Module 2.

GATT Principles and WTO Rules on Trade in Goods: Trade Policy Analysis - Market Access Restrictions

ECN 330

Analyzing Economic Integration and Multilateral Trade Liberalization

1. Market Access Restrictions: Trade in Goods

1.1. GATT structure within the WTO

	Goods	Services	Intellectual property	Trade disputes
Basic principles	GATT	GATS	TRIPS	DSM
Additional details	Agreements and Annexes			
Specific sectors or issues	Agriculture Investment SPS + TBT	Telecom Financial Transportation		
Market access commitments	Schedule of Commitments			
Country-specific requirements	Example of schedules: tariffs + quotas	Limitations on market access, national treatment		

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MA Restrictions: Trade in Goods, continued . . .

1.2. General obligations and trade disciplines

- Most favoured nation (MFN)
- National treatment
- Predictability
- Transparency
- Reciprocity
- Safeguards and exemptions

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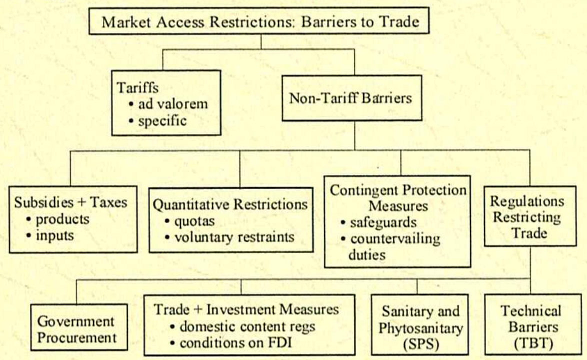
MA Restrictions: Trade in Goods, continued . . .

1.3. MA restrictions

- Types of measures: tariffs, quotas, equivalent measures



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MA restrictions: Trade in Goods, continued . . .

1.4. Objectives of a tariff, quota or equivalent measures

- 1. Protect domestic producers by limiting imports
- 2. Support domestic prices
- 3. Maintain a level of production; self-sufficiency level
- 4. Discourage/distort consumption
- 5. Collect revenue
- 6. Improve BOT
- 7. Policy response to another country's trade policy
- 8. Policy response to non-competitive behaviour of firm
- 9. Improve TOT or SW
- 10. Achieve some other social policy objective

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MA Restrictions: Trade in Goods, continued . . .

1.5. Economic, political and legal issues to consider

- Economic issues
  - Efficiency
  - What is the economic meaning of MFN consistency?
  - What is the meaning of national treatment?
  - What is the meaning of predictability?

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MA Restrictions: Trade in Goods, continued . . .

- Political issues
  - Political administration: objective, method, cost, duration
  - Policy effect: redistribution of income, transfers
  - What does predictability/transparency mean?
  - Reciprocity: policy effect on partners
- Legal issues
  - Interpretation, implementation and enforcement
    - What does non-discrimination imply?
    - What does convergence imply for regs?

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2. The Economics of MA Restrictions

2.1. Economic effects of *ad valorem* vs specific taxes

- MFN consistency
  - Suppose a country imports fresh meat from two trading partners. The importer is to apply a 20% tariff or tariff of 10 kr/kg. The border prices of the meat differs from market factors or marketing factors.

Meat from:	Border price, P_B	P-ratio P_S/P_D	Tariff of 20%	**P-ratio**	Tariff of 10 kr/kg	**P-ratio**
Sweden	20 kr/kg	0.80	24 kr/kg	**0.80**	30 kr/kg	**0.857**
Denmark	25 kr/kg		30 kr/kg		35 kr/kg	

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Economics of MA Restrictions, continued . . .

- Interpretation of the price ratio:
  - What does the increase in $[P_S/P_D]$ from 0.8 to 0.857 imply? **Price of the product from Sweden ↑ relative to price of product from Denmark**
  - Does an increase in the price ratio matter?
    - Legal — **Law applied equally, i.e., according to MFN.**
    - Economic — **Policy effectively discriminated against low-cost producer; violates MFN in spirit.**
    - Political — **Which method of administration is easier; under which is tax collection is most effective?**

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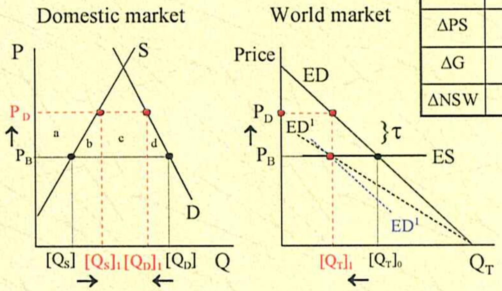
Economics of MA Restrictions, continued . . .

