CHAPTER – 9
INTERNATIONAL TRADE

UNIT I
THEORIES OF INTERNATIONAL TRADE

INTRODUCTION

International trade is the exchange of goods and services as well as resources between countries. It involves transactions between residents of different countries. As distinguished from domestic trade or internal trade which involves exchange of goods and services within the domestic territory of a country using domestic currency, international trade involves transactions in multiple currencies. Compared to internal trade, international trade has greater complexity as it involves heterogeneity of customers and currencies, differences in legal systems, business practices and political systems, more elaborate documentation, exchange rate risks, complex procedures and formalities, high operating costs, issues related to shipping, insurance and transportation and diverse restrictions and interventions from governments in the form of taxes, regulations, duties, tariffs, quotas, trade barriers, standards, and restraints to movement of specified goods and services. At present, liberal international trade is an integral part of international relations and has become an important engine of growth in developed as well as developing countries.

While some economists and policy makers argue that there are net benefits from keeping markets open to international trade and investments, others feel that trade generates a number of adverse consequences on the welfare of citizens. As students of Economics, we need to have an objective understanding of the claims put forth by both sections. We shall first examine the arguments in support of international trade.

i. International trade is a powerful stimulus to economic efficiency and contributes to economic growth and rising incomes. The wider market made possible owing to trade induces companies to reap the quantitative and qualitative benefits of extended division of labour. As a result, they would enlarge their manufacturing capabilities and benefit from economies of large scale production. The gains from international trade are reinforced by the increased competition that domestic producers are confronted with on account of globalization of production and marketing, requiring businesses to compete against global businesses. Competition from foreign goods compels manufacturers, especially in developing countries, to enhance efficiency and profitability by adoption of cost reducing technology and business practices. Efficient deployment of productive resources to their best use is a direct economic advantage of foreign trade. Greater efficiency in the use of natural, human, industrial and financial resources ensures productivity gains. Since international trade also tends to decrease the likelihood of domestic monopolies, it is always beneficial to the community.
ii. Trade provides access to new markets and new materials and enables sourcing of inputs and components internationally at competitive prices. This reflects in innovative products at lower prices and wider choice in products and services for consumers. Also,internationaltradeenables

consumers to have access to wider variety of goods and services that would not otherwise be available. It also enables nations to acquire foreign exchange reserves necessary for imports which are crucial for sustaining their economies.

iii. International trade enhances the extent of market and augments the scope for mechanization and specialisation. Trade necessitates increased use of automation, supports technological change, stimulates innovations, and facilitates greater investment in research and development and productivity improvement in the economy.

iv. Exports stimulate economic growth by creating jobs, which could potentially reduce poverty, and augmenting factor incomes and in so doing raising standards of livelihood and overall demand for goods and services. Trade also provides greater stimulus to innovative service in banking, insurance, logistics, consultancy services etc.

v. Employment generating investments, including foreign direct investment, inevitably follow trade. For emerging economies, improvement in the quality of output of goods and services, superior products, finer labour and environmental standards etc. enhance the value of their products and enable them to move up the global value chain.

vi. Opening up of new markets results in broadening of productive base and facilitates export diversification so that new production possibilities are opened up. Countries can gainfully dispose off their surplus output and, thus, prevent undue fall in domestic prices caused by overproduction. Trade also allows nations to maintain stability in prices and supply of goods during periods of natural calamities like famine, flood, epidemic etc.

vii. Trade can also contribute to human resource development, by facilitating fundamental and applied research and exchange of know-how and best practices between trade partners.

viii. Trade strengthens bonds between nations by bringing citizens of different countries together in mutually beneficial exchanges and, thus, promotes harmony and cooperation among nations.

Despite being a dynamic force, which has an enormous potential to generate overall economic gains, liberal global trade and investments are often criticized as detrimental to national interests. The major arguments put forth against trade openness are:

i. Possible negative labour market outcomes in terms of labour-saving technological change that depress demand for unskilled workers, loss of labourers' bargaining power, downward pressure on wages of semi-skilled and unskilled workers and forced work under unfair circumstances and unhealthy occupational environments.

ii. International trade is often not equally beneficial to all nations. Potential unequal market access and disregard for the principles of fair trading system may even amplify the differences between trading countries, especially if they differ in their wealth. Economic exploitation is a likely outcome when underprivileged countries become vulnerable to the growing political power of corporations operating globally. The domestic entities can be easily outperformed by financially stronger transnational companies.

iii. International trade is often criticized for its excessive stress on exports and profit-driven exhaustion of natural resources due to unsustainable production and consumption.

