

# Tariff and Non-Tariff Barriers to Trade

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## Introduction

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This paper examines tariff and non-tariff policies that restrict trade between countries in agricultural commodities. Many of these policies are now subject to important disciplines under the 1994 GATT agreement that is administered by the World Trade Organization (WTO).

The paper is organized as follows. First, tariffs, import quotas, and tariff rate quotas are discussed. Then, a series of non-tariff barriers to trade are examined, including voluntary export restraints, technical barriers to trade, domestic content regulations, import licensing, the operations of import State Trading Enterprises (STEs), and exchange rate management policies. Finally, the precautionary principle, an environment-related rationale for trade restrictions, and sanitary and phytosanitary barriers to trade are discussed.

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## Background

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### Tariffs and Tariff Rate Quotas

Tariffs, which are taxes on imports of commodities into a country or region, are among the oldest forms of government intervention in economic activity. They are implemented for two clear economic purposes. First, they provide revenue for the government. Second, they improve economic returns to firms and suppliers of resources to domestic industry that face competition from foreign imports.

Tariffs are widely used to protect domestic producers' incomes from foreign competition. This protection comes at an economic cost to domestic consumers who pay higher prices for import-competing goods, and to the economy as a whole through the inefficient allocation of resources to the import competing domestic industry. Therefore, since 1948, when average tariffs on manufactured goods exceeded 30 percent in most developed economies, those economies have sought to reduce tariffs on manufactured goods through several rounds of negotiations under the General Agreement on Tariffs Trade (GATT). Only in the most recent Uruguay

Round of negotiations were trade and tariff restrictions in agriculture addressed. In the past, and even under GATT, tariffs levied on some agricultural commodities by some countries have been very large. When coupled with other barriers to trade they have often constituted formidable barriers to market access from foreign producers. In fact, tariffs that are set high enough can block all trade and act just like import bans.

A tariff-rate quota (TRQ) combines the idea of a tariff with that of a quota. The typical TRQ will set a low tariff for imports of a fixed quantity and a higher tariff for any imports that exceed that initial quantity. In a legal sense and at the WTO, countries are allowed to combine the use of two tariffs in the form of a TRQ, even when they have agreed not to use strict import quotas. In the United States, important TRQ schedules are set for beef, sugar, peanuts, and many dairy products. In each case, the initial tariff rate is quite low, but the over-quota tariff is prohibitive or close to prohibitive for most normal trade.

Explicit import quotas used to be quite common in agricultural trade. They allowed governments to strictly limit the amount of imports of a commodity and thus to plan on a particular import quantity in setting domestic commodity programs. Another common non-tariff barrier (NTB) was the so-called “voluntary export restraint” (VER) under which exporting countries would agree to limit shipments of a commodity to the importing country, although often only under threat of some even more restrictive or onerous activity. In some cases, exporters were willing to comply with a VER because they were able to capture economic benefits through higher prices for their exports in the importing country’s market.

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## Issues

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In the Uruguay round of the GATT/WTO negotiations, members agreed to drop the use of import quotas and other non-tariff barriers in favor of tariff-rate quotas. Countries also agreed to gradually lower each tariff rate and raise the quantity to which the low tariff applied. Thus, over time, trade would be taxed at a lower rate and trade flows would increase.

Given current U.S. commitments under the WTO on market access, options are limited for U.S. policy innovations in the 2002 Farm Bill vis a vis tariffs on agricultural imports from other countries. Providing higher prices to domestic producers by increasing tariffs on agricultural imports is not permitted. In addition, particularly because the U.S. is a net exporter of many agricultural commodities, successive U.S. governments have generally taken a strong position within the WTO that tariff and TRQ barriers need to be reduced.

### **Non-Tariff Trade Barriers**

Countries use many mechanisms to restrict imports. A critical objective of the Uruguay Round of GATT negotiations, shared by the U.S., was the elimination of non-tariff barriers to trade in agricultural commodities (including quotas) and, where necessary, to replace them with tariffs – a process called tarrification. Tarrification of agricultural commodities was largely achieved and viewed as a major success of the 1994 GATT agreement. Thus, if the U.S. honors its GATT commitments, the utilization of new non-tariff barriers to trade is not really an option for the 2002 Farm Bill.

