PRELIMINARY ANALYSIS OF THE DRAFT TPP CHAPTER ON DOMESTIC COHERENCE[*]

The leaked draft text of the regulatory coherence chapter[1] seeks to impose a structure and set of procedures for domestic decisions on most forms of central government regulation in TPPA parties. Its target is domestic regulation making behind the border—not, as the title implies, coherence of regulations across the parties. Some of its elements are conducive to well-informed and consistent good decision making. However, it is inappropriate for a 'trade' agreement to dictate to governments how they should structure their domestic bureaucracy and procedures. Despite the apparent focus on procedures, the proposal also has substantive biases in favour of light-handed regulation—a model that has proved highly problematic in many countries and sectors, not least the financial industry. Moreover, the proposed national and TPP-wide mechanisms cross-fertilise with other chapters of the agreement to confer undue corporate influence over national policy and regulatory decisions and would impose excessive compliance burdens on low-income developing countries that are parties to the TPPA.

This preliminary analysis outlines: 1) key elements of the proposal; 2) the context of the proposal; 3) the legal nature of the obligations; 4) the substantive disciplines it could impose on domestic regulation; 5) cross-fertilisation with other chapters of the proposed TPPA; and 6) the privileged influence it confers on corporate "stakeholders".

1. Key Elements of the Proposal

This draft chapter has nothing to do with trade. It targets the institutional and procedural approach to domestic regulation of parties to the TPPA. 'Coherence' refers to the internal regulatory decisions and choices of the state. This is achieved by imposing disciplines on its bureaucratic structure, decision-making processes and criteria.

The first step is for national governments to establish a central process or mechanism, preferably a formal body, to coordinate the development of policy and regulation and the associated decision-making processes on a whole-of-government basis. This body, process or mechanism is intended to enjoy superior status in the hierarchy of central government from which to co-ordinate, supervise and if necessary critique the work of other regulatory agencies. Its mandate applies to central government, with an expectation that '"channels of communication" will be maintained with regulatory authorities not subject to its oversight and subcentral government bodies.

Governments have some choice as to the scope of "covered regulatory measures", but coverage is expected to be "significant". This encourages a top-down approach that identifies what measures or agencies are not covered. Assuming that cross-references to other chapters already bring sectors or subject matter within the scope of this mechanism, the range of areas that parties can exclude will be limited. The criteria for determining the scope of coverage must be made public.

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[1] Trans Pacific Partnership, 'Regulatory Coherence', undated

The characteristics of this coordinating mechanism or body are expected to include public documentation of its institutional elements; sufficient resources and stature to ensure its credibility; authority to review measures of other agencies to ensure "good regulatory practices"; facilitate streamlining and coherence of decisions across government agencies; and issue periodic reports on its operations and activities. It is also encouraged to recommend and report on "systemic regulatory reform" (Article X.2.2.e), which envisages a whole-of-government review of domestic regulation either generally or across integrated regulatory agencies or activities. It is expected to provide annual projections for future regulation (Article X.3.6) and set in train a review of "some or all of its existing stock of significant regulatory measures" (Article X.3.5). The proposed processes are directly linked to the goods and services obligations in other chapters, and the Transparency chapter in particular.

To implement "good regulatory practices" a Regulatory Impact Assessment (RIA) is "generally encouraged, consistent with domestic law". Use of an RIA is subject to a self-defined "threshold of economic impact"; the methodology for determining that threshold is not defined. Some of the proposed content of a RIA is standard good practice for any new policy or regulation: all regulators should be able to state the problem and policy objective that a measure aims to address, the significance of the problem and the need for regulatory action. They should also consider a range of potentially effective and reasonably feasible alternatives and be able to explain the grounds for selecting the preferred option. Problems arise with the level of detail required, the method of identifying and describing those factors, the range of considerations that are considered appropriate, the relevant factors and methodology for assessing "net benefits" and "distributional impacts" (Article X.3.1.a(3) and X.3.1.b). These are discussed below.

The draft text also exhorts parties to "take into account" their international obligations, a critical context for any international treaty. This should be unproblematic in relation to other trade agreements or OECD instruments. However, there is a large literature that documents the conflicts between free trade agreements and states' international obligations on human rights, environment, indigenous rights, labour, etc.[2] The TPPA, and this chapter itself, would impose disciplines that extend further behind the border than previous agreements and create an even higher risk that states will breach those international obligations. The quantitative orientation of cost benefit analyses and the partisan role for commercial interests mean this conflict is unlikely to be addressed through the process proposed in this chapter.

