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Homeland Security and the Rules of International Trade^{*}

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International trade law is very clear: national security concerns take precedent over any commitments in trade agreements. In response to the terrorist attacks in New York and Washington on September 11, 2001, the United States and other countries have been putting in place new anti-terrorist measures, many of which will act to inhibit international trade. As with any measure that inhibits international trade, these new measures will provide an economic benefit to domestic vested interests in importing countries. Guarding against the possibility of terrorist acts is by nature a speculative activity, and it is difficult to refute the need for the anti-terrorist measures put in place by governments. As a result, trading partners may be frustrated by what they perceive as protectionist measures and tempted to reply with trade-restricting measures of their own, imposed under the guise of national security. Thus, governments have a vested interest in being willing to listen to the comments of their trading partners and ensuring that the policies put in place achieve their goal in the least-trade-distorting manner – even if they are not obliged to do so. It is particularly important that the measures put in place have either sunset clauses or automatic reviews pertaining to their efficacy in achieving anti-terrorist goals. These provisions will help ensure that anti-terrorist measures are not captured by those who benefit from the economic protection they provide.

Keywords: agents, capture, cost, essential security interests, homeland security, national security, protectionism, terrorism

Nothing in this Agreement shall be construed...

(b) to prevent any contracting party from taking any action which is necessary for the protection of its essential security interests...

(iii) taken in time of war or other emergency in international relations;

(Article XXI – Security Exemptions – of
The General Agreement on Tariffs and Trade)

International agreements that are entered into by independent nation-states, including those that establish the rules for international commercial policy, represent voluntary constraints on those countries' exercise of sovereignty. There are, however, exceptions built into treaties and agreements whereby countries reserve the right to act in a sovereign manner for certain specified reasons.¹ The most closely guarded exceptions are those that can be invoked for national security reasons. National security is one of the most basic responsibilities of nation-states, and political leaders would be remiss in not insisting on its inclusion in international arrangements and not invoking it in the face of a perceived threat. In terms of international commercial policy agreements, this means that once the *essential security interests* clause is invoked, all of the basic principles that, for example, underlie the World Trade Organisation, such as non-discrimination and transparency, can be ignored, as well as any specific commitments in agreements or sub-agreements. This is as it should be.

In the wake of the events that took place in the United States on September 11, 2001, there can be no objection to the invocation of essential security interests for border measures and other regulations that may affect international commercial transactions put in place in an attempt to reduce the risk of terrorist acts. This applies to all countries, not just the United States. The precedence accorded to national security, however, raises questions related to how the concerns of trading partners can be accommodated and the extent to which trading partners should feel free to comment on measures put in place on national security grounds. While the simple response is that a country is under no compulsion to accommodate its trading partners, and trading partners have no right under international law to comment on trade measures put in place on national security grounds, taking such a hard line may have considerable and costly externalities associated with it. This is because trade measures put in place for national security reasons may increase the costs for exporters just as effectively as measures put in place to placate protectionist interests and, hence, will

provide domestic firms with the benefits of economic protection. Thus, the measures are not without value to domestic vested interests.

The danger is that trading partners may not accept that a particular measure enhances the importing country's national security, or, more likely, they may not believe that the measure is the most efficient method of achieving the desired level of national security. As a result, they will conclude that the measure is, at least in part, protectionist in nature. This may lead them to retaliate with similar or even more onerous regulations, ostensibly put in place for national security reasons of their own. The way is open for unconstrained *tit for tat* retaliation of the sort that international commercial policy agreements are negotiated to limit.

Further, as border measures and other regulations that inhibit international commercial transactions have value to domestic vested interests, if they are found wanting in terms of satisfying their national security goals they may prove difficult to remove due to the political influence of those that reap the benefits arising from the economic protection provided. As a result, over the long run, global welfare will be reduced without any enhancement in security. Much of the progress made in international trade agreements over the last half century may be at risk. Politically, it may be difficult to directly take into account the complaints of trading partners because to do so opens one up to accusations of being 'soft on terrorism' or being 'willing to trade the security of citizens for economic benefits'. There is no reason to believe that those with an interest in the benefits that arise from protectionism would in any way be unwilling to use such arguments to their advantage. Thus, while countries are under no international obligation to take the concerns of trading partners into account when putting their anti-terrorist measures in place, they should be cognisant of the trade effects of the measures they put in place and the fact that trading partners have equal opportunity to respond in kind.

One of the difficulties with the policy environment post-9/11/01 is that there is little information or data upon which to base decisions. The general assumption is that the attacks on the World Trade Centre and the Pentagon were not isolated acts and that there are at least some terrorist organisations that have the resources, training, organisational capacity and commitment to attempt to carry out acts with similar, or even larger, consequences. While there is no way to verify this assumption, making it is only prudent.

