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CANADA'S NEXT TOP TRADE BARRIER:

Taking International Regulatory Cooperation Seriously • *April 2016*

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INTRODUCTION

Nearly every international business has a horror story about getting its products approved in a new market. From redesigning a headlight because it tilted a few degrees higher to losing a shipment of cookies at the border because they were made with regular (unfortified) flour, companies from all sectors spend enormous amounts of money and time navigating and complying with a vast web of divergent regulations.

Good regulation is a force for competitiveness. Demanding and evidence-based regulation protects the health, safety, environment and pocketbooks of Canadians. It builds trust with consumers and gives companies confidence to invest. But Canada's rules do not carry much weight with its trading partners, who prefer to create their own rules. Sometimes Canada, too, fails to recognize when others get it right. So the world is left with a patchwork of divergent regulations that gums up supply chains and undermines international trade and investment.

So what is Canada doing about it? Its free trade agreements are good at taking down tariffs, but they have not had much success with regulatory issues.

This report explores this important gap in Canada's trade policy and outlines a new international regulatory cooperation strategy for the federal government. Our objective is to better understand the nature of regulatory barriers to trade—how they emerge and why they are so difficult to address—and to recommend changes to the institutions and approaches used by policymakers today to knock such barriers down.

The study began with a working paper that examined research on regulatory barriers to trade and the various forms of regulatory cooperation pursued by governments and international organizations around the world. Then we consulted with member companies, officials and regulatory experts. They were asked questions like:

- What does meaningful international regulatory cooperation look like?
- How can we use trade agreements to generate stronger regulatory alignment?
- How do we get better outcomes from alternative initiatives, such as the Canada-U.S. Regulatory Cooperation Council? Are there other models we should explore?
- Do Canadian regulators have the resources and mandates they need to effectively coordinate with their counterparts abroad?
- Is Canada active enough in global standard-setting bodies?
- What can we do to help developing countries adopt Canadian best practices?

The findings of the research are presented in this report along with a number of specific recommendations for the Government of Canada. These findings include:

- Regulatory barriers to trade emerge from behind the border. They are not the results of trade policy but of domestic policy. They are like tariffs in that they get in way of trade flows between countries but they are unlike tariffs in that they are neither as observable nor quantifiable. Nor are they as necessarily undesirable. This is why the international trading system has struggled to take them down.

- Regulatory barriers to trade are least likely to come by top-down orders; they are more likely to come down by bottom-up cooperation. Free trade agreements can help but, alone, they are not enough. What is needed are systematized relationships between regulators and relationships without a laundry list of explicit alignment goals. This is what should guide Canada's policy agenda with its trading partners.

- Regulators need to be properly incentivized to cooperate with their counterparts abroad and the Canadian business community. Regulators also need to better understand the trade effects of their work and figure them more prominently in their day-to-day work.

A regulatory system that generates the best outcomes for the public, while supporting an ambitious trade agenda, is a major competitive advantage for Canada. Companies that introduce products in Canada would have a passport to international markets.

REGULATORY BARRIERS HAVE BECOME THE BIGGEST THREAT TO INTERNATIONAL TRADE

The main barriers in the way of exporters and importers today are not tariffs or quotas; they are regulatory barriers to trade. These barriers are the results of divergent regulations: legal requirements on goods and services that differ by jurisdiction even though the jurisdictions are pursuing similar goals. As more countries develop more regulations, which they often do in isolation from each other, the trade costs to business will increase.

Imagine a Canadian company wanted to export to Europe. Assuming the regulatory requirements for the products in Europe diverge, this Canadian company would have to incur a set of high, unavoidable costs.

First the company would have to hire the expertise to scope out and learn about the regulations in the European market—these are the *information costs*. Then it would have to pay *adjustment costs* to redesign and remanufacture its products to align with European regulations. Finally, the company would have to pay *conformity assessment costs* to prove to European officials that its products conformed to their jurisdiction's regulations.

These delays and costs are justifiable if the divergent regulations make a difference, but sometimes products that are redesigned and remanufactured are, in effect, no less safe than their equivalents in the company's home jurisdiction. Variations of this story can be found across all sectors, from food processors and consumer goods to financial services, software and engineering—wherever a regulatory agency is seeking assurances that foreign products meet local requirements.

Information Costs

These are the costs of learning the regulatory details about the market in which you want to partake. It is not uncommon for firms to hire expertise to learn the regulatory details about the market for them.

Adjustment Costs

These are the costs of redesigning and manufacturing your product so that it conforms to the regulations in the market into which you want to export. Sometimes firms have to duplicate their entire production process.

Conformity Assessment Costs

These are the costs of having your product inspected—sometimes at multiple points along the way—to ensure your product does, in fact, conform to the destination's regulations.

These regulatory barriers are product quality specifications, content and labelling requirements, process specifications and conformity assessment procedures. They are the results of domestic policy and, though they have nothing to do with trade policy, they affect trade flows all the same. They significantly raise the cost of bringing a foreign product to a given market or they de facto prohibit some foreign products from being bought and sold in a given market. The case of selling lipstick between Canada and the U.S. is an infamous example of how frivolous regulatory differences can undermine trade.

After about 60 years of international trade talks, tariffs are lower than they have ever been—a tenth of what they were at the end of WWII. But the costs of regulatory barriers have increased in relative terms. Several recent studies have found that non-tariff measures—or NTMs—restrict trade almost twice as much as tariffs.[1] On average, the cost imposed by NTMs is equal to a tariff of 45%.[2] In some industries, such as agri-food, companies report that regulatory issues are the single most important factor driving sourcing and investment decisions.[3] Figure 1 shows the growing significance of NTMs for some of Canada's top trading partners.

Box 1 - Making Lipstick 1,700% More Expensive

Differences in the regulatory regimes of the U.S. and Canada make it unusually costly to import some lipsticks to Canada. Obtaining the approval to import lipsticks is usually a negligible cost—about $1,000 per brand. However, if the lipstick contains sunscreen, the cost goes up by several orders of magnitude—about $170,000. To send a SPF lipstick from Canada to the U.S., on the other hand, all that is required is an FDA inspection and any random border screenings and tests. The producer of the SPF lipstick becomes a "drug establishment" and, for that reason, needs to acquire a Drug Establishment License. The producer also needs to demonstrate compliance with Good Manufacturing Practices—a set of quality assurance practices. Then, once the product arrives to Canada, it is quarantined and retested for the active ingredient. The lipstick has to be fully tested annually.