Substantial environmental damage and exhaustion of natural resources in a shorter span of time could have serious negative consequences on the society at large.

iv. Probable shift towards a consumer culture and change in patterns of demand in favour of foreign goods, which are likely to occur in less developed countries, may have an adverse effect on the development of domestic industries and may even threaten the survival of infant industries. Trade cycles and the associated economic crises occurring in different countries are also likely to get transmitted rapidly to other countries.

v. Risky dependence of underdeveloped countries on foreign nations impairs economic autonomy and endangers their political sovereignty. Such reliance often leads to widespread exploitation and loss of cultural identity. Substantial dependence may also have severe adverse consequences in times of wars and other political disturbances.

vi. Welfare of people may often be ignored or jeopardized for the sake of profit. Excessive exports may cause shortages of many commodities in the exporting countries and lead to high inflation (e.g. onion price rise in 2014; export ban on all non-basmati rice in an attempt to reign in soaring prices and to ensure sufficient stocks for domestic consumption as global reserve levels hit a 25-year low). Also, import of harmful products or international trade in hazardous chemicals may cause health hazards and environmental damage in those countries which do not have sufficient infrastructure or capacity to scrutinize such imports.

vii. Too much export orientation may distort actual investments away from the genuine investment needs of a country.

viii. Instead of cooperation among nations, trade may breed rivalry on account of severe competition

ix. Finally, there is often lack of transparency and predictability in respect of many aspects related to trade policies of trading partners. There are also many risks in trade which are associated with changes in governments' policies of participating countries, such as imposition of an import ban, high import tariffs or trade embargoes.

IMPORTANT THEORIES OF INTERNATIONAL TRADE

You might have noticed that many goods and services are imported by us because they are simply not produced in our country for various reasons and therefore not available domestically. However, we do import many things which can be produced or are being produced within our country. Why do we do so? Is it beneficial to engage in international trade? The theories of international trade which we discuss in the following sections provide answers to these and other related questions.

THE MERCANTILISTS' VIEW OF INETRNATIONAL TRADE

Mercantilism, which was the policy of Europe's great powers, was based on the premise that national wealth and power are best served by increasing exports and collecting precious metals in return. Mercantilists also believed that the more gold and silver a country accumulates, the richer it becomes. Mercantilism advocated maximizing exports in order to bring in more "specie" (money in the form of precious metals rather than notes) and minimizing imports through the state imposing very high

tariffs on foreign goods. This view argues that trade is a 'zero-sum game', with winners who win, does so only at the expense of losers and one country's gain is equal to another country's loss, so that the net change in wealth or benefits among the participants is zero. The arguments put forth by mercantilists were later proved to have many shortcomings by later economists. Although it is still very important theory which explains policies followed by many big and fast-growing economies in Asia.

THE THEORY OF ABSOLUTE ADVANTAGE

Adam Smith was the first to put across the possibility that international trade is not a zero-sum game. According to Adam Smith who supported unrestricted trade and free international competition, absolute cost advantage is the determinant of mutually beneficial international trade. The absolute cost advantage theory points out that a country will specialize in the production and export of a commodity in which it has an absolute cost advantage. In other words, exchange of goods between two countries will take place only if each of the two countries can produce one commodity at an absolutely lower production cost than the other country.

Smith's thoughts on the principle of division of labour constitute the basis for his theory of international trade and therefore, the value of goods is determined by measuring the labour incorporated in them. The theory is generally presented with an example of a hypothetical two countries and two commodities model (2x2 model). Absolute advantage exists between nations when they differ in their ability to produce goods. Each nation can produce one good with less expenditure of human labour or more cheaply than the other. As a result, each nation has an absolute advantage in the production of one good. Absolute advantage can be explained with a simple numerical example given in table 4.1.1:

Table 4.1.1
Output per hour of labour

Commodity	Country A	Country B
Wheat (bushels/hour)	6	1
Cloth (yards/hour)	4	5

As can be seen from the above table, one hour of labour time produces 6 bushels and 1 bushel of wheat respectively in country A and country B. On the other hand, one hour of labour time produces 4 yards of cloth in country A and 5 in country B. Country A is more efficient than country B, or has an absolute advantage over country B in production of wheat. Similarly, country B is more efficient than country A, or has an absolute advantage over country A in the production of cloth. If both nations can engage in trade with each other, each nation will specialize in the production of the good, it has an absolute advantage in and obtain the other commodity through international trade. Therefore, country A would specialise completely in production of wheat and country B in cloth.

If country A exchanges six bushels of wheat (6W) for six yards of country B's cloth (6C), then country A gains 2C or saves half an hour or 30 minutes of labour time (since the country A can only exchange 6W for 4C domestically). Similarly, the 6W that country B receives from country A is equivalent to or would require six hours of labour time to produce in country B. These same six hours can produce 30C in country B (6 hours x 5 yards of cloth per hour). By being able to exchange 6C (requiring a little over one hour to produce in the country B) for 6W, country B gains 24C, or saves nearly five hours of work.

This example shows trade is advantageous, although gains may not be distributed equally, because their given resources are utilised more efficiently, and, therefore, both countries can produce larger quantities of commodities which they specialize in. By specialising and trading freely, global output is , thus, maximized and more of both goods are available to the consumers in both the countries. If they specialise but do not trade freely, country A's consumers would have no wheat, and country B's consumers would have no cloth. That is not a desirable situation.

The theory discussed above gives us the impression that mutually gainful trade is possible only when one country has absolute advantage and the other has absolute disadvantage in the production of at least one commodity. What happens if a country had higher productivity in both commodities compared to another country? Let us now think of a situation where country A makes both wheat and cloth with fewer resources than country B. In other words, country A has absolute advantage in the production of both commodities and country B has absolute disadvantage in the production of both commodities. This is the question that Ricardo attempted to answer when he formalized the concept of 'comparative advantage' to espouse the argument that even when one country is technologically superior in both goods, it could still be advantageous for them to trade.

