Peterson Institute for International Economics

Local Content Requirements: Report on a Global Problem

Gary Hufbauer, Jeffrey Schott & Cathleen Cimino

Peterson Institute for International Economics

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Book outline

Motivation

- In the wake of the Great Recession, more than 100 new Local Content Requirements (LCRs) have been proposed or implemented.
- Several depart from the classic format of mandated purchases from domestic suppliers and mix price and quantity signals to influence market outcomes.

Three part study

1. Documents “new LCRs” and outlines six policy alternatives.
2. Comprehensive databank of LCRs since 2008 with estimated impact on global trade.
3. Six cases studies highlight the costs of LCR measures and their effect on domestic and international markets.

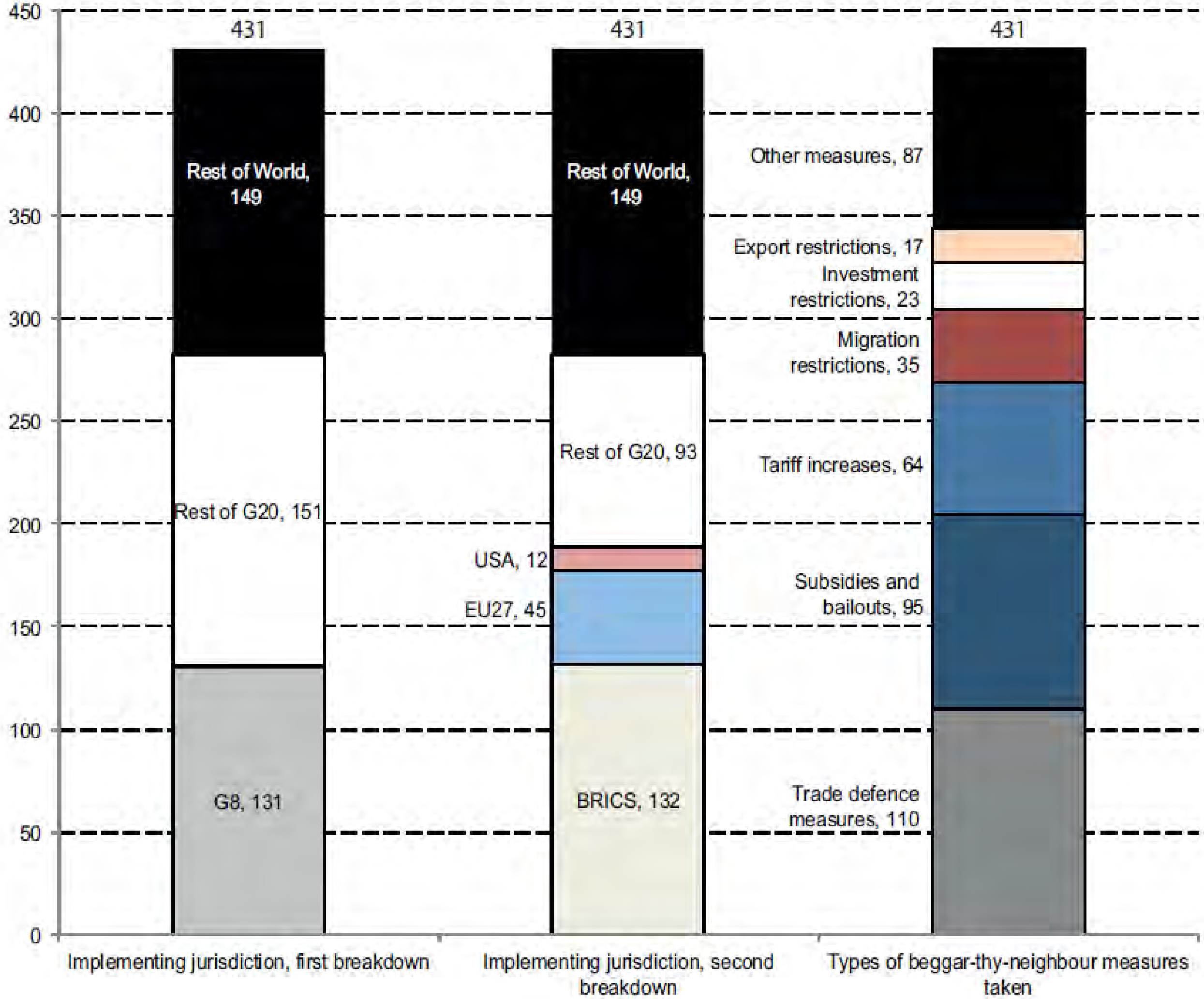
Six case studies:
Developed and developing economies