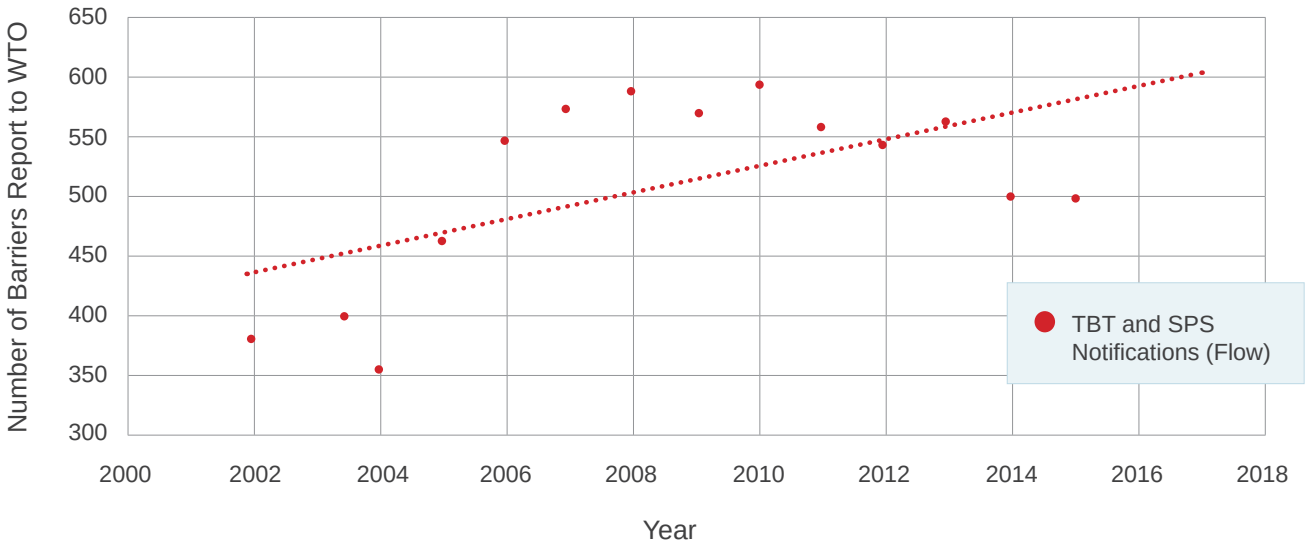
Source: CCTFA

1 UNCTAD 2013. Companies report that regulatory barriers, such as conformity assessments and quality control measures, are among the most significant NTMs, see Hermelink and Knebel 2012.

2 Kee, Nicita, and Olarreaga 2009.

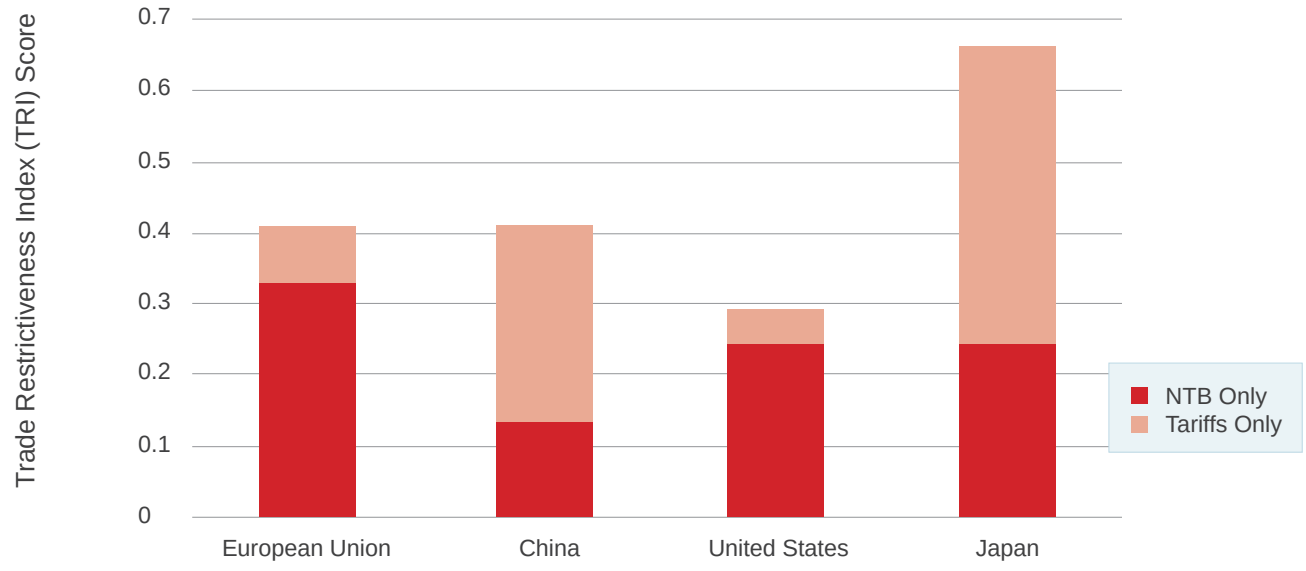
3 OECD-WTO Global Aid for Trade Review (2013)

Figure 1
Reported Regulatory Barriers to Trade with Top 4 Trading Partners



Source: WTO

Figure 2
Trade Restrictiveness: Tariffs vs. Regulatory Barriers



Source: Kee, Nicita, and Olarreaga (2009)

According to the WTO, the number of regulatory measures affecting trade has increased more than ten-fold from 1995 to 2010, with a spike after the global financial crisis in 2008.[4] Not only are countries adopting a higher number of measures, but countries that used to simply defer to U.S. and European regulatory decisions are also creating their own agencies and processes, especially in the area of food and health. There has been a five-fold increase in the number of countries issuing their own, often separate, regulations in food and health. Box 2 reviews some of the reasons why regulatory barriers are on the rise.

Box 2 - The Political Economy of Regulatory Barriers

Regulations are designed to solve market failures, not manipulate the flow of trade between countries. While regulations may restrict trade, they will often do so for good reasons.

Moreover, their use can be expected to grow as countries develop. Research shows that as countries become more democratic and prosperous, their use of regulation grows. On average, an increase in democratic openness from the level found in a country such as Cameroon or Egypt to the level of Brazil or India doubles the share of products covered by NTMs.[5] The growth of trade between countries is also responsible since the more goods and services move between countries with different regulatory systems, the more likely their quality, safety and ethical production will be called into question.

Nonetheless, regulatory measures are also effective ways to protect domestic industry from foreign competition, and this does happen.[6] In such a case, the purpose of the measure becomes creating exclusive benefits for certain producers.[7] Such rules work like tariffs, but the economic effects of "regulatory protectionism" can be worse.[8] This approach has political advantages over tariffs, too. Because it is less visible, voters are less likely to blame politicians for the higher prices it creates.[9] And their opacity makes regulatory measures hard for other countries to challenge in trade disputes—making them a more attractive option as trade agreements eliminate other forms of protectionism.[10]

4 See WTO I-TIP Database.

5 Kono 2006.

6 See Goldberg and Maggi (1999), Gawande and Bandyopadhyay (2000), Facchini et al. (2005), and Bombardini (2008)

7 Posner 1974.

8 Krueger 1974; Sykes 1999a.

9 Kono 2006.

10 Sykes 1999a.

THE CHALLENGE OF REDUCING REGULATORY BARRIERS TO TRADE

Trade policy is failing to deal with regulatory barriers. Whereas the reducing of tariffs is straightforward, reducing regulatory divergence is a complex, multifaceted problem that requires of jurisdictions that they cede some of their sovereignty. As a result, multilateral and regional trade agreements have primarily focused on issues of discrimination and transparency. More ambitious forms of regulatory cooperation, such as harmonization or functional equivalence, are more challenging, requiring alternative approaches rooted in long-term cooperative relationships between regulatory agencies. Governments need to rethink trade policy and expand their toolkits.