THE THEORY OF COMPARATIVE ADVANTAGE

David Ricardo developed the classical theory of comparative advantage in his book 'Principles of Political Economy and Taxation' published in 1817. The law of comparative advantage states that even if one nation is less efficient than (has an absolute disadvantage with respect to) the other nation in the production of all commodities, there is still scope for mutually beneficial trade. The first nation should specialize in the production and export of the commodity in which its absolute disadvantage is smaller (this is the commodity of its comparative advantage) and import the commodity in which its absolute disadvantage is greater (this is the commodity of its comparative disadvantage). Comparative advantage differences between nations are explained by exogenous factors which could be due to the differences in national characteristics. Labour differs in its productivity internationally and different goods have different labour requirements, therefore comparative labour productivity advantage was Ricardo's predictor of trade.

The theory can be explained with a simple example given in table 4.1.2:

Table 4.1.2
Output per hour of labour

Commodity	Country A	Country B

Wheat (bushels/hour)	6	1
Cloth (yards/hour)	4	5

Table 4.1.2 differs from table 4.1.1 only in one respect; i.e., in this example, country B can produce only two yards of cloth per hour of labour. Country B has now absolute disadvantage in the production of both wheat and cloth. However, since B's labour is only half as productive in cloth but six times less productive in wheat compared to country A, country B has a comparative advantage in cloth. On the other hand, country A has an absolute advantage in both wheat and cloth with respect to the country B, but since its absolute advantage is greater in wheat (6:1) than in cloth (4:2), country A has a comparative advantage in production and exporting wheat.

In a two-nation, two-commodity world, once it is established that one nation has a comparative advantage in one commodity, then the other nation must necessarily have a comparative advantage in the other commodity. Put in other words, country A's absolute advantage is greater in wheat, and so country A has a comparative advantage in producing and exporting wheat. Country B's absolute disadvantage is smaller in cloth, so its comparative advantage lies in cloth production. According to the law of comparative advantage, both nations can gain if country A specialises in the production of wheat and exports some of it in exchange for country B's cloth. Simultaneously, country B should specialise in the production of cloth and export some of it in exchange for country A's wheat.

How do these two countries gain from trade by each country specializing in the production and export of the commodity of its comparative advantage? We need to show that both nations can gain from trade even if one of them (in this case country B) is less efficient than the other in the production of both commodities.

Assume that country A could exchange 6W for 6C with country B. Then, country A would gain 2C (or save half an hour of labour time) since the country A could only exchange 6W for 4C domestically. We need to show now that country B would also gain from trade. We can observe from table 4.1.2 that the 6W that the country B receives from the country A would require six hours of labour time to produce in country B. With trade, country B can instead use these six hours to produce 12C and give up only 6C for 6W from the country A. Thus, the country B would gain 6C or save three hours of labour time and country A would gain 2C. However, the gains of both countries are not likely to be equal.

However, we need to recognize that this is not the only rate of exchange at which mutually beneficial trade can take place. Country A would gain if it could exchange 6W for more than 4C from country B; because 6W for 4C is what it can exchange domestically (both require the same one hour labour time). The more C it gets, the greater would be the gain from trade.

Conversely, in country B, 6W = 12C (in the sense that both require 6 hours to produce). Anything less than 12C that country B must give up to obtain 6W from country A represents a gain from trade for country B. To summarize, country A gains to the extent that it can exchange 6W for more than 4C from the country B. Country B gains to the extent that it can give up less than 12C for 6W from country A. Thus, the range for mutually advantageous trade is $4C < 6W < 12C$.

The spread between 12C and 4C (i.e., 8C) represents the total gains from trade available to be shared by the two nations by trading 6W for 6C. The closer the rate of exchange is to 4C = 6W (the domestic or internal rate in country A), the smaller is the share of the gain going to country A and the larger is the share of the gain going to country B. Alternatively, the closer the rate of exchange is to 6W = 12C (the domestic or internal rate in country B), the greater is the gain of country A relative to that country B. However, if the absolute disadvantage that one nation has with respect to another nation is the same in both commodities, there will be no comparative advantage and no trade.

Ricardo based his law of comparative advantage on the 'labour theory of value', which assumes that the value or price of a commodity depends exclusively on the amount of labour going into its production. This is quite unrealistic because labour is not the only factor of production, nor is it used in the same fixed proportion in the production of all commodities.

In 1936, Haberler resolved this issue when he introduced the opportunity cost concept from Microeconomic theory to explain the theory of comparative advantage in which no assumption is made in respect of labour as the source of value. Opportunity cost is basically the value of the forgone option. It is the 'real' cost in microeconomic terms, as opposed to cost given in monetary units. According to the opportunity cost theory, the cost of a commodity is the amount of a second commodity that must be given up to release just enough resources to produce one extra unit of the first commodity.

