International Trade and Domestic Regulation

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Existing formal models of the relationship between trade policy and regulatory policy suggest the potential for a regulatory race to the bottom: (e.g., Markusen, 1975, Copeland, 1990, Ederington, 2001 and Bagwell and Staiger 2002, chapter 9).

Nations might lower their regulatory standards to advantage their firms against foreign competitors.

Ederington (2009) surveys the recent body of empirical research that lends some support to the concerns emphasized by these models.
The existing models highlight an important potential concern for the world trading system.

WTO rules and disputes, however, center on complaints about excessively stringent regulations.

Legal obligations that explicitly address national regulatory policies – GATT Article III, TBT, SPS – do not place legal constraints on nations that wish to lower domestic regulatory standards.

Rather, they restrict the ability of member governments to impose regulations on foreign suppliers.

Likewise, virtually all pertinent WTO disputes regarding national regulations (e.g., beef hormones, asbestos, sardines, Korean beef) involve complaints about excessive regulation by importing nations.
This paper bridges the gap between the existing formal literature and the actual pattern of rules and disputes.

We employ the terms of trade framework for the modeling of trade agreements.

But we focus specifically on the kinds of regulatory standards—namely *product standards*—that are typically the subject of WTO disputes.

We show how “large” nations may have an incentive to discriminate against imported goods in regulatory policy once border instruments are constrained.

And we show how inefficiently stringent regulation may emerge under certain circumstances even if regulatory discrimination is prohibited.
We then assess the WTO legal framework in light of our results. We argue that it does a reasonably thorough job of policing regulatory discrimination. But we argue that it does relatively little to address excessive nondiscriminatory regulations.
The Basic Model

- A simple partial equilibrium model of trade between a domestic and a foreign country, with ‘*’s denoting foreign variables.
- The product under consideration is produced in both countries but only demanded in the domestic country:
  \[ D = \alpha - P, \]
  with \( P \) the consumer price of this good in the domestic market.
- Consumption of the good generates an “eye sore” pollutant that is not internalized by individual consumers and which does not effect production, but which detracts from aggregate national welfare in the domestic country (the externality does not cross borders).
- The domestic government can impose a regulatory standard which specifies a (maximum) level of pollution generated per unit of the good consumed, and the standard may differ across domestically produced and imported units.
Denote by $r$ the standard imposed on domestically produced units, and by $\rho$ the standard imposed on imported units.

Denote by $\theta(r)$ and $\theta^*(\rho)$ the associated per-unit pollution levels generated by consumption of domestically produced and imported units under the respective standards $r$ and $\rho$.

We assume that $\theta$ and $\theta^*$ are decreasing and convex in their respective arguments.

To meet the standard $r$, domestic producers must incur the per-unit compliance cost $\phi(r)$; and similarly, to meet the standard $\rho$, foreign producers must incur the per-unit compliance cost $\phi^*(\rho)$.

We assume that $\phi$ and $\phi^*$ are increasing and convex in their respective arguments.

For any regulatory standards $r$ and $\rho$, domestic and foreign supply are then given by

$$S = q - \phi(r) \quad \text{and} \quad S^* = q^* - \phi^*(\rho),$$

where $q$ and $q^*$ are the domestic and foreign producer prices.
In addition to the regulatory standards, the domestic government has at its disposal an import tariff $\tau$ and a consumption tax $t$ (all taxes expressed in specific terms).

The foreign government has an export tax $\tau^*$. Assuming all taxes set at non-prohibitive levels, domestic consumer and producer price/domestic and foreign producer price relations:

$$P = q + t, \text{ and } q = q^* + \tau + \tau^*.$$ 

Note: all units of the product sell in the domestic country at the same price $P$ regardless of the standard to which they are produced ("eye sore" pollutant).

Define the "world" producer price (i.e., the price at which the good is available for sale in international markets once it clears customs in the exporting country):

$$q^w \equiv q^* + \tau^* = q - \tau.$$
Market clearing – the volume of domestic imports must equal the volume of foreign exports:

$$D - S = S^*,$$

determines the market-clearing world price as a function of the tax and regulatory policies:

$$\tilde{q}^w = \frac{1}{3}[\alpha - 2\tau + \tau^* - t + \phi(r) + \phi^*(\rho)].$$

