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Non-Tariff Barriers and Pakistan's Regional Trade

A Legal and Economic Analysis of Non-Tariff Barriers in Pakistan, India, China, and Sri Lanka

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Pakistan, China, India, and Sri Lanka are developing countries with large labor forces and consumer bases. The countries are neighbors, so that transportation costs and cultural barriers to trade are low. Free trade among these countries would allow consumers to get the best products and services at the least cost. However, both economic and non-economic factors have caused these states to close their economies to varying degrees.

States close their economies through domestic laws that enact tariffs and non-tariff barriers (NTBs). Tariffs are taxes on trade, whereas non-tariff barriers are non-monetary restrictions of various kinds, such as documentation requirements, technical or safety standards, and packaging requirements. Tariffs and non-tariff barriers are typically set by regulatory agencies that are empowered by statutes passed in legislatures.

Exceptions in trade law for protecting local industry: The World Trade Organization (WTO) in particular and international trade law in general attempt to limit the use of domestic laws that restrict trade. However, trade law contains several exceptions that allow states – particularly developing countries such as India, Pakistan, and Sri Lanka – to protect local industry. These exceptions are contained in the General Agreement on Tariffs and Trade (GATT) and its associated documents. They include antidumping measures, countervailing duties, safeguards, allowances for developing states, and national security exemptions. Antidumping measures prevent foreign manufacturers from "dumping" their excess stock at low prices (even below cost) in the host country. Countervailing duties are meant to cancel government subsidies to foreign producers that artificially lower their costs. Safeguard measures are used to stem a rapid increase in imports that many cause "serious injury" to a domestic industry. Allowances for developing states allow such states to implement "measures affecting imports" to raise the "general standard of living" of their people[1]. Finally, Article 20 of the GATT allows for trade restrictions to protect health, morals, legal compliance, and various other national interests. Since the scope of these exceptions is unclear, countries can enact numerous non-

[1]GATT Article 18

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tariff barriers under the garb of a recognized exemption.

We find that China, India, and Sri Lanka have enacted more non-tariff barriers (NTBs) than Pakistan. China and India have particularly sophisticated NTB regimes. We highlight three points about non-tariff barriers in these countries. First, while Pakistan's NTBs protect entrenched rent-seekers, such as agriculturalists, Indian and Chinese NTBs protect strategic industries, such as small businesses, defense contractors, and electronics manufacturers.

Second, while many Pakistani NTBs operate as bans that shut competitors out of the Pakistani market, Indian and Chinese NTBs create costs that make foreign products more expensive (but still available) to their consumers. Foreign businesses can at least compete with Chinese and Indian businesses, albeit on unequal terms, and provide local businesses with some incentive to improve; in contrast, Pakistani businesses that are protected by bans (or effective bans) face no foreign competition at all.

Third, while Indian and Chinese NTBs are narrowly tailored to particular types of businesses, Pakistani NTBs tend to protect very general categories of products. Put differently, Pakistani NTBs are blunt instruments, and it is difficult to use them to provide targeted protection to strategic industries.

Sri Lanka's trade restrictions are low, and are concentrated on tariffs rather than NTBs. Sri Lanka's NTBs focus clearly on safety and health concerns and appear less strategic than the NTBs employed by China and India.

A brief overview of the NTB regime in each country follows:

Non-Tariff Barriers in Pakistan

Seven (7) legal instruments have been used to create NTBs in Pakistan. Statutory regulatory orders (SROs) have been used the most, followed by the Import Policy Order 2009 and the Export Policy Order 2009. Its main imports from India are cotton, black tea and chemicals such as polypropylene, which is used in the manufacture of plastics, ropes, auto parts and textiles; and p-Xylene, which is used in the production of polyester. Its main import from China is telephone and radio equipment.

Pakistan's non-tariff barriers are concentrated on agriculture, plant, and food-related products. Agriculturists have historically been entrenched in political offices across the country, so the dominance of agricultural NTBs appears to be a predictable result of interest group pressures to maintain economic rents.

