

# **A Primer on Tariff and Non-Tariff Barriers to International Trade: (Hopefully) a Common Sense, Non-Technical Discussion from a U.S. Perspective**

**Hector R. Lozada<sup>1</sup>, Richard J. Hunter<sup>2</sup>**

## **Abstract**

Although it would be both customary and prudent for an importer or exporter to secure the services of an experienced customs broker in facilitating an international transaction, it is still important for the businessman to understand the issues relating to these endeavors. This paper is a study of tariffs, tariff and non-tariff barriers, and their impact on international trade. It describes tariff standards from the standpoint of classification and valuation criteria. The paper also discusses the major quantitative non-tariff barriers such as import quotas, numerical export quotas, and non-quantitative tariff barriers such as testing standards, restrictive access to distribution networks, government procurement policies, regulatory controls, and currency controls. The paper closes with a discussion of the impact of the “Golden Share” on the international trading regime.

**Key Words:** International trade; tariffs; tariff barriers; non-tariff barriers; “Golden Share”

**Classification:** F10

## **1. Introduction**

Consider these basic facts about the importance of international trade in the U.S. economy, presented by the office of the United States Trade Representative (2014a):

“The U.S. is the world's largest trading nation, with exports of goods and services of nearly \$2.3 trillion in 2013. U.S. goods and services exports supported an estimated 11.3 million jobs in 2013. Every billion dollars of goods and services exports supported nearly an estimated 5,600 jobs in 2013. Every billion dollars of goods exports supported more than 5,400 jobs in 2013. Every billion dollars of services exports supported more than 5,900 jobs in 2013.

An estimated 25 percent of all manufacturing jobs are supported by exports.

U.S. agricultural exports supported an estimated 929 thousand jobs on and off the farm in 2012 (latest data available). Every billion dollars of U.S. agricultural exports in 2012 (latest data available) required 6,577 American jobs throughout the economy. US jobs supported by goods exports pay 13-18 percent more than the US national average. Exports of goods and services full year share of U.S. GDP at 13.45 percent in 2013.”

It is unmistakably true that the U.S. position in international trade is being buffeted by competition from both trading friends and foes alike! In this environment, it is also not altogether unsurprising that a nation might try to protect its domestic industries from foreign competition. The United States International Trade

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<sup>1</sup>Associate Professor of Marketing; Fellow, Institute for International Business and Director of Teaching and Research Stillman School of Business Seton Hall University, South Orange, New Jersey 07079

<sup>2</sup>Professor of Legal Studies Chair, Department of Economics and Legal Studies Adjunct Professor of Law (International Trade), Rutgers University School of Law (Newark and Camden, N.J.) Fellow, Institute for International Business Stillman School of Business Seton Hall University, South Orange, New Jersey 07079

Commission 1997 Annual Report (2012) commented extensively on the policy choices available to a government. Two basic approaches to international trade have risen to prominence in recent times, which have their roots in a traditional policy debate over a concept known as mercantilism—a policy that promotes government regulation of an economy for the purpose of enhancing a state’s power at the expense of its economic or political rivals. (Bhala, 20008, Chapter 7, pp. 201-207)

Under an historical free trade approach, a national government will exert “minimal influence on the exporting and importing decisions” (Griffin & Pustay, 2002, p. 219), ideally resulting in long range growth in per capita income as a consequence of an increase in savings and investment, population expansion, and positive technological change. Denise Froning (2000) of the Heritage Foundation is even more expansive. She notes the benefits of free trade as promoting innovation and competition; generating economic growth; disseminating democratic values; and fostering economic freedom.

Under a free trade regime, import and export taxes, tariffs, and import quotas would be eliminated or severely reduced, as would be subsidies, tax breaks, and other forms of governmental support (subsidies, anti-dumping measures) to domestic producers. Restrictions on the free flow of currency, such as blocking of a currency or more nefarious currency manipulation, would also be lifted or severely limited. Free trade, in theory, enables foreign companies to compete on an “even playing field” with domestic producers, usually inuring to the benefit of consumers who can expect lower prices in the domestic market.

Professor Robert McGee (1993, 2004), no friend of the fair trade approach or government intervention into the free market, states that in contrast, under a fair trade approach, a national government will actively intervene in export and import decisions in order to ensure that its imports and exports receive an equitable or fair share in a foreign market—essentially guaranteeing a “level playing field.” Thus, a nation may seek to actively intervene in the area of international trade on behalf of domestic producers as a matter of both fairness and equity.

The fair trade argument may appear to be more attractive from the standpoint of protecting national interests, but do its negative consequences outweigh its perceived benefits? In rejecting an essentially protectionist or interventionist point of view, Siprut (2004, p. 710) argues that “voters” in individual nations may believe that free trade produces “negative consequences” in the aggregate and may cling to these “anti-free trade beliefs even if information or evidence to the contrary is freely disseminated and is otherwise obtainable at a minimal cost...” From this standpoint, the fair trade approach may thus be more of a populist or political, rather than economic, approach.

