

For years now, China has been the world's manufacturing powerhouse, leveraging its cheap labor to dominate global trade through increase in exports. But China's traditional advantage of cheap labor is slowly waning off due to increase in labour costs. Also, China has been appreciating its currency by 30% since 2006 due to pressure from the developed world particularly the United States of America. This has definitely taken a toll on its attractiveness as a manufacturing hub as the total manufacturing cost has shot up and is likely to shoot up further in the future.

Herein lies an opportunity for India. We are a country with a strong labor force of approximately 500 million workers including unskilled labourers, scientists, researchers and engineers. According to the US Bureau of Labor Statistics, the average labor cost in India is \$1.46 per hour in contrast to China's \$3.50 per hour. Apart from cheap labor, we have several other advantages such as engineering skills, a steadily growing domestic market and a raw material base.

Manufacturing sector contributes only 15% to India's GDP and the government wants to increase the share to about 25%. Many large companies such as Reliance, Tata motors and Micromax have already started setting up manufacturing plants across India. This is a very positive start to the 'Make in India' campaign. However, India has a long way to go for the road ahead is interminable. Further, many countries that rank higher than India as far as manufacturing is concerned, have better chances of gaining by China's loss. It is fairly apparent that India's window of opportunity is short lived and we must not squander this opportunity. The difference between ordinary and extraordinary is a little extra and to meet up this difference we must soon get our acts together, work harder and one day live the dream of becoming a manufacturing colossal.

“Unless India stands up to the world, no one will respect us. In this world, fear has no place. Only strength respects strength.”

-Dr. A.P.J Abdul Kalam

Can Regionalism Lead to Multilateralism?

Debasmita Padhi- 3rd year

Summary: *The article aims to answer the question: Are regional trade agreements a stepping stone or stumbling blocks in the process of multilateral trade liberalization?*

Introduction

The debate on multilateralism versus regionalism is not new. Some scholars suggest that regional trade agreements are a stepping-stone for multilateral trade liberalization while others who are major proponents of free trade say that it is a stumbling block. This essay tries to establish how RTAs can prove effective in promoting multilateral trade liberalization while examining arguments against it as well. We examine the history of world trade and formation of the GATT briefly before moving on to an analysis of the major research undertaken by international political economists to determine the extent to which regional

trade agreements impact multilateral trade liberalization.

“Effective multilateralism requires some form of regional organization.” RTAs have ceased to be regional and have now become “interregional” in nature.²⁵

Trade in history: An overview

A textbook of international trade would undoubtedly start with Adam Smith's work. Adam Smith's phenomenal book 'An Inquiry into the Nature and Causes of the Wealth of Nations' published in 1776 laid down the basics of what we call classical economics and also advocated free and unrestricted trade policies. He believed that international competition would be much more beneficial to nations than mercantilism.²⁶ Mercantilism was characteristic of 18th century Europe where government used protectionist measures for improving gains from trade.

One country's export is the other's import and hence, it is not possible for all countries to gain.²⁷ According to the absolute advantage theory, countries should specialize in production of goods in which they have an absolute advantage. A country is said to have an absolute advantage in production if it can produce greater amount of output using same amount of inputs. But, even if a particular country has absolute advantage in production of both goods (in a 2 good model), it will have a Ricardian comparative advantage in production of one good.²⁸ And thus, there are benefits from specialisation and exchange. The first wave of trade globalization existed from 1860-1914²⁹. During this period, the North saw industrialization while the South saw de-industrialization and North-South income gap increased.³⁰ It was the peak of the period of colonial rule and Great Britain was the world's economic leader. In the interwar period, the era of relatively free trade was replaced by protectionism which was one of the reasons that led to the Great Depression. After World War II, the US emerged as the economic superpower and it pushed for economic liberalization.³¹ The IMF (International Monetary Fund) and IRDB (International Bank for Reconstruction and Development) or World Bank were set up for worldwide economic cooperation. The International Trade Organization (ITO) was envisaged as the global trade organization but as the US Congress did not support it, the GATT (General Agreement on Tariffs and Trade) that had managed post war trade negotiations became the global trade organization. The GATT/WTO follows two major rules: consensus and single-undertaking. It was originally a provisional institution until the World Trade Organization (WTO) replaced it in 1995.³² GATT was highly successful in bringing down trade barriers substantially through its various rounds of discussions. This was the second round of globalization that industrialized the South and reduced income inequality.³³ Earlier, it was possible for US and other major countries to steer the direction of international negotiations. Now, with the emergence of many power blocs like the BRIC (Brazil, Russia, India, China) economies, the OPEC (Organization of Petroleum Exporting Countries), the emerging market economies, this ability of the developing countries has reduced. These countries are willing to go to great lengths to bargain for better deals and has led to the current stalemate situation in WTO.