The Ministry of Commerce is the organ of the Federal Government that is responsible for trade regulation. It controls the Trade Development Authority of Pakistan and several other agencies. The Ministry derives its authority to regulate trade primarily from the Imports and Exports (Control) Act, 1950. Article 3 of the Imports and Exports (Control) Act entrusts the Central Government with the authority to prohibit, restrict or otherwise control the import or export of any goods and regulate all practices and procedures involved in import and export. Applications for licenses, the grant, use, transfer, sale or cancellation of such licenses, the determination of the form, manner and period of any associated appeals and the fees charged in respect of any such matters falls within the ambit of powers conferred by the same article.

The Ministry of Commerce uses its statutory authority to regulate trade by passing Statutory Regulatory Orders (SROs). Several SROs have been used to restrict imports over time.

Non-Tariff Barriers in India

In India, on the other hand, sixteen (16) legal instruments have been used extensively to restrict trade. The most-used NTBs include the Defence Procurement Procedure, preference to domestically manufactured electronic goods in Government procurement and a ban on the import of cars whose engine capacity ranges from 1000 to 2500cc.

Some NTBs are targeted at particular countries. For example, import of Chinese milk is prohibited. Other NTBs explicitly protect particular industries, such as the list of "reserved items for small industries."

Two features distinguish Pakistani and Indian NTBs. First, many of the leading Indian NTBs are soft barriers, which operate as delays or bureaucratic hurdles rather than bans. Pakistan's NTBs often operate as bans. Second, Pakistan's NTBs focus on general categories of goods, India's often focus on particular industries and trading partners. India's main imports from China are diamonds, telephone equipment, and computer components. Pakistan is not a major exporter to India.

The Defence Procurement Procedure, 2011[2] covers all capital acquisitions, (except medical equipment) undertaken by the Ministry of Defence, Defence Services, and Indian Coast Guard both from indigenous sources and ex-import. This Procedure was amended in 2013[3] with the express intention of reversing the trend of importing most of the equipment and weapons systems that the armed forces need by giving the first opportunity to the Indian industry to meet the requirement. The first major change relates to the introduction of the 'preferred categorization' in the following order; Buy (Indian), Buy & Make (Indian), Make (Indian), Buy & Make, Buy (Global). While seeking the approval for an Accord of Necessity (AoN) in a particular

[2]Available online at http://www.dgqadefence.gov.in/documents/DPP2011.pdf (last visited, 25 November 2013).

[3]See Press Information *Bureau, Government of India, Salient Features of Defense Procurement Procedure 2013*, available online at http://pib.nic.in/newsite/erelease.aspx?relid=96361 (last visited, November 2013).

category, say, Buy (Global), it will now be necessary to give justification for not considering the other higher preference categories. This is expected to give a stronger impetus to indigenization. Stipulations related to the indigenous content have been clarified and made more stringent. Indigenous content requirements will now extend all the way to the lowest tier of the sub-vendor. Hence, import content in the products supplied by the sub-vendors will not qualify towards indigenous content.

The foreign trade of India is guided by the Foreign Trade policy, more commonly known as the Export Import policy, of the Government of India. This is governed by the Foreign Trade Development and Regulatory Act 1992, supra. Section 5 of the EXIM policy dictates that the Central Government has the authority to formulate and amend the import and export policy by notification in the Official Gazette.

The EXIM Policy incorporates all the bans and prohibitions on imports that are listed in the Indian Trade Classification code, abbreviated as the ITC (HS) code. The ITC (HS) code is issued by India's Directorate General on Foreign Trade (DGFT). Currently, the ITC bans 54 (primarily animal-based) products and restricts 442 items.[4]

Non-Tariff Barriers in China

China regularly uses at least eighteen (18) legal instruments to restrict imports. Many of China's NTBs protect sophisticated manufacturers. For example, China's Law on Product Quality is the third most-reported NTB; restrictions on used mechanical and electronic products is the seventh most-reported; and product certification requirements are the ninth.

Like India, and unlike Pakistan, a large proportion of China's NTBs create delays and processing hurdles that raise the costs of foreign competitors rather than shutting them out of the market.

The apex lawmaker in China is the National People's Congress, which comprises 3,000 representatives drawn from each of China's 33 administrative units (including provinces, municipalities, administrative zones, and autonomous regions) as well as the military. Most of the Congress's powers are delegated to a standing committee, which can interpret laws, enact decrees, sign treaties, and approve economic plans.