In the context of adopting an interventionist policy or a “fair trade” approach into foreign trade decision-making, nations might decide to employ both tariff and non-tariff barriers to execute a particular strategy. This paper will outline the basic strategies inherent in both approaches.

### **Tariff Strategies**

A tariff is essentially a tax placed on a good that is traded in the international marketplace. Export tariffs are levied on goods as they leave a country; import tariffs are collected on imported goods. Some countries charge a transit tariff for goods that pass through their customs’ territory. Bhala (2012, p. 313, note 310) states that import tariffs continue to provide a source of funds for developing countries which may be lacking domestic tax resources. In historical terms, tariffs were the main source of all federal revenue from 1790 to 1914. At the end of the Civil War in 1865, roughly 63% of all the income of the Federal government was generated by the revenues from excise taxes; however, tariffs still amounted to 25.4% of aggregate governmental revenues. In 1915 during World War I, tariffs generated 30.1% of federal revenues. However, since 1935 tariff income has declined and today is an insignificant percentage of federal tax income. In 2000, tariffs amounted to 1% of Federal revenues; in 2005, tariffs were 1.1% of revenues; and in 2010, tariffs were 1.2% of Federal revenues. (Office of Management and Budget, 2014)

Suranovic (2010) comments that in general, there are three forms of import tariffs:

- An ad valorem tariff is assessed as a percentage of the customs value of an imported good—most typically the sales price at which the product enters a country or the custom’s territory of a country;
- A specific tariff is assessed as a specified dollar amount based some quantity of the imported goods such as the weight, bulk, volume, etc.; and
- A compound or combination tariff is comprised of both an ad valorem component and a specific component.

Most nations, including the United States, have adopted what is termed as the Harmonized Tariff Schedule or HTS, which is a detailed system of classification for imported goods. (House Committee on Ways and Means, 2005; SICCODE.com, 2014) In the United States, an importer may contact the U.S. Customs Service to request in advance a tariff classification. The HTS came into effect in 1988 under the auspices of the World Customs Organization (WCO, 2014), formerly known as the Customs Cooperation Council, an independent inter-governmental organization based in Brussels, Belgium. Currently, more than 200 countries subscribe to the HTS.

The HTS for the United States may be found in the Schedules published by the United State International Trade Commission (2014). The Schedules contain twenty two sections and ninety nine chapters. The HTS assigns or classifies goods to sections, and then proceeds to assign these goods to their specific chapter, heading, and subheading, in that order. The HTS assigns up to a total of 8 digits at the tariff-rate (legal) level. Two additional digits may also be assigned as statistical reporting numbers for a total of 10 digits to be listed on entries. (House Committee on Ways and Means, 2005; SICCODE.com, 2014.)

To ensure proper harmonization, parties must employ at least 4- and 6-digit provisions, international rules and notes, but are free to adopt additional subcategories and notes. Chapter 98 comprises special classification provisions, and chapter 99 contains modifications pursuant to a parties' national directive or legislation. (House Committee on Ways and Means, 2005; SICCODE.com, 2014.) An importer often will use the services of a knowledgeable customs broker in classification and valuation. (E.g., Enslin, Coleman & Newton, 2013.) The next revision of the HTS is scheduled for 2017.

### **Classification and Valuation Issues**

The first step for an importer in the process is termed classification—the process by which an article is placed in the correct HTS category. Valuation is the process of appraising the value of an article for tariff purposes. To begin, Bhala (2008, p. 548), notes that while the meaning of a classification is a question of law, “the issue of whether merchandise comes within the definition of a classification term is a question of fact subject to the clearly erroneous standard of review.” (Simod America Corp. v. United States, 1989)

The HTS relies on four considerations in order to classify merchandise:

1. A general description of the merchandise;
2. An eo nomine description, that is, a description according to the commonly used name of the article;
3. A description according to component material; or
4. A description by the actual or principle use of an article.

In legal terms, the “Customs’ classification of imported merchandise is presumed to be correct (28 U.S.C. Section 2639(a)(1), 1988), and the party challenging the classification has the burden of overcoming this presumption.” (Marubeni America Corp. v. United States, 1994)

Valuation is the second part of the task of assessing the proper tariff amount. The Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade (Agreement on Customs Valuation) (WTO, 1994) attempted to assure uniformity in valuation methodologies, in that customs officials of WTO members will use the same general approach in determining the value of an article for the purposes of applying the individual tariff. There are four generally accepted valuation methodologies employed today:

## **2. Valuation Methods**

### **Method #1: Transaction Value**

The price actually paid or payable for the merchandise when sold for export to the United States, plus certain other costs if these costs were not already included in the price (for example, packing costs, selling commissions, assistance costs, or royalty or license fees). Amounts may also be excluded from the calculation. These may include costs, charges, or expenses for transportation, insurance, and other services incident to the international shipment of goods; costs or charges incurred for constructing, erecting, assembling, maintaining or providing technical assistance with respect to the goods after transportation into the United States; or transporting goods after importation. In addition, the seller may exclude the customs duties or other federal taxes (excise taxes) for which a seller in the United States is ordinarily liable. (U.S. Customs and Border Protection, 2006, pp. 84-90.)