Market-clearing levels of each of the other prices as functions of the tax and regulatory policies:

$$\tilde{P} = \frac{1}{3}[\alpha + \tau + \tau^* + 2t + \phi(r) + \phi^*(\rho)],$$

$$\tilde{q} = \frac{1}{3}[\alpha + \tau + \tau^* - t + \phi(r) + \phi^*(\rho)], \text{ and}$$

$$\tilde{q}^* = \frac{1}{3}[\alpha - 2(\tau + \tau^*) - t + \phi(r) + \phi^*(\rho)].$$
Define the market-clearing foreign producer price of the “raw” unregulated good – prior to bringing it into compliance with the prevailing regulatory standard – and the associated world price of the foreign-produced unregulated good:

\[
\tilde{q}_0^* \equiv \tilde{q}^* - \phi^*(\rho) = \frac{1}{3}[\alpha - 2(\tau + \tau^*) - t + \phi(r) - 2\phi^*(\rho)], \quad \text{and}
\]

\[
\tilde{q}_0^w \equiv \tilde{q}^w - \phi^*(\rho) = \frac{1}{3}[\alpha - 2\tau + \tau^* - t + \phi(r) - 2\phi^*(\rho)].
\]

We will refer to \(\tilde{q}_0^w\) rather than \(\tilde{q}^w\) as the terms of trade, although for any \(\rho\) there is a one-to-one mapping between the two.

Notice as well from the definition of \(S^*\) that \(\tilde{q}_0^*\) is also the market-clearing volume of foreign exports (production).
The Basic Model (cont’d)

- Domestic welfare: given by calculating the usual partial equilibrium measure of CS plus PS plus TR, and then subtracting off the disutility of the consumption-generated pollution.

- Consumer surplus and producer surplus:

  \[ CS = \int_\tilde{P}^{\alpha} [\alpha - P] dP \equiv CS(\tilde{P}), \text{ and} \]

  \[ PS = \int_{\phi(r)}^{\tilde{q}} [q - \phi(r)] dq \equiv PS(r, \tilde{q}). \]

- Trade and domestic tax revenue:

  \[ TR = [\tilde{P} - \tilde{q}] \cdot [\alpha - \tilde{P}] + [\tilde{q} - \tilde{q}_0^w - \phi^*(\rho)] \cdot [(\alpha - \tilde{P}) - (\tilde{q} - \phi(r))] \]

  \[ \equiv TR(r, \rho, \tilde{P}, \tilde{q}, \tilde{q}_0^w). \]

- Utility cost of domestic pollution (\( Z \)):

  \[ Z = \theta(r) \cdot [\tilde{q} - \phi(r)] + \theta^*(\rho) \cdot [(\alpha - \tilde{P}) - (\tilde{q} - \phi(r))] \]

  \[ \equiv Z(r, \rho, \tilde{P}, \tilde{q}). \]
Domestic welfare:

\[ W = CS(\tilde{P}) + PS(r, \tilde{q}) + TR(r, \rho, \tilde{P}, \tilde{q}, \tilde{q}_0^w) - Z(r, \rho, \tilde{P}, \tilde{q}) \]

\[ \equiv W(r, \rho, \tilde{P}, \tilde{q}, \tilde{q}_0^w). \]

\( W \) ultimately a function of domestic regulatory policies and domestic and foreign tax policies.

But as \( W(r, \rho, \tilde{P}, \tilde{q}, \tilde{q}_0^w) \) indicates: tax policies all impact domestic welfare indirectly through their impacts on domestic and world prices; regulatory policies impact domestic welfare both directly and also indirectly through the price channels.

Note: \( W_{\tilde{q}_0^w} = -[(\alpha - \tilde{P}) - (\tilde{q} - \phi(r))] < 0: \) the domestic welfare loss that comes when \( \tilde{q}_0^w \) rises holding all regulatory standards and domestic local prices fixed is the income effect of the terms-of-trade deterioration for the domestic country, which amounts to the domestic import volume.
Foreign welfare very simple. First, define:

\[ PS^* = \int_{\phi^*(\rho)}^{\tilde{q}_0^* + \phi^*(\rho)} [q^* - \phi^*(\rho)] dq^* = \int_0^{\tilde{q}_0^*} q^* dq^* \equiv PS^*(\tilde{q}_0^*), \text{ and} \]

\[ TR^* = [\tilde{q}_0^w - \tilde{q}_0^*] \cdot \tilde{q}_0^* \equiv TR^*(\tilde{q}_0^*, \tilde{q}_0^w). \]

Foreign welfare:

\[ W^* = PS^*(\tilde{q}_0^*) + TR^*(\tilde{q}_0^*, \tilde{q}_0^w) \equiv W^*(\tilde{q}_0^*, \tilde{q}_0^w). \]

Note: foreign welfare does not depend directly on the standard \( \rho \), but only indirectly through the impact of \( \rho \) on \( \tilde{q}_0^* \) and \( \tilde{q}_0^w \).