### **Domestic Content Requirements**

Governments have used domestic content regulations to restrict imports. The intent is usually to stimulate the development of domestic industries. Domestic content regulations typically specify the percentage of a product’s total value that must be produced domestically in order for the product to be sold in the domestic market (Carbaugh). Several developing countries have imposed domestic content requirements to foster agricultural, automobile, and textile production. They are normally used in conjunction with a policy of import substitution in which domestic production replaces imports.

Domestic content requirements have not been as prevalent in agriculture as in some other industries, such as automobiles, but some agricultural examples illustrate their effects. Australia used domestic content requirements to support leaf tobacco production. In order to pay a relatively low import

duty on imported tobacco, Australian cigarette manufacturers were required to use 57 percent domestic leaf tobacco. Member countries of trade agreements also use domestic content rules to ensure that nonmembers do not manipulate the agreements to circumvent tariffs. For example, North American Free Trade Agreement (NAFTA) rules of origin provisions stipulate that all single-strength citrus juice must be made from 100 percent NAFTA origin fresh citrus fruit.

Again, as is the case with other trade barriers, it seems unlikely that introducing domestic content rules to enhance domestic demand for U.S. agricultural commodities is a viable option for the 2002 Farm Bill.

### **Import Licenses**

Import licenses have proved to be effective mechanisms for restricting imports. Under an import-licensing scheme, importers of a commodity are required to obtain a license for each shipment they bring into the country. Without explicitly utilizing a quota mechanism, a country can simply restrict imports on any basis it chooses through its allocation of import licenses. Prior to the implementation of NAFTA, for example, Mexico required that wheat and other agricultural commodity imports be permitted only under license. Elimination of import licenses for agricultural commodities was a critical objective of the Uruguay Round of GATT negotiations and thus the use of this mechanism to protect U.S. agricultural producers is unlikely an option for the 2002 Farm Bill.

### **Import State Trading Enterprises**

Import State Trading Enterprises (STEs) are government owned or sanctioned agencies that act as partial or pure single buyer importers of a commodity or set of commodities in world markets. They also often enjoy a partial or pure domestic monopoly over the sale of those commodities. Current important examples of import STEs in world agricultural commodity markets include the Japanese Food Agency (barley, rice, and wheat), South Korea's Livestock Products Marketing Organization, and

China's National Cereals, Oil and Foodstuffs Import and Export Commission (COFCO).

STEs can restrict imports in several ways. First, they can impose a set of implicit import tariffs by purchasing imports at world prices and offering them for sale at much higher domestic prices. The difference between the purchase price and the domestic sales price simply represents a hidden tariff. Import STEs may also implement implicit general and targeted import quotas, or utilize complex and costly implicit import rules that make importing into the market unprofitable.

Recently, in a submission to the current WTO negotiations, the United States targeted the trade restricting operations of import and export STEs as a primary concern. A major problem with import STEs is that it is quite difficult to estimate the impacts of their operations on trade, because those operations lack transparency. STEs often refuse to provide the information needed to make such assessments, claiming that such disclosure is not required because they are quasi-private companies. In spite of these difficulties, the challenges provided by STEs will almost certainly continue to be addressed through bilateral and multilateral trade negotiations rather than in the context of domestic legislation through the 2002 Farm Bill.

### **Technical Barriers to Trade**

All countries impose technical rules about packaging, product definitions, labeling, etc. In the context of international trade, such rules may also be used as non-tariff trade barriers. For example, imagine if Korea were to require that oranges sold in the country be less than two inches in diameter. Oranges grown in Korea happen to be much smaller than Navel oranges grown in California, so this type of "technical" rule would effectively ban the sales of California oranges and protect the market for Korean oranges. Such rules violate WTO provisions that require countries to treat imports and domestic products equivalently and not to advantage products from one source over another, even in indirect ways. Again, however, these issues will likely be dealt with through bilateral and multilateral trade negotiations

rather than through domestic Farm Bill policy initiatives.

### **Exchange Rate Management Policies**

Some countries may restrict agricultural imports through managing their exchange rates. To some degree, countries can and have used exchange rate policies to discourage imports and encourage exports of all commodities. The exchange rate between two countries' currencies is simply the price at which one currency trades for the other. For example, if one U.S. dollar can be used to purchase 100 Japanese yen (and vice versa), the exchange rate between the U.S. dollar and the Japanese yen is 100 yen per dollar. If the yen depreciates in value relative to the U.S. dollar, then a dollar is able to purchase more yen. A 10 percent depreciation or devaluation of the yen, for example, would mean that the price of one U.S. dollar increased to 110 yen.

