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THE EU REFIT PROGRAMME AS A MEANS OF REDUCTION OF ADMINISTRATIVE COST[*]

I. PAPADOPOULOS[**]

Abstract

This paper presents, analyses and criticises the EU REFIT (Regulatory Fitness and Performance) programme that aims to reduce administrative costs and to create an environment that is friendly for the SMEs. This programme is of vital importance for the economy, since it produces best practices of red tape reduction and of administrative reform. The REFIT philosophy, tools, specialized organs, and actions are capable of leading towards a smaller and leaner public sector by optimizing regulatory and administrative functions for businesses with the least cost to them.

This paper is divided into the following parts: An Introduction – Presentation of REFIT, where the importance of this programme for the European Commission is presented, followed by an overview of the REFIT actions by the European Commission, the EU Legislator, and the Member States, a typology of nine REFIT actions, and the new Regulatory Scrutiny Board that is by now used for Impact Assessments.

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1. Introduction – Presentation of REFIT

REFIT, which is the acronym for "European Commission Regulatory Fitness and Performance Programme", is a programme launched by the European Commission. Until now, significant action is taken to make EU law simpler and to reduce regulatory costs, thus contributing to a clear, stable and predictable regulatory framework so as to enhance growth and promote the creation of jobs.

Taking into consideration the key role that the EU plays with its legislation in promoting growth and employment by ensuring a level playing field and by facilitating competitiveness for businesses, while at the same time protecting the public interest with regard to public health and safety, it is a serious

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challenge for the European Institutions to keep this legislation simple – not to legislate beyond what is strictly necessary to achieve policy goals (principle of proportionality)[1] and to avoid overlapping several layers of regulation.

The European Commission endeavors to meet this challenge through its Regulatory Fitness and Performance Programme (REFIT), which commits to a simple, clear and predictable regulatory framework for businesses, workers, and citizens[2]. This programme aims to cut red tape and reduce the administrative expenses and costs, improve the efficiency of legal systems, remove regulatory burdens and minimize over-regulation, simplify and improve the design and quality of legislation so that desirable policy objectives are achieved and the benefits of EU legislation are enjoyed at the lowest cost possible and with a minimum of administrative burden, in full respect of the Treaties, particularly the principles of subsidiarity and proportionality. Under REFIT, the Commission is screening the entire stock of EU legislation on an ongoing and systematic basis to identify burdens, inconsistencies and ineffective measures and to come up with corrective actions. REFIT actions (such as withdrawals, amendments and repeals)[3] reinforce the broader benefits that regulating at EU level can bring by replacing 28 different national measures by one single EU measure, leading to a simpler regulatory environment for businesses and citizens across Europe.

2. Importance of this programme for the European Commission

The Juncker European Commission considers this programme as a part of the challenge it was elected to undertake, meaning to make a difference on the big economic and social challenges – high unemployment, slow growth, high levels of public debt, an investment gap, and lack of competitiveness in the global marketplace. It aims to serve the expectations of the European citizens for less EU interference on the issues where Member States are better equipped to give the right response at national and regional level[4]. It also aims to make the EU more open, flexible and accountable about its actions[5].

The European Commission is determined to change both what the European Union (hereinafter EU) does, and how it does it. The EU, its institutions, and its body of law are there to serve citizens and businesses and make a difference in their daily lives and operations. It aims to restore their confidence in the EU's ability to deliver[6]. The Juncker Commission is said to represent a new start. Its priority is to deliver solutions to the big issues that cannot be addressed by the Member States alone, such as: an investment plan to leverage €315 billion to boost jobs and growth; an Energy Union to deliver secure,

affordable and sustainable energy; an Internal Security Agenda to tackle common threats like terrorism and organised crime; a Digital Single Market to unlock online opportunities; and a Migration Agenda[7].

It is undeniable that improving and simplifying the regulatory environment in the EU had always been the highest priority of the Commission. This is part of its wider objective of delivering results to citizens and businesses. The Better Regulation Agenda, adopted in 2005, aimed both to ensure that all new initiatives are of high quality, and to modernize and simplify the existing stock of legislation. In doing so, it has helped to stimulate entrepreneurship and innovation, to realize the full potential of the Single Market, and thereby promote growth and job creation. Better Regulation has therefore been a key element of the Lisbon Growth and Employment Strategy. The Better Regulation agenda also has helped and still assists the EU to respond to globalization, and to shape global regulation rather than to be shaped by it[8].

Its logical process is simple: European legislation often simplifies matters for businesses, citizens and public administrations by replacing 28 sets of rules with just one. But in a rapidly changing world, legislation adopted over the last 60 years –since the creation of the European Institutions– must be constantly reviewed and modernized for the sake of its adaptation to the constantly changing needs[9].

Better Regulation is thus indisputably a tool to provide a basis for timely and sound policy decisions – but it can never replace political decisions[10]. From the outset, the Juncker Commission has outlined further measures to deliver better rules for better results, it has further opened up policy-making, and aims to listen and interact better with those who implement and benefit from EU legislation. The main goals are to take a fresh look across all policy areas to see where existing measures need to be improved, focusing on the things that really do need to be done by the EU and making sure they are done well. Applying the principles of Better Regulation will ensure that measures are evidence-based, well designed, and deliver tangible and sustainable benefits for citizens, businesses, and society as a whole[11].

This applies both to impending legislation and to the large body of the acquis communautaire. This legislation is essential for sustainable development, for the Single Market that drives the European economy, and for unlocking the investments needed to support jobs and growth. It underpins the European Social Model and gives meaning to the rights and freedoms that citizens cherish, including their security and right to justice. It also helps the EU respond to common challenges such as energy security, protection of the environment, and fight against climate change. In many cases, one set of EU rules

replaces a patchwork of 28 different national rules, thus making life easier for citizens and businesses, simplifying the legal framework, reducing regulatory burdens across the Single Market, and increasing regulatory predictability. The body of EU law is not only necessary, it is the EU's great strength – it makes the EU qualitatively different from any other model of collective governance in the world. That is why it is so important that every single measure in the EU's rulebook is fit for purpose, modern, effective, proportionate, operational, and as simple as possible. Legislation should do what it is intended to do: it should be easy to implement, provide certainty and predictability, and it should also avoid any unnecessary burdens. Rules have to be sensible, realistic, properly implemented, and enforced across the EU – rules that do their job to meet the European common objectives, no more and no less[12].

Over the last decade, the EU has introduced a comprehensive set of Better Regulation tools and procedures to ensure this. These important changes are already delivering results, but the Juncker Commission has decided to go further: it is determined to apply Better Regulation across the board, building on the progress already made with impact assessments and the Regulatory Fitness Programme (REFIT)[13].

The European Commission strongly advocates that the EU should not impose policies, but should instead prepare them inclusively, based on full transparency and engagement, listening to the views of those affected by legislation so that rules are easy to implement. It is open to external feedback and scrutiny by stakeholders to ensure it gets it right. EU policies should also be reviewed regularly: there should be transparency and accountability about whether the EU is actually meeting its policy objectives, about what has worked well and what needs to change. Better Regulation is not a bureaucratic exercise. Citizens, businesses and other stakeholders judge the EU on the impacts of its actions: not just new initiatives, but even more importantly, the rules already in force. The Commission commits to taking political responsibility for applying Better Regulation principles and processes in its work, and calls on the other EU institutions and the Member States to do likewise[14].

3. Overview of REFIT actions by the European Commission, the EU Legislator, and the Member States

In October 2013, the Barroso Commission set out an ambitious agenda by publishing its Communication on REFIT[15]. At an initial stage, the Commission identified several policy areas where initiatives foreseen would not be taken forward. It withdrew a number of proposals that had been long blocked in the

legislature, and repealed a number of pieces of legislation. In total, over 100 actions were identified, half of which were new proposals aimed to simplify and reduce regulatory burdens in existing legislation. The other actions are Fitness Checks and Evaluations designed to assess the efficiency and effectiveness of EU regulation and to prepare future burden reduction initiatives. The Barroso Commission delivered on these commitments before the expiration of its mandate in November 2014[16].

3.1. Action taken by the Commission

Out of a total number of 23 legislative proposals the Barroso Commission committed to make in order to simplify and reduce regulatory burdens, 2 were adopted in 2013, 15 were adopted in 2014, and the rest had been planned for adoption in the following five years after the end of its mandate in 2014. Important simplification proposals for businesses, such as the introduction of a standard EU VAT declaration and the improvement of the European small claims procedure, had already been tabled by the Commission and were awaiting decision by the EU legislator (European Parliament and Council). The Commission formally approved 53 withdrawals of pending proposals after consultation of the European Parliament and the Council, including all nine REFIT initiatives, among others those on the simplification of VAT obligations, the statute of a European Private Company, and the protection of soil. The Commission decided not to present a number of proposals during its current mandate on which it had been working, and prepared repeals as foreseen[17].

The Commission applies the Think Small First principle[18] and has also taken action to apply lighter regimes for SMEs and exemptions for micro-companies wherever appropriate. 17 REFIT actions in the scoreboard contain exemptions for micro-companies and lighter regimes for SMEs. In addition, fees for micro-companies for registration and authorization were reduced in the areas of chemicals, health and consumer protection. The REFIT Communication of October 2013[19] recognised that, given the length of the legislative process, all efforts should be made to provide immediate burden relief within the existing regulatory framework, with a particular focus on supporting SMEs. This is being done in the area of food information to consumers, for example, where food business operators, and in particular SMEs, have difficulties to identify which rules (EU and/or national; general or food category-specific) apply to their particular situation. The Commission has published guidance documents and is working on a database on EU and national labelling requirements. This should help food business operators to quickly identify which requirements are applicable to them.

Additional initiatives are being taken to better use the internet to simplify and improve the implementation of regulatory requirements to the benefit of administrations, businesses and consumers alike. Building on the experience with energy labelling, which is now uniformly presented in online sales, a similar approach is being explored in the field of food information to consumers, for example.

Finally, if we take legislation on food information to consumers as an example, we can see that it includes exemptions, lighter regimes for small quantities and retailers, and flexibility provisions, which allow Member States to adapt labelling provisions to the specific needs of SMEs. The legislation also foresees one standard application date for new measures in every calendar year and generous transition measures. All of these efforts should facilitate improved implementation within the existing legal framework[20].

3.2. Action taken by the EU Legislator

Since October 2013, the legislator of the Union (European Parliament and Council) has adopted a number of important proposals for simplification and burden reduction. The amended Directive on the recognition of professional qualifications will simplify recognition procedures and facilitate the access to information; the new legal framework for public procurement contains measures to make procurement easier and administratively less burdensome, and promotes electronic procurement. The new regulation on tachographs reduces administrative burdens and improves enforcement through the introduction of "digital tachographs" linked to satellite navigation systems and control authorities. To accommodate the specific situation of craftsmen, vehicles of less than 7.5 tons driving within a limited range of 100 kms from the craftsmen's base of activity were taken out of the scope of the social and tachograph rules.

These proposals should bring substantial cost savings to SMEs. The Regulation on the simplification of prospectus and disclosure requirements in relation to the Internal Market of Securities, for example, would save 20% or between €20.000 and €60.000 per prospectus. The legislation on the digital tachograph would entail a cost reduction of 20% or €415 million in total. The new Directive on public procurement was adopted on 26 February 2014, and has entered into force since April 2016. It encourages the increased use of e-procurement and further measures to reduce regulatory burdens, and it simplifies access of SMEs through reduced requirements for the provision of authentic documents and promotion of smaller procurement parcels. For example, the Commission estimates that increasing the use of self-certifications

could reduce administrative burdens on firms by €169 million, and the overall savings through e-procurement could amount to between 5% and 20% of procurement costs.