Intuition: production of unregulated good an increasing cost (upward-sloping supply) industry; for given \( \rho \), the per-unit cost of compliance is constant (and equal to \( \phi^*(\rho) \)) regardless of how many units of the unregulated good must be altered to meet the standard.

As a consequence, foreign producer surplus is impacted by the standard level \( \rho \) only to the extent that \( \rho \) impacts the market-clearing foreign supply decisions for the unregulated good (through \( \tilde{q}_0^* \)).
Finally, note: $W_{\tilde{q}_0^w}^* = \tilde{q}_0^* > 0$. Same intuition as above for $W_{\tilde{q}_0^w} < 0$.

What about joint welfare (which efficient policies must maximize)?

Using market clearing, world price $\tilde{q}_0^w$ cancels from sum of domestic and foreign tax revenue: $TR(r, \rho, \tilde{P}, \tilde{q}, \tilde{q}_0^w) + TR^*(\tilde{q}_0^*, \tilde{q}_0^w)$

\[
\begin{align*}
\ldots &= [\tilde{P} - \tilde{q}] \cdot [\alpha - \tilde{P}] + [\tilde{q} - \tilde{q}_0^* - \phi^*(\rho)] \cdot [(\alpha - \tilde{P}) - (\tilde{q} - \phi(r))] \\
&= g(r, \rho, \tilde{P}, \tilde{q}, \tilde{q}_0^*).
\end{align*}
\]

Hence $W + W^*$

\[
\begin{align*}
\ldots &= CS(\tilde{P}) + PS(r, \tilde{q}) + PS^*(\tilde{q}_0^*) + g(r, \rho, \tilde{P}, \tilde{q}, \tilde{q}_0^*) - Z(r, \rho, \tilde{P}, \tilde{q}) \\
&= G(r, \rho, \tilde{P}, \tilde{q}, \tilde{q}_0^*).
\end{align*}
\]

Note that $\tilde{q}_0^w$ enters into each country’s welfare function, but not into joint welfare, because movements in the world price represent pure (lump-sum) international transfers between countries: that is, $W_{\tilde{q}_0^w}^* + W_{\tilde{q}_0^w} = \tilde{q}_0^* - [(\alpha - \tilde{P}) - (\tilde{q} - \phi(r))] = 0$. 
Efficient and Nash Policies

- Efficient policies: joint welfare depends only on local prices; local prices depend only on sum of $\tau$ and $\tau^*$ (and consumption tax and regulations); so efficiency ties down only sum of $\tau$ and $\tau^*$, not individual levels.

- Efficient policy choices must satisfy the four first-order conditions:

\[
\begin{align*}
W_{\tilde{P}} \frac{d\tilde{P}}{d\tau} + W_{\tilde{q}} \frac{d\tilde{q}}{d\tau} + W_{\tilde{q}_0^*} \frac{d\tilde{q}_0^*}{d\tau} &= 0, \\
W_{\tilde{P}} \frac{d\tilde{P}}{dt} + W_{\tilde{q}} \frac{d\tilde{q}}{dt} + W_{\tilde{q}_0^*} \frac{d\tilde{q}_0^*}{dt} &= 0, \\
W_r + W_{\tilde{P}} \frac{d\tilde{P}}{dr} + W_{\tilde{q}} \frac{d\tilde{q}}{dr} + W_{\tilde{q}_0^*} \frac{d\tilde{q}_0^*}{dr} &= 0, \text{ and} \\
W_{\rho} + W_{\tilde{P}} \frac{d\tilde{P}}{d\rho} + W_{\tilde{q}} \frac{d\tilde{q}}{d\rho} + W_{\tilde{q}_0^*} \frac{d\tilde{q}_0^*}{d\rho} &= 0.
\end{align*}
\]
More explicitly:

\[
\tau^E + \tau^{*E} = \left[ \theta^*(\rho^E) - \theta(r^E) \right], \\
t^E = \theta(r^E), \\
-\theta'(r^E) = \phi'(r^E), \text{ and} \\
-\theta^{*'}(\rho^E) = \phi^{*'}(\rho^E),
\]

