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ISSUEBRIEF

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GLOBAL BUSINESS AND ECONOMICS PROGRAM

# An Economic NATO: A New Alliance for a New Global Order

In the aftermath of World War II, the greatest concern facing the United States and its European allies was restraining the Soviet Union and preventing the spread of communism. Cooperation on military security was paramount, and the United States and Europe rose to the challenge by creating NATO, a new type of multilateral defense agreement. Once again, the transatlantic relationship is at a new and perilous crossroads. But now it is economic, rather than military security that is at risk. Crisis grips the economies of Europe, just as the United States, mired in historic levels of unemployment in the wake of the 2008 recession, is rethinking its strategic priorities and place in the world. As before, fears mount concerning the future of liberal democracy and Western capitalism. The question is whether transatlantic cooperation will again rise to the challenge.

The stakes could not be higher. Unless the United States and Europe make a concerted, focused, and intensive effort to meet the challenges of the post-recession era together, they risk ceding to rising powers their economic and political influence in ways that could undermine global stability, as well as their long term prosperity and values. The United States and Europe need to reimagine their relationship, engaging strategically to manage the greatest shift of economic and military power since the 19th century.

## New Challenges

In the past, efforts to increase transatlantic economic cooperation have focused on removing embargoes, tariffs, and subsidies. In the modern era, however, these explicit restrictions are not the major stumbling block in US-EU economic relations. Although agricultural issues and marginal disagreements (such as the highly-publicized debate over chlorine-washed chicken) may capture the public's attention, today, conflicting regulations and standards, also known as "non-tariff barriers to trade" (NTBs), are the major impediment to transatlantic trade.

Regulatory action on both sides of the Atlantic is generally the result of good intentions—promoting safety, protecting the populace from fraud or unsafe business practices, and protecting the environment—but the resultant burden can make it difficult for small businesses to shoulder the cost of compliance. At the international level, the problem is compounded. In many cases, the same underlying values prompt our respective regulatory regimes—yet standards are implemented in conflicting ways that nevertheless form a very real barrier to trade.

### Global Business and Economics Program

Concerted leadership by the United States and Europe is essential for the health and vitality of the global economy. The Atlantic Council's Global Business and Economics Program is a policy center where business and government leaders from both sides of the Atlantic exchange ideas and design solutions to today's most pressing financial issues in order to advance shared economic prosperity and innovation.

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As US businesses attempt to expand internationally, overlapping and conflicting regulations mean that regulatory burdens are multiplied, making it difficult to compete. Indeed, duplicative compliance costs can prompt even the most successful companies to constrain trade and expansion. As a result, conflicting standards and regulations create friction in the transatlantic marketplace, yielding market inefficiencies, decreasing economies of scale, and preventing the free movement of capital. This leads to reduced US competitiveness, increased economic stagnation, and higher consumer prices—the very opposite of what we need as we attempt to recover from a global recession. The growing power of state-sponsored capitalism makes the need to remain competitive even more acute.

## We Need an "Economic NATO"

In order to promote a return to a flourishing economy, we need to focus on aligning US and European regulatory frameworks in order to attain greater inter-operability through increased cooperation, mutual recognition, or convergence. As a result, in today's paradigm, we do not simply need a "free trade agreement." We need a new type of agreement that will eliminate barriers to economic growth and spur creativity and investment both domestically and across the Atlantic.

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This challenge demands an innovative framework: a broad-reaching multilateral pact that blends transatlantic economic cooperation in the spirit of the Marshall Plan with flexibility and rigor reminiscent of the world's most successful security agreement. If we are to continue our role as global economic hegemons, the United States and Europe must put economic cooperation on the same robust footing as military security. In other words, we need to create an "economic NATO."

## The Time is Ripe

The current global recession may make policymakers wary of entering into such a major—indeed, revolutionary—new economic initiative at a time when domestic markets are floundering. Instead, leaders may be tempted to "hunker down" and focus on internal, domestic economic and political agendas. However, such narrow thinking is counterproductive: increased trade and investment with Europe is needed now more than ever. The purpose of any free trade or investment agreement is to promote economic growth and job creation, and a focused effort to reach greater degrees of regulatory compatibility, in particular, promises to bring increased productivity, lower prices, and stronger global competitiveness—precisely the tonic needed to counteract domestic stagnation. The financial crisis should therefore be viewed as a reason for, not an impediment to, international economic cooperation.

What is more, the recent recession carried an important lesson about the global economy—we have learned the hard way that we are more interconnected than ever before. In a world of increasing globalization, domestically-regulated industries have the ability to cause effects well beyond national boundaries. Domestic regulations interact in the globalized economy and domestic institutions have the ability to prompt international crises. Thankfully, we now have an opportunity to turn this "lesson learned" into a proactive path forward. Given the current economic crisis, this action is needed now.