At the same time, there are also cases where cost savings projected at the stage of the impact assessment could not be delivered due to amendments in the legislative process, such as those regarding producer registration in the context of waste of electrical and electronic equipment. Simplifications in environment proposals on waste shipment and environmental impact assessments were not supported by the legislator. Combating late payments in commercial transactions, company accounting requirements, collection of statistics, coordination on VAT and simplification of VAT obligations are also areas where Member States have been reluctant to reduce burdens, citing subsidiarity or additional national policy justifications.

Furthermore, a number of important simplification proposals with significant potential savings are still pending, awaiting adoption by the legislator: for instance, the Commission proposal for a Common Consolidated Corporate Tax Base, which would considerably reduce tax compliance costs of businesses operating in the Single Market. There are also other cases where current discussion in the legislative process could have resulted in a reduction of estimated savings. For example, savings to businesses estimated at €15 billion per year, included in the Commission's proposal for an EU standard VAT return, never actually materialized, since the legislative proposal was withdrawn because the file was blocked in Council, as there was no political agreement[21].

3.3. Action taken by Member States

Member States have the important responsibility of the timely implementation and full application of EU law. In that regard, it is up to Member States' authorities to use simplification options offered by EU legislation, and to ensure that EU laws are applied at the national, regional and local level as effectively and efficiently as possible. It is estimated that up to one-third of administrative burdens linked to EU legislation stems from national implementing measures.

An example of significant variations in Member States' practices is the area of public procurement, where the typical duration of a procurement procedure varies between 11 and 34 weeks, while the average cost in persons' days of work (opportunity cost) varies by a factor of one to four between different Member States. Another example concerns the environmental impact assessment, where the average duration of the process in the Member States varies

between less than 5 and 27 months, and the average direct cost to developers varies between less than €4,000 and €200,000 per project.

Several simplification proposals in the areas of customs' enforcement of intellectual property rights (IPR) and take-back of electronic waste (WEEE) have entered into force in early 2014. The IPR Regulation will reduce administrative burdens and costs, will enable better risk management, and will improve the enforcement of intellectual property rights. The WEEE Directive provides an exemption of small retailers from the take-back obligation for electric and electronic waste. It is important that all Member States fully implement and take advantage of the simplification and burden reduction provisions in these proposals.

There are however significant examples where Member States do not use simplification options offered by EU legislation, or burden is added through national regulations in areas not directly covered by EU rules (a process widely known as "gold-plating"). This is the case, for instance, in the area of food safety, where optional lighter regimes for small establishments are not always used, in the area of road freight transport, where some national requirements for recording of driving time for light commercial vehicles in areas not covered by EU law add regulatory burden for small companies, and in company accounting requirements. Significant benefits can also be brought for SMEs through the full use by Member States of the flexibility allowed under the regulations on how food information is provided to consumers. The Commission continuously monitors the implementation practice by Member States of these and all other REFIT actions, and includes the state of play in each edition of its scoreboard.

While the Commission works closely with Member States on implementation across all sectors of the acquis communautaire, monitoring horizontal regulatory impacts has developed alongside the increasing focus on regulatory fitness. It has started, for example, under the Administrative Burden Reduction Plus Programme (ABR+), under which the Commission follows up on the implementation choices of Member States regarding the 12 most advanced priority measures taken within the Administrative Burden Reduction Programme since 2007 and investments for small business in the meat processing sector in 2012. The purpose of this exercise is to share best practices in implementation and to verify whether the estimated reduction in administrative burdens has been achieved on the ground. Initial findings indicate that estimations of savings can be confirmed in some Member States in the areas of Intrastat, the Industrial Production Survey, and the Digital Tachograph. However, difficulties have been encountered in obtaining sufficient and consistent quantitative

data and statistics, and relatively few examples of best practices in implementation and opportunities for further simplification at national level have been received. Strong support has been expressed in a Group of High Level National Regulatory Experts for this collaborative follow-up between the Commission and Member States on the practical impact of EU regulation on-the-ground. The Commission continues to work with Member States and stakeholders to produce sounder information on the impacts of EU regulation. The results of this work feeds into each REFIT scoreboard[22].

4. Typology of REFIT actions

In order to meet REFIT objectives, the European Commission applies some types of actions that will be presented here in a codified way.

REFIT is a rolling programme to keep the entire stock of EU legislation under review and ensure that it is “fit for purpose”, i.e. that regulatory burdens are minimized and that all simplification options are identified and applied. The tools that are used by the Commission in order for this programme to be implemented will be codified hereby in a typology following their growing normative intensity, i.e. starting from the actions that are the least restrictive and/or have the least binding legal effects, and gradually proceeding with the actions that are the most restrictive and/or have the most binding legal effects. I have delineated nine types of actions that can be roughly divided into two categories: firstly, four types of actions not associated with a legislative initiative (Study, Fitness Check, Evaluation, and Cumulative Cost Assessment), and secondly, five types of actions implying a new legislative initiative (Consolidation/Simplification, Codification, Update/Review, Recast, and Repeal). For the sake of clarity, a chart containing one or more examples will be presented for each action.

Category A: Non-legislative Initiatives

A1. Study

The main target of this action is to formally declare that acts that have exhausted their effects are obsolete, while they cannot be repealed for lack of a legal base.

Examples	
Title	**Description**
Study on rules on audiovisual commercial communication for alcoholic beverages	Study to assess whether rules on audio-visual commercial communication for alcoholic beverages have afforded minors the level of protection required, and thereby contributing to assessing the Audio-visual Media Services Directive's (Directive 2010/13/EU) regulatory fitness.

A2. Fitness Check

A Fitness Check is a comprehensive evaluation of a policy area that usually addresses how several related legislative acts have contributed (or not) to the attainment of policy objectives. Fitness checks are particularly well-suited to identify overlaps, inconsistencies, synergies, and the cumulative impacts of regulation. The Fitness Check is an example of joint evaluation work between the Commission and Member States. Fitness Checks generally examine the key principles of a regulation as well as its implementation through subsequent regulations and administrative action. They focus on relevance, EU added value, effectiveness, efficiency and coherence.

Examples	
Title	**Description**
Ecolabel and Eco-Management and Audit Scheme (EMAS) Regulations	Fitness Check of: • Regulation (EC) No 1221/2009 of 25 November 2009 on the voluntary participation by organisations in a Community eco-management and audit scheme (EMAS) • Regulation 66/2010 on the EU Ecolabel The purpose of the fitness check is to evaluate and assess the contribution to competitiveness, sustainable consumption and production.

Environmental Noise	Evaluation of Directive 2002/49/EC relating to the assessment and management of environmental noise. In its Articles 10(4) and 11 the Directive provides for a regular five yearly report by the Commission containing an assessment of the implementation of the Directive, a summary of maps and action plans reported, and an assessment of the need for further Community action.
Petroleum/oil refining sector	Fitness check of the EU legislation relevant for the petroleum refining industry, such as the Renewables Energy Directive, the Energy Taxation Directive, the EU Emissions Trading System, the Fuels Quality Directive, the Directive on Clean and Energy Efficient Vehicles, the Industrial Emissions Directive, the Strategic Oil Stocks Directive, the Marine Fuels Directive, the Energy Efficiency Directive, and the Air Quality Directive.

A3. Evaluation

Evaluation is a procedure during which the Commission assesses in a proportionate way all EU spending and non-spending activities that are intended to have an impact on society or the economy. Evaluations gather evidence to assess how well a specific intervention has performed (or is working) and to draw conclusions on whether the EU intervention continues to be justified, or should be modified. By evaluating, the Commission takes a critical look at whether EU activities are fit for purpose and deliver, at a minimum cost, the desired changes to European businesses and citizens, as well as whether they contribute to the EU's global role.

Examples	
Title	**Description**
Promotion of renewable energy	Evaluation of Directive 2009/28/EC of 23 April 2009 on the promotion of the use of energy from renewable sources and amending and subsequently repealing Directives 2001/77/EC and 2003/30/EC.
Environmental Liability	Evaluation of Directive 2004/35/EC on environmental liability with regard to the prevention and remedying of environmental damage (ELD). According to Article 18 of the Directive, the Commission shall report on the experience gained in its application to the European Parliament and the Council.
Strategic Environmental Assessment (SEA) Directive	Evaluation of the Strategic Environmental Assessment Directive (Directive 2001/42/EC): According to Article 12 of the Directive, the Commission shall, starting in 2006, report on its application and effectiveness at seven-year intervals. The second implementation report, completed in 2016, evaluated the application and effectiveness of the Directive across the EU, and assessed the potential for simplification.
Application of the principle of mutual recognition for goods	Evaluation of the principle of mutual recognition and the way it is applied in Member States (Art. 34 TFEU).
Remedies in the field of public procurement	Evaluation of Directive 2007/66/EC amending Directives 89/665/EEC and 92/13/EEC with regard to improving the effectiveness of review procedures concerning the award of public contracts.

Pre-packaging directives	Evaluation of Directives 75/107/EEC, 76/211/EEC and 2007/45/EC on pre-packaging.

A4. Cumulative Cost Assessment

This tool's main target is to assess the cumulative cost impacts of specified EU legislation and policies over a specified period of years by quantifying the direct and indirect costs, notably on profit margins and in relation to international competitors – in their own home markets – that are not fully subject to EU legislation and policies.

Example	
Title	**Description**
Chemicals Industry	Cumulative cost assessment of the most relevant EU legislation and policies relevant for the European chemicals industry.

Category B: Legislative Initiatives

B1. Consolidation/Simplification

Legislative consolidation means combining in a single text the provisions of a basic instrument and all subsequent amendments. There is no change in the content or form of the existing material. Consolidation corresponds to a purely declaratory, unofficial simplification of the legislation.

Incorporating the amendments into the basic instrument does not entail adopting a new instrument. This is a purely clarification-oriented exercise. Consolidation serves the interests of citizens, administrative authorities and the business world by providing a more accessible and more transparent legislative framework, and has the advantage of making the law more reader-friendly. But consolidation, unlike codification, does not generate a new mandatory legal instrument.

Example	
Title	**Description**
Simplification of technical measures for the protection of marine organisms	Proposal for a simplified framework of technical measures amending Regulation (EC) No 850/98 for the conservation of fishery resources through technical measures for the protection of marine organisms.

B2. Codification

Codification is the process of bringing together one or several legislative acts and all their amendments into a single new act. The new act passes through the full legislative process and replaces the acts being codified. This action facilitates the implementation of the EU legislation, granted that users have thereafter to consult only one single authentic text, and the volume of the acquis communautaire (i.e. all the binding legal acts adopted by the European institutions) is reduced.

There are two types of codification:

- Vertical: one original act and its amendments are incorporated in a single new act;
- Horizontal: two or more original acts covering related subjects – and the amendments to them – are incorporated in a single new act.

Example	
Title	**Description**
Company Law	Codification of seven Company Law Directives into one instrument to increase transparency and readability (Directives 82/891, 2005/56, 2009/101, 2009/102, 2011/35, 2012/17, 2012/30). The purpose of codifying several company law directives into a single instrument is to increase transparency and readability.

B3. Update/Review

Update/review is a tool that aims at making a piece of EU legislation more modern, up to date, or suitable for use by adding new information, amending or modifying the old elements, or by changing its design, for the sake of the evolution of EU legislation and its responsiveness to today's challenges.

Example	
Title	**Description**
Regulation of the Supply Agency of the European Atomic Energy Community of 5 May 1960 determining the manner in which demand is to be balanced against the supply of ores, source materials and special fissile materials (OJ P 032 11/05/1960)	Update / Review of Regulation.
Regulation of the Supply Agency of the European Atomic Energy Community amending the rules of the Supply Agency of 5 May 1960 determining the manner in which demand is to be balanced against the supply of ores, source materials and special fissile materials (OJ L 193 25/7/1975)	Update / Review of Regulation.

B4. Recast

Recasting is like codification in that it brings together in a single new act a legislative act and all the amendments made to it. The new act passes through the full legislative process and repeals all the acts being recast. The difference between recasting and codification is that recasting involves new substantive changes, as amendments are made to the original act during preparation of the recast text.