- \( t^E = \theta \), a Pigouvian tax that reflects the externality associated with consumption of a unit of the domestically produced good.
- \( \tau^E + \tau^{*E} \) is positive (a net tax on imports) if consumption of a unit of the imported good generates more pollution than a unit of the domestically produced good (or vice versa): a tariff is a (discriminatory) domestic tax on consumption of imported good.
- \( r^E \) equates \(-\theta'(\cdot)\) with \(\phi'(\cdot)\); and similarly for \(\rho^E\): in general, neither the efficient regulatory standards for domestic and imported goods, nor the efficient level of the externality produced by each type of good, will be the same.
If domestically produced and imported goods share an identical technology:

$$\tau^E + \tau^E = 0,$$

$$t^E = \theta(r^E),$$

$$-\theta'(r^E) = \phi'(r^E),$$

and

$$\rho^E = r^E.$$

Efficient policy intervention in the case of identical technologies across countries: free trade, a nondiscriminatory regulatory standard that equates the marginal benefit of pollution reduction to the marginal compliance cost, and a Pigouvian consumption tax set at the level of the consumption externality.
Nash policy choices. Domestic best-response policies satisfy the four first-order conditions:

\[
W_{\tilde{P}} \frac{d\tilde{P}}{d\tau} + W_{\tilde{q}} \frac{d\tilde{q}}{d\tau} + W_{\tilde{q}_0^w} \frac{d\tilde{q}_0^w}{d\tau} = 0,
\]

\[
W_{\tilde{P}} \frac{d\tilde{P}}{dt} + W_{\tilde{q}} \frac{d\tilde{q}}{dt} + W_{\tilde{q}_0^w} \frac{d\tilde{q}_0^w}{dt} = 0,
\]

\[
W_r + W_{\tilde{P}} \frac{d\tilde{P}}{dr} + W_{\tilde{q}} \frac{d\tilde{q}}{dr} + W_{\tilde{q}_0^w} \frac{d\tilde{q}_0^w}{dr} = 0, \text{ and}
\]

\[
W_{\rho} + W_{\tilde{P}} \frac{d\tilde{P}}{d\rho} + W_{\tilde{q}} \frac{d\tilde{q}}{d\rho} + W_{\tilde{q}_0^w} \frac{d\tilde{q}_0^w}{d\rho} = 0.
\]

Best-response foreign export tax satisfies:

\[
W_{\tilde{q}_0^*} \frac{d\tilde{q}_0^*}{d\tau^*} + W_{\tilde{q}_0^w} \frac{d\tilde{q}_0^w}{d\tau^*} = 0.
\]
Nash is joint solution to these conditions:

\[
\begin{align*}
\tau^N &= \left[\theta^*(\rho^N) - \theta(r^N)\right] + S^* N, \\
\tau^* N &= \frac{S^* N}{2}, \\
t^N &= \theta(r^N), \\
-\theta'(r^N) &= \phi'(r^N), \text{ and} \\
-\theta^*(\rho^N) &= \phi^*(\rho^N).
\end{align*}
\]

- \( r^N = r^E \) and \( \rho^N = \rho^E \): the Nash standards correspond to the efficient standards.
- \( t^N = t^E \): the Nash consumption tax corresponds to the efficient consumption tax.
- \( \tau^N + \tau^* N > \tau^E + \tau^* E \): reflects each country’s incentive to manipulate the terms of trade \( (\tilde{q}_0^w) \) with its unilateral tariff choice.
Same characterization applies in the case of identical technologies:

\[
\tau^N = S^*N, \quad \tau^*N = \frac{S^*N}{2}, \\
t^N = \theta(r^N), \\
-\theta'(r^N) = \phi'(r^N), \text{ and } -\theta^*'(\rho^N) = \phi^*'(\rho^N).
\]

Evidently, inefficiency of the Nash equilibrium can be traced to a single source: Nash tariffs are higher than is efficient, because each country seeks to manipulate its t-o-t with its tariff.

And from this vantage point, a key insight emerges: despite complex domestic policy environment, fundamental problem for a trade agreement to address is to prevent t-o-t manipulation and to thereby reduce tariffs and raise trade volumes, without introducing distortions into the choice of domestic regulatory and tax policies.
Efficient and Nash Policies (cont’d)

- Confirm with thought experiment of “political optimum”: those policies that would hypothetically be chosen by govn’s unilaterally if they did not value the t-o-t implications of their policy choices.