2.2. Equivalence of specific and *ad valorem* tariffs

- Production and consumption effects
- Welfare effects



Welfare analysis	
ΔCS	- (a+b+c+d)
ΔPS	+ (a)
ΔG	+ (c)
ΔNSW	- (b+d)

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Economics of MA Restrictions, continued

- Equivalence of specific and *ad valorem* tariffs when the following holds:
  - Same effect on price, $(P_D - P_W)$
  - Same effect on production, ↑ $[Q_S]_0$ to $[Q_S]_1$
  - Same effect on consumption, ↓ $[Q_D]_0$ to $[Q_D]_1$
  - Same effect on trade, ↓ $[Q_M]_0$ to $[Q_M]_1$
  - Same welfare and redistribution effects
  - Same DWLs
- For every specific tariff there is an *ad valorem* tariff equivalent and vice versa

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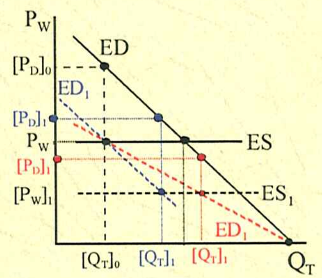
Economics of MA Restrictions, continued . . .

- Non-equivalence of tariffs
  - Consider case where importer has long-run comparative disadvantage (i.e., ↑ ES in rest of the world over time)



Result:

$[P_D]_1 < [P_D]_1$ and $[Q_T]_1 > [Q_T]_1$ so ED_1 is less distorting than ED_1.

For a given amount of initial protection, the *ad valorem* tariff is less distorting over time.

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Economics of MA Restrictions, continued . . .

2.3. Rules against the use of quantitative restrictions

- Economic, legal and political issues
  - Efficiency
  - Compatibility with WTO principles
  - Political administration of a quota

Economics of MA Restrictions

- Economics of a quota: simple example
  - Lamb market in Norway, 1999 – 2001
  - Small country, net importer
  - Quota is 1% of average consumption

Quantities (tons)				
$Q_S = 23{,}760$	$Q_D = 24{,}000$	$Q_M = 240$		
Prices (kr/kg)			Tariff equivalence	
			kr/kg	%
$P_D = 43.50$	$P_B = 31.25$		**12.25**	**39.2**

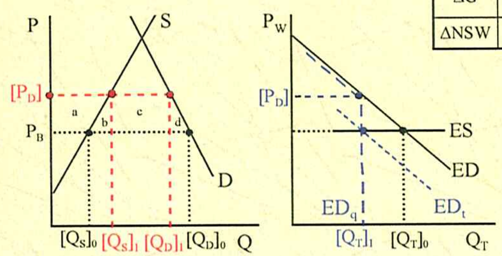
Economics of MA Restrictions, continued . . .

- Production and consumption effects
- Trade and welfare effects

Welfare analysis	
ΔCS	**- (a+b+c+d)**
ΔPS	**+ (a)**
ΔG	**+ (c)**
ΔNSW	**- (b+d)**

Domestic market

World market

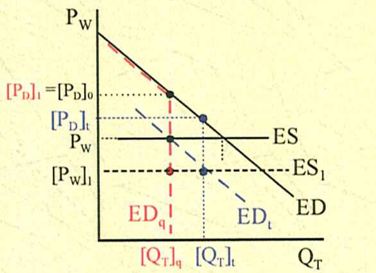


Economics of MA Restrictions, continued . . .

- Equivalence of tariffs and quotas when the following holds:
  - Same effect on price, $(P_D - P_W)$
  - Same effect on production, ↑ $[Q_S]_0$ to $[Q_S]_1$
  - Same effect on consumption, ↓ $[Q_D]_0$ to $[Q_D]_1$
  - Same effect on trade, ↓ $[Q_M]_0$ to $[Q_M]_1$
  - Same welfare effects
- For every quota there is a tariff equivalent of the quota (in either specific or *ad valorem* terms)

Economics of MA Restrictions, continued . . .