A major criticism related to the GATT was the free-riding problem associated with MFN status (continued in WTO). According to the MFN (Most Favoured Nation) clause, every country must give equal treatment to all signatories of the GATT with regards to trade policy.³⁴ Hence, if a country lowers trade barriers for a particular good, it has to do so for all signatories of GATT. This provision has been included in order to prevent discrimination against particular countries. This implies that when two countries mutually exchange trade barriers reduction, it is automatically extended to the other members of GATT/WTO. The other members may not, however, necessarily reciprocate. This creates two kinds of problems. There is no incentive for member nations to enter into negotiations as others may free ride and they, themselves will not reap the entire benefits from liberalization.³⁵ The enabling clause in GATT allows for preferential trade agreements in favour of developing countries and Article XXIV of GATT allows for RTAs.³⁶ These two clauses override the MFN clause.

The number of RTAs has shown an upward trend since the early 1990s but since the early 2000s, there has been an exponential increase which has been a major concern for economists and political scientists. Among the best known are The European Union (a customs union), The European Free Trade Association (EFTA), The North American Free Trade Agreement (NAFTA), The Southern Common Market (MERCOSUR), The Association of Southeast Asian Nations (ASEAN) Free Trade Area (AFTA), and The Common Market of Eastern and Southern Africa (COMESA). Some figures might give us an idea about the extent of proliferation of regional trade agreements (RTAs). RTAs are reciprocal trade agreements between two or more countries. The WTO has been notified of 585 RTAs as of 15 June, 2014. 379 are in force currently.³⁷ Free trade agreements (FTAs) and Customs Union (CUs) are the two major kinds of RTAs. FTAs give rise to free trade areas where all tariffs, import quotas and preferences on most goods are eliminated, for example, the European Union. Members of an FTA may follow autonomous external trade policy while a CU is a type of FTA in which members have a common external tariff.³⁸ FTAs and partial scope agreements account for 90% and the rest 10% is made up of customs unions.

For or Against: An Analysis

The “spaghetti-bowl effect” first used by Bhagwati, is an oft repeated argument against RTAs. When a single member nation is a part of several RTAs, there are different, complex rules of origin and different standards. This leads to lobbying by various groups and hence, transaction costs. There is a possibility of trade diversion.³⁹ Trade diversion refers to the fact that an RTA might shift trade from a more efficient supplier outside the RTA, towards a less efficient supplier within the RTA. Trade creation refers to a case where the RTA allows supply from a more efficient producer. An RTA has both the effects. World trade is, increasingly, being channelled through these agreements and it stands in stark contrast to the most favoured nation criteria of the WTO.⁴⁰ Hence, there is a need for simplification of the world trade regime.

Freund and Ornelas state that measuring the extent of trade creation or diversion is based on assumptions. Even then, based on a wide range of studies, they conclude that trade diversion is the exception, while trade creation, the norm. Moreover, the magnitude of trade diversion is in such cases is insignificant. They further suggest that, bilateral agreements have often led to more gains than losses as Governments are careful while choosing trading partners.⁴¹

Another major bone of contention is the Article XXIV of the GATT, “4. The contracting parties recognize the desirability of increasing freedom of trade by the development, through voluntary agreements, of closer integration between the economies of the countries parties to such agreements. They also recognize that the purpose of a customs union or of a free-trade area should be to facilitate trade between the constituent territories and not to raise barriers to the trade of other contracting parties with such territories.”⁴²

Though it has been clearly outlined in the clause, that member countries of RTAs are not to raise trade barriers to other countries (non-member), it is argued that there is relative increase in trade barriers implicit in such a case.⁴³ When member countries reduce tariffs for each other while keeping external tariffs unchanged, the relative tariff levels for non-member countries would increase simultaneously.

Freund and Ornelas show that there is a tendency for external tariffs to fall after a RTA which is more

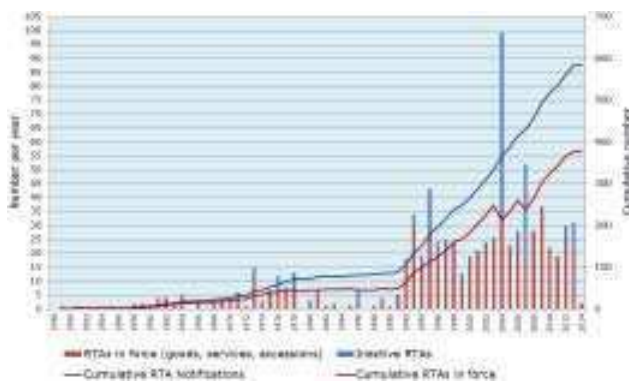
pronounced in case of developing countries rather than developed like UK and the US. However, since their tariff rates are already quite low, there may not be room for much change. This is proved by a simple yet logical analysis that shows marginal cost (economic) of high tariff rises while the marginal benefit (political) falls.⁴⁴ Hence, resulting in the afore-mentioned behaviour of tariff policy.

