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## Session 2

### Political economy of non-tariff measures



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## Outline

- General objective: Motives for which NTMs exists and are part of trade agreements
  - Why is trade policy (NTMs) constrained by international rules?
  - How trade policy is constrained within the WTO?
    - Chapter by Chapter.



# Two main purposes of NTMs

Governments use NTMs for 2 main purposes

- **Align trade policy to development strategy**

- E.g. quotas, subsidies, price mechanism

These NTMs affect trade directly

Favor domestic industries ( often to the expenses of foreigner firms)

- **Pursue public policy objectives**

- E.g standards (quality, safety, environmental, health, industry, etc)

These NTMs affect trade indirectly.

Potentially distortionary effects, but not always negative effects

Both purpose often have trade effects on trading partners so the NTMs are object of trade negotiations, and subject to obligations.

What is the optimal policy space?

# Why is trade policy constrained by international rules? (1)

- Terms-of-trade approach:
  - When policymakers are unconstrained by a trade agreement, they will consider only domestic benefits and costs of trade policy, **ignoring any harm that their policy imposes on foreign countries.**
  - AS NTMs affect trading partners then there is room for **reciprocal concessions**  
-> trade agreements can be mutually advantageous
- In practice this argument is valid under the assumption that NTMs are used in lieu of tariffs. That is there is substitution between tariffs and NTMs.
- If tariffs were still unconstrained the incentives for agreeing on the NTM type of policies would be lower, as governments would prefer to use first-best policies (tariffs) for terms-of-trade manipulation.

# Why is trade policy constrained by international rules? (2)

- **Commitment theory**

- Constraining government policies, makes governments less responsive to lobbies seeking protection, thus resulting in higher aggregate welfare. In the economic literature this rationale for trade agreements is that they can act as a commitment device.
- Government policies becomes **more predictable and less uncertain**.
  - Border policies (quotas, entry procedures)
  - Behind-the-border (subsidies)
    - Advantageous for investments, long term.

# Why is trade policy constrained by international rules? (3)

- **International fragmentation of production processes requires rules**
  - Offshoring-related theories of trade agreements provide another argument in relation to include behind-the-border measures in trade agreements.
    - Within cross-border value chains, international prices are no longer determined by market-clearing conditions but involve **bilateral bargaining between firms**.
      - Enforcing bilateral bargains may need NTMs.
  - **Merchandise-Service link.**
    - The prevalence of global supply chains is associated with trade in different types of services, which become more intertwined with merchandise trade. As a consequence NTMs that prevail in service sectors (e.g. finance requirements) have an indirect impact on merchandise trade, providing further incentives for governments to include NTMs related to the service sectors in trade agreements.

# Why is trade policy constrained by international rules? (4)

- Coordination externalities

- The **growing number of product standards** governing international trade and differences in such norms across jurisdictions gives **rise to trade costs** and global inefficiencies.
  - Because they have trade-distorting effects, the adoption of technical measures is increasingly dealt with in trade agreements. In some cases the aim may be to harmonize standards and technical regulations (ISO, international standards) In others the goal is to achieve mutual recognition (i.e. when countries agree to recognize one another's conformity assessment to standard). In both cases the rationale is to reduce coordination externalities.
- Trade agreements also help to resolve coordination externalities by reducing **information asymmetries** through measures to promote the transparency of prevailing NTMs. An example is notification requirements in the areas of sanitary and phytosanitary (SPS) and technical barriers to trade (TBT) measures to reduce the asymmetric information problem.

# Counterargument: Regulating trade (NTMs) in trade agreements give powers to lobbies.

- Assumption: **Trade agreements dismantle protectionism.**
  - Easy to verify for some types of NTMs (quotas). Lead to free trade
- **This assumption may not hold for some types of NTMs.**
  - Not so easy for other measures (standards)
    - Removal of implementation of standards may be protectionist
    - where is the efficient benchmark is? May not be zero as in the case of tariffs.
    - Are standards beneficial to consumers or help to protect producers?
    - Harmonization may not be mutually beneficial. Does harmonization reflect domestic preferences?
- In reality the use of **NTMs may be captured by lobbying interests**, NTMs many not be set at optimal level, so it could be counter productive to lock NTMs in trade agreements. Who writes the agreements (**lobbies vs benefactor government?**)