### **Method #2: Transaction Value of Identical or Similar Merchandise**

The term “identical merchandise” means merchandise that is “identical in all respects to the merchandise being appraised; produced in the same country as the merchandise being appraised; produced by the same person as the merchandise being appraised.” (U.S. Customs and Border Protection, 2006, pp. 90-91.) If merchandise meeting all three of these criteria cannot be found, then identical merchandise which satisfies the first two criteria, but which is produced by a different party than the producer of the merchandise being appraised, can be used.

The term “similar merchandise” means merchandise that is “produced in the same country and by the same person as the merchandise being appraised; like the merchandise being appraised in characteristics and component materials; commercially interchangeable with the merchandise being appraised.” (U.S. Customs and Border Protection, 2006, pp. 90-91.) If merchandise meeting the above criteria cannot be found, then the term would include merchandise produced by a different party.

Excluded from both definitions is merchandise that “incorporates or reflects engineering, development, art work, design work, and [or] plans and sketches provided free or at a reduced cost to the buyer and undertaken in the United States.” (U.S. Customs and Border Protection, 2006, pp. 90-91.)

### **Method # 3: Deductive Value**

This method is the third alternative after the two methods above are not able to be used. This method is based on the resale price in the United States after importation of the goods, with deductions for such items as commissions or profits and general expenses; transportation and insurance costs; customs duties and federal taxes; and the value of further processing. (U.S. Customs and Border Protections, 2006, pp. 91-94.) Generally, the appraisal begins with a unit price and then makes additions or subtractions, as outlined above. The unit price depends on the condition of the merchandise calculated from a date certain. Packing costs for the “merchandise concerned,” which is a term of art that includes the merchandise being appraised, identical merchandise, or similar merchandise, are added to the price used for deductive value, provided these costs have not been previously included. Packing costs include all containers and coverings and costs in either “labor or materials used in placing the merchandise in condition, packed ready for shipment to the United States.” (U.S. Customs and Border Protection, 2006, pp. 91-94.)

### **Method #4: Computed Value:**

If customs valuation cannot be computed on the basis of the three methods described above, computed value may be considered. Computed value consists of the sum of the cost or value of the materials, fabrication, and other processing used in the production of the imported merchandise; profit, general expenses; any “assist amounts” provided by the buyer of imported merchandise directly or indirectly, free of charge or at a reduced cost, “for use in the production or sale of merchandise for export to the United States (U.S. Customs and Border Protection, 2006, pp. 84-90); and any packing costs.

An assist includes “materials, components, parts, and similar items incorporated in the imported merchandise; tools, dies, molds, and similar items used in producing the imported merchandise; merchandise

consumed in producing the imported merchandise; and engineering, development, artwork, design work, and plans that are undertaken outside the United States.” (U.S. Customs and Border Protection, 2006, pp. 84-90.)

Hoechman, English, and Mattoo (2002) note that the WTO established a basic framework for trade policies and is mainly concerned with setting the “rules” of international trade policy. They outline five principles that are of particular importance in understanding both the pre-1994 GATT and the WTO that relate to the issues of tariffs, valuation, and classification in international trade:

### **3. Non-Discrimination**

#### **The WTO Is Based on Two Major Components**

The “most favored nation” (MFN) concept and according imports “national treatment” with regard to goods, services, and intellectual property. Application of the MFN principle requires that a WTO member must apply the same conditions on all trade with all WTO members once a condition is according bilaterally with an individual nation. Kokaram (2004, p. 69) notes that “The Most Favoured Nation rule requires that a product made in one member country is treated no less favourable than a “like” (very similar) good that originates in any other country. This basic pillar allows for equity among larger and smaller nations and theoretically puts them on the same level.” [The text of the MFN principle may be found in Appendix I.] In a practical sense, a WTO member has to grant the most favorable conditions under which it allows trade in a certain product type or service to all other WTO members. National treatment means that imported goods should be treated no less favorably than domestically produced goods, in relation to non-tariff barriers to trade.

#### **Reciprocity**

Reciprocal negotiated concessions will assure that “real progress will materialize with relation to important international issues.” The principle of reciprocity requires that all participating countries offer to reduce some of their own import barriers or export subsidies in exchange for comparable steps by their negotiating partners.

Binding and enforceable commitments or contracts. The tariff commitments made by WTO members in multilateral trade negotiations are then enumerated in a schedule (list) of concessions. These schedules establish “ceiling bindings.” (Kokaram, 2004.). A country can only change its bindings after negotiating with its trading partners. A change may mean that a nation may be required to compensate another country for a loss of trade. **If satisfaction is not obtained on a bilateral basis, the complaining country may invoke the WTO dispute settlement procedures (Kogan, 2013; Hunter & Lozada, 2010, pp. 15-16) in order to resolve an outstanding issue or dispute.**

Transparency. WTO members are required to publish their trade regulations and tariffs, to establish institutions or bodies which provide for a “systematic review of administrative decisions affecting trade, to respond to requests for information by other members, and to notify the WTO when there are changes to trade policies.”