There are only two significant provisions in the draft text for *inter*-party coherence. One promotes various ways to achieve "successful collaboration among Parties and their respective stakeholders" which, if adopted, would create diverse opportunities for foreign states, corporations and lobby groups to pressure national governments about proposed or existing domestic regulation (Article X.3.7).

The second is the Committee on Regulatory Coherence. Each party must notify the Committee promptly of the establishment of this process, mechanism or

[2] See the paper on 'The Case for a Human Rights Impact Assessment of the Proposed Trans-Pacific partnership Agreement', presented by the author to the Stakeholder Seminar at the Chicago Round of the Trans-Pacific Partnership negotiations, http://web.me.com/jane_kelsey/Jane/TPPA.html

agency, its responsibilities and activities, the scope of coverage, and the contact point for inquiries from other parties. The Committee is also tasked to discuss "cooperative" activities to advance common approaches relating to other chapters, including sectoral initiatives that are informed by the experience with provisions in other chapters. Its activities and work plan are to interface with and not duplicate other chapters. However, this mandate offers a vehicle to address the unfinished business at the WTO and in the TPPA, and develop new sectoral or subject-specific disciplines.

There is a further expectation of "improving and strengthening the disciplines". The Committee must meet annually, or alternatively every five years, to consider "best practice" developments (Article X.5.5). Given the context of this chapter, discussed below, these discussions would be strongly influenced by developments in APEC and the OECD. The spectrum of innovations could range from adoption of the Australian Department of Finance and Deregulation template for "best practice regulation"[3] to the British proposals for a Regulatory Budget.[4] The requirement for consensus of the Committee would be a vital protection against such proposals.

Ironically, there is no recognition of the massive burden that is imposed on governments to pursue the objective of reducing the regulatory burden on business. Preparation of the level of documents proposed for the RIA, and the publication obligations in Articles X.2.2(f), X.3.4 and X.3.6 would impose huge burdens on low-income developing countries that have more pressing demands on their limited budget. The proposal in Article X.3.5 that governments should establish a procedure to review the effectiveness of existing 'significant' regulatory measures in achieving policy objectives would be hugely burdensome and divert limited policy resources from addressing current priorities. Ironically, governments are likely to require more resources to be able to satisfy these obligations, or will have to divert them from other uses.

2. The Context of the Proposal

The genesis of the draft chapter is the Anglo-American model of deregulation, light-touch pro-market regulation and self-regulation that has prevailed in New Zealand, Australia and the US since the 1980s. This approach has driven over a decade of APEC initiatives, notably the Information Notes on Good Practices for Technical Regulation 2000[5] and the APEC/OECD Integrated Checklist on Regulatory Reform,[6] which are explicitly referred to in Article X.3.2.

Australia, New Zealand and the United States all have agencies of the kind being proposed. The Australian Commonwealth Office of Best Practice Regulation (OBPR), a division within the Australian Ministry of Finance and Deregulation,[7] illustrates the model these TPPA parties should be presumed to have in mind—if not

[3] http://www.finance.gov.au/obpr/proposal/coag-guidance.html

[4] HM Government, *Regulatory Budgets: A Consultation Document,* 2008 www.bis.gov.uk/files/file47129.pdf. The pros and cons of the proposal are discussed by Deputy Head of the OECD Regulatory Policy Division Nick Malyshev, in 'A Primer on Regulatory Budgets', *OECD Journal on Budgeting*, 2010/3, 1-10

[5] www.jisc.go.jp/eng/apec-asem/pdf/grp_info.pdf

[6] www.oecd.org/dataoecd/41/9/34989455.pdf

[7] http://www.finance.gov.au/obpr/about/

immediately, then in the future. Australia's 'best practice guidelines' are an expanded and more explicit version of the 'core good regulatory practices' in Article X.3.[8] The Australian principles read:

1. establishing a case for action before addressing a problem;
2. a range of feasible policy options must be considered, including self-regulatory, co-regulatory and non-regulatory approaches, and their benefits and costs assessed;
3. adopting the option that generates the greatest net benefit for the community;
4. in accordance with the Competition Principles Agreement, legislation should not restrict competition unless it can be demonstrated that:-

    a. the benefits of the restrictions to the community as a whole outweigh the costs, and

    b. the objectives of the regulation can only be achieved by restricting competition;
5. providing effective guidance to relevant regulators and regulated parties in order to ensure that the policy intent and expected compliance requirements of the regulation are clear;
6. ensuring that regulation remains relevant and effective over time;
7. consulting effectively with affected key stakeholders at all stages of the regulatory cycle; and
8. government action should be effective and proportional to the issue being addressed.[9]