1. Healthcare Industry in Brazil
2. Wind Turbines in Canada
3. Automobile Industry in China
4. Solar Cells and Modules in India
5. Oil and Gas Industry in Nigeria
6. Buy America in the United States

Rising protectionism since the Great Recession

- According to the latest Global Trade Alert report (Evenett 2013), a total of 3,334 protectionism measures have been implemented worldwide since 2008.
- From June 2012 to May 2013, 431 protectionist measures were imposed, more than three times the number of liberalizing measures.
- Estimates for 2012 Q4 and 2013 Q1 show the highest levels of protectionism since monitoring began in 2008.
- Traditional forms of protectionism (tariffs and trade remedies) represent less than 40% of all measures. Rather, “since 2008, governments have become very creative in evading WTO disciplines” (Evenett 2013).

Figure 1.2 Decomposing the sources and form of protectionism over the past 12 months, June 2012-May 2013



Source: Simon J. Evenett. 2013*. Protectionism's Quiet Return* GTA's Pre-G8 Summit Report. London: Center for Economic Policy Research.

Forms of LCRs since 2008

- Classic mandatory LCR percentages for goods or services.
- Tax, tariff, and price concessions conditioned on local procurement.
- Import licensing procedures tailored to encourage domestic purchases of certain products.
- Certain lines of business that can be conducted only by domestic firms.
- Data must be stored and analyzed locally or products must be tested locally.

Motivation for LCRs

- Political urgency to create jobs.
- Infant industry argument applied to renewable energy.
- LCRs are “off-budget” and do not entail a fiscal cost.
- Shield domestic firms through procurement favoritism.
- Ensure that important industries, e.g., civil aviation, broadcasting, and electric power, are locally owned

The incidence of “new LCRs” since 2008

Comparative statistics for select countries with LCRs

Country	Number of LCR cases	2010 GDP (US$ billions)	Two-way trade (% of GDP)	Inward FDI stock (% of GDP)
Select advanced economies				
Australia	7	1,132	45	45
Canada	5	1,577	60	36
United States	14	14,587	28	24
Average: advanced economies with LCRs	9	5,765	45	35
Average: all other advanced economies	0	905	72	84
Select developing and other economies				
Argentina	8	369	41	24
Brazil	15	2,088	23	23
China	10	5,927	56	10
India	9	1,727	47	11
Indonesia	12	707	47	17
South Africa	3	364	57	36
Average: developing economies with LCRs	10	1,863	45	20
Average: all other developing economies	0	44	105	40

Sources: Number of LCR measures drawn from Appendix A; GDP and trade data from World Bank WDI database and WTO statistics database; FDI data from UNCTADStat.

Why LCRs are bad policy

- Extent of assistance to local activity is highly variable.
- Officials often have little knowledge as to their effectiveness.
- LCRs may enable domestic producers to capture economies of scale and enter global markets, but they insulate firms from competition and generate lags in new technology.
- The cost impact on downstream producers difficult to calculate.
- LCRs create unnecessary delays and raise costs, and the costs are highly variable, depending on supply and demand.
- LCRs seldom contain “sunset” provisions and hence market distortions may last for a very long time.