Safety valves or exceptions. There are “special circumstances” under which a government is able to enact measure which may restrict trade. The WTO has established rules which permit members to enact measures to protect the environment, public health, animal health, and plant health. (E.g., Hunter & Blodgett, 2010.)

### **4. Non-Tariff Barriers**

Non-Tariff Barriers (NTBs) generally refer to “restrictions that result from prohibitions, conditions, or specific market requirements that make importation or exportation of products difficult and/or costly.” (CES (COMESA, EAC, and SADC), 2014.) NTBs may also arise from the unjustified and/or the improper application of certain Non-Tariff Measures (NTMs), such as sanitary and phytosanitary (SPS) measures (measured designed to control diseases in plants) and other technical barriers to trade (TBT).

NTBs arise from measures taken by governments and other regulatory authorities in the form of laws, regulations, policies, procedures, conditions, restrictions, or specific requirements, and private sector business practices or prohibitions that protect domestic industries from foreign competition.

An exhaustive list of potential non-tariff measures or barriers has been provided on the website of a regional economic organization in Africa consisting of twenty-six individual countries and which is comprised of the following organizations: Common Market for Eastern and Southern Africa (COMESA), East African Community (EAC), and Southern African Development Community (SADC) (CES, 2014). These barriers are not particular to any one region or trading relationship and may include:

- Import bans
- General or product-specific quotas
- Complex/discriminatory Rules of Origin
- Quality conditions imposed by the importing country on the exporting countries
- Unjustified Sanitary and Phytosanitary conditions
- Unreasonable/unjustified packaging, labeling, product standards
- Complex regulatory environment
- Determination of eligibility of an exporting country by the importing country
- Determination of eligibility of an exporting establishment (firm, company) by the importing country.
- Additional trade documents like Certificate of Origin, Certificate of Authenticity, etc.
- Occupational safety and health regulations
- Employment law
- Import licenses
- State subsidies, procurement, trading, state ownership
- Export subsidies
- Fixation of a minimum import price
- Product classification
- Quota shares
- Multiplicity and Controls of Foreign exchange market
- Inadequate infrastructure
- "Buy national" policy
- Over-valued currency
- Restrictive licenses
- Seasonal import regimes
- Corrupt and/or lengthy customs procedures

UNCTAD (2009) notes that non-tariff measures (NTMs) generally include measures adopted other than customs tariffs that have an economic effect on international trade in goods. NTMs affect the quantities of goods available or traded in international markets, or changes in prices or both. The detailed classification of NTMs by the United Nations Conference on Trade and Development (UNCTAD) identifies and distinguishes among the various forms of non-tariff measures.

“The UNCTAD classification of non-tariff measures is taxonomy of all those measures considered relevant in today’s situation in international trade.” (CES, 2014.) The classification adopted by UNCTAD comprises both technical and non-technical measures, such as sanitary or environmental protection measures, technical barriers to trade or TBTs, and other strategies or practices traditionally identified as instruments of a nation’s commercial or trade policy, such as “quotas, price control, exports restrictions, or contingent trade protective measures, as well as other behind-the-border measures, such as competition, trade-related investment measures, government procurement or distribution restrictions.” (CES, 2014.)

The classification of non-tariff measures encompasses 16 chapters (A to P), and each individual chapter is further divided into groupings with depth up to three levels:

- A: Sanitary and Phytosanitary Measures (of, relating to, or being measures for the control of plant diseases especially in the agricultural sector);
- B: Technical Barriers to Trade;
- C: Pre-Shipment Inspection and other Formalities;
- D: Contingent Trade-Protective Measures;
- E: Certain Non-Automatic Licensing, Quotas, Prohibitions and Quantity Measures;
- F: Price-Control Measures, Including Additional Taxes and Charges
- G: Finance Measures;
- H: Measures Affecting Competition;
- I: Trade Related Measures;
- J: Distribution Restrictions;
- K: Restrictions on Post Sale Services;
- L: Subsidies
- M: Government Procurement restrictions;
- N: Intellectual Property;
- O: Rules of Origin;
- P: Export Related Measures.

(United Nations Conference on Trade and Development (UNCTAD), 2012.)

### **Quantitative Non-Tariff Barriers**

This section will provide a close look at import quotas, numerical export controls, and other common NTBs. As presciently noted by Professor Bhala (1995, p. 3), it was certainly recognized as early as 1995, the year of the founding of the WTO, that “Nontariff barriers are what matter in late twentieth and early twenty-first century international trade law, leaving protectionists with few remaining weapons to achieve their goals.”