# How the use of NTMs are constrained by international rules?

- General purpose of international rules (and the WTO).
  - **Generally:** Rules aim at **preventing** governments from using certain types of policies (those with negative externalities to trading partners) and to a lesser extent establish norms that members must adopt.
  - **Methods:** The basic non-discrimination rules help to ensure that WTO members abide by **trade liberalization commitments** and do not re-impose protection through domestic policies that discriminate against foreign providers.
  - **Rationale:** Many - if not most - WTO rules prevent discrimination beyond that which is implied and permitted by the set of tariff commitments a country has made – that is, **WTO bind countries to not use NTMs instead of tariffs**

# International classification of NTMs and WTO

<b>Technical Measures</b>	A	SANITARY AND PHYTOSANITARY MEASURES	Art. XVII	State trading enterprises to abide by MFN rule	Chapter H
	B	TECHNICAL BARRIERS TO TRADE			
<b>Non Technical Measures</b>	C	PRE-SHIPMENT INSPECTION AND OTHER FORMALITIES	Art. XVIII	Allows developing countries to restrict trade to promote infant industries and to protect the balance-of-payments, imposing weaker conditionality than Article XII	Chapters D, E, F, H, I, P.
	D	CONTINGENT TRADE PROTECTIVE MEASURES			
	E	NON-AUTOMATIC LICENSING AND QUANTITY CONTROL MEASURES	Art. XIX; WTO Agreement on Safeguards	Allows for emergency action to restrict imports of particular products if these cause serious injury to the domestic industry	Chapters D, E, F
	F	PRICE CONTROL MEASURES, ADDITIONAL TAXES AND CHARGES			
	G	FINANCE MEASURES			
	H	MEASURES AFFECTING COMPETITION	Art. XX; TBT and SPS Agreements	General exceptions provision – allows trade restrictions if necessary to attain non-economic objectives (health, safety)	Chapters A, B, C, E, H, I, L, N, P
	I	TRADE-RELATED INVESTMENT MEASURES			
	J	DISTRIBUTION RESTRICTIONS	Art. XXI	National security exception	Chapters E, F, G, I, L, M, P
	K	RESTRICTION ON POST-SALES SERVICES			
	<b>Export Measures</b>	L	SUBSIDIES	Agreement on rules of origin	Harmonization work programme for non-preferential rules of origin
M		GOVERNMENT PROCUREMENT RESTRICTIONS			
N		INTELLECTUAL PROPERTY			
	O	RULES OF ORIGIN			
	P	EXPORT RELATED MEASURES			

# Chapter A – Sanitary and Phytosanitary measures

- SPS measures include all relevant regulations and procedures, including product criteria; processes and production methods; testing, inspection, certification and approval procedures; quarantine treatments; provisions on relevant statistical procedures and risk assessment methods; and packaging and labelling requirements directly related to food safety.
- GATT Art XX
  - **WTO members can impose measures** necessary to protect human, animal or plant life and health, as long as the measure **does not result in unjustifiable discrimination** between countries or acts as a disguised restriction on trade.

# Chapter A – Sanitary and Phytosanitary measures

- In general, the basic rules of the SPS Agreement are that **SPS measures are not more trade restrictive than necessary to achieve underlying objectives**, do not unjustifiably discriminate and do not constitute a disguised restriction on international trade.
- The SPS Agreement goes further than the TBT rules in encouraging countries to use **international SPS standards**, guidelines or recommendations (e.g. Codex Alimentarius Commission)
  - Proof of harm not strictly necessary, **precautionary principle** sufficient.
- **Equivalence**: WTO members must accept the SPS measures of other members as equivalent – even if they differ from their own – if the exporting country can demonstrate that its SPS measures achieve the desired level of protection (Article 4).
- Administrative costs: Conformity assessment procedures and fees are to be non-discriminatory, procedures and criteria should be published, confidentiality respected and an appeals procedure established.

# Chapter B – Technical Barriers to Trade

- The TBT Agreement deals with a **much broader set of goods** that includes all industrial products, measures to protect the environment, safeguard consumers and protect the welfare of animals – all matters that are not covered by the SPS Agreement.
- The TBT Agreement imposes disciplines on the adoption of mandatory technical product regulations in member countries, as well as on conformity assessment, testing and certification procedures.