Lowering regulatory barriers to trade is not as straightforward as reducing traditional trade barriers. Tariffs and quotas can go up or down and their purpose is to raise the costs of imports. Regulatory measures, on the other hand, have layers of costs that are hard to quantify, are not targeted at foreign products, per se, and are usually motivated by, at face value, legitimate policy objectives. Cooperation to reduce these barriers is, therefore, a complex and multifaceted challenge. Table 1 breaks down regulatory cooperation into five types, each with its own benefits and costs for businesses and governments. It lists the types from most ambitious and challenging to the least so.

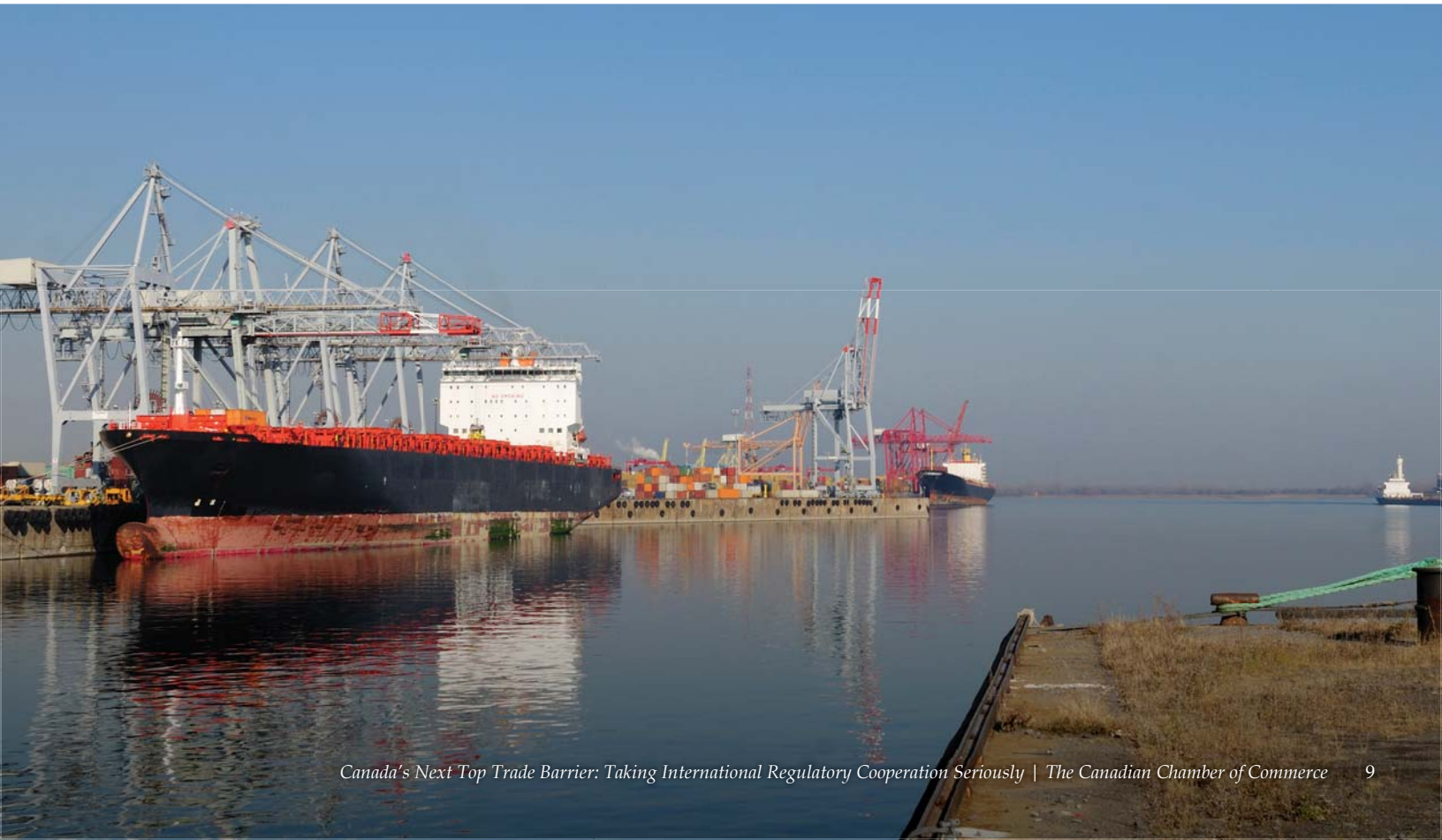


Table 1
Regulatory Cooperation: Benefits and Challenges

Type	Description	Benefits Once in Place	Challenges
Regulatory harmonization	Agreement between jurisdictions to comply with one set of regulations and/or standards across all jurisdictions, as the jurisdictions were, altogether, a common market	• Eliminates information costs for businesses • Eliminates adjustment costs for businesses • Eliminates conformity assessment costs if regulatory agencies are consolidated	• Sovereignty is ceded • Requires a high level of trust and shared regulatory objectives between jurisdictions • Harmonized rules may entail distributional costs for regulations and/or businesses in the jurisdictions
Functional equivalence	Agreement between jurisdictions to recognize each other's regulations and/or standards as equivalent, despite the possible differences	• Eliminates information costs for businesses • Eliminates adjustment costs for businesses	• Sovereignty is reduced • Requires a high level of trust and shared regulatory objectives between jurisdictions • May create an uneven playing field for businesses if regulations recognized as equivalent effectively differ, which may entail significant distributional costs (e.g., businesses may move to the lower regulatory-cost jurisdiction)

Type	Description	Benefits Once in Place	Challenges
Mutual recognition of conformity assessment procedures	Agreement in which jurisdictions recognize conformity assessments done by foreign bodies, even when businesses are complying with different standards and/or regulations	• Eliminates or reduces conformity assessment costs for businesses and/or government officials while leaving intact the regulations of the parties to the agreement	• Requires of parties prior convergence and/or trust of conformity assessment practices
Transparency and notification	Agreement to maintain publicly accessible lists of local regulatory requirements and to notify foreign governments, intergovernmental institutions or businesses of any changes made to regulations; sometimes governments will agree and be obliged to provide rationales for the changes and to consult with affected foreign businesses	• Reduces information costs and regulatory uncertainty for businesses • Governments are more easily held accountable to international trade obligations • Can help build trust between regulators from different jurisdictions	• May entail sovereignty costs if governments are parties to agreements that constrain the sorts of regulations they may pass • Minor administrative costs
National treatment	Agreement to apply the same regulatory measures to foreign producers and products that are applied to domestic producers	• Prohibits outright discriminatory regulatory measures • Does not impinge on regulatory sovereignty	• Hard to prove cases where domestic regulations apply equally but are designed to have a discriminatory effect on foreign products

Regulatory Harmonization

The most ambitious form of cooperation is *regulatory harmonization*. That is when separate jurisdictions agree to operate by a common set of rules for a particular product or set of products. In a bilateral context, this would be done either by having one jurisdiction adopt the regulations of the other or by having the two meet somewhere in the middle. With only one set of regulations to comply with, the jurisdictions are a common market. Box 3 shows that the gains of harmonization are not negligible. In its most extreme form, jurisdictions may even agree to consolidate regulatory activities in a shared agency. Harmonization is also the most challenging form of cooperation because of the sovereignty implications and potentially high, one-time adjustment costs for industries.