Article 3 of the China's foreign trade law[5] empowers the department for foreign trade under the State Council to regulate trade with other countries. The State Council is the most important executive organ in China. It operates under the President, who is China's chief executive.

Article 16 of the foreign trade law allows the foreign trade department to restrict exports and imports for 11 reasons. Several rationales are geared toward restricting exports, such as exports of items that are domestically in short supply. However, subsection (7) to (10) provide rationales for restricting imports which include the establishment of a particular domestic industry, maintaining the State's international financial position and balance of international receipts and payments, and restrictions on the import of agricultural, animal husbandry, and fishery products of any form.

Non-Tariff Barriers in Sri Lanka

Sri Lanka also uses eighteen (18) legal instruments to limit trade. Unlike Pakistan, India, and China, most of Sri Lanka's NTBs are explicitly geared toward controlling trade in dangerous substances, such as poisons, opiates, radioactive elements, and processed food. These NTBs do not appear to be protecting specific pressure groups of Sri Lankan producers. Thus, Sri Lankan consumers may be better off than consumers in the other three countries.

Despite efforts to open the economy to foreign trade and investment, the pace of reform in Sri Lanka has been uneven. In 2011, Sri Lanka faced a large current account and balance of payments (BOP) deficit due to increased imports, including rising petroleum imports. The government has enacted several policy measures to curtail the growth of imports. For instance, in early 2012 the government moved to a more flexible exchange rate policy by depreciating its currency. There has been an increase in tariffs on motor vehicles so as to discourage imports.

An Export Development Board (EDB) levy, often referred to as a "cess", ranging from 10 percent to 35 percent ad valorem is applied on a range of imports identified as "nonessential." Most items on the list are subject to specific duties. The EDB levy is calculated in such a way so as to impose an imputed profit margin of 10 percent, which is added onto the import price. This levy is sometimes not charged on the import price but rather on 65 percent of the maximum retail price. The levy is not applicable to locally manufactured products. It is continuously increased by the government: in November 2012 the EDB was increased on dairy products, meat, fruits, vegetables and confectionary.

While local goods are not subject to the Ports and Airports Development Levy of 5 percent, imports are. In November 2011, the government introduced an all-inclusive tax on imported textiles not intended for use by the apparel export industry. This all-inclusive tax was increased in November 2012.

[4]See Goverment of India Data Portal, *Import Export Classification, ITC* (HS) Code and Import Policy 2012, available online at http://data.gov.in/dataset/import-export-classification-tchs-and-import-policy (last visited 25 November2013)

[5]Available online at http://www.china.org.cn/china/LegislationsForm2001-2010/2011-02/14/content_21917089.htm (last visited, 25 November 2013).

Analysis and Recommendations

Our research suggests that Pakistan's non-tariff barriers are lower than those of India, China, and Sri Lanka. Pakistan uses only a handful of statutes and regulations (statutory regulatory orders) to implement non-tariff barriers. These NTBs do not appear to have a substantial effect on imports: both China and India have overwhelming trade surpluses against Pakistan, and both countries figure as major suppliers of some of Pakistan's main imports.

However, insofar as Pakistan's low non-tariff barriers are the result of a lack of legal know-how, **we expect that Pakistani NTBs could grow.** As lawyers and policymakers become aware of the ways in which exceptions to the free trade regime have been used to restrict imports into China, India and Sri Lanka, they are likely to emulate these methods to erect stronger barriers to trade.

Pakistani trade representatives and officials should be trained on the specific non-tariff barriers that affect Pakistan's exports to India. This training should include the basic theory of non-tariff barriers, empirical evidence of the effects of NTBs, and information on the laws that create these NTBs.

In light of this, we feel that **Pakistan has three options:**

1. It can insist that all countries eliminate their NTBs, with the knowledge that Pakistani businesses stand to lose the least, since they are the least protected.