The opportunity cost of producing one unit of good X in terms of good Y may be computed as the amount of labour required to produce one unit of good X divided by the amount of labour required to produce one unit of good Y. That is, how much Y do we have to give up in order to produce one more unit of good X. Logically, the nation with a lower opportunity cost in the production of a commodity has a comparative advantage in that commodity (and a comparative disadvantage in the second commodity).

In the above example, we find that country A must give up two-thirds of a unit of cloth to release just enough resources to produce one additional unit of wheat domestically. Therefore, the opportunity cost of wheat is two-thirds of a unit of cloth (i.e., 1W = 2/3C in country A). Similarly, in country B, we find that 1W = 2C, and therefore, the opportunity cost of wheat (in terms of the amount of cloth that must be given up) is lower in country A than in country B, and country A would have a comparative (cost) advantage over country B in wheat.

In a two-nation, two-commodity world, if country A has a comparative advantage in wheat, then country B will have a comparative advantage in cloth. Therefore, country A should consider specializing in producing wheat and export some of it in exchange for cloth produced in country B. By such specialization and trade, both nations will be able to consume more of both commodities than what would have been possible without trade.

In summary, international differences in relative factor-productivity are the cause of comparative advantage and a country exports goods that it produces relatively efficiently. This fact points to a tendency towards complete specialization in production. Ricardo demonstrated that for two nations without input factor mobility, specialization and trade could result in increased total output and lower

costs than if each nation tried to produce in isolation. Trade generates welfare gains and both countries can potentially gain from trade. Therefore, international trade need not be a zero-sum game.

However, the Ricardian theory of comparative advantage suffers from many limitations. Its emphasis is on supply conditions and excludes demand patterns. Moreover, the theory does not examine why countries have different costs. The theory of comparative advantage also does not answer the important question: Why does a nation have comparative advantage in the production of a commodity and comparative disadvantage in the production of another? The answer to this question is provided by the Heckscher-Ohlin theory.

THE HECKSCHER-OHLIN THEORY OF TRADE

The Heckscher-Ohlin theory of trade, (named after two Swedish economists, Eli Heckscher and his student Bertil Ohlin), also referred to as Factor-Endowment Theory of Trade or Modern Theory of Trade, is considered as a very important theory of international trade. In view of the contributions made by P. A. Samuelson, this theory is also sometimes referred to as Heckscher-Ohlin- Samuelson theorem.

The Heckscher-Ohlin (H-O) model studies the case that two countries have different factor endowments under identical production function and identical preferences. The difference in factor endowment results in two countries having different factor prices in the beginning. Consequently, H-O model implies that the two countries will have different cost functions.

The Heckscher-Ohlin theory of trade states that comparative advantage in cost of production is explained exclusively by the differences in factor endowments of the nations. In a general sense of the term, 'factor endowment' refers to the overall availability of usable resources including both natural and man-made means of production. Nevertheless, in the exposition of the modern theory, only the two most important factors—labour and capital—are taken into account.

According to this theory, international trade is but a special case of inter-regional trade. Different regions have different factor endowments, that is, some regions have abundance of labour, but scarcity of capital; whereas other regions have abundance of capital, but scarcity of labour. Different goods have different production functions, that is, factors of production are combined in different proportions to produce different commodities. While some goods are produced by employing a relatively larger proportion of labour and relatively small proportion of capital, other goods are produced by employing a relatively small proportion of labour and relatively large proportion of capital. Thus, each region is suitable for the production of those goods for whose production it has relatively abundant supply of the requisite factors. A region is not suitable for production of those goods for whose production it has relatively scarce or zero supply of essential factors. Hence different regions have different capacity to produce different commodities. Therefore, difference in factor endowments is the main cause of international trade as well as inter-regional trade.

According to Ohlin, the immediate cause of inter-regional trade is that goods can be bought cheaper in terms of money than they can be produced at home and this is the case of international trade as well. The cause of difference in the relative prices of goods is the difference the amount of factor endowments, like capital and labour, between two countries.

The theory states that a country's exports depend on endowment of resources i.e. whether the country is capital-abundant or labour-abundant. If a country is a capital abundant one, it will produce and export capital-intensive goods relatively more cheaply than other countries. Likewise, a labour-abundant country will produce and export labour-intensive goods relatively more cheaply than another country. The labour-abundant countries have comparative cost advantage in the production of goods which require labour-intensive technology and by the same reasoning; capital-abundant countries have comparative cost advantage in the production of goods that need capital-intensive technology.

The Heckscher-Ohlin theory of foreign trade can be stated in the form of two theorems namely, Heckscher-Ohlin Trade Theorem and Factor-Price Equalization Theorem.
The Heckscher-Ohlin Trade Theorem establishes that a country tends to specialize in the export of a commodity whose production requires intensive use of its abundant resources and imports a commodity whose production requires intensive use of its scarce resources.

The 'Factor-Price Equalization' Theorem states that international trade tends to equalize the factor prices between the trading nations. In the absence of foreign trade, it is quite likely that factor prices are different in different countries. International trade equalizes the absolute and relative returns to homogenous factors of production and their prices. In other words, the wages of homogeneous labour and returns to homogeneous capital will be the same in all those nations which engage in trading.