Functional Equivalence

Not as ambitious as regulatory harmonization is *functional equivalence*. Functional equivalence requires of jurisdictions that they recognize each other's regulations as equivalent in achieving shared policy goals. If the U.S. and Canada agreed to recognize each other's regulations in a particular area, for example, a product approved in Canada would, by extension, comply with requirements in the U.S. This eliminates day-to-day information and adjustment costs for companies while avoiding the one-time adjustment costs associated with moving to a new set of harmonized regulations. It does, however, have its challenges. If there are significant differences in the costs of "equivalent" regulations, firms might relocate their production and approval processes to the lower-cost jurisdiction. Functional equivalence also requires a great deal of trust between governments.

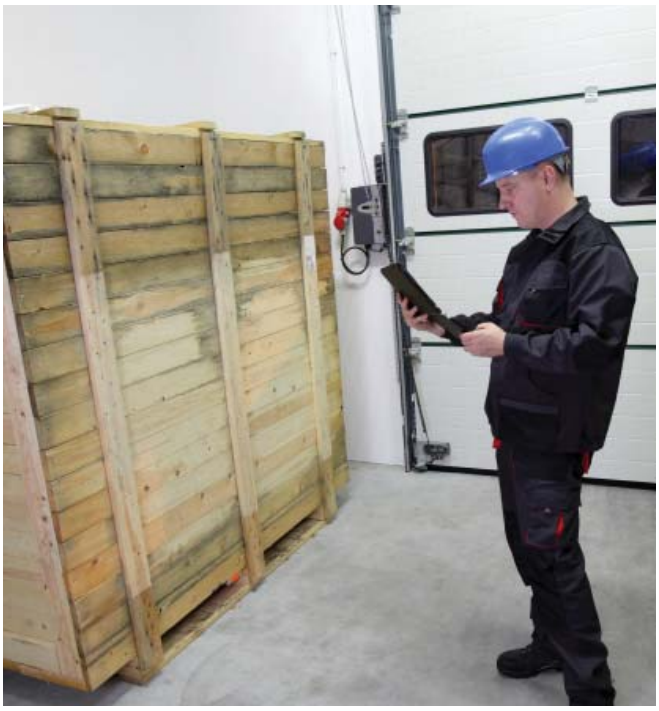
Box 3 - Orphan Drug Regulations

Health Canada's proposed Orphan Drug Regulations would impose hefty costs on research-based pharmaceutical companies if they do not align with those in the U.S. and the EU. In part, that is because they would erect a hefty trade barrier in between Canada and the U.S. and in between Canada and Europe. A study by Innovative Medicines Canada concluded that the proposed regulations, if not harmonized with those in the U.S. and the EU, would cost a company about $1.7 million annually. By harmonizing the proposed regulations with those in the U.S. and the EU, however, they would cost a research-based pharmaceutical company about eight times less, approximately $210,000 annually.

Source: Innovative Medicines Canada

Mutual Recognition of Conformity Assessment

Unlike functional equivalence and harmonization, *mutual recognition of conformity assessment* does not equalize regulations. Mutual recognition of this sort happens when jurisdictions recognize the conformity assessments done by a foreign agency or assessment body. What this means for companies is that, though they still have to abide by the divergent regulations, they may demonstrate their compliance fewer times or in a more streamlined way. For mutual recognition to work, a high level of trust typically needs to exist between conformity assessment bodies. However, it is a way to reduce the costs of doing business without necessarily impinging on the ability of countries to set their own regulations. Though it leaves the taller regulatory barriers intact, the benefits are not negligible (Box 4).



Box 4 - Equivalence without Mutual Recognition of Conformity Assessment Leaves Regulatory Barriers Intact

On average, Canada annually exports nearly 600,000 tonnes of meat to the United States. That is more than 28,000 truckloads crossing the Canada-U.S. border every year. Though the U.S. FSIS has formally acknowledged that Canada's meat inspection system is equivalent to USDA standards, Canadian meat on its way to the U.S. still has to be inspected twice—once by Canadian authorities and again by U.S. authorities at the border.

Canada re-inspects imports, too, but it carries out its re-inspections periodically. For example, based upon the equivalency recognitions in the Canada-U.S. Free Trade Agreement, Canada re-inspects imports from the U.S. at a frequency of one in 10. USDA's re-inspections of *all* U.S. meat imports from Canada are redundant and they put a damper on Canadian competitiveness. Reporting to U.S. inspection centres costs drivers two to four hours of time, which, at $100 per hour, amounts to $5.6 million to $11.2 million in time. And that is not including the re-inspection fees that apply.

Worse is that the re-inspections that take place at the U.S. border introduce product and marketing risks. Many of the U.S. inspection centres, which are privately owned, charge re-inspection fees without USDA oversight and are old, non-refrigerated facilities that do not adhere to the same food safety standards as do the CFIA and USDA facilities from which the meat is first inspected and shipped.

Source: Canadian Meat Council

Transparency and Notification

Giving foreign agencies a role in our regulatory processes, or their giving us a role in theirs, can be uncomfortable. Successful cooperation of this variety is rare, and the more common practice is for countries to commit to *transparency and notification*. Obliging by these commitments requires that governments publish their regulations, including the rationales for having adopted the measure. They may notify relevant stakeholders—businesses, foreign governments—when they are planning on developing new regulations, giving them a chance to provide technical assistance on their substance and implementation. This form of cooperation may leave regulatory differences and conformity assessment procedures intact, but it reduces the uncertainty and information costs of companies doing business across borders. It is also an important building block between regulatory agencies and can help encourage further cooperation in the future.

National Treatment

The least ambitious form of regulatory cooperation is when countries commit to extending each other *national treatment*. This means that regulations that countries apply to foreign products will also apply to those produced domestically. This prevents the most egregious forms of regulatory protectionism, but otherwise lets countries develop their domestic regulatory regimes with little consideration of indirect impacts on international trade.

Over the years, countries have used many instruments and institutions to pursue regulatory cooperation, ranging from the legalistic to more ad hoc forums. The results have been mixed. While treaties, such as trade agreements, have committed states to regulate more even-handedly and transparently, they have had little success in the harmonization and mutual recognition of regulations or conformity assessments. Where these more ambitious and consequential outcomes have been achieved, success has come from hard work and relationship-building between regulators—not trade agreements and the multilateral trade system.

