A Proposed Code to Discipline Local Content Requirements

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Proponents of liberalized trade and finance were relieved when the global economic crisis in 2008 produced a broad range of pledges from countries around the world to avoid new barriers to trade and investment (see Evenett 2013). These promises, designed to avert a replay of the Great Depression of the 1930s, were largely honored when it came to classic forms of protection (tariffs and quotas). But the spirit of that pledge was violated as countries shifted from traditional forms of protection to behind-the-border nontariff barriers (NTBs), including local content requirements (LCRs)—policies mandating that local suppliers of goods, services, and even entire projects be favored by governments and private firms, even when foreign firms offer lower costs, better quality, and faster delivery.

This Policy Brief builds on an earlier Peterson Institute study—Local Content Requirements: A Global Problem (Hufbauer et al. 2013)—that analyzed the scope of new LCR practices and estimated their collective impact on global trade. Identifying the scope of the LCR problem is an important step to curbing their use. Equally important is designing effective policy constraints. This Policy Brief addresses the second challenge.

A number of World Trade Organization (WTO) agreements appear to discipline the use of LCRs, but the rules are neither comprehensive nor effectively enforced. Even though LCRs flout the spirit of multilateral agreements, they have been challenged in only three cases brought in the WTO.

After sketching the background and existing WTO rulebook of disciplines, this Policy Brief recommends a new WTO code that would help constrain the use of LCRs. The proposal aims to address the three leading problems that undermine existing disciplines: gaps in the current multilateral rulebook, weak surveillance, and inadequate enforcement. The main features of the new code would expand coverage of LCRs on services as well as goods, enhance transparency, expedite dispute resolution, and impose penalties for noncompliance. We envision the LCR code as a new plurilateral agreement that would bind only countries that voluntarily join. It should be negotiated in the medium term as part of post-Bali WTO negotiations.

LOCAL CONTENT REQUIREMENTS SINCE 2008

LCRs are not new, although the use of behind-the-border NTBs to achieve localization objectives has become more frequent over the past decade. In fact, it would be fair to characterize the tariffs levied by English and French monarchs of the 16th century as the LCRs of that era.

The shift from conventional trade barriers to unconventional ones like LCRs has been widely acknowledged by the trade community. In part, this trend results from well-established institutional constraints on tariffs and quotas, but it also reflects the perception that NTBs offer greater policy flexibility (Deardorff and Stern 1997). More than 100 LCRs have been proposed or implemented since 2008, according to our broad survey (Hufbauer et al. 2013), reducing global trade by about $93 billion annually.

Historically, LCRs have been associated with government procurement and mandates attached to publicly financed projects. But LCRs can take many forms, including price preferences awarded to domestic firms that bid on government procurement contracts, mandatory minimum percentages required for the domestic goods and services used in production, import
licensing procedures designed to discourage foreign suppliers, and discretionary guidelines that both encourage domestic firms and discourage foreign firms. Many governments and trade officials classify these practices collectively as “localization barriers” to trade.¹ Our analysis takes into account this broad classification of LCRs as they relate to government procurement; market access conditions for foreign direct investment; the receipt of government subsidies, financing, or other preferences; the forced transfer of technology and intellectual property; and offsets that aim to advantage local firms.

**Localization can be an acceptable and even welcome strategy for foreign firms on their own initiative—but not when it is unilaterally imposed to benefit preferred domestic industries.**

Examples from our survey include Nigeria’s Oil and Gas Content Development Act of 2010, which entails comprehensive use of LCRs through mandates that Nigerian firms receive first consideration in the award of oil blocks and oil-lifting licenses and that indigenous services suppliers and employees receive exclusive consideration.² India’s Jawaharlal Nehru National Solar Mission serves as another example. Under this initiative, the Indian government extended feed-in tariffs and power purchase agreements to solar developers under the condition that solar photovoltaic projects use cells and modules manufactured in India, with some exceptions.³

But LCRs are not limited to developing countries: Buy America policies in the United States as part of the American Recovery and Reinvestment Act (ARRA) of 2009 required that all iron and steel procured using ARRA stimulus funds be produced domestically. Similar policies have been adopted since the Great Recession.

Indeed, the survey of new LCR measures reveals use in both developed and developing economies and across all types of industries, including agriculture, automobiles, and health care, with particularly frequent use in certain sectors, such as energy and information technology. Of the 117 LCR measures identified since 2008, more than a dozen involved LCRs directly or indirectly attached to renewable energy policies, and another dozen involved restrictions on the cross-border flow of data (namely, the requirement that firms locate servers or complete data analysis within a host country) (Hufbauer et al. 2013).

Localization can be an acceptable and even welcome strategy for foreign firms on their own initiative—but not when it is unilaterally imposed to benefit preferred domestic industries. Establishing linkages to local firms and building local capacity can be cost-effective, promote the integration of supply chains, and encourage social and economic development. However, foreign firms are much better than government officials at determining when localization makes sense.

The most common rationale for the recent crop of LCRs is that they create highly visible jobs for local constituents. Other rationales include the infant industry argument (the idea that nascent industries should be afforded temporary protection in order to become competitive), especially for renewable energy projects, and concerns about data privacy—namely, the notion that countries should restrict the location of data servers and data analysis conducted by foreign firms (these arguments were amplified by Edward Snowden’s revelations about the collection methods of the US National Security Agency). Dani Rodrik (2007), a leading scholar, argues that the use of LCRs—though contrary to the agenda of more liberal trade and investment—forms an integral part of the “policy space” that developing countries should be afforded for pursuing their development goals.