An import quota is a numerical limitation on the amount of a good that may be imported into a country during a specified period of time. Quotas have been a traditional tool adopted in order to protect industries or particular products—most especially agricultural products, textiles, and automobile production. A tariff rate quota (TRQ) imposes a low tariff on a limited amount of the importation of a specified good; however, above that amount, the TRQ imposes what some might argue is a prohibitively high tariff on the good which effectively limits its importation.

The United States Code, Sections 2251(a) (1982 and Supp. 1985), permits the President to take action if an article being imported into the U.S. at increased quantities injures or threatens to injure a domestic industry. (Generally, Ryan, 2012.) [Appendix II contains the text of the authority granted to the President.]

An import quota or a TRQ may be of benefit to a domestic producer, but will often have a negative impact on consumers who are forced to pay higher prices for the protected good no longer threatened with price competition from an imported product.

A country may also impose a quantitative or numerical limit on the amount of a good it exports. This limitation may found be in the form of a voluntary export restraint or VER which is an agreement by a country to limit its export of a good to a specified country to either a predetermined amount or to a stipulated percentage of a market. Fu and Ho (2013) report that this strategy, often seen as a tool in the process of managed or “strategic trade,” may be employed in order to avoid a more costly and disruptive trade conflict with a trading partner. One prominent example of a voluntary export agreement was that concluded by Canada and the United States in 1996 wherein Canada voluntarily agreed to limit its annual export of softwood lumber from Alberta and Quebec to a certain number measured in board feet. In return, the United States agreed that it would not open any formal investigation of its claim that Canada had been subsidizing its lumber industry for a period of five years. During this period, both sides would attempt to settle the underlying dispute—which was in fact eventually accomplished through traditional bilateral negotiations. (Lysons, 2009.)

Shivers (2014) reported that perhaps the most famous example of a VER involved the U.S. auto industry and Japan. In May 1981, during an especially dire period for the American auto industry and the U.S. economy in general, Japanese car makers agreed to limit exports of passenger cars to the United States. This “voluntary export restraint” program permitted only 1.68 million Japanese cars into the U.S. each year. The cap was raised to 1.85 million cars in 1984, and to 2.30 million in 1985, before the program was terminated in 1994. (Benjamin, 1999; Berry, Levinsohn & Pakes, 1999.)

Kobul (2010) noted that as a result of the Uruguay Round of the General Agreement on Tariffs and Trade, completed in 1994, prospective members of the World Trade Organization (WTO) agreed not to implement any new VERs and to phase out any existing VERs over a four year period. Exceptions could be granted for one sector in each importing country as a component of a “strategic trade” regime (generally, Nuesch, 2010), or for “national security” reasons. Understandably, the appreciation for VERs as a tool of governmental intervention is not universal. McGinnis and Movsesian (2000) noted ironically that, “for example, instead of pressuring the Japanese automobile industry to adopt voluntary export restraints in the 1980s, the United States could have paid cash compensation to American autoworkers. This strategy would have cost far less than the \$3 billion that American consumers ultimately spent in higher car prices.”

An embargo is a joint political-economic tactic designed to punish a political enemy in which a country imposes in an absolute ban on the exporting and/or importing of goods to or from a particular destination. In the United States, the President has the authority to regulate a “comprehensive range” of international transactions, subject to Congressional review. (House Committee on Ways and Means, 2005.) The following countries have been subjected to various types and degrees of embargoes by the United States: Burma (1997), Cuba (1962) (Manchak, 2010; Gordon, 2012), Iran (1979) (Schwartz & Donaldson, 2010), North Korea (1950), Sudan (2002), and Syria (1986).

In pursuing an embargo strategy, sanctions may play an important role and may also be imposed by a government. Countries may be subjected to economic sanctions for a variety of reasons, the most prevalent being supporting acts of international terrorism (Cuba, Iran, Sudan, and Syria); nuclear arms proliferators (Iran, North Korea, Syria), and violators of international human rights standards (Syria, Burma, Cuba, Iran, North Korea (Cooper, 2014). Examples of sanctions imposed by the United States in the past have included:

- No arms-related exports;
- Controls over dual-use exports;
- Restrictions on economic assistance;
- Financial restrictions, such as:

- Requiring the United States to oppose loans by the World Bank and other international financial institutions;
- Diplomatic immunity waived to allow families of terrorist victims to file for civil damages in U.S. courts;
- Tax credits for companies and individuals denied for income earned in listed countries;
- Duty-free goods exemption suspended for imports from those countries;
- Authority to prohibit a U.S. citizen from engaging in financial transactions with the government on the list without a license from the U.S. government; and
- Prohibition of Defense Department contracts above \$100,000 with companies controlled by countries on the list. (Department of State, 2009.)

More recently, Strybel (2014) reports that Russia announced an embargo of fruits and vegetables, meat, fish, dairy, and vegetable oils against the European Union, the United States, Canada, Australia, and Norway in retaliation for actions taken against Russia in connection with the Ukrainian crisis.