Table 2
Forms of Cooperation and Examples

Type	Examples
Regulatory harmonization	The ***Treaty of Rome (1958)*** created the European Economic Community, which established **supranational institutions** that issued directive standard-setting bodies such as **CEN**, **CENELEC** and **ETSI**. In New Zealand and Australia, there is the **Australia/New Zealand Food Authority** and the **Joint Accreditation System of Australia and New Zealand**. There was also the promising **Australia/New Zealand Therapeutic Product Agency**, but it failed to materialize.
Functional equivalence	In Europe, functional equivalence was established through a decision by the **European Court of Justice** and, later, through the **Single European Act (1986)**. In Australian and New Zealand, there is the **Trans-Tasman Mutual Recognition Agreement**.
Mutual recognition of conformity assessment	Bilateral or multilateral **Mutual Recognition** (of conformity assessments) **Agreements** are quite common. There are, for example, **Telecommunications and Electronic Equipment MRAs** under **APEC**.
Transparency and notification	Transparency and notification is a legal obligation in many trade agreements such as the **GATT**, **GATS**, **TBT** and **SPS Agreements**, **CETA** and the **TPP**. Institutionalized dialogues also take place between governments at the **WTO** through the **SPS** and **TBT Committees**.
National treatment	Since **GATT (1947),** modern **free trade agreements** require parties to regulate foreign products "no less favourably" than domestic products.

The 1947 General Agreement on Tariffs and Trade (GATT) only requires signatories to extend national treatment to foreign products when it comes to behind-the-border regulations. In the 1960s, a GATT committee set up a working group to study what it called "technical barriers to trade." The intention was to build on these basic national treatment rules and deal with a problem that national treatment could not fix: regulations that, at face value, applied equally to domestic and foreign products, but which, in practice, imposed unequal burdens for no legitimate reason.

These discussions sowed the seeds of two multilateral agreements that came out of the Uruguay Round and remain significant to this day: the Agreement on Technical Barriers to Trade (TBT), which applies to regulations, standards and conformity assessments more generally, and the Agreement on the Application of Sanitary and Phytosanitary Measures (SPS), which applies to behind-the-border measures on health, food and plant safety. The agreements essentially prohibit behind-the-border measures that serve "illegitimate" purposes. Signatories to the agreements cannot treat foreign goods any differently than domestic goods, and regulations have to be rooted in sound science and risk management. Signatories are also required to display their regulations publicly and to notify other members of new regulations that will affect trade in goods. Some of these principles found their way into the General Agreement on Trade in Services, or GATS, which also came out of the Uruguay Round.

Some good has come out of these agreements. The WTO dispute settlement mechanism, for instance, has occasionally forced countries to remove discriminatory regulations—most recently the case of U.S. country-of-origin labelling requirements discriminating against Canadian and Mexican meat imports. Still, the WTO agreements do not prevent divergent regulations from emerging from poor coordination between national regulators. There is still nothing to stop behind-the-border measures from becoming regulatory barriers to trade so long as they are appropriately purposed and not discriminatory.

Regional and bilateral agreements have tried to go further. The Canada-Korea Free Trade Agreement (CKFTA), the Canada-EU Comprehensive Economic and Trade Agreement (CETA) and the Trans-Pacific Partnership (TPP) agreement, for instance, have enhanced chapters on TBT and SPS as well as new chapters on regulatory "cooperation" and "coherence." Parties commit to higher levels of transparency and more advanced notification as well as good rule-making practices. These regional and bilateral agreements also establish committees of regulators to exchange information and co-develop future regulations. Some even have explicit commitments to not just cooperate but align. Still, these are few and far between.

Officials need to expand their toolkits. Aligning regulations and prohibiting future divergence is not as easy as signing a trade deal. Trade negotiators are reluctant to negotiate such commitments, and regulators are unlikely to sign away their policy space wherever they can. Regulatory cooperation has to be more than a legal outcome and more than a one-time effort. And it starts by getting everyone together in one room.

Cooperative forums

Experience suggests that ambitious regulatory cooperation, like harmonization or functional equivalence, needs to start in broader institutions that develop trust and familiarity and understanding among the parties involved. These institutions are forums where officials regularly meet to build professional relationships, exchange information and experiences and build common approaches to regulatory problems.

Such forums have proliferated in recent years. Some start as general institutions, such as the Organisation for Economic Cooperation and Development (OECD), the Asia-Pacific Economic Cooperation (APEC), the Black Sea Economic Cooperation, the Central European Initiative, and the Canada-U.S. Regulatory Cooperation Council. They serve as effective platforms to develop smaller working groups. Other cooperative forums start as issue- or sector-specific. The International Competition Network, the International Medical Device Regulators Forum and the Basel-based institutions that focus on financial regulation are a few examples. Cooperative forums are easy to establish because there are no binding obligations, which means state sovereignty is kept in full, and the administrative costs are limited and can be shared between parties.

Despite lacking hard legal commitments and ambition at the outset, cooperative forums have led to reductions in regulatory barriers to trade. Studies of the Basel Committee for Banking Supervision and the International Organization of Securities Commissions, for example, found that they have produced a great deal of regulatory convergence on such things as capital requirements and the prosecution of insider trading, even though the cost of doing so was high for some members.[11]

11 Bach and Newman (2010), Singer (2007).

A NEW REGULATORY COOPERATION STRATEGY FOR CANADA

Canada needs a regulatory cooperation strategy. Officials should refocus Canada's resources and efforts where they actually can chip away at what is becoming its biggest trade barrier. Because the problem of regulatory barriers to trade is two-fold—consisting of intergovernmental initiatives and the domestic regulatory regime—Canada's strategy, too, must consist of these two elements.

Abroad, officials need to adjust their approach with key trading partners. Sometimes, officials will need to leverage an institution or forum that already exists more effectively while other times, they will need to work with trading partners to create a new institution or forum. And, at home, regulators need to be brought into the game. They need the signal from leadership to care more about regulatory barriers to trade and they need the power to do something about them. This means having the budgets to travel and meet with their foreign counterparts and build relationships that will make for effective regulatory cooperation and having more channels to do something about regulatory barriers themselves.

What Canada should not do is align with or cooperate on regulations without thought. There will always be situations where local conditions require local solutions or where it is in the interest of Canadian industry to push a certain set of international standards, either alone or with major trading partners. But creating the mechanisms to cooperate when it makes sense should be a top priority for the federal government.

THE AGENDA WITH CANADA'S TRADING PARTNERS

Canada's relationship with the United States already has a lot of moving parts. CETA, the TPP and a new push to deepen its ties with China gives Canada new, unexplored opportunities to reduce regulatory barriers. A more intense engagement with the WTO and with international development policies will also be a necessary part of any comprehensive strategy.

Building stronger North American regulatory cooperation

The United States is Canada's top trading partner. The Canada-U.S. relationship is deep and has a long history. The Regulatory Cooperation Council (RCC) is promising but its success will require persistent effort by Canadian officials. Canada can get more out of the RCC through reforms to its structure and by finding ways to bring other countries in.