There are two types of recasting:

- Vertical: one original act and its amendments are incorporated in a single new act;
- Horizontal: two or more original acts covering related subjects –and the amendments to them– are incorporated in a single new act.

Example	
Title	**Description**
Fishing Authorisation Regulation (FAR)	Proposal for a Regulation replacing Regulation (EC) No 1006/2008 on fishing authorisations. Recast of the current FAR was made to simplify the current system, harmonise highly variable data requirements from Member States, and improve the efficiency of sanctions.

B5. Repeal

Repealing is the procedure of removing or reversing a law. There are two basic types of repeal, the repeal with re-enactment or replacement of the repealed law, and the repeal without replacing.

Example	
Title	**Description**
Directive 1999/45/EC on the classification, packaging and labelling of dangerous preparations	Legislative initiative for repeal: The Directive was repealed in accordance with article 60 of the CLP Regulation (EC) No 1272/2008 on 1 June 2015.

5. Regulatory Scrutiny Board

5.1. Mission, tasks and staff

As part of the Commission's renewed commitment to Better Regulation, the Juncker Commission announced that the Impact Assessment Board would be transformed into an independent Regulatory Scrutiny Board to strengthen the existing system of quality control.

The adoption of the Communication "Better Regulation for better results: An EU Agenda"[23] sets out the Commission's new approach. Therefore, this was considered the right moment to set up the new Regulatory Scrutiny Board

and to define its mission and duties and its composition and recruitment rules. The Board is established by a Decision of the President of the European Commission.

Compared to the previous Impact Assessment Board, the Regulatory Scrutiny Board's functions are widened to include major retrospective evaluation and fitness checks of existing Union policies and legislation. Its composition and capacity are also strengthened. The new functions of the Board have been phased-in to reflect the time needed to recruit its new members, during which time the members of the Impact Assessment Board continued to work for the Regulatory Scrutiny Board.

The Board operates within the framework of the Commission's Working Methods 2014-2019.

5.2. The scope of the new independent Regulatory Scrutiny Board

The Impact Assessment Board was established in 2006 to improve the quality of the Commission's impact assessments. The Impact Assessment Board has examined over 700 impact assessments since then, and its scrutiny has been rigorous; the Board has required over 40% of cases to be resubmitted in recent years. Yet, while forward-looking impact assessments are critical, they are only one part of the policy cycle. The evaluation of existing policies and legislation is also important. It was time, therefore, to extend the mission of the existing Impact Assessment Board to cover the most significant retrospective evaluations and "Fitness Checks" of existing policies to ensure that the Commission's policymaking is based on high quality evaluation of what is already in place, in line with the "evaluate first, legislate afterwards" principle.

The new Regulatory Scrutiny Board scrutinizes the quality of all impact assessments, major evaluations and fitness checks of existing legislation, and issues opinions on the draft of the related reports in line with the relevant guidelines. The Board's opinions provide recommendations on how these draft reports should be improved by the Commission services. The Board's opinions on impact assessment reports are assessments of the quality of draft impact assessments. They are not assessments of the legislative proposals that are presented and decided later. The Board gives advice and opinions to the political level of the Commission.

According to the Commission's Working Methods 2014-2019, any initiative with an impact assessment must be accompanied by a positive Board opinion on its draft impact assessment for the proposal to be launched in Inter-Service Consultation. The Board may also offer advice to individual Commission

services regarding the application and interpretation of the relevant guidelines, particularly on challenging assessments/evaluations and on methodological issues. It may also offer advice on horizontal issues relating to the further development of the Commission's impact assessment and evaluation/fitness check processes and guidelines.

5.3. Independence and objectivity

The Regulatory Scrutiny Board members shall act independently and autonomously in preparing opinions. They shall not seek or take instructions from any other institution, body, office or agency. They must disclose any potential conflict of interest to the Board Chairperson and can be requested not to participate in the scrutiny of any impact assessments, or evaluations, or fitness checks where such potential conflict of interest arises.

5.4. Composition of the Regulatory Scrutiny Board

The Regulatory Scrutiny Board comprises a Chairperson and six members. The expertise of the members covers macroeconomics, microeconomics, social policy and environmental policy (so as to cover the three pillars of sustainable development – economic, social, and environmental). The Board is administratively attached to the Secretariat-General of the European Commission.

Three members of the Board are officials selected from within the Commission services. Three posts have been created, therefore, for officials who work full-time exclusively for the Board and are transparently selected on the basis of their expertise in accordance with prevailing Commission rules. They are ranked as Director, Principal Adviser and Adviser.

For the first time, three temporary posts were created to allow for the recruitment of the external members, i.e. for the members from outside the Commission, on the basis of their proven academic expertise in impact assessments, ex-post evaluation, and regulatory policy more generally. These members are engaged as temporary staff pursuant to Article 2(a) of the Conditions of Employment of Other Servants of the European Union (CEOS) and are ranked as Director, Principal Adviser and Adviser.

All members shall serve for a fixed non-renewable period of three years so as to reinforce their functional and institutional independence. They shall work full-time for the Board, and will be administratively attached to the Secretariat-General of the European Commission. At the time of their appointment, and as a condition of their subsequent service as members of the Board, all

members will be subject to the Staff Regulations governing the conditions of employment of officials and other servants of the European Union, and to the Commission's code on good administrative behavior. These lay down strict rules on ethics, confidentiality and conflicts of interest that are particularly relevant and important in relation to the activities of the new Board. The Commission officials members of the Board will, after their three-year mandate, return to the Directorate-General of origin.

5.5. Functioning of the Regulatory Scrutiny Board

The functioning of the Regulatory Scrutiny Board is governed by its Rules of Procedure that have been decided by its Chair, with the agreement of the President of the European Commission, after having consulted the First Vice-President of the European Commission. The secretariat of the Board is provided by the Secretariat-General of the European Commission. In addition, the Board is supported by up to three assistants, to be selected by the Chair.

When scrutinizing draft impact assessments and evaluation or fitness check reports, the Board's opinion takes account of the Commission's guidelines and agreed standards on impact assessment, evaluation, fitness checks and public consultations.

The Board may call upon any Commission department, official or external expert as appropriate, for ad hoc advice when assessing an individual impact assessment, fitness check or evaluation report, bearing in mind the need to avoid any potential conflict of interest.

5.6. Transparency

With a view to transparency, the names and CVs of the Regulatory Scrutiny Board members are published on the internet site of the Commission. The opinions of the Board, similar to the previous Impact Assessment Board opinions, are published on the Commission's website at the same time as the report concerned and, in the case of impact assessments, once a political decision has been taken by the Commission on a related initiative.

Notes

1. Treaty on the European Union, Art. 5 par. 4.
2. European Commission, Staff Working Document "Regulatory Fitness

and Performance Programme (REFIT): Initial Results of the Mapping of the Acquis", SWD(2013) 401 final, Brussels, 01.08.2013.

3. See the full Typology of REFIT actions *infra* section D "Typology of REFIT actions".

4. European Commission, Communication "Commission Work Programme 2015: A New Start", COM(2014) 910 final, Strasbourg, 16.12.2014: 2.

5. See Typology of REFIT actions *infra* section D "Typology of REFIT actions".

6. European Commission, Communication "Better regulation for better results: An EU agenda", COM(2015) 215 final, Strasbourg, 19.05.2015: 3.

7. Ibidem.

8. European Commission, Communication "Second Strategic review of Better Regulation in the European Union", COM(2008) 32 final, Brussels, 30.1.2008: 2.

9. Ibidem.

10. European Commission, Communication "Better regulation for better results: An EU agenda", COM(2015) 215 final, Strasbourg, 19.05.2015: 3.

11. Ibidem.

12. Ibid.: 3-4.

13. Ibid.: 4.

14. Ibidem.

15. European Commission, Communication "Regulatory Fitness and Performance (REFIT): Results and Next Steps", COM(2013) 685 final, Brussels, 02.10.2013.

16. European Commission, Communication "Regulatory Fitness and Performance Programme (REFIT): State of Play and Outlook", COM(2014) 368 final, Brussels, 18.6.2014: 2.

17. Ibid.: 3-4.

18. The Think Small First Principle is a principle according to which the EU and Member States should take into account SMEs' (Small and Medium-sized Enterprises) characteristics when designing legislation, and should simplify the existing regulatory environment.

For the sake of the improvement of the regulatory environment, the Commission and the Member States are committed to rigorously assess the impact of forthcoming legislative and administrative initiatives on SMEs ("SME test") and take relevant results into account when designing proposals.

Besides, they had to come forward with all the proposals to reduce the administrative burden on business that were necessary to achieve the EU reduction target of 25% by 2012, alongside with a total screening of the acquis

communautaire. Particular attention had to be paid to identifying proposals where legislation could be simplified for the benefit of SMEs, and in particular company law. Last but not least, the Member States were invited to adopt targets of comparable ambition to the commitment to cut administrative burdens by 25% by 2012 at EU level, where this has not yet been done, and implement them.

For more references, see European Commission, Communication "Think Small First" – A "Small Business Act" for Europe, COM(2008) 394 final, Brussels, 25.06.2008: 7-8.

19. European Commission, Communication "Regulatory Fitness and Performance (REFIT): Results and Next Steps", COM(2013) 685 final, Brussels, 02.10.2013.

20. European Commission, Communication "Regulatory Fitness and Performance Programme (REFIT): State of Play and Outlook", COM(2014) 368 final, Brussels, 18.06.2014: 4-5.

21. European Commission, Communication "Regulatory Fitness and Performance Programme (REFIT): State of Play and Outlook", COM(2014) 368 final, Brussels, 18.06.2014: 5-7.

22. Ibid.: 7-9.

23. European Commission, Communication "Better regulation for better results – An EU agenda", COM(2015) 215 final, Strasbourg, 19.05.2015: 3.

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CRYPTOCURRENCY, TAX LAW AND ANTI-MONEY LAUNDERING LAW

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Abstract

Blockchain constitutes a relatively new technology, on the basis of decentralization, proof-of-work consensus and practical immutability. Its mainstreaming application, since 2009, has consisted in virtual cryptocurrencies, mainly exemplified by Bitcoin (BTC), which has been officially admitted as a form of currency, initially by the USA jurisprudence. In October 2015 the Court of Justice of the European Union, interpreting Directive 2006/112/EC on the common system of value added tax, did not consider bitcoin as a material good and judged that the exchange of traditional currencies (such as krona, euro…) against bitcoins is exempted from value added tax. Virtual cryptocurrencies have been recognized as means of payment, being similar to the rest currencies, but many investors prefer them as an alternative means of investment. Besides, EU Anti-money Laundering Law has recently made a step forward, by introducing the fifth text on the matter, directive 2018/843, which is the first to cope with virtual cryptocurrencies.

JEL Classification Code: K (Law and Economics)

Keywords: Bitcoin (BTC), blockchain, cryptocurrency, Tax Law, Anti-money Laundering Law

1. Introduction: The Blockchain new technology

Blockchain or Distributed Ledger Technology (DLT) constitutes a kind of technology, whose first application started in 2009. It emerged on the basis of the following three elements: decentralization, proof-of-work consensus, and practical immutability (Fulmer, 2019, pp. 160-192). Combined, these core components provide a unique solution to any digital transaction that eliminates the need for an intermediary to legitimize the transaction. This technology was associated to new means of payment, but its consequences are not limited to this domain. As it was the case of other previous new technologies, Blockchain, let alone cryptocurrency, is linked to a political ideology supporting capitalism, although it is marked by skepticism against States.