# Chapter B – Technical Barriers to Trade

- The basic rules are that central government bodies not discriminate and adopt TBT requirements that are **not more trade-restrictive than necessary to meet legitimate objectives**. This applies to conformity assessment procedures as well.
- Technical regulations based on product requirements should be worded in terms of performance rather than design or descriptive characteristics.
- What the **underlying regulatory objectives are is not questioned by WTO**.
  - Members are free to pursue any objective they deem appropriate but should do so with policy instruments that minimize negative trade effects. This “least trade restrictiveness” criterion is a reflection of a basic objective of WTO: to facilitate trade.
- The TBT Agreement **encourages the use of international standards** where these exist (Article 2.4) and participation in international systems for conformity assessment as trade facilitating measures.
  - However WTO case law has made clear that governments are **effectively unconstrained in the scope to diverge from international standards**. More lax language than in the SPS agreement.

# Chapter C – Pre shipment inspections

- PSI involves the **verification of prices and inspection of goods** by specialized firms before they are shipped to the country of importation. Governments have used PSI in large part because national customs administrations are not able to undertake the required activities, or because of fraud.
- **PSI are not mandatory**: Members shall not require the use of pre-shipment inspections in relation to tariff classification and customs valuation. The WTO Agreement on Pre-shipment Inspection specifies that countries using PSI agencies ensure that PSI is carried out in an objective, transparent and non-discriminatory manner.
- PSI is a NTMs because it increase costs (fee). Several countries are considering termination on the use of inspection companies' service, following upon WTO Agreement on Trade Facilitation, Article 10.5
- Replaced by better administration: **as a second best policy** for countries where administrative weaknesses in the area of customs administration are sufficiently serious. Trade facilitations / aid for trade to replace PSI.

# Chapter D – NTMs of Contingent protection

- **WTO allows for temporary suspensions of obligations in particular circumstances**
  - Proven Injury to domestic industry
    - Because of dumping and because of subsidies abroad
  - Or because of problems in national accounts (trade deficits)

Measures are temporary (**sunset clause**):

- Anti-Dumping
- Countervailing duties
- Safeguards
- Balance of Payments

## Chapter D – Anti-Dumping

- *Anti-dumping*: measures to offset dumping – pricing of exports below what is charged in the home market; foreign pricing below costs of production; or foreign pricing below what is charged in a third market
- Anti-dumping actions may be taken only if it can be shown that dumping has caused or threatens material injury of the domestic import-competing industry.
- Anti-dumping duties are to be terminated within five years of imposition (extension possible).
- Price is the determining variable and therefore the Agreement on Implementation of Article VI of the GATT constrains creative uses of methodologies that are designed to result in high dumping margins.
- More constraints to avoid protectionist intent: Duties may not be imposed if dumping margins are less than 2 per cent, or the level of injury is negligible, or the market share of a firm is less than 3 per cent.

## Chapter D – Countervailing duties to subsidies

- WTO members may impose duties to countervail the **injurious effect on domestic industries of subsidized imports**.
- Necessary conditions for the imposition of countervailing duties include **demonstration of the existence of a foreign subsidy**, a finding that a domestic industry producing similar (like) products is materially injured and a causal link between the subsidization and injury.
- Injury requires that the volume of subsidized imports has increased, and that at least 25 per cent of the firms in the domestic industry must support the launching of a countervailing duties investigation.
- As for anti-dumping, a sunset provision of **five years** applies, unless a review determines that the abolition of protection would be likely to lead to the continuation or recurrence of injury.

# Chapter D – Balance of Payments related measures

- GATT Article XII (for industrialized countries) and Article XVIII(b) (for developing countries) permit the use of trade restrictions to **safeguard a country's external financial position**.
- **Second best policies**. Given that a floating exchange rate or a depreciation is a more appropriate instrument to deal with balance-of-payment disequilibria (as part of a comprehensive macroeconomic adjustment programme if needed) these GATT provisions have largely become **redundant**.
- Surcharges or similar measures must be **applied on an across-the-board basis**. However, exemptions may be made for certain essential products, necessary to meet basic consumption needs or which help to improve the balance-of-payments situation, such as capital goods or inputs needed for production.