Being as close as they are, Canada and the United States have a long history of economic cooperation, both formal (such as the North America Free Trade Agreement and treaties to manage waterways) and informal. This history has made it easy for the two countries to create the Canada-U.S. Regulatory Cooperation Council whose goal is to encourage even closer, more formal regulatory cooperation with the hope of seeing regulatory alignment going forward.

In December 2011, the RCC put out the Joint Action Plan, which laid out its 29 work initiatives, each developed in cooperation with industry stakeholders and involving either ongoing cooperation or alignment or both. It largely failed to meet expectations so the RCC came out with another Joint Forward Plan in 2014. The RCC reported what it had learned would be needed to make regulatory cooperation work better. The RCC announced that its goal was to have "bilateral regulatory cooperation within the regular planning and operational activities of regulatory agencies." In May 2015, each of the two countries' similarly mandated lead regulatory departments and agencies made regulatory partnership statements that outlined the scope and mechanics of their ongoing cooperation.

Though industry stakeholders acknowledge the RCC's successes (Box 5), there is a growing sense of frustration. The bottom-up approach of its 2014 plan has enormous potential and is informed by the experiences of other regulatory cooperation initiatives around the world. But, with the focus having moved from the RCC itself to the departments and agencies on the frontlines, some report they are not aware of the opportunities to provide technical input and are not regularly updated on the progress of department or agency work plans and initiatives. Some feel the RCC has become impotent or has lost sight of its core objective. To fix this, industry needs to be better engaged.

Box 5 - RCC Wins

Vehicle emissions

Environment Canada aligned its new vehicle and fuel standards, whose purposes were to reduce air pollution from on-the-road vehicles, with the United States. Alignment with the U.S., in this case, resulted in more stringent standards for the vehicular emissions of air pollution in Canada.

Rail cars

Transport Canada and the U.S. Department of Transportation collaborated to strengthen the safety of rail cars by introducing a new standard of rail tank cars that carry flammable liquids. As Canada and the U.S. have the same standard, it enables the rail industry to operate more efficiently in either country.

Motor vehicle safety

Transport Canada and the U.S. National Highway and Traffic Safety Administration aligned their standards for tires, frontal impact occupant protection and motorcycle brake systems. Not only did the alignment improve safety standards but it also reduced unnecessary costs for businesses by precluding unnecessary duplication.

Common Electronic Submission Gateway

January 2014 saw the launch of the Common Electronic Submission Gateway, which enables companies to send data through the Food and Drug Administration's existing electronic system for product review and approval to Health Canada. Now, businesses can initiate the regulatory process in both jurisdictions at once.

Source: Privy Council Office

Crop protection

The Pest Management Regulatory Agency and the U.S. Environmental Protection Agency have not only aligned their product reviews and risk assessment methodologies, which includes a joint review process to do away the administrative burden caused by duplication, but also their crop groupings.

Nanotechnology

Canada and the United States agreed to regulate nanomaterials under a common set of principles, laying the foundation to build consistent regulatory frameworks as the cross-cutting industry and its regulations develop.

Meat cutting

Canada and the U.S. agreed to use the same terminology to identify wholesale cuts of meat, eliminating the cost to businesses of having to keep separate inventories of effectively the same cuts of meat.

Workplace chemicals

Health Canada and the U.S. Department of Labor aligned their classification and hazard communication requirements to a global standard and they require common label and safety data. It was estimated that the common labelling alone would save North American paint and coating companies $30 to 55 million in 2015.

Veterinary drugs

While Health Canada and the U.S. Food and Drug Administration's Center for Veterinary Medicine have worked together to conduct reviews and approvals for veterinary drugs simultaneously, the two are also developing a process whereby they will receive submissions and conduct reviews collaboratively where possible, leaving each of the two to decide for itself whether the product ought to be approved for its market.

Another challenge facing the RCC is the fact that the Government of Canada shoulders most of the burden for its direction and administration. The secretariat that is responsible for overseeing the RCC is housed in the Privy Council Office in Ottawa and is comprised of over a dozen staff. Its counterpart is the Office of Information and Regulatory Affairs (OIRA) in the White House, which has very few staff involved with the RCC. Still, the RCC's existence depends on ongoing support and engagement from OIRA and the White House. It will, therefore, be important for Canada to reinforce the value of the RCC to the next U.S. president. One way to enhance the status of the RCC in Washington would be to link it to the U.S.'s global regulatory objectives, like trade negotiations with the European Union and the Trans-Atlantic Trade and Investment Partnership (TTIP) where regulatory cooperation is front and centre.

Recommendations

The federal government should:

- Create a dashboard that industry stakeholders can use to track the agendas and progress of bilateral partnerships between Canadian and U.S. regulatory agencies under the 2014 Joint Forward Plan. It should show the pipeline of regulations under development, a schedule for stakeholders to provide input and technical advice as well as regular status updates.
- Reinforce the importance of the RCC to the next U.S. president and seek ways for the RCC to contribute to U.S. global regulatory objectives, including through potential links to U.S.-Mexico regulatory cooperation efforts.

Get the most out of CETA

The European Union is one of Canada's largest trading partners. The EU's market has stringent regulations in such areas as agri-food and data privacy. Because of its experience developing the European single market, the EU is one of the world's more sophisticated practitioners in regulatory cooperation. While Canada should work to make CETA a house of regulatory cooperation, it should, in most cases, prioritize North American alignment and wait for the bigger gains from TTIP that would naturally extend to it.

Canada and the European Union already have a venue for regulatory cooperation: the Comprehensive Economic and Trade Agreement (CETA). CETA's provisions on regulatory cooperation are the most advanced of any Canadian free trade agreement, with strong obligations on transparency and notification and even some provisions around the recognition of conformity assessments. It also commits the parties to establish committees on regulatory cooperation, including in the area of biotech, which has been a long-standing trade irritant.

Though CETA sounds promising, it is vague enough to leave officials with quite a bit of room to develop diverging regulations. CETA's impact on regulatory barriers will depend upon how seriously regulators consider the trade effects of their day-to-day work and how closely they interact and consult on future regulations. Consultative mechanisms alone may be insufficient to get meaningful regulatory cooperation underway.[12] Even in cases where there was to be prescriptive cooperation—e.g., allowing Canadian exporters to use Canadian conformity assessments to certify to European standards—some companies involved suggest the gains may not be meaningful in practice.

12 Vogel (2012)

CETA is only a starting point. Canada should work with the EU to establish the committees outlined in CETA and bring in line agencies that could establish partnerships around specific issues. By doing this, and by having the EU as an observer of the RCC with the U.S., Canada can increase its chance of being included in the broader discussion about regulatory cooperation underway in the ongoing trade negotiations between the U.S. and the EU.

Recommendations

The federal government should:

- Rapidly establish the regulatory cooperation committees outlined in CETA and, where appropriate, sign an agreement between similarly mandated agencies that requires the agencies to share their regulatory agendas, develop agendas in cooperation with stakeholders and communicate progress regularly.
- Exchange observer status in the RCC for observer status on regulatory cooperation discussions in TTIP.