- In particular, the domestic government acts as if \( W_{\tilde{q}^*_0} \equiv 0 \) when choosing its politically optimal policies, while the foreign government acts as if \( W_{\tilde{q}^*_0} \equiv 0 \) when choosing its politically optimal policy:

\[
\begin{align*}
W_{\tilde{P}} \frac{d\tilde{P}}{d\tau} + W_{\tilde{q}} \frac{d\tilde{q}}{d\tau} &= 0, \\
W_{\tilde{P}} \frac{d\tilde{P}}{dt} + W_{\tilde{q}} \frac{d\tilde{q}}{dt} &= 0, \\
W_r + W_{\tilde{P}} \frac{d\tilde{P}}{dr} + W_{\tilde{q}} \frac{d\tilde{q}}{dr} &= 0, \\
W_{\rho} + W_{\tilde{P}} \frac{d\tilde{P}}{d\rho} + W_{\tilde{q}} \frac{d\tilde{q}}{d\rho} &= 0, \text{ and } W_{\tilde{q}^*_0} \frac{d\tilde{q}^*_0}{d\tau^*} &= 0.
\end{align*}
\]

- Are politically optimal policies efficient when evaluated in light of the governments’ actual objectives? If so, then the Nash inefficiencies identified above can be given the t-o-t interpretation.
• But with last condition implying that $W^{*}_{\tilde{q}_{0}} = 0$, it is immediate that politically optimal policies are indeed efficient.

• Hence, if governments could be induced to make policy choices free from motives reflecting terms-of-trade manipulation, there would be nothing left for a trade agreement to do.

• And as a consequence, the fundamental inefficiency for a trade agreement to correct in this setting – and therefore the problem that gives rise to the need for a trade agreement to exist – is the unilateral incentive for governments to manipulate the terms of trade $\tilde{q}_{0}^{W}$ with their tariff choices.
With the problem now identified, next explore possible logic behind features of trade agreements that are designed to correct this problem.

Adopt assumption of identical technologies: may often be plausibly met in reality; not obvious which way distinction would go.

We begin with a simple thought experiment: What would be the shortcoming of an international agreement that simply constrained tariffs to their efficient levels?

An immediate answer: tariff commitments alone that are not protected by a nondiscrimination (“national treatment”) clause applied to domestic taxation will be meaningless in this setting.

Suppose, then, that countries agree to bind their tariffs below their Nash levels and also agree (in the domestic government’s case) not to impose discriminatory consumption taxes on imported goods.

To fix ideas, consider an agreement to eliminate tariffs completely.

The question is whether the domestic govn’s choices of $t$, $r$ and $\rho$ will be altered by the move from Nash tariffs to free trade and, if so, how.
Consider first the domestic government’s best-response choice of consumption tax in this setting, taken as given the levels of $r$ and $\rho$:

$$t^{BR}(\tau \equiv 0 \equiv \tau^*, r, \rho) = \theta(r) + \frac{\alpha - \theta(r) - \phi(r)}{7} + 4[\theta(\rho) - \theta(r)] + 2[\phi(r) - \phi(\rho)]$$

The second term on the right-hand side is strictly positive for non-prohibitive policies.

Hence, if $r$ and $\rho$ remain at their Nash and efficient levels $\rho^E = r^E$, the domestic government will raise its consumption tax above the efficient level (i.e., $t^{BR}(\tau \equiv 0 \equiv \tau^*, r^E, \rho^E) > \theta(r^E)$) in response to the tariff binding.

A second-best way to manipulate t-o-t.
Consider next the domestic government’s choice of regulatory standards:

\[-\theta'(r)[2\alpha - \theta(r) - \theta(\rho) - 5\phi(r) + 3\phi(\rho)] = \]
\[\phi'(r)[3\alpha - 4\theta(r) + 2\theta(\rho) - \phi(r) + \phi(\rho)],\]
\[-\theta'(\rho)[2\alpha - \theta(\rho) - \theta(r) + 2\phi(r) - 4\phi(\rho)] = \]
\[\phi'(\rho)[\alpha - 4\theta(\rho) + 3\theta(\rho) - 2\phi(\rho) + \phi(r)].\]

Implications:

First, \(\rho^{BR}(\tau \equiv 0 \equiv \tau^*) > r^{BR}(\tau \equiv 0 \equiv \tau^*)\): binding tariffs at free trade introduces an incentive for the domestic country to implement discriminatory regulation against foreign imports.

Intuition: discriminatory regulation can force some of cost of pollution abatement on to foreign producers; regulatory cost-shifting.