One effect of currency depreciation is to make all imports more expensive in the country itself. If, for example, the yen depreciates by 10 percent from an initial value of 100 yen per dollar, and the price of a ton of U.S. beef on world markets is \$2,000, then the price of that ton of beef in Japan would increase from 200,000 yen to 220,000 yen. A policy that deliberately lowers the exchange rate of a country's currency will, therefore, inhibit imports of agricultural commodities, as well as imports of all other commodities. Thus, countries that pursue deliberate policies of undervaluing their currency in international financial markets are not usually targeting agricultural imports.

Some countries have targeted specific types of imports through implementing multiple exchange rate policy under which importers were required to pay different exchange rates for foreign currency depending on the commodities they were importing. The objectives of such programs have been to reduce balance of payments problems and to raise revenues for the government. Multiple exchange rate programs were rare in the 1990s, and generally have not been utilized by developed economies.

Finally, exchange rate policies are usually not sector-specific. In the United States, they are clearly under the purview of the Federal Reserve Board and,

as such, will not likely be a major issue for the 2002 Farm Bill. There have been many calls in recent congressional testimony, however, to offset the negative impacts caused by a strengthening US dollar with counter-cyclical payments to export dependent agricultural products.

### **The Precautionary Principle and Sanitary and Phytosanitary Barriers to Trade**

The precautionary principle, or foresight planning, has recently been frequently proposed as a justification for government restrictions on trade in the context of environmental and health concerns, often regardless of cost or scientific evidence. It was first proposed as a household management technique in the 1930s in Germany, and included elements of prevention, cost effectiveness, and ethical responsibility to maintain natural systems (O'Riordan and Cameron). In the context of managing environmental uncertainty, the principle enjoyed a resurgence of popularity during a meeting of the U.N. World Charter for Nature (of which the U.S. is only an observer) in 1982. Its use was re-endorsed by the U.N. Convention on Bio-diversity in 1992, and again in Montreal, Canada in January 2000.

The precautionary principle has been interpreted by some to mean that new chemicals and technologies should be considered dangerous until proven otherwise. It therefore requires those responsible for an activity or process to establish its harmlessness and to be liable if damage occurs. Most recent attempts to invoke the principle have cited the use of toxic substances, exploitation of natural resources, and environmental degradation.

Concerns about species extinction, high rates of birth defects, learning deficiencies, cancer, climate change, ozone depletion, and contamination with toxic chemicals and nuclear materials have also been used to justify trade and other government restrictions on the basis of the precautionary principle. Thus, countries seeking more open trading regimes have been concerned that the precautionary principle will simply be used to justify nontariff trade barriers. For example, rigid adherence to the precautionary principle could lead to trade embargoes on products such as genetically modified oil seeds with little or no

reliance on scientific analysis to justify market closure.

Sometimes, restrictions on imports from certain places are fully consistent with protecting consumers, the environment, or agriculture from harmful diseases or pests that may accompany the imported product. The WTO Sanitary and Phytosanitary (SPS) provisions on technical trade rules specifically recognize that all countries feel a responsibility to secure their borders against the importation of unsafe products. Prior to 1994, however, such barriers were often simply used as excuses to keep out a product for which there was no real evidence of any problem. These phony technical barriers were just an excuse to keep out competitive products. The current WTO agreement requires that whenever a technical barrier is challenged, a member country must show that the barrier has solid scientific justification and restricts trade as little as possible to achieve its scientific objectives. This requirement has resulted in a number of barriers being relaxed around the world.

It should be emphasized that WTO rules do not require member countries to harmonize rules or adopt international standards — only that there must be some scientific basis for the rules that are adopted. Thus, any options for sanitary and phytosanitary initiatives considered in the 2002 Farm Bill must be based on sound science and they do not have to be harmonized with the initiatives of other countries.

O’Riordan, Tim and James Cameron. “Interpreting the Precautionary Principle,” Earthscan Publications, Ltd., Island Press, 1994.

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## References and Suggested Readings

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