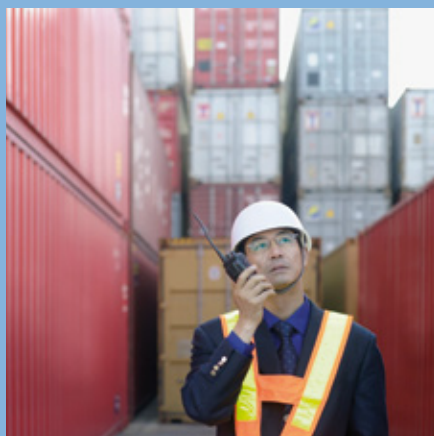




WORLD TRADE
ORGANIZATION

World Trade Report 2012

**Trade and public policies:
A closer look at non-tariff measures in the 21st century**



What is the World Trade Report?

The World Trade Report is an annual publication that aims to deepen understanding about trends in trade, trade policy issues and the multilateral trading system.

Using this report

The 2012 World Trade Report is split into two main parts. The first is a brief summary of the trade situation in 2011. The second part focuses on the special theme of non-tariff measures in the 21st century.

Find out more

Website: www.wto.org
General enquiries:
enquiries@wto.org
Tel: +41 (0)22 739 51 11

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Foreword by the WTO Director-General



This year's *World Trade Report* takes a fresh look at an old issue. Non-tariff measures (NTMs) have been with us since nations have traded and they have certainly constituted a key element of the work of the GATT and the WTO over the years. I offer seven reasons why it is a good time for the WTO to be thinking about NTMs.

First, NTMs have acquired growing importance as tariffs have come down, whether through multilateral, preferential or unilateral action. Secondly, a clear trend has emerged over the years in which NTMs are less about shielding producers from import competition and more about the attainment of a broad range of public policy objectives. You could say we are moving from protection to precaution. This tendency is discernible in practically every economy, as concerns over health, safety, environmental quality and other social imperatives gain prominence. Moreover, issues such as these take on a more central role in policy as economies develop and incomes grow.

Thirdly, growing public policy concerns add significantly to the complex nature and variety of NTMs deployed by governments, calling for an additional layer of analysis to tease out the trade effects of alternative approaches towards the attainment of declared policy goals. Fourthly, the expansion of the public policy agenda means that NTMs will not follow a path of diminishing relevance like tariffs have done. They will not shrink in importance. Regulatory interventions addressing market failures and international spillovers, with inevitable consequences for trade flows and investment, are here to stay. Fifthly, the increased role of public policy becomes ever more present in international economic relations as globalization intensifies interdependency among nations. Sixthly, all this takes us to where the WTO comes in. I see effective international cooperation on NTMs as a key challenge facing the multilateral trading system in the years ahead. Finally, a related point to the last is that NTMs figure prominently among disputes brought to the WTO.

We have to think differently about the challenges of international cooperation. When trade opening is the core business, the “level playing field” imagery applies. But with public policy, it does not. The aim is not to reduce public policy interventions to zero; it is to render them compatible with the gains from trade. We can no longer think about reduction formulae,

becoming immersed – and sometimes lost – in endless debates about the size of reduction coefficients or exceptions to the coefficients. Reciprocity in negotiations does not have the same meaning. The policy tool box is quite different. The challenge is about finding ways of managing a wider set of policy preferences without disrespecting those preferences or allowing them to become competitiveness concerns that unnecessarily frustrate trade.

Reference is often made to distinctions between shallow and deep integration and between border measures and behind-the-border measures. These are not clear-cut categories and they are used in different ways by different commentators. From the current perspective, where vibrant trade relations must be underpinned by public policy infrastructure with potential trade effects, it makes sense to think in terms of the deeper end of the integration spectrum. Indeed, one way of thinking about the challenges of economic integration is less as a quest for free trade and more as progress towards a global market.

These are some of the issues that the *World Trade Report* takes up this year. Beginning with a short historical overview, the Report shows how the early focus on removing NTMs that were largely surrogates for tariffs has given way to a much subtler and more complex world in which public policy concerns find greater expression in trade relations than they did a few decades ago. The Report tries to identify the major motivations that prompt governments to use NTMs. A simple three-fold distinction is between those NTMs that serve public policy (essentially non-economic issues), those that have an economic focus based on a national welfare-increasing calculus, and those that have a political economy motivation that serves particular interests, and quite possibly do not increase national welfare.

These distinctions cannot always be easily drawn, but they make clear why dealing with NTMs is so much more complicated than simply working for more open markets by removing other barriers to trade. NTMs can generally be expected to have trade effects and they may increase or decrease trade. The outcome depends both on the motivation for the measure and the way it is designed. In keeping with policy trends in the area of NTMs, most of the analysis in the Report focuses

primarily on public policy interventions that are covered by the Technical Barriers to Trade (TBT) Agreement, the Application of Sanitary and Phytosanitary (SPS) Measures Agreement, Article XX of the General Agreement on Tariffs and Trade (GATT), and on the domestic regulation provisions of the General Agreement on Trade in Services (GATS).