The factor price equalization theorem postulates that if the prices of the output of goods are equalized between countries engaged in free trade, then the price of the input factors will also be equalized between countries. This implies that the wages and rents will converge across the countries with free trade, or in other words, trade in goods is a perfect substitute for trade in factors. The Heckscher-Ohlin theorem, thus, puts forth that foreign trade eliminates the factor price differentials. The factor price equalization theorem is in fact a corollary to the Heckscher-Ohlin trade theory. It holds true only as long as Heckcher-Ohlin Theorem holds true.

The basic assumption of the Heckscher-Ohlin theorem is that the two countries share the same production technology and that markets are perfectly competitive. The opening up to trade for a labour-abundant country, will increase the price of labour-intensive goods, say clothes, and, thus, lead to an expansion of clothes production. As there is demand for exports of clothes in foreign markets, the demand for factors of production increases in the clothes sector. Because clothes are labour-intensive goods, an increasing demand for labour in the factor market will attract labour from the capital-intensive industry, within the country, say machine, tools. The expanding clothes industry absorbs relatively more labour than the amount released by the contracting machine tools industry.

The price of labour goes up, and whilst its relative price increases, the relative price of capital declines. As a result, capital returns decreases in relation to wage rate and the factors of production will become more capital-intensive in both sectors leading to a decline in the marginal productivity of capital and an increase in that of labour in both sectors. Similarly, when country B increases its specialization in the production of capital-intensive commodity, its demand for capital increases causing capital returns to increase in relation to wage rate. This means that specialization leads to change in relative factor prices.

When the prices of the output of goods are equalized between countries as they move to free trade, then the prices of the factors (capital and labour) will also be equalized between countries. It means that product mobility and factor mobility become perfect substitutes.

With trade, whichever factor receives the lowest price before two countries integrate economically and effectively become one market, will therefore tend to become more expensive relative to other factors in the economy, while those with the highest price will tend to become cheaper. This process will continue till factor prices are equalized between the trading nations.
The table 4.1.3 presents, though not exhaustive, a comparison of the theory of comparative costs and modern theory.

Table 4.1.3
Comparison of Theory of Comparative Costs and Modern Theory

Theory of Comparative Costs	Modern Theory
The basis is the difference between countries is comparative costs	Explains the causes of differences in comparative costs as differences n factor endowments
Based on labour theory of value	Based on money cost which is more realistic.
Considered labour as the sole factor of production and presents a one- factor (labour) model	Widened the scope to include labour and capital as important factors of production. This is 2-factor model and can be extended to more factors.
Treats international trade as quitedistinct from domestic trade	International trade is only a special case of inter-regional trade.
Studies only comparative costs of thegoods concerned	Considers the relative prices of the factors which influence the comparative costs of the goods
Attributes the differences in comparative advantage to differences in productive efficiency of workers	Attributes the differences in comparative advantage to the differences in factor endowments.
Does not take into account the factorprice differences	Considers factor price differences as the main cause of commodity price differences

Does not provide the cause ofdifferences in comparative advantage.	Explains the differences in comparative advantage in terms of differences in factor endowments.
Normative; tries to demonstrate thegains from international trade	Positive; concentrates on the basis of trade

NEW TRADE THEORY – AN INTRODUCTION

New Trade Theory (NTT) is an economic theory that was developed in the 1970s as a way to understand international trade patterns. NTT helps in understanding why developed and big countries are trade partners when they are trading similar goods and services. These countries constitute more than 50% of world trade.

This is particularly true in key economic sectors such as electronics, IT, food, and automotive. We have cars made in the India, yet we purchase many cars made in other countries.

These are usually products that come from large, global industries that directly impact international economies. The mobile phones that we use are a good example. India produces them and also imports them. NTT argues that, because of substantial economies of scale and network effects, it pays to export phones to sell in another country. Those countries with the advantages will dominate the market, and the market takes the form of monopolistic competition.

Monopolistic competition tells us that the firms are producing a similar product that isn't exactly the same, but awfully close. According to NTT, two key concepts give advantages to countries that import goods to compete with products from the home country:

- **Economies of Scale:** As a firm produces more of a product, its cost per unit keeps going down. So if the firm serves domestic as well as foreign market instead of just one, then it can reap the benefit of large scale of production consequently the profits are likely to be higher.
- **Network effects** refer to the way one person's value for a good or service is affected by the value of that good or service to others. The value of the product or service is enhanced as the number of individuals using it increases. This is also referred to as the 'bandwagon effect'. Consumers like more choices, but they also want products and services with high utility, and the network effect increases utility obtained from these products over others. A good example will be Mobile App such as What's App and software like Microsoft Windows.

SUMMARY

- International trade is the exchange of goods and services as well as resources between countries and involves greater complexity compared to internal trade.