But LCR measures often impose high economic costs and have uncertain effects. Box 1 summarizes the problems identified in the Peterson Institute report (Hufbauer et al. 2013). For this reason, the spread of LCRs has drawn the attention of international forums, which have begun considering whether new disciplines on such practices would be desirable. In 2012, the US Trade Representative (USTR) established a Trade Policy Staff Committee Task Force on Localization Barriers to Trade, with a mandate to develop a strategic approach to the LCR phenomenon. The Asia-Pacific Economic Cooperation (APEC) countries flagged LCRs as a continuing agenda item at their Senior Officials Meeting in April 2013. These and other dialogues highlight LCR practices and, in the words of the USTR Office, “encourage trading partners to pursue policy approaches that help their economic growth and competitiveness without discriminating against imported goods or services.”⁴

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² See appendix A in Hufbauer et al. (2013) for a comprehensive overview of recent LCR cases.

³ Feed-in tariffs have become a common policy tool for encouraging the development of renewable energy capacity. Governments offer long-term contracts for developers and a higher set price for renewably generated electricity. A troubling feature of many of these programs—such as the programs in India and Canada—is the coupling of these incentives with LCRs to develop local manufacturing capacity.

Alternative Policies

The Peterson Institute book *Local Content Requirements: A Global Problem* (Hufbauer et al. 2013) argues that governments should consider alternatives to LCRs that can deliver jobs and growth at less cost to the economy. Such alternatives include measures to promote a business-friendly climate and foster corporate social responsibility norms that encourage transactions with local suppliers, better and larger training programs, improved logistics to cut transaction costs, and a sharp boost in infrastructure investment financed by user fees. These alternative policies would create a business environment that attracts investment and encourages multinational firms to engage in localization strategies without crossing the line to forced localization.

We recognize that governments may not have the imagination or political determination to implement better alternatives and may thus continue to opt for traditional protectionist measures. In that event, it would still be better if they provided greater disclosure of LCRs, to ensure that costs can be easily calculated rather than hidden “off budget.” A more open administration of LCRs would also be less prone to corruption.

Countries that adopt LCRs should adhere to certain agreed upon standards, such as using classic price preferences (e.g., allowing a local supplier to be awarded the contract as long as its price does not exceed the most competitive foreign bidder by more than a fixed percentage, say 25 percent). It would also help if countries could agree that LCRs apply only to a narrowly defined set of products or projects. They should not entail quantitative restrictions or employ opaque discretionary guidelines (e.g., product registration and approval processes, import license procedures) that make it much more costly for multinationals to do business, thereby forcing them to localize economic activity.

Domestic subsidies breach WTO obligations only when they cause adverse effects to the commerce of another WTO member. In practice, few domestic subsidies ever reach this threshold. Instead of LCRs, countries should provide direct subsidies to domestic firms on a time-limited basis. Such subsidies would compel governments to disclose the costs of LCRs to their publics.

Without violating their WTO obligations, governments can impose higher tariffs to protect preferred industries rather than adopt LCRs. Many developing countries maintain a sizable gap between bound and applied tariffs in their WTO schedules, for example, and can raise their applied tariffs to the bound levels. If a country breaks its bound tariff level, it should offer compensation to its trading partners, in the form of lower duties on less sensitive products.

The World Trade Organization’s Rulebook

The WTO rulebook on LCRs consists of provisions within the General Agreement on Tariffs and Trade (GATT), the

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5. For more detail on these measures, see Hufbauer et al. (2013, chapter 2 ["Alternatives to Local Content Requirements"]).
Government Procurement Agreement (GPA), the Agreement on Trade-Related Investment Measures (TRIMs), and the Agreement on Subsidies and Countervailing Measures (ASCM). WTO rules have proven most effective when LCRs violate the GATT obligation of national treatment in cases where procurement commitments are covered by the GPA. They also violate investment rules when LCRs are attached to investment incentives in contravention of the TRIMs agreement.

In practice, existing rules have not stopped the proliferation of forced localization measures; only a few cases that challenge LCRs have been lodged in the WTO’s Dispute Settlement Body. Regional trade agreements (RTAs) seldom offer safeguards against LCR practices beyond the existing WTO rulebook, and RTA dispute settlement provisions are generally weak.

Creative trade policy officials can exploit gaps in the restrictions on LCRs governed by existing rules in the WTO and some free trade agreements. Equally important, the rules have not been vigorously enforced, partly because it can be expensive to bring cases through dispute settlement procedures and partly because countries may refrain from highlighting foreign abuses that are similar to policies they practice at home.

But many steps can be taken to limit the use of LCRs. Before describing them, we first summarize the existing disciplines on LCRs to provide context for why they have provided only limited protection against LCRs. The appendix provides the full text of the relevant WTO language cited here.

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6. The most recent cases include the following: (1) in November 2012, China requested consultations with the European Union regarding LCRs that affect renewable energy generation as a byproduct of feed-in tariff programs of EU member states; (2) in February 2013, the United States requested consultations with India concerning LCRs and subsidies for solar energy; and (3) in May 2013, the WTO Appellate Body ruled with the European Union and Japan that LCRs attached to Canada’s feed-in tariff program for the wind sector violated WTO obligations under GATT and TRIMs.

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7. John Jackson, a leading scholar of GATT jurisprudence, contends that government procurement was also excluded from the obligation of most favored nation treatment set forth in Article I (Jackson 1969). His view is widely accepted.

8. GATS Article XIII(2) does establish a mandate that "there shall be multilateral negotiations on government procurement in services under this Agreement within two years from the date of entry into force." Discussions to develop these obligations have been ongoing, but to date unproductive (see WTO Negotiations on GATS Rules, www.wto.org/english/tratop_e/serv_e/gats_rules_negs_e.htm [accessed on November 12, 2013]).
and LCRs often accompany procurement policies, these exclusions potentially affect a substantial volume of trade.