2. It can unilaterally lower its NTBs to help its consumers (while harming its producers).

3. It can invest in setting up NTBs to counteract the affects of Indian and other NTBs.

The first-best solution would be for all countries to lower their NTBs. Economic theory suggests that this would increase welfare across all countries and force producers to compete on a level playing field. However, we feel that it is unreasonable to expect all four countries to lower their barriers for at least three reasons:

- In practice, it is difficult to identify NTBs and to monitor compliance with any agreement to reduce NTBs.

- It is difficult to tell whether a particular NTB is legal, as a valid exemption under GATT or other trade law, or illegal.

- Political considerations may make it infeasible for Pakistan, India, China or Sri Lanka to open their markets to each other. Composite dialogue, national security, international law, domestic pressure groups, and other matters may force governments to maintain certain NTBs.

The second-best solution would be for Pakistan to unilaterally eliminate its NTBs. This approach also makes economic sense: it would benefit Pakistani consumers and force Pakistani producers who are unable to compete with foreign businesses to redirect their investments. However, we believe that a unilateral opening of the market is also unlikely for two reasons:

- The WTO recognizes the right of developing countries to nurture local businesses, and the international trade regime accepts some protective measures, which every other developing country is already employing. This means that the other countries' businesses are effectively subsidized. They may be able to drive Pakistani businesses out of their own market even though they have no genuine cost advantage.

- Local industries will lobby against such a move and politicians may be unwilling to make such powerful enemies. A unilateral lowering of barriers will be politically costlier than a reciprocal lowering, and industries that will be hurt by such a move may be able to gather formidable political support

We suspect that the first two solutions are unworkable under the current international trade law regime and political climate. Therefore, **we propose a third approach: Pakistan develop sophisticated NTBs to counteract the effects of Indian and other NTBs.** Pakistan's current NTBs are unsophisticated and protect low-tech industries. In contrast, we recommend that:

All Pakistani NTBs be justifiable under international trade law exemptions. The government should ensure that it only uses non-tariff barriers that qualify under the various exceptions (both general ones and ones geared toward developing countries) contained in international trade law instruments such as the GATT, GATS, TBT Agreement, SPS Agreement, and Agreement on Agriculture. In particular,

- The government must hire and train a cadre of lawyers who are well-versed in international trade law and can evaluate the legality of proposed NTBs.

- The government should organize a standing task force, which regularly studies the changes in the trade policies of partners, evaluate the impact of those policies and respond with counter-policies in real time with the relevant interest groups on board.

Domestic interest groups be educated in the relationship between domestic taxes and subsidies and Pakistani trade policy. We believe that interest groups for and against NTBs can negotiate directly, and successfully, if they agree on lobbying for domestic policies, such as taxes and subsidies, rather than trade policy. For example, if lowering NTBs will help textiles more

than harm agribusiness, then textiles may agree to redistribute wealth to agriculture, through a tax on textiles and a subsidy to agribusiness. If agribusiness would lose more from lowering NTBs than textiles would gain, then agribusiness may agree to have subsidies switched to the textile industry. Domestic interest groups can thus delink their concerns with redistribution from trade policy by using taxes and subsidies.

In order to make such bargaining possible, we recommend that interest groups and officials be educated on the current regime of taxes and subsidies to Pakistani industries. This process should be bolstered by domestic interests groups who are representative of their industry. Thus, the All Pakistan Textile Mills Association (APTMA) may adequately represent the concerns of textile millers, but no such parallel can be found in the loosely organized agri-business.

NTBs be disaggregated and slowly redirected to protect strategic industries rather than rent-seekers. The Pakistan government should begin by lowering non-tariff barriers that protect industries with lower political influence, such as the automobiles industry. We expect that once the government lowers NTBs that protect less influential lobbies, the consumers/electorate will appreciate the benefits of free trade (lower prices) and support the abolition of NTBs for politically entrenched industries as well. In particular,

- The government must be educated on which particular NTBs protect which industries. The government must be able to match certain NTBs to certain interest groups in order to remove an NTB strategically.

- NTBs that affect many industries simultaneously should be disaggregated into NTBs that affect single industries. This can be accomplished by rewriting laws in more particular language. For example, a standard that applies to "all electronics" can be rewritten into separate laws that apply to cell phones, microchips, hardware, electronic sockets, etc. so that any one of these industries can later be targeted for NTB relaxation without ruffling the others.

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