- Trade can be a powerful stimulus to economic efficiency contributes to economic growth and rising incomes, enlarges manufacturing capabilities, ensures benefits from economies of large scale production, and enhances competitiveness and profitability by adoption of cost reducing technology and business practices.
- Efficient deployment of productive resources to their best use, productivity gains, decrease in the likelihood of domestic monopolies, cost-effective sourcing of inputs and components internationally, innovative products at lower prices and wider choice in products and services for consumers are claimed as benefits of trade.
- Enhanced foreign exchange reserves, increased scope for mechanization and specialisation, research and development, creation of jobs, reduction in poverty, augmenting factor incomes, raising standards of livelihood, increase in overall demand for goods and services and greater stimulus to innovative services are other benefits of trade.
- There are also other possible positive outcomes of trade in the form of prospects of employment generating investments, improvement in the quality of output, superior products, labour and environmental standards, broadening of productive base, export diversification, stability in prices and supply of goods, human resource development and strengthening of bonds between nations.
- The arguments against trade converge on negative labour market outcomes, economic exploitation, profit-driven exhaustion of natural resources, shift towards a consumer culture, risky dependence, shortages resulting in inflation, disregard for welfare of people, quick transmission of trade cycles, rivalries and risks in trade associated with changes in governments' policies of participating countries.
- Mercantilism advocated maximizing exports in order to bring in more precious metals and minimizing imports through the state imposing very high tariffs on foreign goods.
- According to Adam Smith's Absolute Cost Advantage theory, a country will specialize in the production and export of a commodity in which it has an absolute cost advantage.
- Ricardo's theory of comparative advantage states that a nation should specialize in the production and export of the commodity in which its absolute disadvantage is smaller (this is the commodity of its comparative advantage) and import the commodity in which its absolute disadvantage is greater (this is the commodity of its comparative disadvantage).
- Haberler resolved the issue of dependence on labour alone in the case of theory of comparative advantage when he introduced the opportunity cost concept. Opportunity cost which is the value of the forgone option.
- The Heckscher-Ohlin theory of trade also referred to as Factor-Endowment Theory of Trade or Modern Theory of Trade, states that comparative advantage in cost of production is explained exclusively by the differences in factor endowments.

- A country tends to specialize in the export of a commodity whose production requires intensive use of its abundant resources and imports a commodity whose production requires intensive use of its scarce resources.
- Accordingly, a capital abundant country will produce and export capital- intensive goods relatively more cheaply and a labour-abundant country will produce and export labour-intensive goods relatively more cheaply than other country.
- The Factor-Price Equalization Theorem states that international trade equalizes the factor prices between the trading nations. Therefore, with free trade, wages and returns on capital will converge across the countries.
- NTT is the latest entrant to explain the rising proportion of world trade between the developed and bigger developing economies (such as BRICS), which trade in similar products. These countries constitute more than 50% of world trade.

UNIT II
THE INSTRUMENTS OF TRADE POLICY

INTRODUCTION

Before we go into the subject matter of this unit, we shall take a quick look into a few recent developments in the international trade arena.

- 21 June 2020: China has lost a dispute to the European Union at the World Trade Organization (WTO) for a market economy status, as the former allowed the dispute to lapse. According to the EU, China subsidizes its industries to a great extent, particularly steel and aluminium, making their sales prices in the international market unfair.
- 21 June 2020: India argues against farm tariff concessions to ease Covid-19 woes and proposes that only a balanced, inclusive and calibrated response is needed to tackle temporary crisis.
- 2nd July 2020: China sees India's ban on 59 apps with Chinese links as 'discriminatory', and calls for reversal of the move as it has been discriminatory and selective, and may have violated World Trade Organization (WTO) rules.
- 8th July 2020: India asked Japan to lower the entry barriers in agricultural and pharmaceutical sectors.
- 19th July 2020: The WTO to set up dispute panels against India on request from Japan and Taiwan. The panels will look into the request against import duties on mobile phones and ICT products imposed by New Delhi.
- 15TH September 2020: The WTO ruled that the tariffs the USA imposed on Chinese goods in 2018, triggering a trade war, were inconsistent with international trade rules.

The above vignettes are just a few of the multitudes of episodes that arise almost on a daily basis when countries engage in trade. A glance at similar newspaper reports makes it obvious that governments do not conform to free trade despite the potential efficiency and welfare outcomes it will generate; rather, they employ different devices for restricting the free flow of goods and services across their borders.

As we know, under free trade, buyers and sellers from separate economies voluntarily trade with minimum of state interference. The free interplay of market forces of supply and demand decides prices. Protectionism, on the other hand, is a state policy aimed to protect domestic producers against foreign competition through the use of tariffs, quotas and non-tariff trade policy instruments. Trade liberalization refers to opening up of domestic markets to goods and services from the rest of the world by bringing down trade barriers.

In unit 1, we have seen that there are clear efficiency benefits from trade in terms of economic growth, job-creation and welfare. The persuasive academic arguments for open trade presuppose that fair competition, without distortions, is maintained between domestic and foreign producers. However, it is a fact that fair competition does not always exist and unobstructed international trade also brings in severe dislocation to many domestic firms and industries on account of difficult adjustment problems. Therefore, individuals and organisations continue to pressurize policy makers and regulatory authorities to restrict imports or to artificially boost up the size of exports.

Historically, as part of their protectionist measures, governments of different countries have applied many different types of policy instruments, not necessarily based on their economic merit, for restricting free flow of goods and services across national boundaries. While some such measures of government intervention are simple, widespread, and relatively transparent, others are complex, less apparent and frequently involve many types of distortions.