WTO Government Procurement Agreement

The GPA applies only to its 42 signatories. GPA members schedule specified federal and subfederal agencies; firms in other GPA members are eligible to bid for those agencies’ procurement contracts. By design, scheduled agencies cannot give preferences to domestic suppliers or engage in LCRs. GPA Article XVI (Offsets) prohibits governments agencies from selecting suppliers or awarding contracts using measures, such as LCRs, that aim to encourage local development.9

However, members’ schedules do not cover many government agencies (such as state and local governments), and they contain numerous exceptions, opening a huge loophole for LCRs. Furthermore, government procurement has generally avoided WTO scrutiny over discriminatory practices: the attempt to separately negotiate disclosure and transparency rules as part of the Doha mandate ended in failure in 2003.10 The GPA has been expanded more than once since it was inaugurated in 1979.11 Nevertheless, the current agreement has only limited impact on procurement that is conditioned by LCRs.

Many developing countries are simply “observers” to the GPA, without adhering to its rules.12

9. Paragraph 2 of Article XVI does allow for exceptions for developing countries to negotiate conditional use of LCRs if such requirements are “used only for qualification to participate in the procurement process and not as criteria for awarding contracts” and are nondiscriminatory (see Agreement on Government Procurement, Article XVI, available at www.wto.org/english/docs_e/legal_e/gpvr94_02_e.htm#articleXVI [accessed on November 12, 2013]). Article V establishes more specific terms of special and differential treatment for developing countries.

10. The agreement was intended to address transparency in government procurement procedures rather than entail market access commitments or restrict a country’s use of preferences for domestic suppliers. After members were unable to overcome differences and launch negotiations during the Fifth WTO Ministerial in Cancun, a decision by the WTO in 2004 officially struck the issue from the Doha working program. The benefits associated with transparency rules in procurement include greater efficiency, competitiveness, and innovation; encouragement of foreign investment and partnerships with local suppliers; reduced corruption; reinforcement of good governance; and promotion of the legal certainty of procurement procedures, among others (see WTO 2003, 2–3).

11. The first GPA was signed in 1979, as part of the Tokyo Round. An enlarged GPA was signed in 1994, as part of the Uruguay Round. Further enlargement of the GPA is under discussion as part of the Doha Round, although members were unable to ratify the deal in time for the Bali Ministerial held in December 2013. See “Revised GPA Will Not Enter into Force by Bali due to Ratification Shortfall,” Inside US Trade, November 4, 2013, www.insidetrade.com (accessed on November 5, 2013).

12. Twenty-seven countries are observers to the GPA, of which 10, including China, are currently negotiating accession to the agreement. See “Parties and Observers to the GPA,” www.wto.org/english/tratop_e/gpvr_e/memobs_e.htm (accessed on November 12, 2013).

WTO Agreement on Trade-Related Investment Measures

The TRIMs agreement contains strong language that seems to prohibit certain LCRs in the form of performance requirements (e.g., mandatory local procurement of parts and components) relating to foreign investment. An “illustrative list” in an annex to the agreement provides detail on LCRs and other measures that are inconsistent with TRIMs obligations (see the appendix for a comprehensive list).

TRIMs provisions have been enforced in select cases.13 In the vast majority of cases, however, when investment incentives are coupled with LCRs, complaints do not materialize, as the multinational firm receiving the incentives quietly, and perhaps gratefully, complies. Moreover, some governments do not consistently publish their performance requirements. Instead, they simply reach a private understanding with the firm.

Furthermore, the TRIMs agreement applies only to goods and not services, leaving ample room for discretionary LCRs. Countries continue to implement LCRs not only in connection with their investment incentives but also in new forms. Certain types of LCRs—namely, LCRs relating to technology transfer, intellectual property licensing,14 and localization of data centers—have become increasingly popular and escape discipline under TRIMs.

WTO Agreement on Subsidies and Countervailing Measures

The ASCM enables a WTO member to bring a case in several circumstances, including a situation in which it suffers “adverse effects” from the subsidy practices of another WTO member. A subsidy practice must fall within the meaning of ASCM Article 1, which defines a subsidy as existing if there is a financial contribution or price support given by a government that confers a benefit to domestic firms. ASCM Article 3 also explicitly prohibits subsidies of two types: subsidies that are contingent on export performance (i.e., export subsidies) and subsidies that...

13. Most notable was the automobile case against Indonesia brought by the United States, the European Union, and Japan in 1996. The Dispute Settlement Body ruled that Indonesia’s LCRs and additional taxes and charges against imported vehicles violated most favored nation treatment (GATT Article I) and national treatment (GATT Article III(2)); qualified as LCRs prohibited by Article 2 of the TRIMs; and violated Article 5(c) of the ASCM as a subsidy that caused “serious prejudice.” For a summary of the case, see “Indonesia—Certain Measures Affecting the Automotive Industry (DS54, 55, 59, 64),” 2013, WTO Dispute Settlement: One-Page Case Summaries, World Trade Organization Legal Affairs Division, www.wto.org/english/tratop_e/dispu_e/cases_e/1pagesum_e/ds54sum_e.pdf.

14. Compulsory licensing is permitted by an exception in the Trade Related Aspects of Intellectual Property Rights (TRIPS) agreement; it will continue to be used by countries like India. So far, however, compulsory licensing has been confined largely to pharmaceuticals.
are contingent on the use of domestic goods over imports (i.e., LCRs and other import substitution subsidies).

However, the ASCM provides only limited protection against LCRs because of two features. First, the definition of subsidies does not include all practices that economists might regard as subsidies. Second, for a subsidy that is not prohibited under ASCM Article 3 to be “actionable,” the complaining country must show evidence of an “adverse effect” on its domestic industry or commercial interests.\(^{15}\)

The Canada wind turbine case (WTO 2013a) is an example of the subsidy agreement’s limited protection against LCRs. In the case brought against Canada by Japan and the European Union, the WTO panel ruled that the LCR attached to Canada’s feed-in tariff program did violate nondiscrimination and national treatment obligations under GATT Article III(4) and TRIMs Article 2, but it rejected the claim that the LCR amounted to a subsidy covered under the ASCM.\(^{16}\) The majority of panelists concluded that the feed-in tariff did not confer a benefit on wind power generators (box 2). With some exceptions, the final Appellate Body report upheld the major findings of the panel but abstained from making a ruling on the subsidies analysis.