Laying the foundation for regulatory cooperation in the Asia-Pacific

The Asia-Pacific is a major growth market for Canadian business. As emerging countries in the region continue to develop, so will their regulatory regimes as new needs arise and people demand more regulatory capacity. The Asia-Pacific is also where Canada's regulatory relationships are least developed. By using the TPP, APEC and development assistance to build relationships and regulatory capacity that aligns with international standards and best practices, Canadian businesses will be more likely to succeed there.

Regulatory barriers to trade are becoming a major problem in the Asia-Pacific, but Canada's relationships in the region are weak. Canada's first step should be to ratify and implement the TPP, which contains provisions on regulatory issues that go beyond what Canada has in the WTO and is set to cover much of the region's economy. In addition to current parties— Japan, Malaysia, Vietnam and Singapore—others, including the Philippines, Indonesia, Thailand and Taiwan, have said they intend to join. This is an unrivalled platform for Canada to foster high-quality regulatory practices across the Asia-Pacific.

The TPP has provisions on technical barriers to trade and sanitary and phytosanitary measures that are not just reaffirmations of WTO obligations, but augmentations thereof. Along with transparency measures, including a requirement to hold public consultations early in the life of a regulatory proposal (before it is finalized), the TPP establishes mutual recognition of conformity assessments for certain types of products. In addition to obligations that promote science-based, transparent regulation, the SPS chapter creates a new consultative mechanism for the quick resolution of SPS issues.

The TPP also contains a chapter on what it calls regulatory coherence. One of the things to come out of this chapter is a committee on regulatory coherence, which is tasked not only with carrying out the implementation of measures that promote good regulatory practices, but also with "identifying future priorities, including sectoral initiatives and cooperative activities." There are references in the agreement to ongoing regulatory cooperation forums, such as APEC.

Outside of the TPP, Canada can complement these efforts by using development assistance to help countries in Southeast Asia build their public sector and improve the quality of regulation. Canada has experience sending regulators from the Canadian Food Inspection Agency, Natural Resources Canada and other institutions to help develop local regulations and technical capacity. The spillover of this involvement is that local rules will be more familiar to Canadian companies doing business in the region.

Recommendations

The federal government should:

- Ratify the TPP and use related cooperative forums, such as APEC, to improve alignment with Japan and other key markets in the TPP. The government must ensure Canada's regulators are not only incentivized to partake, but also have the budgets to partake.
- Increase development programming that helps build regulatory capacity in areas of Canadian expertise, such as food safety, environmental regulations, extractives and so forth.

Create a plan for China

China is now Canada's second-largest trading partner, but Canada's relationship with China is less developed than it is with the EU and the U.S. It is time to further develop the relationship by completing a comprehensive study of the barriers to trade, including those of a regulatory nature, and how a free trade agreement might take them down. Canada should also pursue regulatory cooperation through the intergovernmental committees that already exist and offer technical assistance to help develop a science-based regulatory regime.

Canada and China established their economic ties early, and they are not insignificant. Canada helped China to develop its food safety regime, for example. Canada and China have also established cooperative committees on different sector-specific issues, and many of those committees meet regularly. Canada and China have agreed to improve market access, technical cooperation and research, as well as establish a "track two" business dialogue to study the potential for a free trade agreement.

The "track two" business dialogue is an opportunity for the Canadian and Chinese governments to review all the regulatory barriers to bilateral trade and examine how a trade agreement would take them down. In other words, Canadian and Chinese officials should explore exactly what form regulatory cooperation between the two countries should take. It is important that business stakeholders are invited to partake in this dialogue because they understand first-hand the domestic effects and the trade effects of regulation.

Officials should also use existing bilateral committees to expand regulatory cooperation. Here, too, business stakeholders need to be better integrated into the process. They need to be involved in the agenda-setting and in the joint meetings with officials. They need to be involved as participants, not as the mere bystanders they are now. Canada should also make these committees more relevant by funding technical assistance programs to deal with the changes underway in China as many Canadian companies find it challenging to comply with the changing local requirements (Box 6).

Box 6 - Get Canada-China Sector Groups Doing Regulatory Cooperation

Over the past decade, Canada's canola farmers, processors and exporters have capitalized on the advances in plant science and the growing demand in Asia to become an industry that contributes nearly $20 billion a year to the national economy. Hoping to replicate this success with soybeans and corn, seed developers plan to invest hundreds of millions of dollars over the next 10 years to expand the production of these crops by eight to 10 million acres.

But the long-term potential of these industries in China, which imports a third of Canada's canola production, depends on whether the barriers to trade in the Chinese market can be knocked down. Securing marketing approvals for biotech crops in China has become challenging. In-country field trials are being delayed, approval criteria have become murkier and the overall regulatory review period is longer and more unpredictable. As a result, new high-yield seed varieties are often stuck in limbo and are unavailable to Canadian farmers.

This is something Canada-China joint sector groups can deal with as officials spend their time having higher-level discussions about the feasibility of a trade agreement. The Canada-China joint agricultural group consists of the relevant departments in both Canada and China. Some of the group's more concrete goals include modernizing each country's approach to agriculture and agri-products, encouraging sustainable development and improving bilateral trade between the two countries.

Some of the areas where the joint agricultural group has identified potential for cooperation are food security, sustainable development, biotechnology, animal husbandry and the communication of agricultural policy and regulations. In these ways, Canadian and Chinese officials already cooperate on regulatory matters by exchanging information and keeping each other up-to-date on what is ahead. Industry believes these joint groups are beneficial and have helped them do their jobs better, so officials should not let the potential of these groups go to waste.

Recommendations

The federal government should:

- Conduct a joint study with business in both Canada and China to explore the feasibility of a free trade agreement, with specific attention to the effect it would have on regulatory barriers to trade.
- Involve businesses in the agenda-setting of ongoing sector-based committees and communicate progress on regulatory cooperation.
- Undertake technical assistance projects to support science-based regulations in China.

Make the WTO matter more

While a multilateral treaty on regulatory cooperation is unlikely to emerge anytime soon, the WTO still has an important monitoring role to play. Many member states adhere to their transparency and notification requirements under the WTO treaties, but there is room for improvement.[13] Notifications do not work as they are supposed to in theory. In practice, notifications are too narrowly obligated, too poor in their informational depth and too slow in their arrival, with regulatory proposals often coming to light after the point where anything can be done about them.

There are a variety of reasons as to why the WTO's record is lacklustre. There is the problem of bureaucratic capacity, with many developing countries being unable to collect, assemble and present the necessary information they need. While the U.S.' intelligence on TBT and SPS is well resourced and well gathered by its network of agencies, embassies and private-sector committees, for instance, many other countries lack the means to do the same.[14]

The WTO Secretariat is best positioned to get the information and knowledge about regulatory barriers to trade better flowing between members.[15] In addition to increasing the flow of information to countries that lack bureaucratic capacity to do it themselves, the WTO Secretariat could leverage the Trade Policy Review Body to pay closer attention to the regulatory process issues of member countries—ones that erect regulatory barriers to trade and raise costs—as well as the trade effects of regulations. All the WTO Secretariat needs is more resources and wider scope.