The Australian government's commentary on principle 2 makes it clear that the assessment of all feasible options works from an initial presumption against new or increased regulation; principle 4 requires that regulation should only restrict competition where this is necessary to achieve the objective and the benefits of restricting competition outweigh the costs; and proportionality requires that government action does not "overreach". Justification of intervention for "market failure" refers to problems of imperfect competition, externalities, public goods and imperfect or costly information, and should not be "misunderstood to indicate a failure of markets to deliver a desirable social or equity goal".[10]

Some aspects of the Australian approach that are not present in the proposed Regulatory Coherence text, such as the reference to competition principles, may be contained in separate chapters of the TPPA.

The New Zealand approach to 'regulatory responsibility' highlights another dimension of the TPPA. The initial approach to RIAs prepared by New Zealand regulatory agencies were criticised as ineffective. A more comprehensive and

[8] Council of Australian Governments, 'Best Practice Regulation. A Guide for Ministerial Councils and National Standard Setting Bodies', October 2007,
[9] Ibid, p. 4.
[10] Ibid, p. 4-6

disciplined process has been introduced, under a special agency established in the New Zealand Treasury. In August 2009 the current government adopted a policy of "Less Regulation, Better Regulation" that is broadly similar to the Australian approach. [11]

There have been repeated and so far unsuccessful attempts to secure a more overtly ideological Regulatory Responsibility Act since 1994. This law would define principles of regulatory responsibility that presume minimal regulation, apply a strong necessity test, and elevate protection of private property rights over other rights in the regulatory process. Private interests could seek a declaration from the domestic courts that regulations were incompatible with the principles. The current National-led government agreed to advance the widely criticized legislation as part of a coalition agreement.[12] The latest version, renamed The Regulatory Standards Bill, is currently before a Parliamentary select committee. [13]

The New Zealand debate is especially significant for the TPPA as the protection of property rights, compensation of property rights holders/investors for regulatory takings, and the power to seek judicial review of government's regulatory decisions have strong parallels in the proposed investment chapter of the TPPA.

3. The Legal Nature of the Obligations

The TPPA proposal significantly changes the character of the existing OECD/APEC "best practice" documents from information notes and voluntary guidelines to an apparently enforceable obligation to establish processes and mechanisms enforceable. This transformation is not immediately evident, as the text primarily uses hortatory language. It says "each Party *shall endeavor to ensure* that it has a process or mechanism to facilitate central coordination and review" of covered regulatory measures and "*should consider* establishing and maintaining a national coordinating body" for that purpose (Article X.2.1). While a Party may determine the appropriate scope of covered regulatory measures, "it *should ensure* that coverage is significant and not arbitrarily limited in order to avoid application of this chapter". Similarly, the coordinating body, process or mechanism "should generally encourage" the use of regulatory impact assessments, which "should" identify certain matters and include certain elements (Article X.3).

The only mandatory requirement is for each Party to notify the Committee promptly "with relevant information regarding the national process or mechanism established pursuant to Article X.2.1" (Article X.5) and identify within a year a contact point for information regarding its implementation of those processes and practices.

[11] For the ministerial statement and associated Cabinet minute see http://www.treasury.govt.nz/economy/regulation/statement/release

[12] Much of this controversy related to constitutional relationship between the Parliament and the Courts. For a discussion of the range of issues and perspectives see Special Issue: Regulatory Responsibility Bill, 6(2) *Policy Quarterly*, May 2010. For analysis on links to the government policies referred to here see Jane Kelsey, '"Regulatory Responsibility: Embedded Neoliberalism and its Contradictions', 6(2) *Policy Quarterly*, May 2010, 36-41

[13] For the Regulatory Standards Bill, submissions and related documents see http://www.parliament.nz/en-NZ/PB/Legislation/Bills/8/2/0/00DBHOH_BILL10563_1-Regulatory-Standards-Bill.htm

This flexibility seems to be contradicted by Article X.8 on Dispute Settlement, which limits enforcement to "*the obligation to have* processes or mechanisms to facilitate central coordination and review of certain new regulatory measures" (emphasis added). An actionable breach would require a violation of that obligation and a demonstrably adverse effect on trade and investment between the two parties. This implies that a government could be challenged for taking inadequate steps to "endeavour to ensure" such a process, mechanism or body was established.[14]

It is unclear whether legal disputes would extend to the mandate and modus operandi of such mechanisms or bodies. The requirement for the complainant to prove that the violation adversely affected trade and investment strongly suggests that challenges are likely to include the substance of the mechanism. Whether a Party has ensured a "significant" level of coverage could become subject to dispute. It is not clear what an "arbitrary" limitation on coverage to avoid application of the chapter on coverage refers to, but exclusion of highly-regulated areas of commercial interests such as public services and utilities, land use, resource management, natural resource exploitation, retail outlets, professional qualifications and accreditation, or technical standards for products and services could become subject to a legal challenge. Harm to trade or investment may not be difficult to show, especially as Article X.8 does not specify any threshold for adverse effects.