Since public policy NTMs are likely to have trade effects, we cannot altogether escape consideration of these effects. Policy-makers may not ostensibly reflect any trade intent in their public policy interventions, but in practice these interventions might be intended to serve a dual purpose. They may be designed or administered in ways that intentionally restrict trade even if their primary purpose is to serve a public policy. This has been referred to as “policy substitution” and it arises either where alternative, less opaque policies (such as tariffs) are unavailable, or where policy-makers wish to conceal the objective. Note also that this problem can arise not so much in the design of a policy but in the way it is administered. When this is the case, finding a systematic remedy can be much more difficult. A good deal of the case load in GATT/WTO dispute settlement has turned on the tension between good public policy and hidden protection.

The issue of policy substitution is but one element of engagement when it comes to international cooperation on NTMs. It is probably one of the easier aspects of cooperation. Matters become more complicated when we think about the trade effects of NTMs not in terms of protectionist intent, but rather in terms of the trade effects of divergent approaches to NTMs. The issue of divergence embodies at least three elements. The first is potentially the least complicated and relates to what we might think of as “incidental or path-dependent divergence” – that is, localized regulatory cooperation may have led to different regulatory approaches that are not grounded in any strong preference, but rather in habit or custom. With no strong vested interest in pursuing divergent approaches, cooperation to harmonize or mutually recognize such diverging approaches should be relatively straightforward. Indeed, this was very much the spirit of the suggestion in last year’s *World Trade Report* on preferential trade agreements that the risks of regulatory divergence could be lessened through a multilateralization of preferential policies in this area.

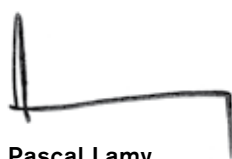
The second aspect of divergence in national or regional approaches to NTMs is much more delicate. Divergence may reflect something more profound that goes to the root of societal preferences. Value systems may vary across societies in ways that make the idea of harmonization or mutual recognition unacceptable. This could be called “preference divergence” and it would be a brave person who argued that trade should trump such diversity. Yet such realities may carry strong

consequences for the ability of nations to cooperate and benefit mutually from exchange. In such cases, the only sensible approach is to ensure that differences are preserved and respected at minimum cost in terms of any slippage towards a dual-purpose approach to public policy formulation and administration.

The third aspect of divergence concerns the difficulties faced by poorer countries in meeting standards in major markets they serve. One could characterize this as “involuntary divergence”. Developing countries have no motivation for preferring different standards; it is merely a question of capacity. With the necessary will and commitment, this problem is readily amenable to solution. As noted in the Report, a number of capacity-building initiatives are attempting to address this issue.

The economic gains from joint international action to remove protectionist elements in the design and administration of NTMs would be considerable. Work on minimizing regulatory divergence, through harmonization, mutual recognition of standards and action to ensure that private standards do not unduly segment markets, would also promise considerable benefits. Much has already been achieved in managing public policy regarding TBT/SPS measures in the goods area, and domestic regulation in services. The progress that has been made holds promise for further advances.

A good part of this report is dedicated to identifying information available on NTMs and our capacity to analyse and assess the impact of these measures. The review is very useful, but it does not make for cheerful reading. We know far less than we should about the existence and effects of NTMs. Some of the difficulty is of a technical nature, as the Report carefully documents. The new Integrated Trade Intelligence Portal (I-TIP) information system being developed by the WTO Secretariat is an effort to increase transparency. But it is clear that governments bear a responsibility for the insufficiency of available information. A strong case exists for seeking improvements in the design and content of notification obligations and in the level of compliance with these obligations. This would seem to be a pre-condition for serious international engagement, whether regionally or multilaterally, in making progress on an agenda that promises significant gains to those who engage.



Pascal Lamy
Director-General

Executive summary

This year's *World Trade Report* ventures beyond tariffs to examine other policy measures that can affect trade. As tariffs have fallen in the years since the birth of the General Agreement on Tariffs and Trade (GATT) in 1948, attention has progressively shifted towards non-tariff measures (NTMs). The range of NTMs is vast, complex, driven by multiple policy motives, and ever-changing. Public policy objectives underlying NTMs have evolved. The drivers of change are many, including greater interdependency in a globalizing world, increased social awareness, and growing concerns regarding health, safety, and environmental quality. Many of these factors call for a deepening of integration, wresting attention away from more traditional and shallower forms of cooperation. Trade in services is a part of this development and has come under greater scrutiny, along with the policies that influence services trade.

The continuing multiplication of policy directions and preoccupations presents challenges for international cooperation. The GATT/WTO has addressed some of the challenges created by NTMs, both through its dispute settlement mechanism and successive rounds of GATT/WTO negotiations. The Tokyo and Uruguay rounds, in particular, focused on a number of NTMs, including standards, which were progressively subject to heightened multilateral discipline. The Uruguay Round also marked the inclusion of services in the WTO.