Recommendation

Canada should push WTO members to better resource and widen the scope of the WTO Secretariat so that it can improve data collection and notification of regulatory measures affecting trade.

13 Wolfe (2013)

14 Ibid.

15 Ibid.

THE AGENDA AT HOME

As international regulatory cooperation becomes a paramount priority for Canada, officials need to rethink the way in which they organize themselves at home. In some ways, trade policy and regulatory policy need to be married. To enable cross-border trade and investment while meeting their obligations under domestic law, regulators need more flexibility, more resources and a deeper working relationship with not only trade officials and industry stakeholders, but with their counterparts abroad.

Empower regulators to cooperate and align

Regulators have told us they want to do more about regulatory barriers to trade, but they have also told us it is difficult for them to do anything about them because they often lack the flexibility and the means. There is not always enough money in departments' budgets to attend regulatory conferences abroad. One of the seeds to regulatory cooperation is trust, but Canada cannot build trust if regulators are not meeting with their counterparts to exchange information and experiences—the first step to developing common regulatory approaches.

Trust also cannot be built if we give our counterparts abroad the impression that we are not adequately resourcing our regulators to work on regulatory alignment *and* meet their obligations under domestic law. Sometimes regulators want to do something about a misaligned regulation but they cannot justify entering the drawn-out regulatory process to change a misaligned yet functioning regulation.

Other times, when regulators can and want to do something about regulatory barriers, they are blocked from it by legislative barriers that Canada has erected ahead of itself. Legislative barriers to regulatory alignment are those that get in the way of regulators when they could easily align. Some of them have already been knocked down. Thanks to Bill S-2, regulators are better equipped to adapt regulations to changing times and circumstances without having to draft the adaptations from beginning to end; regulators may simply cite the texts upon which the adaptations of the regulations are modelled. But some barriers

remain. The One-for-One Rule, for example, can block regulators if they are trying to align with Canada's trading partners since it constrains how regulations can be administered.

Finally, regulators have also told us that there is not enough of an incentive to take down regulatory barriers to trade. In addition to resources, regulators need a mandate to take regulatory barriers to trade more seriously. Canada's regulatory process already requires regulators, when they are submitting a regulatory proposal, to conduct a regulatory impact analysis (RIA)—a necessary component of which is the consideration of how the regulatory proposal might affect international competitiveness and regulatory barriers to trade. To ensure regulators take regulatory barriers to trade more seriously, for example, the regulatory system could reward the regulators who demonstrate that their proposals lowers the costs of regulatory barriers to trade or even knocks down regulatory barriers to trade.

Box 7 - Legislation Sometimes Affects the Ability of Regulators to Align with Trading Partners

Canada's Red Tape Reduction Commission recommended that the Government of Canada stop the growth of administrative burden, which the government did by instating the One-for-One Rule. The rule, when activated, forces regulators to offset any new administrative burden they introduce in their work by reducing an old administrative burden of the existing stock of regulations.

Though it is meant to lower the administrative costs businesses face, the One-for-One Rule may be costing businesses in another way. According to Natural Resources Canada, amending Canada's energy efficiency regulations in a way that would better align with U.S. regulations may activate the One-for-One Rule, which would slow regulators down in their efforts to align. This would force regulators to burn through their resources to not only do the modifications but examine where they can reduce administrative burden to offset the additions thereof. During our consultations, stakeholders told us this is one of the reasons why it has taken so long to update Canada's energy efficiency regulations.

The Incorporation by Reference in Regulations Act (passed in the previous Parliament), on the other hand, is an example of how lawmakers have made it easier, legislatively, for regulators to align with Canada's trading partners. The Act enables regulators to incorporate regulations *by reference*. This means that, instead of drafting a regulation from beginning to end, regulators may cite another text upon which they are modelling their regulation.

Recommendations

The federal government should:

- Ensure departments are adequately staffed and budgeted. The government should conduct a resource review of the regulatory departments to ensure they have enough resources to do their jobs as regulators—not only submitting regulatory proposals as new needs arise, but also modifying existing regulations to increase alignment—and to meet with their peers abroad to share information and experience and access the best science.

- Get the incentives right. The government must leverage the regularly process—e.g., RIAs—to send the signal to regulators that regulatory barriers to trade need to be taken seriously. The government should explore how it could make it easier for regulators to reduce the costs of regulatory barriers to trade or to take them down entirely.

- Take down legislative barriers to alignment, finding a way around legislative barriers when legislative barriers needlessly get in the way of alignment. For example, the government could introduce an exception to the One-for-One Rule when it prevents regulators from administering regulations in a way that would have them align and when business stakeholders think it worth the extra administrative burden to align.

Create an institutional architecture for strategic regulatory cooperation

Even if regulators have the power to do something about regulatory barriers to trade, they still need to know when and where to pursue regulatory cooperation. They need direction and information, which is scarce—some researchers have argued that the regulatory universe in is in a "coherence deficit" because there are persistent knowledge and coordination gaps.

The best place to obtain knowledge is on the ground where business supply chains operate. Businesses in supply chains are uniquely positioned to know where the economic universe and the regulatory universe collide. So supply chain councils would help to fill the knowledge gaps.[16] These councils would serve as advisory bodies to governments and regulators. There would be many of them—each representative of the supply chain of which they are a part—and they would identify where regulatory cooperation would yield the biggest bang for the buck and how it could be done. The councils would also oversee and monitor the progress of cooperation and alignment initiatives.

Supply chain councils, however, would only advise and oversee; they would be without the mandate to direct and coordinate. That would rest with a central government body under whose auspices the supply chain councils would work. The central body would have the authority and mandate to take the findings and advice of the

16 Councils would be representative of value chains or production networks of economic significance. On the councils would sit representatives of businesses, employees, government departments, regulatory agencies and whoever else has a stake in the value chain or production network. One feature of international trade flows that might bias the council is the fact that large firms tend to make it up. Large firms do not necessarily benefit from the knocking down of regulatory barriers to trade and may even benefit the competition-reducing effects of regulatory barriers to trade (WTO, 2013). This bias, if problematic, would need to be accounted for. For a deeper discussion of supply chain councils, see Hoekman (2015).

supply chain councils and put them into action, moving across the whole of Canada's regulatory universe, across agencies and ministries and departments. The Privy Council Office, which has taken the lead on RCC, could assume this role.

Recommendations

The federal government should:

- Close the knowledge gaps. The government should erect supply chain councils that would serve as advisory and overseer bodies to governments and agencies on matters of regulatory cooperation and alignment.
- Close the coordination gaps. The government should grant the PCO, to whom the supply chain councils would serve as advisors, the authority and the mandate to coordinate cooperation and alignment activities across Canada's regulatory universe.

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