It is to underline that capitalism tends to favorize competition and mobility of the market, for instance in the sector of fashion. The doctrine remarks that

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this sector has an ambiguous character, namely utilitarian – practical (reminding of the French etymological origin "façon" of the English word "fashion") or artistic – not functional (Donaud, 2017, p. 41 f). It is to pay special attention to the fact that the USA have promoted the development of the very prosperous domain of clothing products upon the utilitarian approach, through legalizing the copying of original works against conventional institutions, such as the author's copyright. Of course, this is not the case of other countries, such as France, which is a pioneer worldwide as far as the intellectual and industrial property rights of fashion designers are concerned. So private initiative, particularly in the domain of trade, is encouraged, in the framework of capitalism whilst taxation continues to be a constant competence of States.

The enthusiasm which has resulted from blockchain has led some scholars to make speech of a new revolution, which could be compared with the (much wider) Internet revolution. It is to signalize that applications of this technology have been localized in almost all branches of economy. Financial markets, simple contracts, probate, property transfers, taxes, corporate governance, and insurance agreements are areas already penetrated by blockchain, mainly for monetary transactions and tracking data changes (Fulmer, 2019, pp. 160-192). In February 2018, European Commission announced the foundation of an observatory and a forum on blockchain, to monitor the developments on the matter.

The current paper aims at analyzing cryptocurrency as an application of blockchain, particularly upon tax law and anti-money laundering law.

2. Cryptocurrency regulation

Regulatory and legislative bodies do not find it easy to keep up with variations on cryptocurrency transactions given its rapid growth and innovations (Fulmer, 2019, pp. 160-192). In addition to using cryptocurrencies as currencies to buy goods, many entrepreneurs are also issuing their own cryptocurrencies to raise money to fund their products.

The need for legal definition of cryptocurrency implicates its classification in the legal system (Logaras, 2018). Although this term reminds of currencies, the answer does not prove to be so obvious, given that almost no cryptocurrency functions as a currency. To take advantage of the blockchain technology, there are the tokens (such as "ether" for the platform of Ethereum), which are indispensable for the participation in the platform. It results that the nature and the operation of cryptocurrency fit in mainly with digital elements of fortune, whose value exists only in the framework of the "ecosystem" of operation of

a concrete blockchain protocol. The notion of tokens is more understandable through the architecture and the structure of companies that issue and offer them, usually through the procedure called "Initial Coin Offering or ICO". This term reminds of the "Initial Public Offering – IPO" but has nothing to do with public registration.

As for bitcoin, the mainstreaming question consists in the question whether it constitutes a means of payment or a means of hoard. It is to signalize that bitcoin was for the first time admitted as a form of currency in the sentence of the Texas District Court, in the case "Securities and Exchange Commission v. Trendon T. Shavers and Bitcoin Savings and Trust", which was emitted in 2013. Upon this tribunal, "*Bitcoin ("BTC") is a virtual currency that may be traded on online exchanges for conventional currencies, including the U.S. dollar, or used to purchase goods and services online. BTC has no single administrator, or central authority or repository*".

3. Cryptocurrency upon Tax Law

In October 2015, the Court of Justice of the European Union, interpreting Directive 2006/112/EC of 28 November 2006 "on the common system of value added tax", adopted a jurisprudence on bitcoins (C-262/14). Upon this sentence, bitcoin cannot be characterized as a material good in the sense of article 14 of this directive because its exclusive target is to constitute a means of payment. The exchange of traditional currencies against bitcoins is exempted from value added tax, in other words article 135 par. 1e is applicable, which refers to all forms of currency as means of payment. The disposition on the matter is the following: "*The Member States shall exempt the following transactions:… e. transactions, including negotiation, concerning currency, bank notes and coins used as legal tender, with the exception of collectors' items, that is to say gold, silver or other metal coins or bank notes which are not normally used as legal tender or coins of numismatic interest;*".

According to the same sentence, bitcoin is classified among the virtual currencies on the basis of exchange rates. These currencies, on the one hand, are similar to the rest currencies being exchanged (such as krona, euro…), as for their use in the physical world and, on the other hand, are different from electronic money as long as the sums of money are expressed not in conventional units, such as euro, but in virtual ones, like bitcoin. Therefore, the European Central Bank turns down any submission of bitcoin to the dispositions of directive 2009/110/EC on the taking up, pursuit and prudential supervision of the business of electronic money institutions (Theodosaki, 2018).

In spite of the recognition of bitcoin as a means of payment according to the aforementioned sentences in the framework of comparative law, many investors since years have preferred it as an alternative means of investment, taking an approach to bitcoin as a means of store of value. The value of bitcoin, whose emission is going to be stopped (probably in 2140), is nowadays enhanced against its initial value (Kehagia, 2018, pp. 3-5). However, this value is marked by strong fluctuations (20% - 30%) whilst in January 2017 it cost just 998,12 dollars. Due to these economic data, many investors are motivated to buy bitcoins to get benefit from its goodwill which is likely to result from an eventual resale.

Besides, it is notable that the Internal Revenue Service (IRS), which constitutes the revenue central service (of the USA federal government) has tried to classify cryptocurrencies as "virtual currency". On 25.03.2014 IRS emitted some notices, according to which virtual currency will be treated as a means of fortune, as far as taxation policy is concerned. It is obvious that a regulation like this adequately resolves the issue relevant to the revenue resulting from the use of bitcoin as a means of investment. Despite the name "virtual currency", currencies of this category are not taxed as currencies, which presents challenges for users who use cryptocurrencies in different ways (Fulmer, 2019, pp.160-192). That public finance service defined the term "virtual currency" as a "*digital representation of value that functions as a medium of exchange, a unit of account, and/or a store of value*". Most, if not all, blockchain currency would fall under this category, but there is still uncertainty revolving around the classifications and taxation of digital assets. Bitcoin is further classified, by the doctrine, as a "*convertible virtual currency*", which means that it "*can be easily valued and exchanged for real currency or that acts as a substitute for real currency*" (Fulmer, 2019, pp. 160-192).

The aforementioned approach of IRS has raised criticism as long as it underestimates the fundamental function of bitcoin, which is compatible with the initial scope of cryptocurrency, consisting in means of payment (Kehagia, 2018, pp. 3-5). For this reason, in September 2017, a bill was tabled in the US House of Representatives, which aimed at introducing an exception to the rule of virtual currency as a means of fortune, in case of purchases through virtual currency being inferior to 600 dollars. It is also notable that in the same legal order bitcoin is defined as money, in criminal law cases, whilst in October 2017 the independent authority "Commodity Futures Trading Commission (CFTC)" classified it among commodities.

As far as Greece is concerned, the eventuality of use of cryptocurrency is not subject to any particular tax regulation (Kehagia, 2018, pp. 3-5). Taking

into account the aforementioned European jurisprudence, it is not easy to link bitcoin to the cases of tax income coming from transmission of titles (article 42 of Income Taxation Code). Anyway, it is difficult for tax authorities to identify the possessor of bitcoins, with the exception of deals which are endowed with transparency by law, such as transactions taking place in a shop compatible with bitcoin as a means of payment. Even in case that the possessor of this cryptocurrency makes a voluntary statement, it is to examine the purpose of the use of cryptocurrency (payment or investment).

4. Anti-money Laundering Law and cryptocurrency

European Union has created a new branch of law since 10 June 1991, the Anti-money Laundering Law.

The first directive introduced a definition of this activity, following the standard wording of the United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (Maniatis, 2018 pp. 3-4). This definition has become classic given that the main elements of money laundering have remained the same.

Indeed, this is the case of the post-Lisbon directive 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC. For the purposes of this fourth directive, the following conduct, when committed intentionally, is regarded as money laundering:

a. The conversion or transfer of property, knowing that such property is derived from criminal activity or from an act of participation in such activity, for concealing or disguising the illicit origin of the property or of assisting any person who is involved in the commission of such an activity to evade the legal consequences of that person's action;
b. The concealment or disguise of the true nature, source, location, disposition, movement, rights with respect to, or ownership of, property, knowing that such property is derived from criminal activity or from an act of participation in such an activity;
c. The acquisition, possession or use of property, knowing, at the time of receipt, that such property was derived from criminal activity or from an act of participation in such an activity;
d. Participation in, association to commit, attempts to commit and aiding,

abetting, facilitating and counseling the commission of any of the actions referred to in points (a), (b) and (c).

European Union has extended the field of Anti-money Laundering Law to various forms of criminality. More precisely, European law has moved from the prohibition of money laundering relevant to proceeds of drug trafficking to the prohibition of laundering of proceeds of organized and serious crime, and, after the terrorist attacks of 9/11, has added the terrorist finance to the money laundering prohibition regime. The fourth directive went further, by focusing on tax offences, which were defined as tax crimes relating to direct taxes and indirect ones. It required member states to treat this kind of financial criminality as predicate offences.

As noticed by the doctrine, anti-money laundering directives consist of the following elements:

a. the criminalization not only of money laundering but also of terrorist finance, which is a new target that may not involve proceeds of crime, opposite to the classical phenomenon of money laundering;
b. the prevention of money laundering via the imposition of a series of duties on the private sector;
c. the focus on financial intelligence, via the establishment and cooperation of financial intelligence units responsible for receiving and analyzing reports received from the private sector (Mitsilegas and Vavoula, 2016, pp. 261-293).

As already signalized, European Union keeps adopting norms on this modern matter. This fact is proved by directive (EU) 2018/843 amending Directives (EU) 2015/849, 2009/138/EC and 2013/36/EU. This fifth directive entered into force on 9 July 2018 and member states must adopt these new rules into their national legislation by 10 January 2020. According to the preamble of the text, recent terrorist attacks have brought to light emerging new trends, in particular regarding the way terrorist groups finance and conduct their operation. It is also added that certain modern technology services are becoming increasingly popular as alternative financial systems, whereas they remain outside the scope of Union law or benefit from exemptions from legal requirements, which might no longer be justified. So, to the likely criticism consisting in a very extended legal inflation produced by European institutions, particularly the last years, the preamble responds that further measures should be taken to ensure the increased transparency of financial transactions, of corporate and other legal entities, as well as of trusts and legal arrangements having a structure or functions similar to trusts (“similar legal arrangements”), with a view to improving the existing preventive framework and to

more effectively countering terrorist financing. Furthermore, as far as cryptocurrency is concerned, all transactions in cryptocurrencies were omitted from the scope of the fourth anti-money laundering directive. According “Whereas” 8 of the fifth directive, providers engaged in exchange services between virtual currencies and fiat currencies (that is to say coins and banknotes that are designated as legal tender and electronic money, of a country, accepted as a medium of exchange in the issuing country) as well as custodian wallet providers are under no Union obligation to identify suspicious activity. Therefore, terrorist groups may be able to transfer money into the Union financial system or within virtual currency networks by concealing transfers or by benefiting from a certain degree of anonymity on those platforms. It is therefore essential to extend the scope of Directive (EU) 2015/849 so as to include providers engaged in exchange services between virtual currencies and fiat currencies as well as custodian wallet providers. For the purposes of anti-money laundering and countering the financing of terrorism (AML/CFT), competent authorities should be able, through obliged entities, to monitor the use of virtual currencies. Such monitoring would provide a balanced and proportional approach, safeguarding technical advances and the high degree of transparency attained in the field of alternative finance and social entrepreneurship.

The directive on the matter brings the following changes:

- improving transparence on the real owners of companies,
- improving transparency on the real owners of trusts,
- interconnection of the beneficial ownership registers at the European Union level,
- lifting the anonymity on electronic money products (prepaid cards) in particular when used online,
- extending Anti-Money Laundering and Counter Terrorism financing rules to virtual currencies, tax related services, and traders in works of art,
- broadening the criteria for assessing high-risk third countries and improving checks on transactions involving such countries,
- setting up centralized bank account registers or retrieval systems,
- enhancing the powers of European Union Financial Intelligence Units and facilitating their cooperation,
- enhancing cooperation between financial supervisory authorities (Theodosaki, 2018, pp. 1-2).