## A Powerful Partnership

The United States and the European Union currently account for over a third of global trade in goods and over forty percent of global trade in services. The US commercial relationship with the European Union represents close to five trillion dollars a year—making it the largest trading relationship in the world. In addition, over seventy percent of foreign investment in US companies is from Europe, and the transatlantic relationship provides jobs for over 15 million workers on both continents. At a time when unemployment is high and capital and liquidity are more sought after than perhaps ever before, the time is ripe for a regulatory environment that promotes, rather than hampers, investment.

It has been estimated that reducing barriers to transatlantic trade could increase US GDP by 3.5 percent—no small

feat in the current economic environment. This means that we are effectively "leaving money on the table." Without a commitment to greater regulatory compatibility, not only will potential economic gains be forfeited, but we will also have lost an opportunity to cement our leadership in the global economy.

## The History of Regulatory Cooperation

The potential benefits of transatlantic regulatory convergence are widely accepted: the Transatlantic Economic Council (TEC) has been tasked since 2007 with promoting economic partnership between the United States and Europe, namely by addressing divergent regulations and standards across the Atlantic. Yet a truly robust and contemporary transatlantic economic relationship requires a much more ambitious agenda and more leadership support. On both sides of the Atlantic, too many of the necessary constituent parts of a successful economic pact have, perhaps predictably, sought either to gain exclusion from the reach of the TEC or to weaken its efficacy.

This is not surprising. Historically, trade agreements have never successfully addressed regulatory barriers between markets. At the margins, they have forced greater transparency commitments, put in place core obligations regarding technical standards, and put limits on some of the most protectionist standards—all fundamental building blocks necessary to address non-tariff barriers to trade. But the most important transatlantic regulatory challenges cannot be solved by a traditional trade agreement, because they involve standards that must be harmonized and managed by regulators, not trade negotiators. Lasting success with transatlantic interoperability will be possible only if the agreement is given a comprehensive framework that can hold various regulatory agencies accountable. This, in turn, will require high-level support from within the White House and the European Commission Presidency.

## Bringing the Players to the Table

In light of the complex nature of regulatory cooperation, a number of key stakeholders must be brought to the table as soon as possible. US policymakers should seek bipartisan support from Congress, industry, and the general public. The concerns and potential impact of unions, public interest groups, and business leaders should also be considered. In fact, successful negotiation of such a groundbreaking agreement will require a new framework: a centralized, concerted effort, with a unique structure and management template unlike those surrounding past trade agreements. As such, several important decisions need to be made as negotiations begin in earnest.

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One crucial decision is which industries should be included under the auspices of the initial agreement. Although a comprehensive transatlantic economic agreement could make regulations more efficient, more effective, and less costly, it could also require agencies to cede a certain amount of domestic political autonomy, because they would be asked in some circumstances to carefully consider interoperability with European counterparts. As a result, there may be significant internal political pressure to exclude certain sectors from the agreement's compass. This is particularly true if agencies believe that they will be asked to yield authority to the Office of the United States Trade Representative (USTR) or another domestic entity without the requisite regulatory expertise.

Yet if the United States and the European Union want to continue to shape the global economic system, we must cooperate on as many cross-cutting aspects of trade and economic cooperation as possible in a centralized, efficient manner. This is particularly crucial in the modern economic environment, where industries and markets interact in complex ways in the dynamic global marketplace. For example, commodity and derivative hedging rules can deeply affect energy markets, as can SEC reporting rules regarding energy reserves. If a transatlantic partnership is to be broadly successful, siloed regulatory agendas—in the financial, energy, and food and drug sectors, to name a few—must be brought under the tent.

## Tackling the Hard Challenges

Of course, nothing worth doing is easy. The maturity and success of the current transatlantic economic relationship means that there is no more "low-hanging fruit." What remains to be done in terms of regulatory cooperation will be more complex than simple tariff reduction, and will require more political will and creativity. We need an arrangement that takes into account the political and legal realities of both economies, reserving our sovereign rights to regulate but strongly promoting cooperation that will drive innovation and the efficient exchange of goods and services. Several political and legal factors, on both sides of the Atlantic, must be grappled with in order to make this goal a reality.

First, on the US side, the Constitution and Administrative Procedure Act set forth a lengthy and complicated process by which regulations must be developed, including active oversight by the courts, that has no direct parallel in the EU. Because of the complexities of US administrative law, and since agency regulations can be challenged by private groups in the DC Circuit, political oversight for regulatory cooperation will require expertise with the Administrative Procedure Act, the DC Circuit's case-law, and administrative law in general. These legal complexities should inform the crucial question of where in the US political structure guidance over regulatory cooperation should be located.