In this unit, we shall describe some of the most frequently used forms of interference with trade. Understanding the uses and implications of the common trade policy instruments, will enable formulation of appropriate policy responses and more balanced dialogues on trade policy issues and international trade agreements.

Trade policy encompasses all instruments that governments may use to promote or restrict imports and exports. Trade policy also includes the approach taken by countries in trade negotiations. While participating in the multilateral trading system and/or while negotiating bilateral trade agreements, countries assume obligations that shape their national trade policies. The instruments of trade policy that countries typically use to restrict imports and/ or to encourage exports can be broadly classified into price- related measures such as tariffs and non- price measures or non-tariff measures (NTMs).

In the following sections, we shall briefly touch upon the different trade policy measures adopted by countries to protect their domestic industries.

TARIFFS

Tariffs, also known as customs duties, are basically taxes or duties imposed on goods and services which are imported or exported. Different tariffs are generally applied to different commodities. It is

defined as a financial charge in the form of a tax, imposed at the border on goods going from one customs territory to another. They are the most visible and universally used trade measures that determine market access for goods. Instead of a single tariff rate, countries have a tariff schedule which specifies the tariff collected on every particular good and service. Import duties being pervasive than export duties, tariffs are often identified with import duties and in this unit, the term 'tariff' would refer to import duties.

Tariffs are aimed at altering the relative prices of goods and services imported, so as to contract the domestic demand and thus regulate the volume of their imports. Tariffs leave the world market price of the goods unaffected; while raising their prices in the domestic market. The main goals of tariffs are to raise revenue for the government, and more importantly to protect the domestic import-competing industries.

FORMS OF IMPORT TARIFFS

i. Specific Tariff: Specific tariff is the fixed amount of money per physical unit or according to the weight or measurement of the commodity imported or exported. This tariff can vary according to the type of good imported. Example, a specific tariff of `1000/ may be charged on each imported bicycle. The disadvantage of specific tariff as an instrument for protection of domestic producers is that its protective value varies inversely with the price of the import. For example: if the price of the imported cycle is `5,000/- and the rate of tariff is 20%; then, if due to inflation, the price of bicycle rises to `10,000, the specific tariff is still only 10% of the value of the import. Since the calculation of these duties does not involve the value of merchandise, customs valuation is not applicable in this case.

ii. Ad valorem tariff: When the duty is levied as a fixed percentage of the value of the traded commodity, it is called as valorem tariff. An ad valorem tariff is levied as a constant percentage of the monetary value of one unit of the imported good. A 20% ad valorem tariff on any bicycle generates a`1000/ payment on each imported bicycle priced at `5,000/ in the world market; and if the price rises to `10,000, it generates a payment of `2,000/. While ad valorem tariff preserves the protective value of tariff on home producer, it gives incentives to deliberately undervalue the good's price on invoices and bills of lading to reduce the tax burden. Nevertheless, ad valorem tariffs are widely used across the world.

There are many other variations of the above tariffs, such as:

a) Mixed Tariffs: Mixed tariffs are expressed either on the basis of the value of the imported goods (an ad valorem rate) or on the basis of a unit of measure of the imported goods (a specific duty) depending on which generates the most income(or least income at times) for the nation. For example, duty on cotton: 5 per cent ad valorem or ` 3000/per tonne, whichever is higher.

Compound Tariff or a Compound Duty is a combination of an ad valorem and a specific tariff. That is, the tariff is calculated on the basis of both the value of the imported goods (an ad

valorem duty) and a unit of measure of the imported goods (a specific duty). It is generally calculated by adding up a specific duty to an ad valorem duty. Thus, on an import with quantity q and price p, a compound tariff collects a revenue equal to $t_s q + t_a pq$, where ts is the specific tariff and at is the ad valorem tariff. For example: duty on cheese at 5 per cent advalorem plus 100 per kilogram.

b) Technical/Other Tariff: These are calculated on the basis of the specific contents of the imported goods i.e. the duties are payable by its components or related items. For example: `3000/ on each solar panel plus` 50/ per kg on the battery.

c) Tariff Rate Quotas: Tariff rate quotas (TRQs) combine two policy instruments: quotas and tariffs. Imports entering under the specified quota portion are usually subject to a lower (sometimes zero) tariff rate. Imports above the quantitative threshold of the quota face a much higher tariff.

d) Most-Favoured Nation Tariffs: MFN tariffs refer to import tariffs which countries promise to impose on imports from other members of the WTO, unless the country is part of a preferential trade agreement (such as a free trade area or customs union). This means that, in practice, MFN rates are the highest (most restrictive) that WTO members charge each other. Some countries impose higher tariffs on countries that are not part of the WTO.

e) Variable Tariff: A duty typically fixed to bring the price of an imported commodity up to level of the domestic support price for the commodity.

f) Preferential Tariff: Nearly all countries are part of at least one preferential trade agreement, under which they promise to give another country's products lower tariffs than their MFN rate. These agreements are reciprocal. A lower tariff is charged from goods imported from a country which is given preferential treatment. Examples are preferential duties in the EU region under which a good coming from one EU country to another is charged zero tariff rate. Another example is North American Free Trade Agreement (NAFTA) among Canada, Mexico and the USA where the preferential tariff rate is zero on essentially all products. Countries, especially the affluent ones also grant 'unilateral preferential treatment' to select list of products from specified developing countries. The Generalized System of Preferences (GSP) is one such system which is currently prevailing.