**A NEW CODE TO DISCIPLINE LOCAL CONTENT REQUIREMENTS**

In principle, many LCRs are inconsistent with WTO rules; in practice, few have been effectively challenged. A proposed new WTO code to discipline LCRs would seek to address the three leading problems that undermine existing disciplines: gaps in the multilateral rulebook, weak surveillance, and the inadequacy of enforcement.

Codes of good practice were developed to serve as guideposts for ensuring that a country’s domestic regulations and procedures do not act as barriers to trade or investment. Codes were prominent during the Tokyo Round (1973–79), seen as one of the first attempts to tackle trade barriers beyond those in the form of tariffs.\(^{17}\) A number of codes evolved out of this effort, including technical barriers to trade, import licensing, and subsidies. These codes began life in the Tokyo Round as voluntary, plurilateral codes. With modification they become binding agreements of the WTO in the Uruguay Round (1986–94).

In a similar vein, we envisage the LCR code as a plurilateral agreement, open to all WTO members that wish to become signatories. The obligations of the code would apply only to signatories, and only code members could exercise the additional rights in terms of substantive standards and enforcement mechanisms. As between LCR code members, disputes would be subject to resolution by the Dispute Settlement Body of the WTO.

**Addressing Gaps in the Current WTO Rules**

A new plurilateral agreement on LCRs would aim to narrow the gaps in WTO rules that currently allow LCRs to flourish. Such gaps exist within the GPA, TRIMs, and the ASCM.

We propose a series of articles for the LCR code based on the limitations of these WTO agreements. Future plurilateral agreements, notably the Trade in Services Agreement (TISA) and the Agreement on Environmental Goods (EGs)—two areas in which LCRs are common—could contain their own LCR disciplines, which might be generalized in an LCR code. LCR code disciplines could most feasibly be applied to new LCR practices, coupled with a positive list of “nonconforming measures” that would be subject to periodic review and an eventual sunset clause.

**Closing gaps in the Government Procurement Agreement**

The fact that government procurement is excluded from coverage under GATT Article III means that within the WTO system, only the GPA limits LCRs attached to public procurement. However, the GPA effectively covers only a small share of federal and subfederal procurement of goods and services, and only a limited number of WTO members are signatories. Furthermore, it often remains difficult for national governments to bind the practices of state and local governments. Any enlargement of GPA coverage would, as a matter of course, expand disciplines on the use of LCRs.\(^{18}\) However, many GPA members will continue to take advantage of exceptions for specific projects and agency funds, thereby maintaining the flexibility to give preferential treatment to domestic suppliers.

US practice illustrates this problem. Although the GPA schedule agreed to by the United States covers more than 80 federal entities, which administer billions of dollars in govern-

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15. A showing of “adverse effect” is the ASCM requirement for challenging most domestic subsidies. It is a much more difficult test to meet than a showing of material injury to domestic industry as a result of subsidized imports.


ment procurement, much US public expenditure remains outside GPA coverage. Under the Buy America clause, stimulus funds administered by the states generally escape GPA coverage. In principle, however, funds allocated from federal agencies to state or local governments could be conditioned on open procurement practices, precluding LCRs.

A new code would attempt to close the loopholes that perpetuate LCR practices in government procurement. As a prerequisite, it would require that LCR code members accede to the GPA, with an exception for least developed countries (LDCs).

The following articles are proposed:

- Any project administered by subfederal governments (e.g., states, provinces, cities) that is significantly financed by the federal government shall be subject to GPA obligations to the same extent they would if the project were carried out by the federal government.
- All members shall endeavor to use price preferences rather than content rules for all noncovered procurement.

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19. Buy America provisions were inserted into the American Recovery and Reinvestment Act of 2009, the central fiscal program designed to combat the Great Recession.
contracts, defined as contracts below the minimum value threshold and contracts procured by noncovered federal or subfederal entities.20

- Transparency rules related to procurement processes and practices shall apply to both federal and subfederal procurement of goods and services. Domestic and foreign suppliers of code members shall have recourse to domestic review procedures to challenge alleged breaches of transparency provisions. Technical assistance and phased-in implementation shall be afforded for LDCs. LDCs that comply with the transparency obligations of the LCR code shall be considered eligible for full rights and access to bid on procurement contracts of LCR code members under the GPA.21

Closing gaps in the Agreement on Trade-Related Investment Measures

The TRIMs agreement applies only to goods. It does not cover services, leaving ample room for discretionary LCRs. Among other gaps, new forms of LCRs related to technology transfer and data localization escape discipline under TRIMs.

A high-standard bilateral investment treaty (BIT) might resolve these problems. The US model BIT was revised in 2012 to include stronger language prohibiting performance requirements as a condition of market access, in particular for LCRs related to technology.22 If this language were accepted by an important US BIT partner, such as China, it could serve as a precedent for stronger LCR disciplines in the WTO.

The following article in the LCR code would address this problem:

- The obligations of the TRIMs agreement not to impose performance requirements as a condition of investment shall apply to services, including technology and data flows, to the same extent that they apply to goods.

Closing gaps in the Agreement on Subsidies and Countervailing Measures

The Canada wind turbine case (WTO 2013a) illustrates the legal ambiguity in determining whether support schemes with LCRs qualify as prohibited measures under the ASCM. Although ASCM Article 3 prohibits subsidies that are contingent on the use of domestic goods, a challenged LCR measure must first be proven to confer a benefit within the meaning of the agreement. In the Canadian case, the unresolved issue was determining whether the feed-in tariff program with LCRs conferred a benefit on domestic wind power generators. Benefit analysis is clouded when, as in the wind turbine case, the burden is placed on the complainant to prove a benefit.

The LCR code should state that support schemes with LCRs attached are actionable unless the respondent can prove the absence of a benefit. Going beyond ASCM Article 3, the LCR code should cover services as well as goods.