Gary Huftbauer stresses on the fact that through free trade areas there is a possibility of zero or near-zero tariff rates which is consistent with the main goal of bringing down tariffs. And though, regional trade agreements have their own problems, they are fairly easily settled between the participating countries, at least better than the pace of international negotiations. They give faster results.⁴⁵ It is true that regional trade agreements are easier to negotiate because of the fewer number of members involved and common interests. The WTO involves a large number of member nations, 159 to be precise (as of 2 March, 2013) and though there is interest group formation which reduces the effective number of members, the number of effective groups with diverging interests has increased greatly.

Bhagwati also talks of the selfish hegemon which tries to satisfy its demands through FTAs with the weaker trading nations rather than by multilateralism. The point being that, if US tried to bargain at the international level, it might not have got as good a bargain as it could through one-on-one negotiations with smaller, especially, developing countries. Though the Uruguay round was successful, NAFTA was a burden for the US during talks and NAFTA was at that time given undue importance instead of the WTO negotiations.⁴⁶ The free trade agreements might have been a strategic move on part of the US. However, today RTAs are being finalized between many developing nations, under-developed nations etc. The reach of RTAs has extended well beyond regional to become trans-national. The driving force being, that each nation wants to get the best deal and best bargains possible. There is increasing awareness of the inequalities embedded in the system against the developing countries. The conflict of interests is far from being solved.

It is also said that one of the major reasons for the proliferation of The RTAs/FTAs is the failure of the Doha round. However, this exponential rise had started from the 1990s and continued in the 2000s.

(As per the World Trade Organisation website)



The failure of Doha undoubtedly has acted as a catalyst in the process but cannot be the reason. Talks on the international level have always been slow to materialize. Even the success of the Uruguay round was not possible before crossing several hurdles. The recent abandonment of the Doha round has, however, been the longest and most impactful.

Multilateral trade liberalization definitely sounds as the ideal. If there was a free trade regime across the globe, it would definitely be a win-win situation for all provided all countries can benefit. The gains from such a process cannot be limited to a few countries because if it is so, the losers of the process will definitely make attempts to stall its progress. Every country wants a larger share of the pie. Free trade cannot just mean opening up of markets of the developing countries indiscriminately. The developed countries are unwilling to negotiate on issues which may harm their domestic economy adversely (for example, US and agriculture sector). The playing field is heavily tilted in favour of the North in these international discussions and until and unless there is an even playing field, the North-South chasm would continue to widen and free-trade would remain the dream.

Riezman uses a general equilibrium model to show that welfare losses from banning bilateral agreements are quite large and can surprisingly, lead to more protectionist measures and so the potential welfare losses are high. Even bilateral agreements may lead to more protection if trading blocks are of approximately same size but the welfare losses associated with it are quite low. Banning such bilateral trade agreements are a very risky trade policy and will

hurt the world economy.⁴⁷ Although, banning of such agreements is not what is being debated, it gives an idea about the importance of bilateral agreements.

Levy argues that bilateral agreements reduce political support for multilateral free trade. The more politically popular a bilateral agreement is, the more likely it is to undermine support for multilateralism.⁴⁸ And popularity would arise from economic benefits. If the economic gains from such regional agreements are high enough, there is not much incentive for member nations to propagate free trade on a global scale. The same point is highlighted by Ornelas who notes that the source of failure for multilateral trade may be the success of the bilateral agreement in itself. If the gains from trade through bilateral agreements is large enough, these countries would not be willing to support multilateral trade.⁴⁹

Regionalism, by allowing stronger internalization of the gains from trade liberalization, seems likely to facilitate freer trade when it is initially highly restricted. Winter raises a fundamental question about how we define multilateralism. Whether it is the degree to which discrimination is absent and/or the extent to which the country's trading regime approximates free trade. The definition used will require different reasoning. Winter also talks of a brilliant analysis by Ethier (1996) that shows how multilateralism leads to regionalism. Developing countries are initially not very open to trade. As the world trade liberalizes, they gradually realize the benefits of opening the economy. But, if all developing countries were to simultaneously bring down controls, the investment from developed world may not necessarily flow into their country. Through regionalism, these countries can ensure investment in their own country and will lead to further openness and reforms.⁵⁰