Cross-referencing to the regulatory disciplines in other chapters will also open certain sectors or activities to the more extensive dispute provisions in those chapters.

Uncertainty about the degree of flexibility governments' retain could, in itself, have a chilling effect on national regulatory decisions in areas of controversy.

Expectations that parties will pursue information exchanges, dialogues or meetings with other parties and interested stakeholders provide the opportunity for influence short of a dispute (Article X.3.7). The US regulatory dialogue with Japan, which then became the US-Japan Economic Harmonization Initiative, is an example of how this might operate.[15] Both sides set out a wish list of domestic regulatory reforms. This provides an opportunity for the US to pressure Japan on a range of matters that also arise in the annual review of trade policy barriers and of alleged breaches of section 301 of the US Trade Act.

Surveillance is intended as a further discipline on governments. Publication of documents that specify "institutional elements" of the body and periodic reporting of its activities and proposals for "systemic reform" are intended to place the body or mechanism under pressure to be pro-active and to encourage oversight by national and foreign commercial interests.

[14] In considering the legal consequences of the word 'should', the WTO Appellate Body has noted that "depending on the contact, the word may imply either an exhortation or express an obligation". Appellate Body Report, *United States—Tax Treatment for Foreign Sales Corporations,* WT/DS108/AB/R, 24 February 2000, para 111, fn 124

[15] eg. United States-Japan Economic Harmonization Initiative, February 2011, www.ustr.gov/countries-regions/japan-korea-apec/japan

4. Substantive Disciplines on Domestic Regulation

On its face the regulatory coherence chapter is purely procedural. The text affirms the right of a Party to identify its regulatory priorities, and establish and implement measures, and the level at which these apply. It also affirms the role of regulation in achieving policy objectives. The design, scope of authority and institutional location of these mechanisms or bodies are expected to vary according to national circumstances (Article X.2).

Despite those assurances, it is clearly intended that a government's choice of measures to achieve those priorities will be constrained by the "overarching characteristics" of the regulatory mechanism or body (Article X.2.2) and the scope and criteria for RIAs in Article X.3.1.

Experience shows that the proposed text, if it were adopted, would directly and indirectly impose disciplines on the substance of government regulation. Although cost-benefit analyses (Article X.3.1(3)b) purport to be objective and scientific, extensive academic literature shows they are highly subjective in their content and methodology.[16] It is simply not possible to provide an accurate cost-benefit analysis on a hypothetical range of policy options. Quantification of qualitative information is frequently arbitrary and reflects the bias of those who compose the formula. Qualitative factors are commonly excluded or become peripheral. The cost-benefit analysis used in the "best practice" OECD/APEC documents is a clear example where assessment is skewed towards metrics that privilege quantitative calculations and marginalize qualitative, especially non-economic, considerations.

The proposed elements for the RIA require consideration of alternative ways to achieve the policy objectives, specifically non-regulation or voluntary/self-regulation. While this stops short of an explicit 'necessity' test, the Australian guidelines cited earlier show the process is intended to have a similar effect. Governments are expected to publish their RIAs, provide public access to a large range of data, and consult and enter into dialogue with "interested stakeholders" of other parties who will be seeking to minimize regulatory interventions.

Reference in the footnote to Article X.1.2.c to "additional guidance on a Party's right to regulate in pursuit of legitimate objectives" highlights the risk that sovereign authority could be defined in narrow terms. Australia and New Zealand have pushed this controversial position during the GATS negotiations on Domestic Regulation at the WTO.[17] In the only existing example under the GATS, the regulatory disciplines on the accountancy profession describe "legitimate objectives" in market terms (quality of the service, ensuring professional competence, and ensuring the integrity of the profession) with no reference to social, environment or development considerations.[18]

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[16] See eg. Claudio M. Radaelli, 'Evidence Based policy and Political Control: What Does Regulatory Impact Assessment Tell Us?, Paper to the European Consortium for Political Research, University of Rennes, France, April 2008; Claudio M. Radaelli, 'Towards Better Research on Better Regulation', Centre for Regulatory Governance, University of Exeter, January 2007; Fiona Haines and David Gurney, 'The Shadows of the Law: Contemporary Approaches to Regulation and the Problem of Regulatory Conflict', 25(4) *Law and Policy*, October 2003, 353-380