The following article in the LCR code would address gaps under the ASCM:

- If coupled with LCRs on goods or services, subsidies as defined in the ASCM shall be actionable when they result in adverse effects that cause serious prejudice to another code member, unless the respondent can show that no benefit exists.

Closing gaps in plurilateral agreements

Given the low yield of recent multilateral trade talks, important issues on the global trade agenda may first take shape as plurilateral agreements. Notable are the Trade in Services Agreement (TISA) and the Agreement on Environmental Goods and Services (EGs).23 These plurilateral agreements should contain LCR disciplines. Such disciplines would help set norms that the LCR code could generalize through horizontal commitments across all sectors. Early applications of horizontal commitments should be written into the Trans-Pacific Partnership (TPP) and the Trans-Atlantic Trade and Investment Partnership (TTIP).

TISA should include provisions guarding against the forced localization of service activity, especially requirements that companies conduct certain operations within national boundaries. Hufbauer, Jensen, and Stephenson (2012). In

20. To facilitate wider adoption of the LCR code, special and differential treatment for developed countries could permit the use of price preferences, but not LCRs, of up to 20 percent for covered contracts during the first 10 years after the code’s entry into force.

21. Michael Gadgaw, a legal scholar and former government official and business leader, is a leading proponent of transparency rules for procurement. He believes that an agreement on this subject could serve as the cornerstone for a broader anticorruption agenda in the WTO.


23. Current members of the TISA negotiating group are Australia, Canada, Chile, Colombia, Costa Rica, the European Union, Hong Kong, Iceland, Israel, Japan, Liechtenstein, Mexico, New Zealand, Norway, Peru, Korea, Switzerland, Taiwan, Turkey, Pakistan, Paraguay, Peru, and the United States. China’s request to join TISA is under consideration. Australia, Canada, China, Costa Rica, the European Union, Hong Kong, Japan, Korea, New Zealand, Norway, Singapore, Switzerland, Taiwan, and the United States have announced plurilateral EGs talks.
particular, LCRs in energy services, audiovisual services, and digital services are growing, despite their proven ability to undermine the efficient operation of global value chains and deter foreign direct investment. An LCR article in TISA should constrain governments from imposing LCRs in service sectors but allow for exceptions scheduled on a negative list.

Along these lines, in March 2013, the European Union issued a proposal on horizontal market access commitments for services that included a prohibition on LCRs, specifically LCRs “to set up a commercial presence, to be resident, to designate a local agent, or to establish in any form of presence, including computing facilities, in its territory as a condition for the cross-border supply of a service covered in its commitments.”

Similarly, in January 2014 the United States, China, and 12 other countries announced plans to negotiate a plurilateral EGs agreement to eliminate tariffs on environmental goods.25 Efforts to do so in the first decade of the Doha Round proved difficult, but countries committing to a plurilateral approach account for more than 85 percent of global trade in the covered products, so progress is more promising in the post-Bali phase of WTO negotiations.26 LCRs are particularly prevalent in renewable energy projects, at both the federal and subfederal levels of government (see Kuntze and Moerenhout 2013; Rivers and Wigle 2011). They are typically applied as conditions attached to government support, such as feed-in tariffs, or as eligibility requirements for government procurement contracts (Stephenson 2013). Although support schemes and subsidies have been critical to allowing renewable energies to compete with fossil fuels, linking them to LCRs almost always raises the cost of renewable energy deployment; it also contradicts the principle of national treatment (Hußbauer and Kim 2012). An EGs agreement should reinforce existing disciplines on LCRs and set relevant parameters for the use of LCRs in energy policies. Stephenson (2013) proposes LCR disciplines that could be part of a Sustainable Energy Trade Agreement (SETA), including a time limit for existing LCRs, a moratorium on adoption of future LCRs on new projects, and a regional content requirement among members for scheduled renewable energy projects in the SETA.

The following article in the LCR code would address gaps in plurilateral agreements:

Members shall not apply LCRs to the public purchase of goods or services within their territories, except as scheduled in national annexes to the code. Scheduled exceptions shall be periodically reviewed by signatories to the LCR code, with a view to their elimination.

**Improving Surveillance**

To be effective, disciplines on LCRs require surveillance. Lack of adequate surveillance, particularly within the TRIMs agreement, has been a significant weakness. Despite strong language on LCRs and regulatory transparency, governments often sidestep notification of performance requirements and reach undisclosed agreements with firms. Moreover, even publicly known violations of the TRIMs agreement are seldom challenged. More “sunshine” is the place to start, in the form of better reporting of LCR practices, by both code members and the WTO. This change should be followed by stronger enforcement mechanisms.

The crowning strength of the WTO has been its judicial body for dispute resolution. A close second has been its promotion of transparency and surveillance. The purpose of the “sunshine” function rings clear in the adage that “openness is a constraint on the abuse of discretion.”27 The WTO surveys the trade policies of its members through three mechanisms: notifications required of members on their national regulations, laws, and policies; investigative country reviews conducted by the Trade Policy Review Mechanism (TPRM); and crisis monitoring reports issued by the WTO Secretariat, which were initiated following the Great Recession (VanGrasstek 2013). These mechanisms aim to promote transparency and thereby compliance with WTO obligations (VanGrasstek 2013; Wolfe 2013).

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24. The proposal reportedly received a “lukewarm reception” from some TISA countries, which argued that horizontal commitments on market access might discourage major emerging markets from joining the talks and further distance TISA from the format of the GATS. See “EU Proposal on Horizontal Disciplines in Services Talks Met with Skepticism,” *Inside US Trade*, March 28, 2013, www.insidetrade.com (accessed on November 10, 2013).

25. While the removal of barriers to both environmental goods and services trade was part of the Doha agenda, the EGs talks will reportedly address only goods trade, delegating the area of environmental services to the TISA talks. See “U.S., 13 Other WTO Members Unveil Plans To Negotiate Green Goods Deal,” *Inside US Trade*, January 30, 2014, www.insidetrade.com (accessed on February 25, 2014).