In some cases, a nation will also initiate export controls on their own production for certain goods on their own initiative without pressure being exerted by a trading partner. Bhala (2008, pp. 606-607) notes that these controls are generally advanced to serve three policy purposes: “protect commodities in short supply; protect national security; and advance U.S. foreign policy interests.” These controls are not generally considered in a discussion of non-tariff barriers since they are self-executing.

## **5. Non-Quantitative Non-Tariff Barriers**

Many of the non-quantitative non-tariff barriers are deeply rooted in the bureaucratic and regulatory environment of a nation. As a result, they may be much more difficult to ascertain, prove, challenge, and eventually eliminate.

Griffin and Pustay (2002, pp. 233-236) have identified that among the more prevalent of these non-quantitative NTBs are the following:

### **Product and Testing Standard**

a requirement that foreign goods must meet a country’s product standards or testing regime before they can be sold in that country. As noted by ARSO Disnet (2014), the phrase “technical barriers to trade” refers to “the use of the domestic regulatory process as a means of protecting domestic producers which seeks to assure that: (1) Mandatory product regulations, (2) Voluntary product standards, and (3) Conformity assessment procedures... do not become unnecessary obstacles to international trade and are not employed to obstruct trade.”

### **Standards New Zealand (2014) notes**

“Technical regulations and product standards may vary from country to country. Having many different regulations and standards makes it difficult for producers and exporters, not least because the compliance associated with meeting different regulations and standards soon add up. If regulations are set arbitrarily, they could be used as an excuse for protectionism.” There are, however, legitimate reasons—besides protectionism—for a nation establishing product and testing standards. ARSO Disnet (2014), an organization that specializes in the area of testing and testing standards in Africa, reports that standards-related measures may help “ensure the connectivity and compatibility of inputs in different markets; manage the flow of product-related information through complex and increasingly global supply chains; organize manufacturing or other production processes around replicable routines and procedures to yield greater product quality assurance; achieve important regulatory and societal objectives such as ensuring safety, preventing deceptive practices, and protecting the environment; and promote more environmentally-sound or socially-conscious production methods.”

In 1995, the WTO established the Agreement on Technical Barriers to Trade (TBT) which contains specific obligations that seek to “ensure that regulations, standards, testing and certification procedures do not create unnecessary obstacles to trade.” (Standards New Zealand, 2014.) Under this agreement, member nations are required to notify the WTO when any proposed measures could constitute a technical barrier to trade. Kogan (2013) quotes from an Appellate Body Report of the WTO and notes: “The object and purpose of the TBT Agreement is to strike a balance between, on the one hand, the objective of trade liberalization and, on the other hand, Members’ right to regulate.” He continues: “One of the TBT Agreement’s primary objectives is to prevent WTO Members from using regulations as unnecessary barriers to trade while ensuring that they retain their sovereign right to regulate for the protection of human, animal or plant life or health, of the environment, or for the prevention of deceptive practices, at the levels [they] consider appropriate.”

In the United States, each year the office of the United States Trade Representative publishes a Report on Technical Barriers to Trade (2014b). The report considers issues relating to whether standard-related measures are “outdated, overly burdensome, discriminatory, or otherwise inappropriate, these measures can reduce competition, stifle innovation, and create unnecessary technical barriers to trade.” Currently, the United States has identified and described “significant standards-related barriers” facing U.S. exporters in 16 countries: Argentina, Brazil, China, Chile, Columbia, Ecuador, India, Korea, Malaysia, Mexico, Peru, Saudi Arabia, Taiwan, and Turkey—as well the European Union. The Report is updated on a regular basis.

### **Restricted Access to Distribution Networks**

for example, requiring retail distribution of merchandise to be provided only by local (national) companies or individuals (Indonesia); limitations on the distribution of movie prints imported into a country and limits on the number of “screens” in theaters which can show a film (Taiwan); or requiring certain designated intermediaries to handle product lines (Japan).

A prominent example may be found in the Japan-Film case (WTO, Panel Report, 1998; Roland, 2014, pp. 382-383), which “involved a number of ‘administrative guidance’ measures enacted by Japan to regulate retailing and promotional practices aimed at consumers (including discounts, rebates, lotteries and other prize offers), but resulted in decreased distribution of foreign photographic film. The measures, which were technically not all binding on retailers and industry, but which in practice heavily influenced distributors, were found to be in violation of the GATT.”

Mintz (2012) commented on a situation regarding Canadian power generation and its electrical market and posits that distribution restrictions may be more prevalent in an economy that is “generally state-owned.” Surprisingly, however, Cunningham (2012) has reported that China has in fact begun easing regulatory restrictions with regard to distribution rights and that “both foreign and domestic media and entertainment companies are in a position to make new inroads into this extremely promising market.” This would be a most welcome turn-of-events kin international trade if the pattern continued to develop in other areas.