Institutions like the Asian Development Bank seek to promote regional cooperation in Asia and design regional FTAs as the way forward. South Asia has remained relatively fragmented because of its political history but efforts are being made to strengthen trade relations. This will improve their bargaining power on a global platform. They can help deepen production networks for global value chains. It can also help in growth of foreign direct investments through reduction in cross-border impediments. Rationalization of ROOs and upgradation of their administration for example,

by using information technology would help mitigate the “noodle bowl” effects.⁵¹ In fact, there is a lack of information in the industries in South Asian countries that has led to under-utilisation of even the existing trade arrangements. Studies conducted by the ADB reveal that in the South Asian region even SMEs (small and medium enterprises) view FTAs as beneficial rather than burdensome. With proper training programs, even they can benefit from these programs. They get wider market access, easier access to intermediate goods. Although the transaction costs involved may be higher because of complexities arising out of different ROOs, the benefits are far higher. For East Asia, a single FTA can help iron out the difficulties arising out of multiple ROOs (rules of origin) and standards. Further, after the East Asian financial crisis of 1997/98, the need for a mechanism of regional cooperation for stability and growth has been recognized.⁵²

India is a part of almost 15 RTAs (South Asian Free Trade Agreement (SAFTA), South Asian Preferential Trade Arrangement (SAPTA), Asia-Pacific Trade Agreement, ASEAN-India and others) but neither has any major influence on world trade. It is being felt that India has lost from not joining the RTA bandwagon as other countries have. Even, the few RTAs it is a part of have not been utilized efficiently. India needs to improve its trade relations not only with its regional neighbors but also other developing and developed countries in order to grow economically as well as form strategic alliances. If Ethier’s argument (as mentioned above) can be applied to the Indian case, it can ensure enough profitable investment in the form of FDI in the country.

We can take the case of Latin America where regionalism has been a building block for multilateral trade liberalization. Latin America has a complex web of overlapping preferential, regional and free trade agreements due to economic reforms implemented in the mid-1980s and 1990s. Research shows that regional trade integration has favoured general trade liberalization in this case. It suggests that the rising concern of the prohibitory effects of preferential liberalization on external trade liberalization are unfounded.⁵³ Although it is a particular case, it is testimony to the fact that these regional trade agreements can act as stepping stones for multilateralism.

Conclusion:

Thus, regional trade agreements definitely have an impact on multilateral trade liberalization process which cannot be ignored. Many arguments emphasize the negative effects of regionalism. But when international talks have been stalled and there are no signs of revival, RTAs are the only feasible option for world trade. Regionalism may be the process by which the world will move towards multilateralism. Regional trade agreements are way ahead in terms of the issues covered. They take into consideration many sensitive topics which will certainly pose further challenges if they are to be posed for discussion on a global platform. And hence, regional trade agreements seem to be the future. Multilateralism is not the norm and will not be in the near future. Hence, if countries do not enter into trade agreements, they are missing out on a major opportunity for growth. The fear of exclusion from the gains from world trade is one of the major reasons why countries are jumping onto the regional trade agreements’ bandwagon. It does not seem that countries are working towards building a multilateral system of trade liberalization anyhow. As nations progress, especially developing countries, there may be a time when all countries are on the relatively same level of economic and political power. Then, multilateralism may be the order. And regional trade agreements will be the stepping stones for reaching that level of worldwide economic integration. It does not really seem possible, in the current scenario, for countries to chart out a path for multilateralism through step-by-step multilateral liberalization. This is not to say that because of this failure, all efforts for taking multilateral trade talks to the next level should be given up. Persistent endeavours in that direction, by the major economies of the world, are necessary if we are to realize the dream of multilateral free trade.

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Who Bit the Dragon? Understanding China's Downward Trajectory

Falak Arora- 2nd year

Summary: China's economic thrust on the world map has increased over the years. So much so that it was predicted to be the next superpower of the world. But since, a few dents have appeared on the picturesque growth. Zooming in on the fault lines would point towards a structurally weak growth model, a corrupt government, rampant investment in infrastructure and a pending need to increase workers' wages. There is a need more than ever, to shift to a consumption driven model from the present export driven model. The only silver lining is that the government seems to have acknowledged that the so-called Chinese dream needs immediate rescuing. Over the next few years, while the same growth rates will remain elusive for China's citizens, it can still be saved from Japan like conditions if the right policy changes penetrate the economy.

Rewind back to 1978 and China would have been one of the poorest countries, cowed by the puissant powers of the world. Since then, of course, China has miraculously steered its economy, such that it seems to betray its own history today. Deng Xiaoping, China's reformist leader triggered the economy's unprecedented chase in 1982 to realize its potential, catapulting China to the front. In 2012, China accounted for close to 15% of the world's GDP and has lifted more than 500 million people out of poverty since (World Bank). Although, what's redoubtable is the speed at which China has ascended to the top. China recently overtook U.S, adjusted for purchasing power parity, as the world's largest economy. Its GNI per capita is close to \$11,805 PPP dollars, almost 37 times more than what it was in the 1970s. (McKinsey)