26. The group of countries involved intends to extend tariff cuts on environmental goods to all WTO members on a most favored nation basis. As a result, unlike TISA, to go into effect the EGs agreement would require that a “critical mass” of WTO members participates. “Critical mass” is typically defined as members that account for about 90 percent of the product in question. No date has been set for the launch of the EGs talks. See “U.S., China, 12 Other WTO Members Unveil Plans To Negotiate Green Goods Deal,” *Inside US Trade*, January 24, 2014, www.insidetrade.com (accessed on January 30, 2013).

27. As Wolfe (2013, 4) notes, “the transparency norm is based on the principled belief that democratic governance and efficient markets are both enhanced when participants know what is going on, and when administrative agencies have a degree of autonomy, or independence from political interference. The one is effectively a constraint on the other: administrators must be free to get on with the job, but openness is a constraint on abuse of discretion.”
In this spirit, to facilitate more systematic assessment and surveillance, the LCR code should create a new body to monitor national LCR practices. This body could be modeled after the Global Trade Alert (GTA), which is coordinated by the Centre for Economic Policy Research (CEPR) and supported by the World Bank, among others. Drawing on the expertise of research institutions around the world, the GTA provides a forum for reporting discriminatory policy measures.28 It attempts to identify both trading partners and sectors that are potentially harmed by discriminatory policies, combining the “sunshine” of economic cost analysis and real-time monitoring—two features that could help reign in LCR practices.29

At the outset many WTO members will not belong to the LCR code. For these countries, the WTO could carry out the surveillance function through regular reviews conducted by the TPRM. By design, TPRM reviews are descriptive. According to the TPRM Annex, paragraph A(i), although the review “enables the regular collective appreciation and evaluation of the full range of individual Members’ trade policies and practices and their impact on the functioning of the multilateral trading system. It is not, however, intended to serve as a basis for the enforcement of specific obligations under the Agreements or for dispute settlement procedures, or to impose new policy commitments on Members.”30 At some future date, the TPRM reviews should become more prescriptive. When that day arrives, the TPRM reviews should identify measures that are noncompliant with WTO obligations and analyze their trade-distorting costs (VanGrasstek 2013; Zahrnt 2009). This reform would require revising the language in paragraph A(i) of the TPRM annex. To do so, negotiators undoubtedly would have to overcome strong resistance from some WTO members, but the end result would be a much more effective policy review mechanism.

The following article in the LCR code would improve surveillance:

- Members shall issue timely reports, updated semiannually, of all new and existing LCRs imposed by all federal and subfederal government agencies within their jurisdiction. Members shall establish an LCR monitoring body, mandated to issue annual reports identifying the LCRs of member countries and analyzing both their economic impact and their consistency with the LCR code.

### Improving Enforcement

Enforcement mechanisms help ensure that LCR disciplines are implemented and specify consequences for noncompliance. As a plurilateral agreement inside the WTO framework, the LCR code would enable members to resolve their disputes through the WTO dispute settlement system. Additional measures should also be designed to hold code members accountable to their transparency obligations and further discipline policy transgressions.

A code should incentivize compliance with requirements for reporting LCR measures. WTO agreements collectively contain more than 200 notification requirements, a majority of which relate to NTBs (VanGrasstek 2013).31 These obligations entail both prior notification of proposed laws and regulations and regular ex post notifications on issues such as antidumping measures and subsidies. In what Wolfe (2013, 24) describes as the WTO’s “pyramid of legal order,” notifications play an important role as one of the many levels of conflict management outside the formal dispute settlement system.32

Like other NTBs, LCRs should be among a country’s notified measures.33 However, compliance with notification

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30. For the complete text of the TPRM Annex, see www.wto.org/english/res_e/booksp_e/analytic_index_e/prm_01_e.htm.

31. The WTO defines notification as a “transparency obligation requiring Member governments to report trade measures to the relevant WTO body if the measures might have an effect on other Members” (see “WTO Glossary,” www.wto.org/english/thewto_e/glossary_e/glossary_e.htm).

32. For more detail, see Wolfe (2013, 24–31). The exact relationship between the informal and formal levels of WTO dispute resolution has not been fully researched, but Wolfe (2013, 31) argues that “it does appear, however, that the absence of a notification (information asymmetry), or the lack of an opportunity to discuss a measure in a committee, might be more likely to provoke a dispute than the converse.”

33. Among other measures, the Indicative List of Notifiable Measures in the
requirements needs improvement: for example, more than half of ASCM members failed to file subsidy notifications in recent years, according to a 2012 assessment by the Committee on Subsidies and Countervailing Measures. Various efforts are underway to simplify notification procedures and increase technical assistance to countries with limited capacity. But these efforts are often hampered by a “glass house” syndrome—no member wants to draw too much attention to wrongdoing by others in order to insulate its own policies from scrutiny (Wolfe 2013). Adding to the glass house syndrome, countries are not penalized for noncompliance with the notification requirements. One important reason why is that many developing countries lack the capacity to comply. The result is weak real-time monitoring of LCRs and other barriers to trade and investment (Wolfe 2013). Accordingly, the LCR code should specify notification procedures, including requirements for a quantitative assessment of the LCR’s cost, margin of preference, and duration, and specify penalties for noncompliance.

Proposed articles to the LCR code include the following:

- Members shall comply with WTO notification requirements for new LCRs, with recourse to reverse notification procedures, whereby each code member can request that another member notify unreported measures that fail to meet transparency obligations. The responding member shall provide a written response within 60 days, and both parties shall then participate in a peer review process of the code committee. The committee shall determine the adequacy of the response within 60 days.

- Inadequate compliance with notification procedures, as determined by the code committee, shall forfeit the member’s right to file complaints against other code members for a period of time set by the committee.