# Chapter D – Safeguards

- The WTO Agreement on Safeguards requires that safeguard measures against imports be taken only if an investigation demonstrates that **imports have caused** or threaten **serious injury** to an import-competing domestic industry.
- Protection measures are limited to what is necessary to prevent or remedy serious injury and must apply against all imports regardless of origin (i.e. must be non-discriminatory).
- While in principle safeguard actions must be non-discriminatory, quantitative restrictions may be allocated on a selective basis if the Committee on Safeguards accepts that imports from certain members have increased disproportionately and the measures imposed are equitable to all suppliers of the product.
- A safeguard may be applied for a maximum total of **eight years**. If an action is extended beyond four years, a necessary condition is that the industry demonstrates that it is making appropriate adjustments.
- Notwithstanding the many procedural requirements, if governments so wish they can put in place provisional safeguards virtually immediately – in “critical circumstances”.

# Chapter E – Quantitative Restrictions

- **Quotas.** GATT Article XI prohibits the use of quantitative restrictions, whether on imports or on exports. WTO also prohibits measures with a similar effect such as “voluntary export restraints” – measures that are imposed by an exporting government at the request of an importing country so as to avoid the imposition of a safeguard action or similar measures.
- **Licensing.** Agreement on Import Licensing Procedures. The goal is that licensing regimes are **transparent and predictable** and the administration of licensing regimes does not serve as a means of imposing discriminatory quantitative restrictions.

# Chapter F – Price controls

## FEES:

- WTO members are constrained regarding the use of fees and specific import taxes that have an effect equivalent to tariffs – so-called other duties and charges. Examples include taxes on foreign exchange transactions, service fees affecting importers and special import surcharges.
- WTO (GATT Article II) requires that the nature and level of other duties or charges be listed by tariff line in each WTO member's schedule – and thus bound. Binding does not apply to fees or other charges that are commensurate with the cost of services rendered.

## MAX/MIN PRICES

- Governments may establish maximum prices even if these adversely affect imported products. Of course, if such prices do not permit foreign firms to make a profit they will not offer their products. As long as such controls also apply to local firms they are permitted under WTO.
- Insofar as minimum import prices are imposed by a government, these are likely to also require measures to raise the price of imports to the desired level – for example, through additional import charges or through quantitative restrictions. The latter are not permitted while the former are limited by a country's tariff binding levels and in the case of agricultural products by provisions in the Agreement on Agriculture that call for the use of import tariffs instead of minimum import prices.

# Chapter G – Restrictions on payments for goods

- **Monetary and exchange rate policies** are not subject to WTO rules. The primary constraint on policy space in this area is the International Monetary Fund “no member shall, without the approval of the Fund, impose restrictions on the making of payments and transfers for current international transactions”.
- Essentially, WTO **presumes that members have current account convertibility**. Basic WTO rules such as MFN will discipline policies such as extra charges relating to the international transfer of payments for imports and exports. Such charges would be treated as an illegal NTM if they did not apply to all trade.
  - For example, a foreign exchange fee charged only on certain import transactions would violate the MFN rule and could not be justified as a measure to protect the balance of payments because a necessary condition for an exchange restriction to be justified for balance-of-payments purposes is that it applies to all foreign currency transactions.

# Chapter H – State owned enterprises

- **Monopoly or monopsony control** – under which an entity is granted a monopoly right to import or export – to situations where an entity is obliged to compete with domestic buyers on both the domestic and the foreign market.
- The basic obligation imposed by GATT Article XVII is that members should ensure that state-trading enterprises do not act in a manner inconsistent with the general principle of non-discrimination (MFN).
  - Firms granted exclusive privileges are to make purchases or sales solely in accordance with commercial considerations.
- The margins charged by state-trading enterprises (their mark-ups) must be scheduled similarly to tariffs (Article II, paragraph 4). Once bound, mark-ups may not exceed the resulting tariff equivalent.

# Chapter I – Local content and Trade related investment measures

- TRIMs are policies used by governments that require (or incentivize) foreign investors to **source from domestic producers**. The most prevalent TRIMs are local content requirements – a condition that a minimum proportion of inputs used by a firm be of domestic origin.
- The TRIMs Agreement prohibits measures that are inconsistent with the GATT national treatment principle (Article III) and the ban on the use of quantitative restrictions (Article XI). The agreement includes a list of prohibited measures (including local content, trade-balancing, foreign exchange-balancing and domestic sales requirements).
- Article 5, paragraph 3, of the TRIMs Agreement provides for the extension of implementation transition periods, based on specific requests.