Under this directive, users that hold their virtual currencies via a custodian wallet provider or enter into virtual currency transactions via a virtual exchange platform can no longer be anonymous, because of the customer due diligence requirements vested upon the custodian wallet providers and virtual

currency exchange platforms (Houben and Snyers, 2018, pp. 79-80). However, users using hardware of software wallets and, for instance, trade via a P2P network or via any other way than through a virtual currency exchange platform, can still operate anonymously.

Besides, the Greek State proceeded to the adoption of the anti-money laundering act on prevention and suppression of money laundering and terrorist financing and other provisions, 3691/2008, which abolished articles 1-8 of the initial law, 2331/1995. The legislative initiative raised severe criticism as it got rid of the "National Authority on Countering the Legitimization of Proceeds from Criminal Activities" (Maniatis, 2018, pp. 3-4). It was about an independent authority which was replaced by another Committee, whose nine-member composition was dependent on the government, as for the majority. It is to underline that essentially this datum blocks the eventual physiognomy of the Committee as a non-governmental public authority whilst the law does not characterize, at least explicitly, this State mechanism as an independent one. It is also notable that no provision of European Union Law had imposed the replacement of the first authority, despite the claims to the contrary.

5. Conclusion: Cryptocurrency being in need of regulation

As already signalized, European Union has reserved the privilege of tax exemption to virtual cryptocurrencies, such as bitcoin, as far as value added tax is concerned. The lack in this form of tax (as it was, for instance, the case for lawyer's profession in the Greek legal order) obviously facilitates the market and so enhances competition.

However, the doctrine finds it important to introduce norms for the clear differentiation of bitcoin as a means of payment against its use for investment (Kehagia, 2018, pp. 3-5). If this virtual currency is not linked to any central power, it is subject to power of national legislators in various terms, such as taxation. The adoption of Tax Law rules on the matter is recommended, particularly due to the intensive fluctuation of the value of bitcoin and to the speculative trends that this fluctuation implicates.

Besides, as bitcoin is used mainly in international transactions, the inexistence of a single normative approach to it causes further problems. It goes without saying that the advent of new technologies and the use of Internet as a means of transactions have led to rapid developments in the field of trade and economy. It results that the legislative power should be constantly alert, coping with new challenges. On 11 July 2017, about 900 cryptocurrencies in use were localized, so the need for regulation and control is self-evident.

Nevertheless, it is also to highlight the wind of change, thanks to the use of Internet applications. If blockchain has got rid of traditional figures of trade, such as banks, and has facilitated commercial relations and competition, another application of Internet, sharing economy in the field of tourism, has changed the landscape in tourism market, in a quite similar way. Indeed, the role of another traditional figure of merchant, the hotelier, is overridden through platforms such as Airbnb, let alone about at the same time that bitcoin was introduced in the market. It is to add that current tourists making use of cyberspace have gained, in general, their autonomy, against travel agencies and tour operators. Anyway, States should cope with tax evasion (Maniatis, 2018, pp. 1-13) and not let modern transactions become uncontrollable, particularly exempted from their classical competence of taxation promoting public interest.

Last but not least, EU anti-money laundering law has recently made a step forward, by introducing the fifth directive on the matter, which is the first to cope with cryptocurrencies, in spite of the fact that there are crypto players that are not caught by this directive, sometimes because the legislator chose not to, but, so it seems, sometimes also because he did not pay a lot of attention to their existence and the potential risks involved (for instance, coin offerors) (Houben and Snyers, 2018, p. 79).

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OFFSHORING VS RESHORING IN US MNES

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Abstract

The pressure on firms to improve efficiency and competitiveness to position themselves effectively into the globalized market had boost outsourcing and offshoring in the contemporary world. The point of their differentiation is the place, in the sense that in outsourcing the procurement of resources from sources external to the firm to produce a product or to provide a service more efficiently and less costly, takes place inside the country, while just the opposite in offshoring. Although, offshoring strategy is going on at least the last 30 years and still remains popular, recently some offshore companies have been discouraged to continue their activities abroad and decided to return facilities (or supply basins) to their home country, or at least to a neighbouring one. Reshoring is a new phenomenon and occurs in relation to previous offshoring activities. The purpose of this paper is to discover the reasons for the emergence of reshoring phenomenon, especially during the global financial crisis. Reshoring follows the reverse process of offshoring and is viewed as its extension. In this context, an example of US multinational enterprises (MNEs) offshoring into Mexico during 1990s, is used. The increasing tendency of MNEs' reshoring decision is presented in a second place and lastly its impact through the analysis of the reshoring's winners and losers.

JEL Classification: F23,O19

Keywords: Outsourcing, Offshoring, Reshoring, Multinationals (MNEs), Foreign Direct Investment (FDI)

1. Introduction

The pressure on firms to improve efficiency and competitiveness to position themselves effectively into the globalized market had boost outsourcing and offshoring in the contemporary world. Both are acknowledged as two of the most important strategic decisions for MNEs in the current markets on the basis of their contribution to increase firm's productivity. The better performance in productivity is achieved by increasing the efficiency with which inputs are used.

US MNEs have been among the first that incorporate these strategies aimed at achieving sustainable competitive advantages. During 1990s US MNEs intensified offshoring activities to neighbouring country of Mexico by moving many

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of their productive activities, such as labour services (Sarkar and Reddy, 2006, p. 45). The movement of an activity to outside of country is referred as offshoring. The relocation of jobs and processes to any foreign country is associated with Foreign Direct Investment (FDI) and includes both production and/or R&D and innovation activities (IDEA Consult et al., 2014, p. 6). MNEs around the world have proceeded to relocation of their production facilities or their supply basins offshore, seeking mainly resources, efficiency, strategic assets and/or market advantages (Dunning, 1980, cited in Ancarani et al., 2015, p. 141)]. Offshoring is especially common in apparel, auto parts, electronics, and machinery, as these are industries with physically separable production stages, in the sense of taking place in different locations and with distinct differences in their factor intensities that makes the breaking up of production across borders attractive (Bergin et al., 2011, p. 163). Technological advances and changes in social norms have enabled offshoring. Technological breakthroughs in telecommunications, the Internet, and collaborative software tools have reduced the costs of establishing business remotely and across borders. The concept of outsourcing is similar to this of offshoring, differentiated to that the procurement of resources from sources external to the firm to produce a product or to provide a service more efficiently and less costly, takes places inside the country (Sarkar and Reddy, 2006). In outsourcing the tasks are performed under some contractual arrangement by an unrelated party (Wiesmann et al., 2017, p. 22). Although, offshoring strategy is going on at least the last 30 years without losing its popularity, recently some offshore companies have been discouraged to continue their activities abroad and return facilities (or supply basins) to their home country, (called “back-reshoring”) or at least to neighbouring countries, (called “near-reshoring”) (Ancarani et al., 2015). Reshoring is a new and emerging phenomenon and occurs in connection to previous and sometimes failed offshoring activities.

The purpose of this paper is to discover the reasons for the emergence of reshoring phenomenon, especially during the global financial crisis. Reshoring follows the reverse process of offshoring and is viewed as its extension. In this context, an example of US MNEs offshoring into Mexico during 1990s is used. The increasing tendency of MNEs’ reshoring decision is presented in a second place and lastly its impact through the analysis of the reshoring’s winners and losers. Thus, the structure of the paper is developed respectively in the following three sections while the fourth section concludes.

2. The example of US MNEs offshoring to Mexico

Even from 1970s, US-based companies responded to the increased

competition of Japanese and European MNEs by establishing facilities abroad and eliminating the goods producing by relatively well paid and unionized US blue collar workers, such as assembly line workers in the automotive industry (Levine, 2005). It was the time that firms decided to engage in offshoring, attracted mainly by its primary purpose of cost minimization through the relocation of business processes to low-wage location. Thus, companies send jobs "offshore" principally to save on labour costs. Later, offshoring related to a more general location strategy that beyond cost minimization, incorporated knowledge seeking. During 1980s, firms have started offshoring their operations to low-cost and/or low-wage countries, from which imported back products and services produced overseas. General Motors in 1987 planned to phase out the production of A-body cars in the US and move it to its Ramos Arizpe, Coahuila plant in Mexico (Macrides and Berg, 1988). This trend continued in a larger base in the 1990s enhanced by multilateral trade agreements and treaties as the NAFTA (1994) and other economic reforms. Further, as Mexico's will was to cultivate a cozy relationship with the foreign investors, proceeded to implementation of neoliberal economic policies, mitigation of risk for foreign investors by securing property rights and to legislation of tax laws in favor of foreign MNEs. All these combined with geographical proximity and transportation, convenience of doing business in the same or close time zones, communication and technological advances, that reducing further the costs, encouraged US business activities to Mexico. The extent was such that many US firms located even the entire production lines there. In mid-1990s, Mexico had been one of the most favorite countries for U.S. investors, and ranking in number two only behind China as global investors' popular developing country (Kumar et al., 2000).

This "production" or "manufacturing" offshoring implied the free movement of capital to lower-wage countries particulars as Mexico and sometimes reflected factory closure in the US. There were indeed large differences in the wages paid for equivalent skills between the U.S and Mexico. Also, by that time, in the U.S many of the offshored jobs were considered of low prestige and less attractive, while in the recipient country were welcomed by "hungry" workers, doing their best and even outperformed their counterparts in developed countries (McKinsey Global Institute, 2003). Economists of the Institute for International Economics and of Council of Economic Advisers argued about the overall benefits of offshoring to the U.S. economy, such as the reduction in costs and prices (Brainard and Litan, 2004). McKinsey Global Institute report (2003) estimated the net cost savings of moving some jobs offshore to be about of 50 percent. US MNEs' by lowering costs through offshoring, were

in the position to gain a business advantage over their competitors and increase US companies revenues. Thus, U.S. industry could remain competitive and retain its world standing.

Later, US companies being obliged to deal with environmental regulations were motivated to move production to less-regulated countries between them once again Mexico, offshoring in reality pollution. US MNEs were taking advantage of Mexico's lower environmental and labor standards, letting it bear the related social costs.

3. The Reshoring phenomenon

As a reaction to the previously "offshoring" phenomenon in contemporary world emerged its opposite, the "reshoring" one. A congruent definition of the term is not available yet but in literature is mostly used to describe the movement of offshore production back to its previous location (Wiesmann et al., 2017, p. 22). The industry that has brought the most jobs back to the U.S. is that of automotive, followed by makers of electronic components and appliances. Those are industries producing goods of such size and weight that offshoring turn not to offer the expected total cost savings.(Glaser, 2017).The reshoring of manufacturing back to US is a "hot" topic that is sustained by manufacturers, retailers, and politicians (Basu and Schneider, 2015, p. 4). Reshoring is linked to financial crisis because from its outburst and afterwards, costs and prices have been decreasing, new opportunities have arisen and effective and efficient ways of doing business in US have been revealed.

Mainly, the crisis has generated the following drivers of reshoring. The crucial factor that in first place motivated offshoring, the lower labour costs, no longer exists as during the last decade the annual labor cost per hour increased in developing countries, especially in China, faster than in the US (Basu and Schneider, 2015). Furthermore, the advances in the manufacturing process due to automation, has increased productivity and decreased the size of the labor cost component in a produced item. Thus, the developing countries' advantage of low-labor cost is almost vanished. Additionally, the intense use of automation in US manufacturing reduces the impact of higher labor costs enhancing the reshoring (Basu and Schneider, 2015). Another key driver behind the interest in reshoring is the exchange rate changes, meaning that the appreciation of a local currency has a huge impact on product cost in the end-use country, like US (Basu and Schneider, 2015). The energy cost reduction is also of high importance in accelerating reshoring. Cost of electricity production as well as products made from or using natural gas is going down due to existence of a less

expensive source of the domestic supply in oil and natural gas that the advances in the oil fracking process produced (Basu and Schneider, 2015). In the US, energy costs are lower than in many other parts of the world. Major driver is also considered the better awareness of non-price factors by managers within industry, meaning that overtime companies gain knowledge of the other direct and indirect costs so that can better take sourcing decisions, including risk costs, supply chain costs, and the cost of quality (Basu and Schneider, 2015). This fact proved that in many cases, previous offshoring decisions were wrong. Sometimes, decision-making factor in the "reshoring" can be the risk of intellectual property theft since some countries have lax laws permitting this to happen. It is common in cases like highly publicized software development (Tate, 2014, p. 67). An emerging reason for reshoring activity is the arising desire to link manufacturing with product design in the sense to have interaction between the design team and the operators who make the products (Whitfield, 2017, p. 135).