In addition to enhanced notification procedures, the obligations of the LCR code should be subject to enforcement by the Dispute Settlement Body of the WTO. However, pursuing a case in the WTO requires political energy and financial means, the timeline for resolution is lengthy, the remedies are often inadequate, and prevailing parties are not compensated for the costs of litigation or retrospective damages. Moreover, only governments have legal standing to initiate a WTO case; private firms may have difficulty convincing their home countries to pursue a case. To mitigate these obstacles, code members should agree to WTO–plus procedures. The following article in the LCR code would address such procedures:

- A complaining code member shall be permitted to request the establishment of an arbitration panel after consultations not to exceed 30 days. If the complaining party prevails, the arbitration panel shall assess money damages against the responding party to compensate for the impermissible LCR, covering the period from the time the request is filed until the responding member complies with the final ruling by the Appellate Body. The money damages so awarded shall be paid to the injured private parties.

**CONCLUSIONS**

“Micro-protection”—medium- and small-scale barriers—erupted worldwide in the wake of the Great Recession and continues to flourish more than five years later. The number of discriminatory measures that adversely affected foreign commercial interests is now nearly 2,500 worldwide, according to Global Trade Alert (Evenett 2013). Most micro-protection entails behind-the-border NTBs, with numerous LCRs part of this troubling global trend. Our broad estimates find that more than 100 LCR measures have been proposed or implemented since 2008, by both developing and developed economies, across a wide array of industries. This figure likely underestimates the scope of new LCR practices, as many LCRs continue to go unreported because of inadequate information and/or late notification.

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35. Wolfe (2013, 18–19) suggests that reasons for noncompliance include bureaucratic incapacity related to a lack of data, knowledge, or political clout; the cost of translating complex documents into an official WTO language; a government’s “refusal to see information as a public good”; explicit unwillingness to file notifications that could draw attention to prohibited measures; and a lack of trust between trade negotiators and government agencies.

36. This process is inscribed in some agreements, including the ASCM, the Agreement on Agriculture, and the GATS. Attempts to implement like processes within “Procedures for the Facilitation of Solutions to Non-Tariff Barriers” as part of the nontagricultural market access (NAMA) negotiations have seen measured progress. For the complete proposal, see Annex 5 of the “Fourth Revision of Draft Modalities for Non-Agricultural Market Access,” TN/MA/W/103/Rev.3, December 6, 2008, www.wto.org/english/tratop_e/markacc_e/namachairtxt_dec08_c.pdf.

37. Alternative measures have been proposed for penalizing noncompliance with other WTO disciplines. For example, Ezell, Atkinson, and Wein (2013, 71–73) suggest conditioning the receipt of benefits under the Generalized System of Preferences (GSP) on compliance with disciplines related to technology transfer and compulsory licensing.

38. For additional proposed reforms to the WTO dispute settlement procedures, see Hubauer and Schott (2013, 52–54).

39. In normal WTO cases, the consultation period is limited to 90 days. In urgent cases, the period can be shortened to 15 or 30 days.

40. Specifically, 2,134 such measures were found to “almost certainly worsen the treatment of some foreign commercial interest,” and 261 were “likely to harm foreign commercial interests” (Evenett 2013, 61).
The temptation for countries facing economic difficulties to devise new LCRs will continue as long as gaps persist in the multilateral rules and weak surveillance and enforcement remain the order of the day. A plurilateral agreement on LCRs could narrow gaps in the current WTO language governing government procurement (GPA), investment (TRIMs), and subsidies (ASCM). New real-time monitoring mechanisms will facilitate better assessment of the scope and costs of the LCR problem and increase the transparency of LCR practices.

Whether or not the WTO can deliver a substantial package of multilateral agreements as a coda to the Doha Round, the future global agenda on trade and investment should call for plurilateral stand-alone negotiations among willing countries on a number of important issues, including services, the environment, state-owned enterprises, and perhaps exchange rates. Localization barriers should be on the list as well.

That said, with many issues competing for attention in post-Bali negotiations, the biggest challenge will be elevating LCRs to the agenda. Leadership of the business community will be essential, both to ensure that LCRs are among the negotiating priorities and to create a climate of informed opinion that favors new disciplines.

The LCR code would have the widest impact if it enlisted membership of both developed and developing economies. Thus, framing it to attract commitments from developing countries and LDCs will be a critical gauge of its success. By design, the LCR code aims to discourage forced localization. Adherence by developed and developing countries alike would also create opportunities for domestic firms that are shut out when specifications are slanted to favor their competitors. Moreover, curtailing discretionary LCRs would encourage inward foreign investment and efficient participation in global supply chains, thereby fostering new export opportunities. The LCR code envisioned here would not only limit the spread of LCRs, it would also set a precedent for enhanced obligations on NTBs, a longstanding objective of the WTO.
APPENDIX

WTO DISCIPLINES ON LOCAL CONTENT REQUIREMENTS

This appendix includes excerpts of relevant WTO language from the key agreements discussed in this Policy Brief that constrain LCR practices. These rules served as the basis for the assessment of gaps in the WTO rulebook.

General Agreement on Tariffs and Trade

The first paragraph of GATT Article III (National Treatment on Internal Taxation and Regulation) states:

The contracting parties recognize that internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions, should not be applied to imported or domestic products so as to afford protection to domestic production.*

Note:

*Application of paragraph 1 to internal taxes imposed by local governments and authorities within the territory of a contracting party is subject to the provisions of the final paragraph of Article XXIV. The term reasonable measures in the last-mentioned paragraph would not require, for example, the repeal of existing national legislation authorizing local governments to impose internal taxes which, although technically inconsistent with the letter of Article III, are not in fact inconsistent with its spirit, if such repeal would result in a serious financial hardship for the local governments or authorities concerned. With regard to taxation by local governments or authorities which is inconsistent with both the letter and spirit of Article III, the term reasonable measures would permit a contracting party to eliminate the inconsistent taxation gradually over a transition period if abrupt action would create serious administrative and financial difficulties.