Having accepted that one should increase one's vigilance, the question arises as to where the risks are likely to arise. Unfortunately, there are neither data nor even sufficient experience to formulate testable hypotheses regarding the form terrorist acts might take. This puts policy making in the realm of what Isaac (2002) calls

speculative risks.² According to Isaac, speculative risks “lack experience, data, a causal-consequence mechanism and an accepted analytical method for assessment. They are logical possibilities – irrefutable, but also untestable” (p. 130). In other words, for this type of risk it is not possible to assess the credibility of the threat. Hence, there is no logical way to object to trade-restricting measures put in place, for example, as an attempt to reduce the risk of transboundary movements of biological agents that might directly threaten human health (e.g., anthrax) or others that could threaten the safety of food. The only way that such speculative risks can be proved is if an event occurs. If the terrorist act is successful, the evidence exists but the measure is less than fully effective. Evidence will also exist if a terrorist act is thwarted in a detectable way – evidence exists and the measure is effective, at least to some degree. Lack of an incident, however, can neither confirm nor deny the speculative threat. If the terrorist act is thwarted in ways that cannot be detected, then no evidence exists. Far more important, however, is the deterrent effect of the measure. If the measure is an effective deterrent to a terrorist act, then no terrorist act will take place; but there is no way to know if a threat actually existed. Thus, it is not possible for a trading partner to object to a measure on the basis that it thinks that the measure is unnecessary.

Given that neither the imposing country nor the country whose trade is negatively affected has an objective means of assessing the likelihood of a perceived terrorist threat, on what grounds might a country wish to evaluate its anti-terrorism measures in light of its effects on trading partners and their possible reaction? The answer is that the trade-distorting measures should be evaluated on the basis of their efficacy. In other words, are they likely to achieve their goal, and in the least-trade-distorting manner? As the distortion of trade will reduce the benefits of trade for consumers in the imposing country, an assessment should be important to the imposing government; sound foreign policy and sound domestic policy should not be in conflict. Imposing countries should be willing to listen to the suggestions of their trading partners regarding alternative measures to achieve their goals, and trading partners should be free to suggest less trade-distorting alternatives that will allow imposing countries to achieve their goals. The goals, however, need to be well thought out and realistic.

The goal of an anti-terrorist policy should be to minimise the total cost to society. This goal can be illustrated using figure 1. Anti-terrorist measures are put in place to reduce the probability of terrorist acts taking place. If no anti-terrorist measures are taken, then the probability of terrorist acts taking place is high and the expected costs imposed on society are likely to be high. On the other hand, if strong anti-terrorist measures are put in place, then the expected costs of terrorist acts for society will be

low. Thus, the expected total cost of terrorist acts will rise as one moves from left to right in figure 1.