# Chapter J –Distribution of imported products

- **Government Monopolies.** Governments may impose measures monopolizing the distributions of specific products. The main discipline in this regard is non-discrimination. Exclusive distribution and supply agreements are examples of potential “vertical restraints” to competition that can be applied to imports.
- **Competition policy.** A firm may require its distributors to sell only its goods, potentially foreclosing entry by competing products as those producers will be excluded from using those distribution channels. Whether this is anti-competitive depends on market structure and the feasibility of competing firms to establish their own distribution systems. There are no rules under WTO on exclusive distribution of this type as it is a matter of firms’ decisions and strategy, not government policy
- **No hard rules at the WTO.**

# Chapter L - Subsidies

- Subsidies and countervailing measures agreement (SCM)
- **Two main rules:**
  - to avoid or **attenuate adverse effects** of subsidies on members.
  - to prevent the use of subsidies to **nullify concessions** in other areas.
- The focus is only on the effect of the subsidy (not rules on the objective). This reduces the scope for disputes, as the focus of attention centres primarily on whether a contested measure is an export subsidy.
- Subsidies: prohibited (exports and local content) vs actionable (can lead to countervailing measures).
- In general, **targeted** subsidies are not permitted, **untargeted** are possible.
- Agreement on Agriculture deals a lot with subsidies.

# Chapter M – Government procurement

- Government procurement Agreement (GPA) uses a positive list approach to determine what procurement is covered.
  - The main discipline imposed by GPA on covered entities is **non-discrimination, national treatment and MFN. The obligation extends not only to imports but also to subsidiaries of locally established foreign firms.**
- Price-preference policies, local content requirements, offsets and similar discriminatory policies are in principle prohibited by GPA for all covered procurement as a result of the national treatment rule. Negotiations to allow SDT for developing countries are stalled.

# Chapter N – Intellectual property rights

- The TRIPS Agreement covers **copyrights** and related rights (rights of performers, broadcasters and phonogram producers), layout designs of integrated circuits, geographical origin indications, trademarks, industrial designs and patents.
- The agreement **establishes minimum substantive standards** of protection for these IPRs, prescribes the procedures and remedies which should be available to enforce them and extends basic principles such as transparency and non-discrimination to IPRs. As there were no binding disciplines on IPRs before the creation of WTO, the **TRIPS Agreement resulted in an erosion of policy space for developing countries** in an area of policy where historically reverse engineering of technologies and know-how has played a significant role in promoting and supporting industrial development.

# Chapter 0 – Rules of Origin

- A rule of origin (RoO) is a criterion used by customs authorities to **determine the nationality of a product** or a producer. RoO are necessary when there is a desire to discriminate between sources of supply.
- Rules of origin can be **non-discriminatory or specific** to some trading partners. WTO has disciplines on the former type of rules of origin but not on the latter. Preferential RoO are an important dimension of free trade agreements.
- The WTO Agreement on Rules of Origin requires that non-preferential rules of origin be applied in a **non-discriminatory manner**, are transparent, are not designed to be a barrier to trade and are administered in a consistent, uniform, impartial and reasonable manner.
- The most important objective of the Agreement on Rules of Origin is to work towards the harmonization of non-preferential rules of origin (Article 9). This is pursued through a Harmonization Work Programme that is managed by the WTO Committee on Rules of Origin, and executed by the Technical Committee on Rules of Origin, which involves active participation by the World Customs Organization.

# Chapter P – Measures affecting exports

- Current GATT rules basically give members the freedom to impose tariffs on exports – **the use of export taxes is unconstrained**.
- WTO rules also permit governments to establish export monopolies if they wish to do so – unless, as in the case of China, an acceding member makes commitments not to do so as part of its accession to WTO.
- Export prohibitions, **quantitative restrictions** and **export subsidies** are **illegal**. Although GATT Article XI (on quantitative restrictions) is more permissive for agriculture export restraints.
- The WTO Agreement on Safeguards prohibits the use of so-called **voluntary export restraints**, a type of NTM involving an agreement between importing and exporting country governments in which the latter agree to limit the value or volume of exports. In practice such agreements are difficult to control, and if they are concluded, may be difficult to observe.

# Summary points

- Negative vs positive integration. Most WTO rules aim to remove barriers and refrain from certain behaviors negatively affecting trading partners.
  - Exception: TRIPS (imposition on measures to protect IP).
- Non-discriminatory principle
  - Exception: SDT
- Exceptions for good reasons
  - Antidumping, safeguards, waivers to subsidies, etc