Regulatory measures such as technical barriers to trade (TBT) and sanitary and phytosanitary (SPS) measures in goods and domestic regulation in services raise new and pressing challenges for international cooperation in the 21st century. They also pose acute transparency issues. More than many other measures, they reflect public policy goals (such as ensuring health, safety and well-being of consumers). Their trade effects may be incidental, but they can also be designed and applied in a manner that unnecessarily frustrates trade. Moreover, they raise a number of issues that are specific to governments and firms in developing countries. The sheer breadth of the subject area has meant that the focus of this report is on TBT/SPS measures and domestic regulation in services.

A. Introduction

Section A of the Report presents an overview of the history of non-tariff measures in the GATT/WTO. This overview discusses how motivations for using NTMs have evolved, complicating this area of trade policy but not changing the core challenge of managing the relationship between public policy and trading opportunities.

Section B examines the reasons why governments use NTMs and services measures and the extent to which public policy interventions may also distort international trade. The phenomenon of offshoring and the cross-effects of services measures on goods trade are also considered. The section analyses choices among alternative policy instruments from a theoretical and empirical perspective. Finally, case studies are presented on the use of NTMs in particular contexts. These include the recent financial crisis, climate change policy and food safety concerns. The case studies consider how far measures adopted may pose a challenge for international trade.

Section C of the Report surveys available sources of information on NTMs and services measures and evaluates their relative strengths and weaknesses. It uses this information to establish a number of "stylized facts", first about NTMs (TBT/SPS measures in particular) and then about services measures.

Section D discusses the magnitude and the trade effects of NTMs and services measures in general, before focusing on TBT/SPS measures and domestic regulation in services. It also examines how regulatory harmonization and/or mutual recognition of standards help to reduce the trade-hindering effects of the diversity of TBT and SPS measures and domestic regulation in services.

Section E looks at international cooperation on NTMs and services measures. The first part reviews the economic rationale for such cooperation and discusses the efficient design of rules on NTMs in a trade agreement. The second part looks at how cooperation has occurred on TBT/SPS measures and services regulation in the multilateral trading system, and within other international forums and institutions. The third part of the section deals with the legal analysis of the treatment of NTMs in the GATT/WTO dispute system and interpretations of the rules that have emerged in recent international trade disputes. The section concludes with a discussion of outstanding challenges and key policy implications of the Report.

See page 36

B. An economic perspective on the use of non-tariff measures

Reasons for government intervention and types of measures

Governments employ non-tariff measures to increase national welfare and for “political economy” reasons.

Non-tariff measures, such as TBT/SPS measures (including labelling), taxes and subsidies, are often the first-best policy instruments to achieve public policy objectives, including correcting market failures such as information asymmetries (where parties do not have the same information) or imperfect competition, and pursuing non-economic objectives, such as the protection of public health. NTMs such as export subsidies and export taxes increase national income by exploiting market power in international markets. While many NTMs are concerned with consumer protection, NTMs can also be utilized by political incumbents to protect domestic producers.

The use of NTMs, irrespective of the motive that underlies them, will often have trade effects.

In some cases, the use of NTMs can promote trade but in many other cases, they restrict it. In cases where the NTMs are meant to correct a market failure, the trade effects are an inadvertent by-product of pursuing a public policy objective. At other times, when NTMs are employed to manipulate the terms of trade or protect domestic producers, adverse trade effects on partners are the means through which gains are captured. The fact that the same NTM used to pursue a public policy objective can also be used for protectionist purposes underlines the difficulty of distinguishing between “legitimate” and protectionist motivations for NTMs, and of identifying instances where NTMs create unnecessary trade costs.

costs and benefits of a measure and, thus, satisfy the demands of producer lobbies while maintaining the appearance of pursuing a policy of public interest. Various circumstances in the political environment, such as election cycles or inter-departmental conflicts, can give further indications as to why the use of NTMs persists. Sector characteristics also play a role. Pressure from large influential firms regarding increases in fixed costs or the prevalence of international offshoring in certain industries is bound to affect governments' decisions on the use of certain NTMs.

As countries make commitments in trade agreements that constrain their ability to pursue certain trade policies, less effectively regulated measures may emerge as a secondary means of protecting or supporting domestic industries.

When tariffs and other trade measures increasingly become unavailable to governments, certain NTMs, including behind-the-border NTMs such as TBT/SPS measures, may be used to influence trade. For example, a government may be tempted to impose more stringent domestic technical regulations if domestic firms in an import-competing industry find it easier than foreign companies to comply. Existing empirical evidence alludes to increased use of NTMs when tariffs are constrained by international agreements.

Measures affecting trade in services

Despite the peculiarities of services trade, distinguishing when services measures pursue public policy objectives from instances in which they distort trade is fraught with the same fundamental difficulties as in the case of NTMs.

The case for regulating services markets is particularly evident given the incidence of market failures in many services sectors. At the same time, the specific characteristics of services trade, notably the intangibility of services and the different modes of supply, imply that regulatory measures, mostly applied “behind the border”, are the only form of trade

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