[17] See, eg. Working Party on Domestic Regulation, Communication from New Zealand, "The Necessity Test in the Disciplines on Domestic Regulation", 9 February 2011, RD/SERV/39

[18] WTO, 'Disciplines on Domestic Regulation in the Accountancy Sector', adopted December 1998,

In sum, this proposed text has the potential to impose much more comprehensive and far-reaching disciplines than the proposed disciplines on domestic regulation under GATS Article VI:4 that most developing countries have rejected in the WTO.

5. Cross-fertilisation with other Chapters

That potential is greatly intensified by the inter-relationship with other chapters. These arise in three ways: explicit cross-referencing; distinct obligations in different chapters that may cross-fertilise; and international obligations considered during the RIA process.

The regulatory coherence and transparency chapters are explicitly linked: one "overarching characteristic" of the national mechanism/agency is "advancing the transparency disciplines" (Article X.2.2.c). The nature and extent of the transparency disciplines is not yet known, but they are expected to require disclosure of criteria and data, opportunities for prior comment by affected interests and regulators' response to those comments, explanations for final decisions, and access to review or appeal procedures. All of these obligations provide complementary avenues for foreign commercial interests to demand privileged input into the domestic regulatory process (Article X.2.2.c). The transparency disciplines may be targeted at specific regulatory agencies or subjects: the leaked US proposed Annex on Transparency and Procedural Fairness for Healthcare Technologies[19] reveals controversial disciplines in the name of 'procedural fairness' that are designed to break current medicine subsidy regimes (ironically, in Australia and New Zealand).

Similarly, the regulatory coherence mechanisms are to interact with substantive regulatory disciplines in other chapters (Article X.4). Rules on competition, transparency, and sectoral regulation of services and investment are expected to favour market-based, "least burdensome", and industry self-regulation, with a presumption against state-administered regulation, monopolies and single suppliers, and state-enterprises. The recently leaked US proposals for annexes on pharmaceuticals, medical devices and cosmetics to the chapter on Technical Barriers to Trade specify criteria for regulatory decisions that benefit US industry in particular.

There are also less overt inter-relationships with other chapters, in particular with investment protections that may be subject to investor enforcement. Cost benefit analysis involving quantitative assessment of competing interests may indicate costs to an investor for which the government does not compensate. At present, the complainant bears the burden of proof in an investment dispute and has to mount its own argument using the information it can piece together. The RIA could provide evidential material that has been prepared by the government itself, either as evidence to support a complaint or as an evidential basis for the dispute. Concerns about potential use of the information for such purposes may distort the process and the kind of information and analysis that is presented. This would undermine the intention of the regulatory coherence chapter, especially the RIA.

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www.wto.org/english/news_e/pres98_e/pr118_e.htm

[19] Trans-Pacific Partnership, "Transparency Chapter –Annex on transparency and Procedural Fairness for Healthcare Technologies", June 22, 2011

Similar concerns may arise in relation to financial measures where governments wish to rely on the prudential exception as a defence to complaints that it has breached its financial services, investment or transfers obligations. Likewise, the range of options considered and the factors that underpinned the decision could be used as evidence where the necessity test applies.

6. Privileged Influence of Corporate Stakeholders

The preambular provision in Article X.1 affirms the importance of "a wide range of stakeholder input in the development and implementation of regulatory measures" and the role of regulation in areas of public policy like environmental protection, workers' rights and health and safety. In practice, the proposed mechanisms will provide structured opportunities for well-resourced, predominantly foreign corporations and their lobby groups to influence regulatory decisions at the national level and approaches to regulatory coherence at the supra-national TPPA level.

The Transparency chapter, which the regulatory coherence chapter explicitly complements, is expected to empower only interested commercial actors, and provide no equivalent access rights to public interest groups that may have contrary views.

The inter-party Committee is required to establish at its first meeting mechanisms to ensure meaningful opportunities for *interested persons* to provide views on approaches to enhance regulatory coherence through the Agreement (Article X.6). The provision talks of ensuring participation "from a broad-based cross-section of interests in all parties". "Interested persons" is not defined. However, it seems self-evident that only those entities that have the financial and organisational resources, knowledge, connections and permission to participate will have a seat at the table. This mechanism will become a vehicle for major corporations and lobby groups to press their case for future deregulation.