Administrative law and regulatory oversight are outside the purview and expertise of trade negotiators. However, centralized review of most draft agency regulations already takes place in the White House Office of Information and Regulatory Affairs (OIRA), part of the Executive Office of the President. Because OIRA is currently tasked with overseeing agency regulations and preventing conflicts at the domestic level, it is well suited in terms of both tradition and expertise to provide oversight to the international regulatory cooperation process. In fact, an Executive Order issued by President Clinton (and still in effect) names OIRA "the repository of expertise concerning regulatory issues." Housing oversight of transatlantic regulatory cooperation within OIRA would help avoid potential legal and turf problems, particularly in the complex and critical high tech and financial arenas.

However, any discussion of the optimal framework for regulatory cooperation must grapple with the issue of US independent agencies like the SEC, CFTC, and Consumer Product Safety Commission—an important distinction that does not exist in the EU. Independent agencies often possess authority over regulations of particular economic importance, making their inclusion in a transatlantic agreement crucial to its broad success. Although independent agency actions are reviewed by OIRA under the Paperwork Reduction Act and the Information Quality Act, they are currently exempt from more detailed cost-benefit review that is mandatory for other agencies with overlapping and potentially competing jurisdictions.

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There are several options for how OIRA could help independent agencies better harmonize regulations with their European counterparts. At one end of the spectrum, substantive OIRA review could be expanded to include review of independent agency regulations—indeed, this has been suggested by many practitioners and observers even outside the context of international compatibility. At the other end of the spectrum, OIRA could simply be tasked with providing formal comment on international compatibility during the public notice-and-comment period for draft independent agency regulations. Increased transparency and a requirement that any departure from compatible rulemaking be accompanied by a public explanation may be all that is necessary to ensure far greater regulatory harmonization by independent agencies. Between these two poles, there is a range of other ways in which OIRA could provide informal assistance to agency regulators attempting to comply with an international economic agreement.

Finally, execution of the agreement would likely benefit from direct involvement from the vice president's office, which has historically held a significant role in regulatory review.

Since political capital will be crucial to the success of convergence, and since it is necessary to strike a delicate balance that promotes transatlantic harmonization while preserving US sovereignty, direct oversight from the West Wing would serve an essential political function. Such oversight would also help neutralize agency friction during the negotiating process and the development of the political framework necessary to make the agreement a success.

On the EU side, there is no direct parallel to the issue of independent agencies. Moreover, there is no parallel to the lengthy and public US rulemaking procedures set forth in the Administrative Procedure Act, including public notice and comment. On the contrary, it is actually a relative lack of transparency in the regulatory process that will raise the most serious issues of enforcement and administrability of regulatory cooperation on the European side. This problem is compounded by the EU's multilateral structure—tensions between convergence, sovereignty, and regulator independence among the twenty-seven sets of national actors who must be brought into alignment.

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However, these issues should be relatively simple to overcome. European policymakers have already become increasingly vocal about the need for increased competitiveness in the global economic arena, and there is widespread acknowledgement in Europe of the need for increased regulatory transparency. Indeed, the EU has already accepted cost-benefit analysis as part of future regulatory negotiation, and it would not be a major step to add recognition and analysis of the costs that divergent international regulations would impose on the transatlantic relationship. Such analysis would parallel the type of review that OIRA could undertake on the US side, as discussed above, and—as long as it is made public—it could form a useful step toward creating a workable enforcement process for the agreement. Whatever enforcement mechanism is chosen for the final agreement, it must certainly include transparency, and it should ideally include concrete penalties for departures from transatlantic compatibility.

## Renewing the Transatlantic Economic Relationship for 21st Century Challenges

A successful "economic NATO" would promote the common interest of the world's most lucrative trading relationship. Reducing regulatory barriers to transatlantic trade will drive growth and help reverse our current economic stagnation, goals that are particularly imperative during times of recession. Nevertheless, this comprehensive agreement should not be seen as a mere crisis-management tool. Instead, it should be viewed as a positive leadership initiative, a model for trade and regulatory cooperation on a global scale.

To this end, the agreement should, like NATO, have an open—rather than strictly bilateral—membership structure, so that it can grow and evolve over time into a multilateral agreement promoting trade and economic efficiency on a wider scale. And again, like NATO, the agreement should include an incentive structure that provides clear, positive benefits of membership—in addition to the obvious benefits of mutual recognition and frictionless trade. The agreement could, for instance, bestow "most favored nation" or domestic status on its members for the purposes of government procurement contracts or other sought-after advantages.

Although there are still crucial questions to be answered and details to be determined, the time is now ripe for policymakers and industry alike to consolidate efforts to pass a comprehensive US-EU economic agreement, and to bestow it with a domestic management structure likely to lead to its success. As discussed above, the task of structuring such a trailblazing agreement will be both complex and demanding. Nevertheless, efforts to break ground on creating an economic NATO should be innovative, robust, and swift—just like the recovery that it is likely to spur.

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