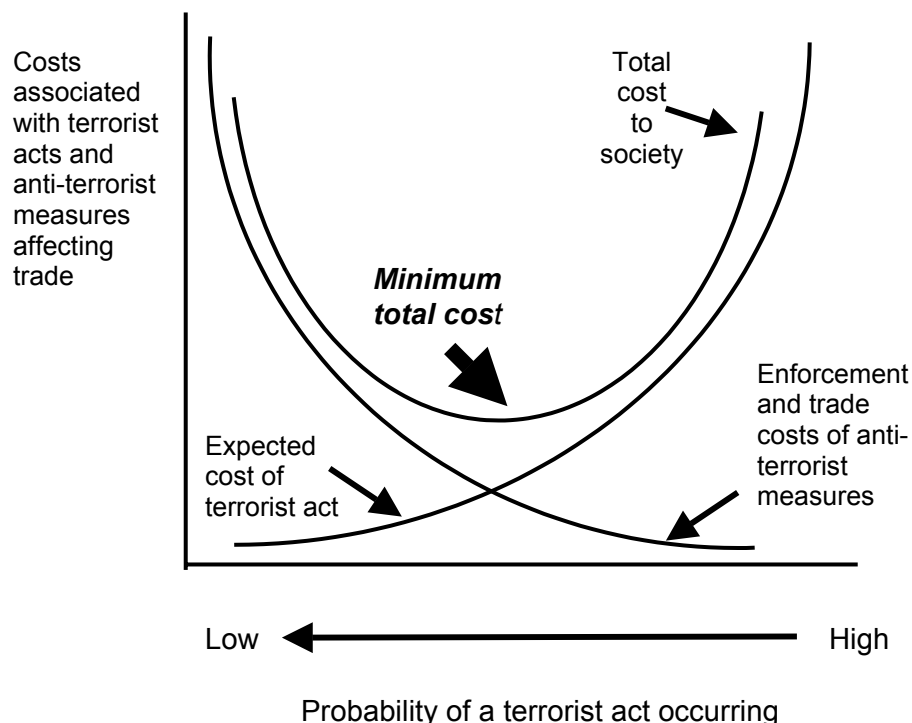


Figure 1 The Cost of Terrorist Attacks and Anti-Terrorist Measures

To reduce the probability of a terrorist attack will require the commitment of resources. As one moves from right to left in figure 1, the total cost of the effort required to reduce the probability of terrorist acts increases. This cost is likely to increase more rapidly as efforts are made to eliminate risk entirely – the cost of reducing the terrorist threat to zero may become infinitely large. Further, as the measures become more stringent, the trade cost can also be expected to rise in a commensurate fashion. Thus, the total cost of anti-terrorist measures that have a trade impact can be expected to rise rapidly if attempts are made to eliminate the possibility of a terrorist threat.

For any probability of a terrorist threat, the total cost to society is the sum of the expected cost of the terrorist act plus the cost of the anti-terrorist measures – the vertical sum of the “expected cost of terrorist act” curve and the “enforcement and trade costs of anti-terrorist measures” curve. Given the configuration of the two cost curves that comprise the “total cost to society” curve, that curve can be expected to be

“U-shaped”, as depicted in figure 1. The policy goal should then be to minimise the total cost to society.³ The important point is that the goal should not be the total elimination of a terrorist threat – the danger is that anti-terrorist agencies will be constituted with a mandate to do just that. If measures are put in place with the objective of achieving a zero probability of a terrorist act occurring, the trade costs for both the implementing country’s domestic economy and those wishing to export to it can be expected to be very high. Of course, there will be arguments about where the minimum cost to society is likely to occur, primarily because the evaluation of the cost of terrorist acts will have to deal with contentious issues such as how to value human life. Still, it is important for countries to keep the concept of total societal cost, including forgone opportunities in international commerce, in mind when setting the goals of their anti-terrorist policies. In particular, those charged with devising anti-terrorist policies that will have trade effects should be aware that their policies will have value to protectionist interests and that those policies are likely to be open to capture by those interests over the long run. It would certainly be prudent to build in sunset clauses and/or automatic reviews of the regulations.

The United States, understandably, has progressed furthest in putting in place a new import regime in the wake of the terrorist attacks of 9/11/01. The creation of the new department responsible for homeland security, which has brought together the major border monitoring and import inspection agencies, among others, under one administrative umbrella and has given them a new primary focus on security and anti-terrorism, represents a significant re-orientation of government resources. While the new agency is still in the early stages of developing a new border policy regime, some elements are becoming clear. One area is the new United States Food and Drug Administration’s (FDA) regulations to protect food imports from acts of bioterrorism.

On the positive side, the FDA has made considerable provisions for consultation and there is some evidence of willingness to address foreign concerns (*Inside U.S. Trade*, October 17, 2003). Still, major trading partners of the United States have been critical of the regulations and the consultation process. For example, *Inside U.S. Trade* (November 14, 2003) reported

The European Union, Japan, Mexico and other countries have heavily criticized new Food and Drug Administration’s (sic) regulations to protect U.S. food imports from acts of bioterrorism. The regulations have come under fire for being too expensive, too burdensome and likely to restrict trade, particularly from small suppliers, embassy and government officials said. These sources also criticized the U.S. for not adequately consulting global trading partners on the new rules (p. 1).

It is not the objective of this paper to provide a detailed examination of U.S. regulations pertaining to the potential to use imports of food as a vehicle for terrorist acts, but one aspect of the complex new set of regulations will serve to illustrate the point of needing to think through the trade effects of the regulations put in place, the ability to demonstrate their efficacy to trading partners and their potential for capture over the long run.

As part of its new regulations the FDA “requires domestic and foreign facilities that manufacture/process, pack, or hold food for human or animal consumption in the United States” to register with the FDA by December 12, 2003 (*Federal Register*, October 10, 2003). As part of this regulation the FDA

requires that every foreign entity that registers with the FDA needs to appoint a U.S. Agent to represent them. The U.S. Agent must be a U.S. Resident or maintain a place of business in the USA. If the Foreign Entity does not appoint a U.S. Agent, the Registration Form will be rejected (*Global Trading Hub*, 2003, p. 1).

The only two qualifications to be an agent are listed above. An agent is not required to undergo a security check or to have any particular skill. An agent will assist the foreign entity with the preparation and filing of the registration document. The FDA envisions that the agent will act as a communication conduit with the foreign entity but the foreign entity is not required to appoint the agent as its communications contact for the FDA (*Federal Register*, October 10, 2003).