During the period 2010-2016, 115 US companies returned their activities home; among them the economic giants American Apparel, Ford, Apple, GE, and even Wal-Mart brought back jobs. According to Reshoring Initiative (2016) "The 2016 results bring the total number of manufacturing jobs brought back from offshore to more than 338,000 since the manufacturing employment low of February 2010" (Esler, 2017). More U.S. manufacturers are reevaluating their manufacturing and sourcing locations. They are attracted by the benefits of reshoring, such as higher product quality, shorter delivery times, rising offshore wages, lower inventory and the ability to better adjust to changing customer demands (Reshoring Initiative, 2018). US MNEs *more than ever seem to realize that producing in or close the market generates balance sheet, risk and strategic benefits that results to outweigh higher wage rates. In this context, companies decide to sustain the* "Made in the USA" branding in a time period that the US government demonstrates the value of "Make America Great Again". Most of US citizens, suffering from the impact of financial crisis, feel optimistic about the perception of rebuilding America, meaning mostly bringing jobs back home. During his campaign, President Donald Trump ran on a "pro-business" platform in which proposed legislation of lower taxes and a less burdensome regulatory environment (Carlson, 2017). The renaissance of "Made in the USA", the government's policy changes *providing incentives towards reshoring* and the expectations of those changes, accelerated the reshoring phenomenon.

4. Reshoring's Winners and Losers

Relying on previous sections arguments and mainly on US example, it is

easy to understand those that are benefit from reshoring. First of all, US companies, both retailers and manufacturers. Retailers benefit from better quality, faster delivery, image of selling "Made in USA," resulting to higher income of customer base. Respectively, manufacturers gain from less warranty costs, inventory, dependence on long-term forecasting and supply chain monitoring, better image resulting to lower total cost. Reshoring reduces the cost of ownership. Therefore, US MNEs increase total revenues through the old good recipe of costs reduction and through the creation of sustainable competitive advantage that raise companies' market value. Above all, reshoring creates positive shareholder wealth effect (Brandon-Jones et al., 2017).

Further, reshoring improves the U.S. economy by increasing competitiveness and reducing intellectual property loss. Productivity rise, increasing country's GDP. US can regain control of production processes in product standardization and quality assurance, safe and fair working conditions, and environmental protection. Reshoring Initiative (2018) states that "reshoring is the fastest and most efficient way to strengthen the U.S. economy because it helps balance the trade and budget deficits; reduces unemployment by creating productive jobs; reduces income inequality; motivates skilled workforce recruitment by demonstrating that manufacturing is a growth career; helps maintain the broad industrial capability required for national defense."

Of course, consumers are benefit from the variety and high quality of products and services. Customers reach high levels of satisfaction since companies can more efficiently adapt to their clients ever-changing needs and demands. In the US case, they feel confidence for products "Made In America" and pay for them. According to Consumer Reports, up to 80 percent of Americans are willing to pay extra for products that are manufactured in the US. Additionally, most of these respondents claimed to be willing to pay up to 10-percent more for a US-made product (Robinson, 2016). This is also a way to satisfy their social solidarity need towards US workers.

The US labour force is positively affected from the creation of new jobs. The possibilities of offering better-paid jobs are increased. This recovery can lead to the development of new talents, well prepared and motivated to work in modern, high-technology driven leading industries that implement efficient management techniques (Ocicka, 2016, p. 112). Reshoring will bridge the skills gap, since will direct millennials towards manufacturing, satisfying companies will for the birth of a new manufacturing generation.

Nevertheless, reshoring is a new phenomenon that has not being tested in long-term and as such can be a topic of political manipulation in the expense of public vote. So, politicians can gain.

On the contrary, host countries that has experienced inflows of FDI they are now “heart-broken” from reshoring. Empirical data does not yet exist to justify the facts, but the conventional wisdom leads to the just opposite situation previous described, like that host countries experience negative economic indicators, lose in productivity & output, record loss in GDP and real income, and increased unemployment rate. Host country’s citizenry is in worse condition as the workforce loses jobs, consumers experience higher prices, smaller product and services’ variety, and lower quality. Nevertheless, these negative effects are related to the level of development of host country. For example, China is a giant that can develop strategies to protect its economy from the reshoring and fill the gap that foreign investments created; of course, that is not the case for low-income countries as Bangladesh. To reach to safe conclusions, additional empirical research is required.

5. Concluding Remarks

During 1980s firms have started offshoring their operations to low-cost and/or low-wage countries, from which imported back products and services produced overseas. This trend continued in a larger base in the 1990s enhanced by multilateral trade agreements and treaties as the NAFTA (1994) and other economic reforms. All these combined with geographical proximity and transportation, communication and technological advances that reduced further costs, encouraged US business activities to Mexico; and in such extent that many US firms moved even the entire production lines there.

The outburst of the global financial crisis in 2008, pushed MNEs to reevaluate their location investment decisions and follow the reshoring movement. Reshoring, a relatively new phenomenon, has started in connection to previously offshoring activities. Recently, US firms reshoring in response to increasing costs of offshoring and taking advantage the creation of new opportunities and the revelation of effective and efficient ways of doing business in US. One key driver of reshoring phenomenon is the labor costs on the basis of increasing faster in low-cost countries than in US. This is related mainly to the intense use of automation in US manufacturing that supports the labor cost declining tendency. Other drivers are the currency value appreciation in low-cost countries (especially China), making foreign produced goods more expensive compared to local production; the declining U.S. energy costs, better education and awareness of managers of the cost of non-price factors influencing their sourcing decisions, including risk costs, supply chain costs, and the cost of quality (Basu and Schneider, 2015). It is argued that the market is

better served resulting to rise of customer satisfaction and thus, to firms' revenues. The renaissance of "Made in the USA", the government's policy changes *providing incentives towards reshoring* and expectations of further changes, enhance the reshoring movement.

Reshoring as new phenomenon faces data limitation and our assumptions of its effects are more or less based on the conventional wisdom that US economy, government, companies, citizenry benefits as a whole most at the expense of the countries that experience the exodus of FDI. In the coming years, hopefully, it will be possible to provide a detailed analysis of data to prove the pros and cons of reshoring to test the rate of possibilities of evolving either as widespread trend or limited to a small number of isolated incidents, and its duration.

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U.S. TRADE WARS AND HOW THEY AFFECT THE WORLD

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Abstract

This study examines the increasing international interdependence that has been accompanied by heightened commercial rivalry among nations. In the past decades, trade conflicts between advanced industrial countries have intensified as these states have competed to maintain a vibrant domestic production base. As the United States was forced to adopt an increasingly aggressive trade strategy in dealing with its competitors in the industrialized world, it also had to cope with growing trade challenges from developing countries whose pursuit of mercantilist and protectionist policies for rapid economic catch-up put them on a collision course with the Americans. More recently, China's remarkable economic growth has begun to pose another major challenge to American trade policy and it is not surpising that Washington and Beijing have found themselves embroiled in a wide range of trade conflicts.

JEL Classification: A12, B17

Keywords: trade strategy, America, China

1. Introduction

World trade has steadily grown faster than world GDP since the early 1970s, and it expanded twice as quickly between 1985 and 2007.Of great policy interest is how globalization affects aggregate productivity and welfare, and how its impact differs across countries at different levels of economic development. In advanced economies, increased competition from low-wage countries has exacerbated public debates about the gains from trade, in the face of rising concerns about domestic employment and inequality and China's dramatic trade expansion after joining the WTO in 2001. In developing countries, trade reforms have not always yielded all or only the desired benefits, leading policy makers to question the merits of trade openness in light of weak macroeconomic fundamentals and slow structural transformation. Economics theory provides a clear rationale for trade liberalization: it enables a more efficient organization of production across countries, sectors and firms, which

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generates aggregate productivity growth and welfare gains. In particular, heterogenous-firm trade models emphasize the importance of firm selection, the reallocation of activity across firms, and within-firm productivity upgrading as key channels mediating these gains. At the same time, recent macroeconomics and growth research highlights that institutional and market frictions distort the allocation of productive resources across firms and thereby reduce aggregate productivity. However, how such frictions modify the gains from trade remains poorly understood. This paper is structured: Section 1 how the trade wars in the US started and what are the todays "phenomena" that lead to the increase of tariffs. On Section 2 we'll see the impact of a global trade war, according to economists. On Section 3 we will discuss what are the effects of a global trade war and following to that, on Section 4 we'll talk about the trade wars from the aspect of Game Theories. At last, on Section 5 we will analyze how a trade war affects the entire world today and conclude.

2. The beginning of trade wars

The impact of a trade war on corporate America is widely debated in the news. On one hand, it is argued that it will discourage abusive trade practices and intellectual property theft by foreign companies. On the other hand, reporters predict that the trade dispute might hurt American exporters, raise costs for manufacturers, and interrupt companies' supply chain. Opponents of tariffs suggest that the prospect of a trade war introduces a higher level of uncertainty that might prompt companies to curtail investments and reduce hiring. Transcripts of first-quarter 2018 earnings calls present an early insight into this debate. This was the first time since the tariffs have been announced that companies had an opportunity to refresh their outlook and communicate to analysts the projected impact that the trade war may have on their businesses.

Viewed objectively, we could be on the verge of a modern-day equivalent to the retaliatory trade wars that, within the recent past, turned economic crises into major depressions. To be sure, the approaching dispute may not resemble a classic trade war, except in its potential severity. But the potential costs of a trade war can be enormous. To give but one example, let's start with the case of the Smoot-Hawley Act of 1930, an American statute that significantly hiked American tariffs at the beginning of the Great Depression and in turn provoked even more intense retaliation from Europe, the Commonwealth, and elsewhere. Although the American public may believe the Great Depression was caused by the Stock Market Crash of 1929, the conventional wisdom among economic historians is that the Great Depression was more directly caused (or at least

deepened in its intensity and prolonged in its duration) by the Smoot-Hawley Act.The process was amazingly rapid. By some estimates, the value of world trade in 1933 (just three years after the Smoot-Hawley Act of 1930) was just one-third of what it had been in 1929. Precisely at the time that depressed industries in all nations needed to sell in foreign markets (because consumers in their home market had lost much of their purchasing power), access to foreign markets was denied to everyone, and the Great Depression deepened.

Such evidence suggests that trade wars are irrational, and the vast majority of economists would agree with this assessment and hence favor free trade. But, even if irrational, trade wars still persist. The now infamous example of the Smoot-Hawley trade war, which is today universally understood as a classic blunder, did not stop later, smaller trade wars from erupting between the U.S. and the E.U., such as the "Chicken Wars" of the early 1960s or the Banana Wars of the 1990s. Scholarly histories of trade wars have traced these conflicts back to medieval times, and Britain and France waged one such war for over two centuries, with the French imposing punitive tariffs on British woolens and the British responding with high tariffs on silk products from France. Then and now, the result has been to hurt consumers in both countries and benefit only a much smaller number of local producers.

Why does this pattern repeat when the public always loses? The most logical answer is "rentseeking". That is, what may be irrational on the aggregate level is perfectly rational for local actors (usually called, "special interests"), who can effectively lobby the legislature for rules that favor them, even if those rules reduce the general welfare. It should not surprise us to learn that individual actors (or, more likely, highly organized coalitions of them) are prepared to subordinate the general welfare to their special interests. A great economist, Mancur Olson, astutely developed this theme that organized coalitions, representing only a small minority, can manipulate the political levers to shape trade policy for their private benefit, even though they inflict much greater damage on the majority of the population. In any event, once a trade war begins and the other side retaliates, the general public on both sides responds with nationalistic indignation to the perceived abuses of the other side. Trust the public to be confused – time and time again.