- Non-equivalence of tariffs and quotas
  - Consider case where importer has long-run comparative disadvantage (i.e., ↑ ES in rest of the world over time)



Result:

$[P_D]_t < [P_D]_q$ and $[Q_T]_t$ so $[Q_T]_q$ so ED_t is less distorting than ED_q.

For a given amount of initial protection, $[P_D]_0 - P_W$, the tariff is less distorting over time.

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3. Agreements and Rules on the Export Regime

3.1. General obligations and trade disciplines

- MFN
- National treatment
- Predictability
- Transparency
- Reciprocity
- Safeguards and exemptions

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Agreements and Rules on the Export Regime

3.2. Objectives of an export restriction: tax, quota or equivalent measure

- 1. Limit exports to stabilize domestic market
- 2. Lower domestic prices
- 3. Maintain a level of consumption
- 4. Encourage more value-added activity
- 5. Collect revenue and redistribute income
- 6. Policy response to another country's trade policy
- 7. Policy response to a firm's non-competitive behavior
- 8. Improve terms of trade or social welfare
- 9. Achieve some other social policy objective

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Agreements and Rules on the Export Regime

3.3. Economic, political and legal issues to consider:

- Economics
  - Efficiency
- Political
  - Policy objectives
  - Administrative issues
- Legal implementation
  - WTO consistency
  - Enforcement

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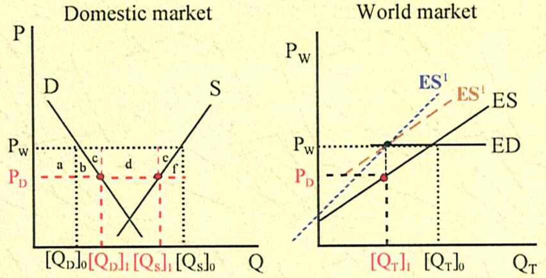
4. The Economics of Export Restrictions

4.1. Export restrictions: specific and *ad valorem* taxes

- Effect on price, production, consumption, trade and welfare
- Equivalence and non-equivalence



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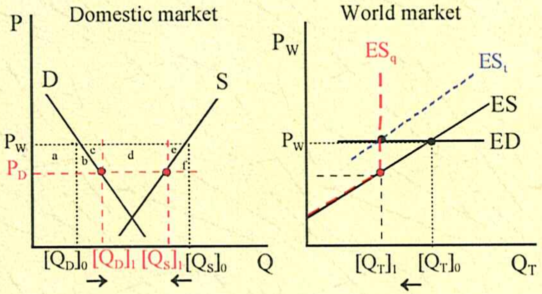
Economics of Export Restrictions, continued . . .

4.2. Economic implications of an export quota

- Price, production, consumption and trade effects
- Equivalence and non-equivalence



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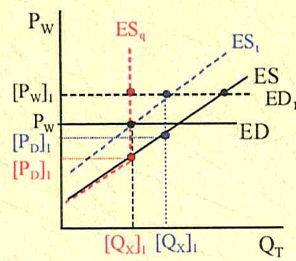
Economics of export restrictions, continued . . .

- Non-equivalence of tax and quota: case where ED is increasing over time (exporter has long-run comparative advantage)



Result:

$[P_D]_t > [P_D]_q$ and $[Q_T]_t > [Q_T]_q$ so ES_t is less distorting than ES_q.

For a given amount of revenue collection, $[P_W] - P_D$, the tariff is less distorting over time.

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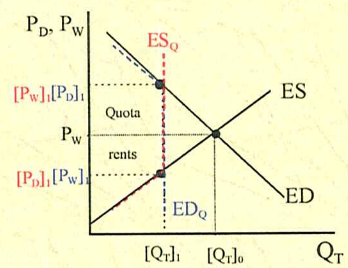
Economics of Export Restrictions, continued . . .

4.3. Symmetry of export and import quotas

- Motivation and objectives
- VERs and OMAs



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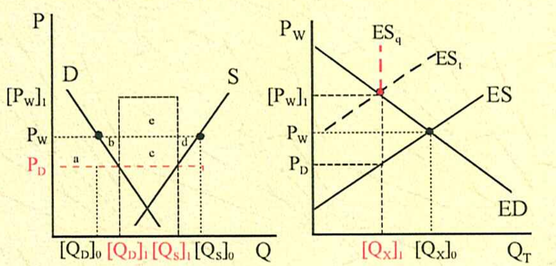
Economics of export restrictions, continued . . .

