by European rules, had a larger presence in the U.S. Instead, Newman argues: "internal transformations within Europe provided the EU with the regulatory capacity to force U.S. adjustment."[16] Subsequently, he argues that the U.S., having developed much greater regulatory capacity in customs security and a better understanding of European regulations, was successfully able to insist on European cooperation in the provision of passenger records for transatlantic flights.

From this standpoint, European and U.S. policy makers should think of their economic power as a necessary, though by no means sufficient, condition for successfully influencing international regulation. Maximizing their potential requires engagement in international forums, and ensuring that regulatory agencies are sufficiently well resourced as to be able to participate, promoting domestic

[15] Drezner (2007), p.5
[16] Newman (2007), p.9

approaches (and defending them from outside criticism) and ensuring that international discussions adequately reflect national interests.

In short, it is better to be engaged than isolated. For the world as a whole, wider participation in international discussions offers the potential for better and more legitimate regulation both within states and across borders. But a broader truth is perhaps more salient: ultimately, participation is fundamentally in countries' own self interest.

The Transatlantic Dimension

Despite these arguments, the global economy suffers from too little regulatory cooperation, not too much. In part, this doubtless reflects the difficulty of bridging the gap between domestic regulatory independence and economic inter-dependence. But it also likely reflects the relative novelty of the problem, having emerged as a significant challenge of the "new economic diplomacy"[17] in the last couple of decades.

Nowhere is regulatory cooperation more important than across the Atlantic, because the depth of U.S./European trade and investment ties brings our systems of regulation closely into contact. It's not just the scale of the relationship, but also its character. Service markets, such as telecoms and financial services, are becoming more and more intertwined, while investment and foreign affiliate sales are growing in importance relative to trade – so-called "deep integration"[18] which gives rise to greater regulatory inter-dependence. Consequently, the costs of friction and the long-term benefits of stronger ties are high relative to other bilateral partnerships. So we should start by making every effort to ensure that transatlantic cooperation is able to provide effective governance of what remains the single most important bilateral economic relationship in the world. We are, in the words of European Commissioner for the Internal Market and Services, Charlie McCreevy, "condemned to cooperate".

But it should also be clear that the issues we've identified are by no means specific to the transatlantic relationship; if globalization fulfills its promise and brings higher levels of economic development around the world, these governance challenges will affect more and more of the dealings that both the U.S. and EU have with third countries. And they, in turn, will need a new toolbox for managing their own regulatory inter-dependence with other states. The world needs to develop and implement new and successful ways of resolving these issues. A globally integrated economy needs regulators and legislators to work with their international partners. It requires governments to give their regulators the resources and policy discretion to cooperate globally.

Because of this, transatlantic efforts to improve cooperation have a global importance. Although we may start with transatlantic issues, the payoffs from these efforts can be spread much wider. By investing resources and political will, EU/U.S. regulatory cooperation can effectively pioneer new approaches to governance, identifying what works well and what doesn't. This fact perhaps underlies the

[17] See, for example, Bayne and Woolcock (2007)
[18] See Hamilton and Quinlan (2005)

characterization of the transatlantic economic relationship by many – including Commissioner McCreevy – as "the laboratory of globalization."[19]

Transatlantic regulatory cooperation is essential. But, seen through this perspective, it becomes clear that it may also be a breeding ground for new forms of economic diplomacy, and a key contribution to the development of more effective global economic governance.

Significantly, playing this role doesn't require any grand vision of selfless purpose. It asks little more of us than to act in our own self-interest. We should make a virtue out of this necessity.

Much, much more than transatlantic trade

It's worth emphasizing a second point here – that the way we make the case for transatlantic cooperation matters.

For the reasons outlined, transatlantic regulatory cooperation needs to address a range of issues, of which efforts to remove unnecessary barriers to EU/U.S. trade and investment are one, albeit significant, foundation. It is this single rationale that has long underpinned repeated transatlantic efforts to strengthen regulatory cooperation. But as a foundation for long-term cooperation, it may not be enough. Why?

First, we noted earlier in this paper that regulatory autonomy or sovereignty has considerable value, even though it may lead to some regulatory divergence between economies. As a result, the cooperation to open markets can look like (and may be) a trade-off between economic integration and policy autonomy or sovereignty. While there may be strong economic case in favor of harmonizing regulation in a particular area, governments may decide that this is a benefit they are willing to forego - a price they are willing to pay - in order to maintain their right to regulate as they choose. As a consequence, international regulatory cooperation, necessary for so many other reasons, may be under-supplied.

Second, a narrow focus on the trade rationale may pay only lip service to the idea that regulatory cooperation may be directed toward an overall increase, or tightening, in regulatory standards. Cooperation is by no means synonymous with de-regulation; nor should it be allowed to be seen that way, if it is to command ongoing political support.

Third, a focus only on trade will also tend to place excessive weight on the harder forms of cooperation such as harmonization or convergence in regulatory standards and approaches that may be necessary for opening up markets. Softer forms of cooperation such as dialogue and best-practice sharing are likely to be under-valued, because they have little immediate pay-off in terms of lower trade/investment barriers – even though, as we have seen, they have value in their own right.

The real irony here, however, is that these softer forms of cooperation may even be the key to many future efforts aimed at opening markets and deepening trade and

[19] See, for example, McCreevy (2008), in which he says: "I believe that transatlantic relations, because of our close ties and common values, are the very laboratory of globalization".

investment. All else equal, they're likely to contribute to greater similarity in regulation across countries in the name of policy effectiveness – which would make further convergence, or even harmonization, much easier. By increasing mutual understanding, spreading best-practice, sharing information and (not to be under-estimated) strengthening the professional relationships and ties between regulators, the looser, soft forms of cooperation may, in the end, make be what helps make the hard cooperation of mutual recognition or harmonization much more possible.

Whichever way you look at it, it pays to recognize that cooperation must be about more than trade.

<u>Conclusion: A False Choice</u>

The depth of argument in favor of cooperation is overwhelming; furthermore, if you think of cooperation as defined here – as a broad spectrum of policy options, from soft to hard coordination, that can adapt to achieve a range of objectives and suit particular circumstances – the costs of engagement can be relatively light. Drawing on the arguments identified above, the provision of modest additional resource to domestic agencies may, for example, maximize their ability to influence regulation globally, and increase their domestic enforcement capabilities.

In any event, as the regulators themselves often know only too well, the choice between openness and policy autonomy is largely a false one. The reality is that cooperation is not optional; it is essential in today's globalised economy. Regardless of how converged or otherwise national regulation becomes, legislators, regulators and supervisory bodies need to be working with their international partners.

In this light, transatlantic regulatory cooperation is particularly important. The depth of EU/U.S. trade and investment ties means that the costs of inaction are higher. And what we develop transatlantically, in terms of innovations in cooperation or solutions to overcome regulatory divergence, will increasingly be of value everywhere.

In many cases, regulators themselves have demonstrated that they are often only too aware of the implications of regulatory inter-dependence. But they also need support for their work – both financial and political. Governments would do well to bear that in mind.

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