In 2016, two critical political decisions were reached –both unfortunate and potentially catastrophic– with the legislature being only remotely related to either story. First, in 2016, British voters narrowly approved a referendum to leave the European Union (with only 51.9% voting for exit). Parliament did not make this decision; it only authorized a democratic vote. Nor did the executive branch make the decision (as then Prime Minister Cameron, who opposed

Brexit, resigned when the public voted for it). What motivated the British voter? Of course, there can be reasonable debate here, but probably most believe that fear of increased immigration into the U.K. was the primary catalyst, with a vaguer apprehension playing a secondary role that the E.U. was unduly usurping the sovereign powers of the U.K. government. In short, this was, in the language of U.S. politics, a "populist" eruption, which surprised most observers.

The second event in 2016 was also a surprise: the election of Donald J. Trump as President of the United States. Again, the legislature was not involved (and both political parties, at different points, were amazed at his success). Again, there was a populist eruption and a narrow vote, and again the fear of immigration was one of the primary forces propelling President Trump to his upset victory. Yet, probably even more important than the immigration issue was Trump's defiant opposition to free trade. Not only did he promise to renegotiate (or simply renounce) the North American Free Trade Agreement ("NAFTA"), but he threatened to build an impenetrable wall on the U.S./Mexican border – thereby adding insult to injury. The "blue collar" American voter, who traditionally was the mainstay of the Democratic Party, responded to these twin calls for reduced free trade and reduced immigration by defecting to the Trump camp, thereby shocking a very unprepared Democratic party that had not seen this coming. Since his election, President Trump has also pulled out of the Paris climate accord, and this could similarly precipitate a trade war involving Europe. That is, if American companies are not compliant with the Paris accords and thereby can produce products at lower cost, trading rivals might turn to punitive sanctions, including the much discussed "carbon tariff." Still, another scenario is that sanctions imposed by the U.S. against firms trading with Russia could also trigger retaliation by the E.U. Finally, President Trump might cause the U.S. to act in violation of the rules of the World Trade Organization ("WTO") and refuse to comply or pay sanctions when ordered to do so. Irrational? Perhaps, but certainly well within the range of actions that President Trump could take. All these scenarios are possible, but it is still premature to predict that any will come to fruition.

In March 2018, the US announced that they will increase tariffs on steel and aluminium imports from all countries, including the EU and NAFTA countries. These measures were temporarily deferred for some countries (e.g. Canada, Mexico and the EU) but finally imposed on June 1st. After this announcement, most partners reacted to these US tariffs by announcing retaliatory tariffs of their own. For example, the EU has provided the WTO with a list of US products that will face 25% additional tariffs when entering the EU (WTO, 2018). Similar measures have been announced by Canada and Mexico.

Moreover, in a separate policy action in April 2018, the US announced it would impose additional tariffs on Chinese imports for a broader set of products. These US tariffs are on top of the steel and aluminium (S&A) tariffs and respond to different strategic decisions by the US – i.e. reduce it trade deficit with China, and negotiate better market access to US firms and issues related with intellectual property rights. In turn, the Chinese administration announced retaliatory measures.

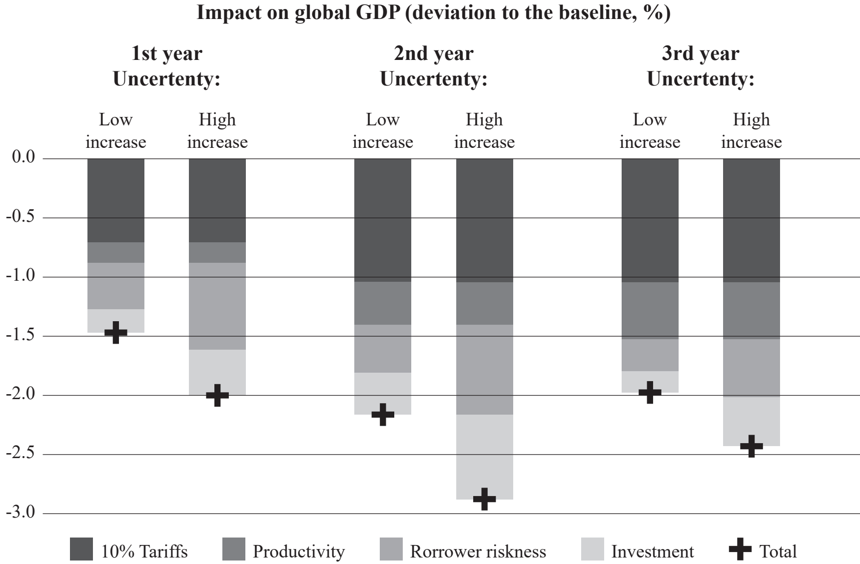
However, the state of the trade policies is still in flux. For instance, the US and Chine where negotiating possible solutions, until on June 15th the US decided to impose the tariffs it announced in April, while China retaliated the day after with its own tariffs on June 16th. The US is also currently involved in trade negotiations regarding changes to the NAFTA agreement it has with Canada and Mexico. After the EU announced its retaliatory measures, the US administration threatened to impose a 25% duty on motor vehicle imports from the EU. Therefore, the final outcome regarding announced and retaliatory tariffs is uncertain and this makes it difficult to design concrete policy scenarios. In addition, there is also the possibility of an escalation of these trade wars. For instance, on June 18th the US announced tariffs to target an additional US$200 billions of Chinese imports as a counter-retaliation, while the EU has signalled that it will target up to US$300 billions of US imports if the US imposes tariffs on EU motor vehicles.

One of the main characteristics of the tariff increases is the almost immediate retaliatory process. The affected countries immediately react with threats of counterbalance trade measures, which are usually of the same magnitude but sometimes even higher than the initial tariff increase. This process could further escalate through internal dynamics into a spiral of tariff increases. To capture this process, where the number of targeted products and the level of the tariffs are bilaterally raised, we create a set of scenarios where bilateral tariffs are raised for all non-services sectors at increasingly higher tariff rates. We model this by imposing uniform tariff increases (i.e. for all traded products), which captures the tendency of the escalation to include more products in each stage. Note that this scenario is for illustrative purposes only and is not meant to be a projection of future tariffs.

We have three scenarios related to trade war escalations:

- First, the US and the EU engage in a trade war with uniform tariffs increasing from 2.5% to 40% (each uniform tariff level is a simulation in the context of this scenario).
- Second, we add China to the US-EU trade war, where both the EU and China have bilateral uniform tariff increases with the US, but not with each other.

Figure 1: Impact of a generalised 10 percentage point increase in tariffs on global real GDP



- Third, in addition to the including the previous trade war scenarios, the US also engages in trade wars with all remaining OECD countries (i.e. Canada, Mexico, Japan, South Korea, Australia and the rest of the OECD), where uniform tariffs between the US and all these countries increase from 2.5% to 40%.

The truth is that no one wins a trade war. Based on a multi-region dynamic general equilibrium model (GIMF), we show that a global and generalised 10 percentage point increase in import tariffs could reduce global GDP by 1% after two years. This effect could be amplified by a fall in productivity, a rise in the financing cost of capital and a decline in investment demand. Taking all these factors into account could result in lowering global real GDP by up to 3% after two years.

Since the beginning of 2018, the US administration has announced a series of protectionist measures for products such as steel and aluminum. While the overall volume of trade covered so far by a global rise in protectionism remains limited (less than 2% of global imports), new measures have been considered by governments. Following China's decision to retaliate against

US tariffs on Chinese goods, the White House announced in July that additional tariffs covering about USD 200 billion of imports from China could be applied. At the same time, automobiles and auto parts imported by the United States could also be subject to a 25% import tariff. These threats to the global trading system have exacerbated the fear that a global trade war generalised to all goods and all trading partners could break out.

3. Impact of a global trade war: lessons from trade models

The general perception of economists about trade wars is that they are not easy to win, even for large countries such as the United States. Unilateral protectionist measures are often subject to retaliation by trade partners, as recently observed following the tariffs imposed on steel and aluminum.

Against this backdrop, different methods can be used to quantify the losses from a trade war. In a widely circulated blog post on the New York Times, Paul Krugman reports that in simulations based on general equilibrium quantitative trade models, a 30 to 60 percentage point (pp) increase in import tariffs would lead to a global real GDP loss of 2% to 3% over the long term. Similar figures are provided in a recent note published by the French Council of Economic Analysis – CAE), which states that a 60 pp increase in import tariffs would result in a 3% to 4% decline in real GDP in large economies. The relatively low impact is explained by the moderate trade openness, even including trade in services, of major economies such as the United States (27%) but also the European Union (35% excluding intra-EU trade) as reported by the EU Commission. However, the cumulated impact (in terms of wealth) is much larger, as GDP falls below its potential every year.

3.1. Quantification based on international macroeconomic models

The quantification of the short-term costs of a trade war in international macroeconomic models may differ from the prediction based on general equilibrium quantitative trade models that focus on the long-term horizon (“steady state”). Possible reasons for this discrepancy include the more complete description of short-term dynamics in international macroeconomic models, which may include frictions in different markets (financial, labour or goods markets) and the reaction of monetary policy. In principle, the question of whether these international macroeconomic models lead to larger or smaller losses in the short and medium term compared with the long-term horizon of general equilibrium quantitative trade models is ambiguous.

In Figure 1, we present the results of a simulation based on a multi-region, forward-looking DSGE model (the GIMF model). We consider the 3-region version of the model, including the United States (US), the euro area (EA) and remaining countries (RC). The full trade war scenario consists in a permanent 10 pp increase in tariffs on imports of both intermediate and final goods in the three regions and for all trading partners. This increase distorts supply and demand conditions in each economy. On the demand side, import tariffs raise the price of imported goods and lower final consumption. When foreign trade partners retaliate, foreign import tariffs also reduce the external demand addressed to domestic producers, leading to a further reduction in output. On the supply side, import tariffs also act as a negative shock by increasing the cost of intermediate goods used for firms' production. The macroeconomic response of output is unambiguously negative. Our baseline simulation shows that the macroeconomic impact of a 10 pp increase in tariffs on global output would amount to -0.7% in the first year and -1.0% at the end of the second year following the shock.

Using the same framework, a simulation of a 60 pp increase in import tariffs would cause a 6% loss in global real GDP in the short term. The long-term impact in this simulation is very similar to the one obtained using general equilibrium quantitative trade models.

4. The amplification effects of a global trade war

Beyond the direct trade policy shock resulting from a rise in import tariffs, several factors associated with a trade war may amplify the decline in global GDP:

- A fall in productivity, as a result of an inefficient reallocation of factors of production across firms;
- A rise in the financing cost of capital due to an increase in actual or perceived borrower risk;
- A decline in investment demand, caused by firms' "wait and see" attitude in a context of higher uncertainty about future business conditions.

The importance of these channels, considered in an alternative simulation, relies on elasticities found in the literature (Berthou, Chung, Manova and Sandoz (2018) for the productivity shock and Bussière, Ferrara and Milovitch (2015) for investment demand). Taking account of these amplification factors, the generalised and global 10pp increase in import tariffs could lower global GDP by around 1.5% to 2.0% in the first year and 2.2% to 2.9% in the second year, depending on whether the increase in uncertainty is assumed to be "low"

or "high" (a 50 to 100 basis point rise in the external finance premium and a one to two standard deviation increase in the volatility index VIX). It is important to note that an increase in uncertainty may produce negative and immediate effects on output even if a full trade war does not occur.