4.4. Why do WTO members care about export restrictions?

- International price implications



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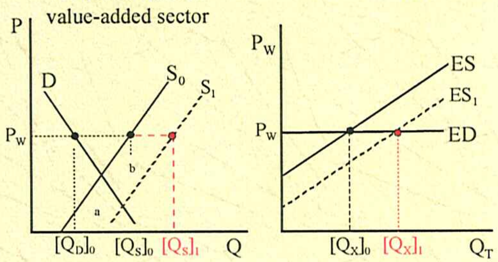
Economics of export restrictions, continued . . .

Why do WTO members care about export restrictions?

- Domestic price implications

Lower commodity prices have a subsidy effect to value-added sector



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5. Trade-Related Investment Measures (TRIMs)

Motivate: Relationship between trade and investment

5.1 Definition of a TRIM

- Distortion of investment
- Distortion of trade
- "China: The white peril", *Economist*, 1 Apr 2006, p 51
  - "Chinese enterprises have long complained bitterly about tax privileges enjoyed by foreign investors, who have to pay income tax at only 15% compared with a 33% rate for domestic firms."

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TRIMs continued . . .

5.2 Types of measures

- Local content or manufacturing requirements
- Domestic sales or export requirements
- BOT, trade balancing or foreign exchange requirements
- Tech transfer conditions; licensing requirements
- Equity and remittance requirements

5.3 Which disciplines, principles or rules are violated?

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TRIMs, continued . . .

5.3 Which disciplines, principles or rules are violated?

- Non-discrimination
- Transparency and predictability
- Rules against use of subsidies
- Rules against use of quantitative restrictions

5.4. Rules on investment in the WTO

- GATT
- GATS
- TRIPS

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TRIMs, continued . . .

5.5 Economic, political and legal issues to consider

- Trade + investment
  - Complements or substitutes?
  - FDI, trade and BOT considerations
  - FDI as S-T K flows BOP considerations
- Regional integration and investment diversion
- IP protection and tech transfer issues
- Industrial policy through investment-trade promotion measures

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TRIMs, continued . . .

5.6. TRIMs: domestic regs with an equivalent MA effect

- Restricting imports a through local content requirement
  - The local content requirement is a proportional quota defined as some % of input use.
  - The local content requirement is superior to the tariff for some targeted amount of imports (k = 60%)
  - Another example of non-equivalence of tariffs and quotas

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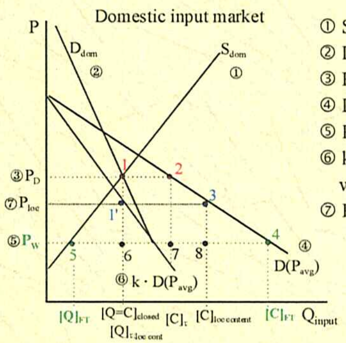
TRIMs, continued . . .

- Modelling local content regulation



① S_{Dom}: supply as usual
② D_{Dom}: D for local input at P_{Dom}
③ P_D: P under a closed economy
④ D(P_{avg}): D as function of P_{avg}
⑤ P_W: P under free trade regime
⑥ k · D(P_{avg}): binding constraint where k is local content required
⑦ P_{loc}: k · P_{Dom} + (1-k) · P_W = P_{Avg}

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TRIMs, continued . . .

- Protection at the same level of production, $[Q]_{Closed}$

	k = 100%	k > 60%	k = 60%	k < 60%
Input use by source	Closed economy	Tariff regime	Local content	Free trade
Price	$P = P_D$	$P = P_D$	$P = P_{Loc}$	$P = P_W$
Total use:	$(Q = C)_{closed}$	$[C]_\tau$	$[C]_{Loc\ content}$	$[C]_{FT}$
Local use	$(Q = C)_{closed}$	$[Q]_{closed}$	$[Q]_{closed}$	$[Q]_{FT}$
Imported	0	Segment 12	Segment 1'3	Segment 54
DWLs				
Production	Δ 156	Δ 156	Δ 156	0
Consumption	Δ 247	Δ 247	Δ 348	0

TRIMs, continued . . .

- Result:
  - For a given amount of protection, tariff and equivalent local content measure (proportional quota) have non-equivalent effects.
  - Proportional quota can be more effective than a tariff if the policy objective is to target some % content.