### **Public Sector Restraints and Procurement Policies**

Policies that give preference to domestic firms or policies that include “capricious and arbitrary changes in existing government policies, discriminatory taxation, regulatory takings, passing new laws making previously acceptable actions now illegal, requiring local ownership, or mandating joint ventures favoring local companies in a discriminatory manner.” (Singham & Sokol, 2004.) For example, many federal, state, or local governments engage in what are termed “Buy American” campaigns when using taxpayer monies; the city of Los Angeles “biased its procurement of mass transit equipment in favor of U.S. producers (Griffin & Pustay, 2002, p. 234; Wall Street Journal, 1992); the federal government requires that international air travel purchased with taxpayer dollars occur on U.S. carriers.

Internationally, Japan has consistently favored Japanese construction firms bidding on public construction projects in Japan. Brazil established criteria for preferential treatment that include a cost preference of up to 12 percent. Singham and Sokol (2004) have identified major issues in government software procurement. As in issues relating to restrictive distribution networks, these policies may be more

successful in a large state-run economy or one in which state-owned-enterprises predominate in the national economy.

Singham and Sokol (2004, p. 645) summarize the issue quite well: “It is public sector restraints that harm trade, affecting the welfare of all people. The pernicious nature of anticompetitive regulations lies in their ability to exist under the radar of our common-sense trade liberalization horizon. Left alone, these restraints will hinder competition and innovation. This is a cost that will be accrued by people at every level of consumption for the benefit of entrenched local elites who lobby their governments so as to extract rents. In order to extend the benefits of competition and innovation to everyone, it is essential to address and reduce public sector restraints.”

### **Local Purchase Requirements**

Oftentimes, host governments will require firms to purchase goods or services from local suppliers. Examples are found in China (electrical equipment), Russia (oil equipment), France (exhibiting films, songs played on radio stations), and generally throughout the EU (entertainment programming requirements). (Wall Street Journal, 1989.) Several Bilateral Investment Treaties or BITS now forbid the imposition of local purchase requirements on a foreign investor once the investment agreement has been entered into (Jarreau, 2004), but the practice remains as a significant non-tariff barrier.

### **Regulatory Controls**

Adoption of policies that impact on foreign competition through such practices as “conducting health and safety inspections, enforcing environmental regulations, requiring firms to obtain licenses before beginning operations or constructing new plants, and charging taxes and fees for public services....” (Griffin & Pustay, 2002, pp. 234-235.) Many of these issues are similar to those raised in the discussion of product and testing standards, found above, since they arise from government regulatory practices or administrative rule-making authority.

### **Currency Controls**

Common forms of foreign exchange controls include banning the use of a foreign currency within the country; banning local citizens from possessing foreign currency; restricting currency exchange to government-approved exchangers; fixed exchange rates; and restrictions on the amount of currency that may be imported or exported. (Foreign Exchange Controls, 2013.) One of the most prominent countries which rigidly control its currency is China, giving it an enormous advantage in international trading and financial relations. (Kong, 1999; Schill, 2007.) Based upon the Economist’s 2014 “Big Mac Index,” China’s advantage may extend to more than 40 percent. (Economist, 2014.)

Countries which undertake exchange controls are also known as “Article 14 countries” (Simmons, 2000), after the provision in the International Monetary Fund agreement which allows for exchange controls for transitional economies—generally countries that are moving from a central-planning, command-and-control model to come variant of a market economy. (Hunter, Ryan & Shapiro, 2003.) The text of the IMF agreement relevant to issues surrounding currency controls reads as follows:

#### **Section 1. Notification to the Fund**

“Each member shall notify the Fund whether it intends to avail itself of the transitional arrangements in Section 2 of this Article, or whether it is prepared to accept the obligations of Article VIII, Sections 2, 3, and 4. A member availing it of the transitional arrangements shall notify the Fund as soon thereafter as it is prepared to accept these obligations.”

#### **Section 2. Exchange Restrictions**

“A member that has notified the Fund that it intends to avail itself of transitional arrangements under this provision may, notwithstanding the provisions of any other articles of this Agreement, maintain and adapt to changing circumstances the restrictions on payments and transfers for current international transactions that were in effect on the date on which it became a member. Members shall, however, have

continuous regard in their foreign exchange policies to the purposes of the Fund, and, as soon as conditions permit, they shall take all possible measures to develop such commercial and financial arrangements with other members as will facilitate international payments and the promotion of a stable system of exchange rates. In particular, members shall withdraw restrictions maintained under this Section as soon as they are satisfied that they will be able, in the absence of such restrictions, to settle their balance of payments in a manner which will not unduly encumber their access to the general resources of the Fund.”

In some developing nations, exporters are permitted to exchange foreign currencies at favorable rates while importers are required to purchase foreign exchange from the central bank at unfavorable exchange rates. (Obstfeld, Shambaugh & Taylor, 2005) Syria, for example, took the process to an entirely different level: it established five official and two unofficial exchange rates. In the 1990s, several other countries used dual or multiple exchange rate systems. They included Cambodia, Guinea-Bissau, Iran, Nigeria, and Zambia. (International Monetary Fund, 1997)

### **Investment Controls**

Nations will frequently place controls on foreign investment and ownership, most especially in certain “strategic industries” such as broadcasting, telecommunications, utilities, air transportation, industries heavily involved in issues relating to intellectual property, defense-related industries, and financial services.