It is not clear how requiring a registered foreign entity to appoint a U.S. agent will act to reduce the threat of bioterrorism. The FDA has stated that

[a]s far as U.S. agent liability, FDA generally does not intend to hold the U.S. agent responsible for violations of the Bioterrorism Act that are committed by the foreign facility (*Federal Register*, October 10, 2003, p. 23).

Thus, at least to trading partners, the requirement to appoint a U.S. agent simply represents an increase in the cost of organising international transactions without any apparent benefit in terms of reduction in the probability that a terrorist attack will take place through the food system. This is the type of policy that will annoy trading partners and could result in the United States itself facing retaliation in kind. Even if the U.S. system remains relatively low cost, it is just the type of policy that is open to rent seeking, cronyism and corruption in developing countries.

Inside U.S. Trade (November 14, 2003) reported the following:

Small- and medium-sized businesses that lack infrastructure or money will likely feel the burden most intensely, sources said. According to the FDA’s interim final rule, 16 percent of manufacturers that export 10 or fewer

tariff line entries to the U.S., will stop sending goods to the U.S. because of the rule – in part because of the cost of the agent – which the FDA estimates will average \$1,000 per year (p. 2).

Of course, the need for an agent will inhibit firms that are thinking of exporting to the United States for the first time. It will also limit the development of cross-border business-to-consumer e-commerce that is characterised by small, consumer-sized shipments of food products (Boyd, Hobbs and Kerr, 2003).

While the cost of hiring an agent at the outset of this program appears to be small and likely more of an annoyance than a deterrent to most existing exporters to the United States, it is the longer run that is more worrisome. There is no way of knowing how the *agent industry* will evolve over time, but I will provide one speculative path that I believe is a logical outcome of the new system. The *agent industry* is starting out as relatively competitive – neither of the requirements represents a barrier to entry. Still, agents will be able to differentiate themselves by the quality of services offered and other ‘reputation building’ activities. Some firms will be able to attract a large number of foreign clients and earn considerable income. As the services provided appear to be relatively minimal, revenues can be channelled into marketing and rent-seeking activities. I would expect that within a relatively short time an *Association of Agents* will arise to establish standards and lobby governments. Given that the government has set down no standards for agents, some will turn out to be charlatans, leading to demands for government sanctioned standards. The *Association of Agents* will become the gatekeeper of those standards and, in the process, be able to limit entry, leading to high fees being collected from those required to employ an agent and supernormal profits for the association’s members. The association will both seek to justify its existence and lobby to protect its position. The costs for those wishing to export to the United States will continue to rise, eventually leading to an ‘agents’ issue – similar to the case of ‘import licence’ issues – at the WTO and other trade negotiation venues. With considerable rents at stake and investment in facilities at risk, the *Association of Agents* will increase its lobbying efforts to protect its interests. The efficacy of ‘agents’ in the ‘War Against Terrorism’ will never be assessed and the original rationale for having agents will be ‘lost in the mists of time’. Idle speculation? I wonder. I fully expect to be writing about the ‘agents’ issue fifteen years from now in this journal or some other venue. The employment of agents is, of course, one minor aspect of the measures being put in place to enhance homeland security in the United States.

History is sometimes a great teacher. The last time there was a general increase in trade barriers – as opposed to increases in barriers as a result of pleading for the protection of special interests – was during the widespread economic depression in the

1930s. In response to that crisis countries put in place high *tit for tat* tariffs. The General Agreement on Tariffs and Trade was established with the primary motive of reducing those tariffs, and it has taken more than fifty years to lower them. The events of 9/11/01 precipitated a similar worldwide crisis and policy responses to deal with it. Just as in the Great Depression of the 1930s, some of those policies are likely to turn out to be wrongly conceived. This is why the measures put in place during a ‘crisis’ need to be carefully crafted initially and, more importantly, subject to automatic review after sober reflection. No one can question the right of countries to respond to national security concerns. It is, however, important that countries that wish to invoke national security take careful account of the effects of their policies on trading partners – to do so is in their own best interest.

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Endnotes

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1. This is in addition to the right to exercise sovereignty by abrogating the entire treaty or agreement. Exceptions exist so that countries do not need to withdraw from an entire international agreement due to a set of particular circumstances.
 2. As opposed to *recognisable* risks, where testable hypotheses can be formed and sufficient data exist to assign objective probabilities, and *hypothetical* risks, where testable hypotheses can be formed but the data do not exist to assign objective probabilities.
 3. Economists will note that it is more usual to cast and depict these arguments in marginal cost terms so that the optimal point would be where the marginal expected terrorist cost equalled the marginal enforcement and trade cost – which would coincide with the minimum total societal cost depicted in figure 1. The casting and depicting of the arguments in total cost terms has been done for pedagogical reasons arising from the multidisciplinary nature of the *Journal's* audience.

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