Second \(-\theta'(r^{BR}(\tau \equiv 0 \equiv \tau^*)) > \phi'(r^{BR}(\tau \equiv 0 \equiv \tau^*))\): the domestic standard lowered below its efficient level.
Suppose, then, that in addition to a nondiscrimination rule applied to domestic consumption taxes, governments also agree to a nondiscrimination rule applied to domestic regulation.

Will a commitment to free trade that is protected by these two rules allow governments to reach the internationally efficient policies?

The regulatory nondiscrimination rule amounts to a restriction that $\rho \equiv r$. But then

$$t^{BR}(\tau \equiv 0 \equiv \tau^*, \rho \equiv r) = \theta(r) + \frac{\alpha - \theta(r) - \phi(r)}{7}.$$ 

When tariffs are eliminated and countries commit not to use discriminatory domestic taxes or regulations, the domestic consumption tax will be raised above its Pigouvian level as a means of manipulating the terms of trade.

What about the regulatory standard level chosen by the domestic government? Interestingly, the (nondiscriminatory) product standard chosen by the domestic government is efficient.
Thus far assumed that good-specific consumption taxes are available. A strong assumption: will relax it next.

But first consider a “market access preservation rule”: countries agree to eliminate tariffs and refrain from discriminatory consumption taxes; no agreement to rule out the use of discriminatory regulations.

But in addition the domestic government submits to the following rule: if, subsequent to the agreement, it alters its non-tariff policies, then it will simultaneously adjust its tariff so that its combined tariff and non-tariff policy adjustments do not alter the volume of imports it demands at the existing terms of trade (“market access”).

Achieves efficient policies, because domestic government prevented from altering t-o-t with its unilateral regulatory choices.

A rule that prevents the domestic country from altering the foreign exporter price of the unregulated good as it considers various levels of domestic taxes and regulatory standards ensures that the domestic country pays the full price of higher standards and taxes.
Now briefly consider how our results must be modified when the consumption tax instrument is unavailable to the domestic government in the industry under consideration, i.e., we set $t \equiv 0$.

Will nondiscriminatory standards remain undistorted when countries agree to eliminate tariffs if $t$ is not an available instrument in the industry under consideration?

No: eliminating tariffs induces the domestic country to distort upward its nondiscriminatory standard $r$ relative to the efficient level.

Intuition: if consumption tax (and tariff) unavailable for t-o-t manipulation, then upward distortion of regulatory standards become attractive for the domestic government, because a portion of the cost of compliance with these higher standards is shifted onto foreign producers in the form of a lower $\tilde{q}_0^w$. 
Legal Implications

- The Original GATT:
- Paragraph 2 of GATT Article III, the “national treatment” article, provides that imported goods “shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products.”
- Article III paragraph 4 provides that imported products “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.”
The Nonviolation Doctrine:

The closest analogue in the WTO system to the “market access preservation” rule that we consider in our formal analysis. But the pertinent nonviolation decisions to date all seem to suggest that the measure in question must somehow favor domestic over imported goods. A regulatory measure that disadvantages them equally (in nondiscriminatory fashion) seems to be outside the scope of the doctrine.

Perhaps it makes sense to embrace a presumption that nondiscriminatory changes in regulatory policy would normally fall outside the strictures of the nonviolation doctrine, while leaving open the possibility that a nonviolation claim could be brought in exceptional circumstances (to ward off cases of obvious abuse).
The Technical Barriers Agreements

TBT/SPS: strengthened the national treatment obligation of GATT Article III as the basis for disciplining regulatory policies that adversely affect international trade.

But TBT/SPS may have little to say about inefficient but nondiscriminatory regulation.

Our formal analysis suggests a potential problem here; but perhaps again the possibility that a nonviolation claim could be brought in exceptional circumstances (to ward off cases of obvious abuse) strikes the right balance.
Conclusion

- This paper employs a terms-of-trade framework to study the choice of regulatory policies in “large” open economies.
- We show how the standard terms of trade externality that affords a rationale for trade agreements to limit protection through border instruments can also lead to distortion of regulatory policies.
- In particular, and unlike the existing “race to the bottom” models, we show how t-o-t externalities may lead to discriminatory regulatory policies that inefficiently impose higher regulatory burdens on imports.
- A nondiscrimination rule applicable to domestic regulation is thus a useful legal principle for a trade agreement to incorporate.
- A nondiscrimination rule does not eliminate the danger of excessively stringent regulation, however, at least if product-specific consumption taxes are administratively or politically infeasible.
- The task of identifying and policing inefficient, nondiscriminatory regulation is nevertheless surely a difficult one, which perhaps explains why the WTO legal system does not do much to address it.