Many investment controls occurred in the context of efforts to privatize industries in a formerly state-controlled economy in the early 1990s. (Generally, Drobak, 2006.) Hunter (2007) reported that government-induced barriers to privatization discouraged or prevented foreign participation or investment in a domestic market. In adopting various restrictions, a government often insisted on maintaining a perpetual controlling interest or a veto power over decision-making even after an initial transitional period.

Russia provides an interesting example. Pulec (2012, p. 510) notes: “The Russian government's desire to have a controlling hand in industry, and particularly strategic industry, is clear: foreign investment in Russian companies is strictly controlled and often entirely disallowed for corporations controlling strategic resources, and Putin himself chairs the committee that oversees foreign investment in light of national security.” Griffin and Pustay (2002) report that Poland had initially limited foreign ownership in broadcasting and fisheries to 49 percent; the Philippines restricted foreign ownership rights in advertising to 30 percent and in public utilities to 40 percent; and Indonesia limited foreign ownership in radio and television broadcasting, forestry, and film and video distribution. As a nation develops its privatization process, it will often ease or completely eliminate these investment restrictions, as has been the case in Poland in implementing its successful mass privatization program. (Hunter & Ryan, 1998, Chapter Seven, pp. 139-159; Hunter & Ryan, 2013.)

This strategy has also involved the creation of the “Golden Share” or the conferring of “special rights” on domestic entities. According to Nourry and Jung (2012, p. 15), “Goldenshares are one of the most commonly used types of special rights, enabling the government to veto specific events or changes in the company's structure. They are usually enshrined in the articles of association of the company and cannot be changed without the government's consent. Special rights may also be conferred on governments by legislation, either under a general framework law covering several economic sectors or specific legislation aimed at an economic sector or a company. Governments may also seek to assert special rights over companies that are awarded concession contracts to provide services of general interest (e.g., in the gambling and broadcasting sectors).”

The existence of the “golden share” is now problematic in light of both European Union and World Trade Organization policies. (Blodgett, Hunter & Hayden, 2009, p. 222, note 89.) As Thomas (2012, p. 356, note 29) states: “to a large extent, golden shares have been outlawed in the European Union,” and may be subjected to phase-out or transitional time agreements. The “golden share” has also been the subject of intense bilateral negotiations, for example, between the United States and China. (Gerber, 2013.)

In practical terms, the “golden share” may discourage companies from transferring new technologies to industries in nations that have adopted such restrictions. It has also made it difficult to replace ineffective

managers who had political connections. Difficult decisions were often impossible to take, especially in reducing or eliminating redundant or inefficient employment in industries where unions or workers' trade associations were especially strong. However, while investment control strategies may have served to discourage foreign investment and entrepreneurship, they may have been the "easiest" political course for a fragile (or unpopular) government under pressure by populist or nationalistic interests who often railed against selling-off of national property, especially to "foreign interests."

## **6. Conclusions or Observations**

While it is certainly true that tariffs have steadily declined as a revenue source, especially for developed national economies, NTBs have become the focus of activity as a nation seeks to protect its indigenous industrial or service base. The list of NTBs has continued to be a flash point in relations between sovereign states which, while attempting to promote and protect its own nation's trade and commerce, at the same time are seeking to penetrate into a foreign market where barriers have been installed, in order to assure a "level playing field" in an environment that is less than level.

With the advent of the WTO, it has become more difficult for a nation to continue to enforce standards and practices that thwart competition in international trade. While the emphasis may have dramatically shifted from a tangible tariff model to a more subtle form of protectionism, the stakes remain high in a truly globalized economy.

## **Appendix I: Most Favored Nation**

"Any advantage, favor, privilege or immunity granted by any member to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other members."

## **Appendix I I: Presidential Authority**

Sec. 2251. Action to facilitate positive adjustment to import competition

(a) Presidential action

If the United States International Trade Commission (hereinafter referred to in this part as the "Commission") determines under section 2252 (b) of this title that an article is being imported into the United States in such increased quantities as to be a substantial cause of serious injury, or the threat thereof, to the domestic industry producing an article like or directly competitive with the imported article, the President, in accordance with this part, shall take all appropriate and feasible action within his power which the President determines will facilitate efforts by the domestic industry to make a positive adjustment to import competition and provide greater economic and social benefits than costs.

(b) Positive adjustment to import competition

(1) For purposes of this part, a positive adjustment to import competition occurs when

(A) the domestic industry

(i) is able to compete successfully with imports after actions taken under section 2254 of this title terminate, or

(ii) the domestic industry experiences an orderly transfer of resources to other productive pursuits; and

(B) dislocated workers in the industry experience an orderly transition to productive pursuits.

(2) The domestic industry may be considered to have made a positive adjustment to import competition even though the industry is not of the same size and composition as the industry at the time the investigation was initiated under section 2252 (b) of this title.

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