When the U.K. leaves the E.U., it leaves behind the single market, and it is potentially exposed to tariffs and other costs that could be punitive (and might be seen in the U.K. as retaliatory). Such penalties or restrictions could be imposed for either of two reasons: (1) to induce the U.K. to comply with political principles that are deeply held within the E.U., particularly those regarding the free movement of persons; or (2) to curb and restrain the U.K.'s ability to market products and financial services within the E.U., as to which the U.K. today enjoys a dominant, world-wide market position. In short, there is a basic duality of motives here. High principles may combine with the predatory desire of some European competitors (and localities) to siphon off some of the extraordinary dominance that the U.K. today enjoys in many financial markets.

5. Trade Wars: How Do They Play Out?

To this point, it has been argued that rent-seeking underlies many economic rivalries, even when both sides refer to high aspirational principles to justify their positions. But how do such wars play out and how do they finally end? Here, a useful perspective is provided by game theory. Scholars of international trade have suggested that the antagonists will likely follow one of several strategies, depending on their relative positions. I will subdivide these into: (1) The Game of Chicken; (2) the Prisoner's Dilemma Game; and (3) the Stag Hunt Game.

5.1. The Game of Chicken

In game theory, a "chicken game" involves two players, heading towards each other on a collision course. If the players continue on that course, the collision will injure both (but possibly to different degrees). To avoid collision, one must swerve, but this involves reputational loss (the one who swerves is the "chicken" and the other is deemed the winner). What is the rational course of action in this context? Put simply, Player 1 should cooperate (and swerve) if it thinks Player 2 will not cooperate, and Player 1 should not cooperate (i.e., should stay on course) if it thinks Player 2 will cooperate (and swerve). If both do not cooperate (and thus do not change course), the worst possible results: collision.

Applied now to international economic rivalries, if Nation 1 raises its tariffs, Nation 2 may retaliate and raise its tariffs in response. This is the equivalent of collision, as a mutually destructive trade war begins. But if Nation 1, in response to Nation 2's actions, rescinds its tariff rise, it has cooperated, and no one is worse off (at least if Nation 2 drops its tariff increase also). If Nation 1 instead further increases its tariffs in response to Nation 2's raise, the trade war has intensified, and both sides may wind up much worse off.

Games of chicken are rarely observed in economic negotiations, with the one exception that a large nation may raise tariffs against smaller nations, knowing that if the latter, smaller nation were to retaliate, it would harm itself much more than the larger nation. Possibly, this bullying strategy could appeal to President Trump in dealing with Mexico, as the U.S. would lose less than Mexico (for whom U.S. trade represents a much larger percentage of its total exports and imports). But this strategy makes much less sense for either the U.K. or the E.U. in the wake of Brexit, as both would face large losses from a retaliatory trade war.

5.2. The Prisoner's Dilemma Game

This is the best known game in game theory, and it depends upon the fact that two sides cannot credibly communicate their intentions. Assume prosecutors suspect that Prisoner 1 and Prisoner 2 are guilty of a serious felony (and also lesser misdemeanors) and have apprehended them (but are keeping them apart so that they cannot communicate). If both Prisoner 1 and Prisoner 2 cooperate and neither confesses or implicates the other, they cannot be prosecuted successfully for murder, although they may be convicted of a misdemeanor charge carrying a one year sentence. However, if Prisoner 1 confesses and implicates Prisoner 2 (and Prisoner 2 does not confess), Prisoner 1 will be rewarded with a short 6 month sentence and Prisoner 2 will go to jail for 10 years. The same will happen in reverse if Prisoner 2 confesses and Prisoner 1 does not (that is, Prisoner 2 now gets 6 months and Prisoner 1 serves ten years). If both confess contemporaneously and implicate each other, each will receive a 3 year sentence. Obviously, the optimal strategy is to defect and implicate the other (which will result in either a 6 month or 3 year sentence). Cooperation makes little sense, because it will result in either a 1 year or 10 year sentence. In such a world, where neither can trust the other, the likely and rational outcome is for both to implicate the other and thereby receive the intermediate three year sentence. In short, cooperation is a mistake.

This game has been used to model many international conflicts, including

trade wars. Here, mutual non-cooperation produces an intermediate (but sub-optimal) outcome, whereas in the chicken game, mutual non-cooperation produces the worst outcome (a collision).

5.3. The Stag Hunt Game

This game, derived from an example first described by Jean Jacques Rousseau, postulates that two hunters go out on a hunt. Each can individually choose to hunt a stag or a hare. Neither player knows the choice of the other, but the stag hunt will only succeed if the two players cooperate (but a hare can be captured by either player individually). Obviously, a stag is a greater payoff than a hare; but it is also more dangerous prey (making it safer to hunt the hare). Thus, if they cooperate and slay the stag, each wins a value of 2; if each hunts the hare, each obtains a value of 1, and if one hunts a hare and the other a stag (i.e., non-cooperation), the former obtains a value of one and the other nets zero.

The point of this illustration is that it provides a counterexample to the Prisoner's Dilemma Game (where the expected outcome is that the two players will not cooperate). Here, cooperation makes sense (but it is not inevitable). Of course, theorists of international trade tend to view free trade as a multi-party stag hunt game where all should cooperate to obtain the greatest payoff.

Not all scholars accept the liberal assumption that the Stag Hunt Game provides the better model for how individuals should decide whether to cooperate. These critics argue that "rent-seeking" trumps everything else, and makes game theory an unrealistic guide. Public policy will be (and is) shaped, they argue, by special interest groups that have little interest in maximizing the general welfare but great interest in either protecting themselves from competition or gaining oligopolistic advantages.

In the case of the E.U.'s reaction to Trump, almost everyone is offended by his brazen claim of "America First," and most see him as the classic bully who wants to play the Chicken Game. Although there is little need to invoke the concept of "rent-seeking" to explain the opposition to Trump, at least some do want to profit from the E.U.'s response. Still, Trump is not responsible for everything that emanates from the United States. The pending legislation that will impose sanctions on those trading with Russia is being pushed not by Trump, but by a coalition of Democrats and Republicans who jointly resent Russia's apparent interference in the 2016 U.S. election. Few U.S. business firms have any economic interest in sanctions.

From the perspective of game theory, President Trump looks like an ardent fan of the Chicken Game. Bullying and forcing others to swerve seems his

natural disposition. Logically, such a tactic should work against a much smaller adversary who can less afford to cut off or penalize trade with a much larger trading party. Thus, the U.S. might be able to pressure a Mexico, but it seems less likely that such a tactic could work against the E.U. or China. One qualification is, however, necessary. Someone in the position of President Trump could be indifferent to the high economic costs of a retaliatory trade war if it allowed him to achieve political objectives that were more important to him.

Thus, what strategy should the E.U. adopt if it is faced with such an adversary? The simplest answer is to attempt to turn a bilateral game into a multiplayer and multi-period game. In a multi-period game, it should become clear to all that retaliation produces counter-retaliation, and thus cooperation may be a superior strategy. In a multi-player game, the smaller countries can seek to coordinate their threatened retaliation against the large country that is trying to engage them in a Chicken Game. To be sure, the E.U. is already a coalition of smaller countries that can use this strategy. But more can be done. For example, if the E.U. can coordinate its threatened retaliation with the WTO, now the odds no longer favor the large nation willing to play Chicken (and in fact the costs could become prohibitive). The nuances involved in enlisting the WTO to ally with the E.U. are beyond the scope of this paper, but the basic strategy here is simple: Do Not Play Chicken on a Bilateral Basis, but Enlist Allies.

6. Conclusions

Over the last third of a century, the rules of America's economic system have been rewritten in ways that serve a few at the top, while harming the economy as a whole, and especially the bottom 80%. The irony of Trump's victory is that it was the Republican Party he now leads that pushed for extreme globalization and against the policy frameworks that would have mitigated the trauma associated it. But history matters: China and India are now integrated into the global economy. Besides, technology has been advancing so fast that the number of jobs globally in manufacturing is declining.

The implication is that there is no way Trump can bring a significant number of well-paying manufacturing jobs back to the US. He can bring manufacturing back, through advanced manufacturing, but there will be few jobs. And he can bring jobs back, but they will be low-wage jobs, not the high-paying jobs of the 1950's . The trade skirmish between the United States and China on steel, aluminum, and other goods is a product of US President Donald Trump's scorn for multilateral trade arrangements and the World Trade Organization, an institution that was created to adjudicate trade disputes.

What was at first a trade skirmish –with US President Donald Trump imposing tariffs on steel and aluminum– appears to be quickly morphing into a full-scale trade war with China. If the truce agreed by Europe and the US holds, the US will be doing battle mainly with China, rather than the world (of course, the trade conflict with Canada and Mexico will continue to simmer, given US demands that neither country can or should accept).

Beyond the true, but by now platitudinous, assertion that everyone will lose, what can we say about the possible outcomes of Trump's trade war? First, macroeconomics always prevails: if the United States' domestic investment continues to exceed its savings, it will have to import capital and have a large trade deficit. Worse, because of the tax cuts enacted at the end of last year, the US fiscal deficit is reaching new records –recently projected to exceed $1 trillion by 2020– which means that the trade deficit almost surely will increase, *whatever the outcome of the trade war*. The only way that won't happen is if Trump leads the US into a recession, with incomes declining so much that investment and imports plummet.

The "best" outcome of Trump's narrow focus on the trade deficit with China would be improvement in the bilateral balance, matched by an increase of an equal amount in the deficit with some other country (or countries). The US might sell more natural gas to China and buy fewer washing machines; but it will sell less natural gas to other countries and buy washing machines or something else from Thailand or another country that has avoided the irascible Trump's wrath. But, because the US interfered with the market, it will be paying more for its imports and getting less for its exports than otherwise would have been the case. In short, the best outcome means that the US will be worse off than it is today.

Joseph Eugene Stiglitz an American economist, public policy analyst, and a professor at Columbia University says "What I worry about is that when Trump is confronted with the reality that he can't do on Nafta what he wants to do he will strike out like a little kid and do something dangerous – like putting his finger on a button he shouldn't be putting his finger on". Would Trump really put his finger on the nuclear button because he was thwarted over Nafta? The crisis of 2008 made things much much worse. Millions of Americans lost their homes and the way things were managed was grossly unfair. The reason neither developed nor developing countries are happy with globalisation, Stiglitz says, is that trade agreements were written by and for corporations and against ordinary workers in both places.

The trade war has raised the prices of consumer goods that use steel and aluminum. Half of all Chinese imports are goods used by U.S. manufacturers

to make other products. The tariffs raise their costs, forcing them to either raise prices or lay off workers. Soda and beer suppliers were the first to raise prices. Costs have increased on imported clothes hangers, heavy-equipment materials, and computer chip and tool makers. The Alliance of Automobile Manufacturers warned that U.S.-produced steel will cost more once cheap foreign imports are eliminated. The move is "threatening the industry’s global competitiveness and raising vehicle costs for our customers".

In October 2018, several companies forecast how much tariff-related costs will hurt in 2019:

- United Technologies: $200 billion.
- 3M: $100 million.
- Honeywell: “hundreds of millions”.
- Ford: $1 billion.

Many U.S. imports from China originated in the United States. Raw materials are sent to China for processing, then exported back into America. An example is salmon caught in Alaska and sent to China for processing, then sent back to U.S. grocery shelves. If Trump imposes tariffs on seafood imports, it will raise prices by 25 cents to 50 cents a pound. Foreign tariffs on U.S. exports will make them more expensive. U.S. exporters may have to cut costs and lay off workers to remain competitively priced. If they fail, they may cuts costs further or even go out of business. In the long term, trade wars slow economic growth. They create more layoffs, not fewer, as foreign countries retaliate. The 12 million U.S. workers who owe their jobs to exports could get laid off. That could slow growth by 0.4 percent. It's occurring at the same time that oil prices and interest rates are rising. Consultant Oxford Economics predicted the trade war could cost the global economy $800 billion in reduced trade.

Over time, trade wars weaken the protected domestic industry. Without foreign competition, companies within the industry don’t need to innovate. Eventually, the local product would decline in quality compared to foreign-made goods.

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