The impact of “new LCRs”

Estimated goods and services trade impacted by LCR measures since 2008

LCR measures	Estimated affected goods and services trade (billions)	Speculated estimate of trade reduced (billions)[1]
47 quantifiable measures	373	37
70 non-quantifiable measures[2]	555	56
117 total LCR measures	**928**	**93**

[1] Estimated tariff-equivalent of 10 percent ad valorem and assuming the elasticity of import demand for foreign goods as approximately -1.0.
[2] Estimated affected trade was calculated by multiplying the 70 measures by the average of $7.9 billion affected trade per "quantifiable" LCR measure.

Source: Authors' calculations.

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The impact of "new LCRs"

Estimated jobs impacted by LCR measures since 2008

Country group	Estimated trade impacted by 117 LCR measures (billions)	Speculated estimate of trade reduced (billions)	Estimated jobs impacted: Estimated employees per billion US$ in import-competing firms (halved)	Estimated jobs impacted: Speculated estimate of jobs impacted by LCRs
Advanced economies	39	4	5,500	22,000
Rest of world	889	89	42,500	3,763,000
Total	**928**	**93**	**-**	**3,784,000**

Notes: Calculations of the estimated trade impacted by 117 LCR measures by country group were based on the following: OECD countries accounted for about 4 percent or $15.7 billion of the total trade impacted by the 47 "quantifiable" LCR measures, namely $373 billion (see table 3.1). The rest of the world accounted for about 96 percent or $357.1 billion of the total trade impacted by the 47 "quantifiable" LCR measures. These percentage shares were applied to the total estimated trade impacted by all 117 LCR measures, namely $928 billion.

Sources: Trade impacted and trade reduced from table 3.1; industry value added data from the World Bank, WDI database; employment data from ILO, Global Employment Trends, 2012; jobs impacted from authors' calculations.

WTO cases against LCRs

1. In November 2012, China requested consultations with the EU, Greece, and Italy regarding domestic content restrictions that affect renewable energy generation as a by product of the feed-in tariffs of EU member states.
2. In February 2013, the US requested consultations with India concerning India's LCRs and subsidies in the solar energy sector, specifically addressing the Jawaharlal Nehru National Solar Mission (JNNSM).
3. In May 2013, the WTO Appellate Body sided with the EU and Japan in ruling that LCRs within Canada's renewable energy and feed-in tariff program violated WTO obligations.

Proposed alternatives to LCRs

1. **Create a business-friendly environment.** A proven way to create jobs and stimulate investment. Low corporate tax rates and honest officials are key ingredients.
2. **Encourage corporate social responsibility.** Governments can encourage MNCs to search out local firms for their supply base, without crossing the line into "forced localization".
3. **Expand training.** Job-related skills are the responsibility of government and firms. For every one percent increase of workers participating in training, the OECD employment and labor force participation rates rose by more than one percent (OECD 2004).

Proposed alternatives to LCRs

4. **Improve logistics.** World trade, characterized by global value chains, is hindered by trade transaction costs (TTC). Every country has the ability through targeted policies to reduce its own TTC burden.
5. **Invest in infrastructure.** US infrastructure projects create 18,000 jobs for every $1 billion in new outlays; and in the "average" developing country 70,000 jobs per $1 billion (Heintz, Pollin, and Garrett-Peltier 2009). User fees can be a viable financing tool.
6. **Use tariffs or subsidies.** If a government has a political choice between a new LCR and a higher tariff or subsidy, the latter are the lesser evils.

Conclusions: Advice to governments

- Governments should roll out alternative policies that deliver better results with less distortion and lower costs.
- Governments determined to support an infant industry should design an appropriate mix of tariffs and subsidies rather than impose LCRs.
- Governments determined to impose new LCRs should express them as classic price preferences on a narrow set of products or projects rather than as quantitative restrictions or discretionary guidelines.

Conclusions: Advice to trade officials

- WTO and regional free trade agreement secretariats should commission periodic reports that describe and analyze LCRs.
- Trade negotiators should craft language that penalizes any form of nontariff preference that has not been specifically scheduled on a “negative list,” for example through a monetary payment.