41. For the full text of the GATT, see www.wto.org/english/docs_e/legal_e/gatt47_01_e.htm#articleI.

42. For the full text of GATT Article XXIV, see www.wto.org/english/res_e/booksp_e/analytic_index_e/gatt1994_09_e.htm#article24.

The fourth paragraph of GATT Article III states:

The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use...

GATT Article XX (General Exceptions) states:

Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures:

(a) necessary to protect human, animal or plant life or health;

(g) relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption;

Agreement on Trade-Related Investment Measures

The annex to TRIMs includes a list of prohibited LCRs:

1. TRIMs that are inconsistent with the obligation of national treatment provided for in paragraph 4 of Article III of GATT 1994 include those which are mandatory or enforceable under domestic law or under administrative rulings, or compliance with which is necessary to obtain an advantage, and which require:

(a) the purchase or use by an enterprise of products of domestic origin or from any domestic source, whether

43. For the full text of the TRIMs agreement, see www.wto.org/english/docs_e/legal_e/18-trims_e.htm.
specified in terms of particular products, in terms of volume or value of products, or in terms of a proportion of volume or value of its local production; or

(b) that an enterprise’s purchases or use of imported products be limited to an amount related to the volume or value of local products that it exports.

2. TRIMs that are inconsistent with the obligation of general elimination of quantitative restrictions provided for in paragraph 1 of Article XI of GATT 199444 include those which are mandatory or enforceable under domestic law or under administrative rulings, or compliance with which is necessary to obtain an advantage, and which restrict:

(a) the importation by an enterprise of products used in or related to its local production, generally or to an amount related to the volume or value of local production that it exports;

(b) the importation by an enterprise of products used in or related to its local production by restricting its access to foreign exchange to an amount related to the foreign exchange inflows attributable to the enterprise; or

(c) the exportation or sale for export by an enterprise of products, whether specified in terms of particular products, in terms of volume or value of products, or in terms of a proportion of volume or value of its local production.

Agreement on Government Procurement

GPA Article XVI (Offsets) states:45

Entities shall not, in the qualification and selection of suppliers, products or services, or in the evaluation of tenders and award of contracts, impose, seek or consider offsets.

Note:

7 Offsets in government procurement are measures used to encourage local development or improve the balance-of-payments accounts by means of domestic content, licensing of technology, investment requirements, counter-trade or similar requirements.

Agreement on Subsidies and Countervailing Measures

The first paragraph of ASCM Article 1 (Definition of a Subsidy) states that a subsidy exists if:46

(a)(1) there is a financial contribution by a government or any public body within the territory of a Member (referred to in this Agreement as “government”), i.e., where:

(i) a government practice involves a direct transfer of funds (e.g., grants, loans, and equity infusion), potential direct transfers of funds or liabilities (e.g., loan guarantees);

(ii) government revenue that is otherwise due is foregone or not collected (e.g., fiscal incentives such as tax credits)1;

(iii) a government provides goods or services other than general infrastructure, or purchases goods;

(iv) a government makes payments to a funding mechanism, or entrusts or directs a private body to carry out one or more of the type of functions illustrated in (i) to (iii) above which would normally be vested in the government and the practice, in no real sense, differs from practices normally followed by governments; or

(a)(2) there is any form of income or price support in the sense of Article XVI of GATT 1994; and

(b) a benefit is thereby conferred.

Note:

1 In accordance with the provisions of Article XVI of GATT 1994 (Note to Article XVI) and the provisions of Annexes I through III of this Agreement, the exemption of an exported product from duties or taxes borne by the like product when destined for domestic consumption, or the remission of such duties or taxes in amounts not in excess of those which have accrued, shall not be deemed to be a subsidy.

44. For TRIMs Article XI, see www.wto.org/english/res_e/booksp_e/analytic_index_e/gatt1994_05_e.htm#article11A1.
45. For the full text of the GPA, see www.wto.org/english/docs_e/legal_e/gpr-94_01_e.htm.
46. For the full text of the ASCM, see http://www.wto.org/english/docs_e/legal_e/24-scm_01_e.htm.
ASCM Article 3 (Prohibition) states:

3.1 Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article 1, shall be prohibited:

(a) subsidies contingent, in law or in fact\(^4\), whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I\(^5\);

(b) subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods.

3.2 A Member shall neither grant nor maintain subsidies referred to in paragraph 1.

Notes:

\(^4\) This standard is met when the facts demonstrate that the granting of a subsidy, without having been made legally contingent upon export performance, is in fact tied to actual or anticipated exportation or export earnings. The mere fact that a subsidy is granted to enterprises which export shall not for that reason alone be considered to be an export subsidy within the meaning of this provision.

\(^5\) Measures referred to in Annex I as not constituting export subsidies shall not be prohibited under this or any other provision of this Agreement.

ASCM Article 5 (Adverse Effects) states:

No Member should cause, through the use of any subsidy referred to in paragraphs 1 and 2 of Article 1, adverse effects to the interests of other Members, i.e.:

(a) injury to the domestic industry of another Member\(^11\);

(b) nullification or impairment of benefits accruing directly or indirectly to other Members under GATT 1994 in particular the benefits of concessions bound under Article II of GATT 1994\(^12\);

(c) serious prejudice to the interests of another Member.\(^13\)

Notes:

\(^11\) The term “injury to the domestic industry” is used here in the same sense as it is used in Part V.

\(^12\) The term “nullification or impairment” is used in this Agreement in the same sense as it is used in the relevant provisions of GATT 1994, and the existence of such nullification or impairment shall be established in accordance with the practice of application of these provisions.

\(^13\) The term “serious prejudice to the interests of another Member” is used in this Agreement in the same sense as it is used in paragraph 1 of Article XVI of GATT 1994, and includes threat of serious prejudice.

REFERENCES


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