g) Bound Tariff: Under this, a WTO member binds itself with a legal commitment not to raise tariff rate above a certain level. By binding a tariff rate, often during negotiations, the members agree to limit their right to set tariff levels beyond a certain level. The bound rates are specific to individual products and represent the maximum level of import duty that can be levied on a product imported by that member. A member is always free to impose a tariff that is lower than the bound level. Once bound, a tariff rate becomes permanent and a member can only increase its level after negotiating with its trading partners and compensating them for possible losses of trade. A bound tariff ensures transparency and predictability.

h) Applied Tariffs: An 'applied tariff' is the duty that is actually charged on imports on a Most-Favoured Nation (MFN) basis. A WTO member can have an applied tariff for a product that differs from the bound tariff for that product as long as the applied level is not higher than the bound level.

i) Escalated Tariff structure refers to the system wherein the nominal tariff rates on imports of manufactured goods are higher than the nominal tariff rates on intermediate inputs and raw materials, i.e. the tariff on a product increases as that product moves through the value-added chain. For example, a four percent tariff on iron ore or iron ingots and twelve percent tariff on steel pipes. This type of tariff is discriminatory as it protects manufacturing industries in importing countries and dampens the attempts of developing manufacturing industries of exporting countries. This has special relevance to trade between developed countries and developing countries. Developing countries are thus forced to continue to be suppliers of raw materials without much value addition.

j) Prohibitive tariff: A prohibitive tariff is one that is set so high that no imports can enter.

k) Import subsidies: Import subsidies also exist in some countries. An import subsidy is simply a payment per unit or as a percent of value for the importation of a good (i.e., a negative import tariff).

l) Tariffs as Response to Trade Distortions: Sometimes countries engage in 'unfair' foreign-trade practices which are trade distorting in nature and adverse to the interests of the domestic firms. The affected importing countries, upon confirmation of the distortion, respond quickly by measures in the form of tariff responses to offset the distortion. These policies are often referred to as "trigger-price" mechanisms. The following sections relate to such tariff responses to distortions related to foreign dumping and export subsidies.

m) Anti-dumping Duties: An anti-dumping duty is a protectionist tariff that a domestic government imposes on foreign imports that it believes are priced below fair market value. Dumping occurs when manufacturers sell goods in a foreign country below the sales prices in their domestic market or below their full average cost of the product. Dumping may be persistent, seasonal, or cyclical. Dumping may also be resorted to as a predatory pricing practice to drive out established domestic producers from the market and to establish monopoly position. Dumping is an international price discrimination favouring buyer of exports, but in fact, the exporters deliberately forego money in order to harm the domestic producers of the importing country.

Dumping is unfair and constitutes a threat to domestic producers and therefore when dumping is found, anti-dumping measures may be initiated as a safeguard instrument by imposing additional import duties/tariffs so as to offset the foreign firm's unfair price advantage. This is justified only if the domestic industry is seriously injured by import competition, and protection is in the national interest (that is, the associated costs to consumers would be less than the benefits that would accrue to producers). For example: In January 2017, India

imposed anti-dumping duties on colour-coated or pre- painted flat steel products imported into the country from China and European nations for a period not exceeding six months and for jute and jute products from Bangladesh and Nepal.

n) Countervailing Duties: Countervailing duties are tariffs that aim to offset the artificially low prices charged by exporters who enjoy export subsidies and tax concessions offered by the governments in their home country. If a foreign country does not have a comparative advantage in a particular good and a government subsidy allows the foreign firm to be an exporter of the product, then the subsidy generates a distortion from the free-trade allocation of resources. In such cases, CVD is charged in an importing country to negate the advantage that exporters get from subsidies to ensure fair and market-oriented pricing of imported products and thereby protecting domestic industries and firms. For example, in 2016, in order to protect its domestic industry, India imposed 12.5% countervailing duty on Gold jewellery imports from ASEAN.

EFFECTS OF TARIFFS

A tariff levied on an imported product affects both the exporting country and the importing country.

i. Tariff barriers create obstacles to trade, decrease the volume of imports and exports and therefore of international trade. The prospect of market access of the exporting country is worsened when an importing country imposes a tariff.

ii. By making imported goods more expensive, tariffs discourage domestic consumers from consuming imported foreign goods. Domestic consumers suffer a loss in consumer surplus because they must now pay a higher price for the good and also because compared to free trade quantity, they now consume lesser quantity of the good.

iii. Tariffs encourage consumption and production of the domestically produced import substitutes and thus protect domestic industries.

iv. Producers in the importing country experience an increase in well-being as a result of imposition of tariff. The price increase of their product in the domestic market increases producer surplus in the industry. They can also charge higher prices than would be possible in the case of free trade because foreign competition has reduced

v. The price increase also induces in the output of the existing firms and possibly addition of new firms due to entry into the industry to entry into the industry to take advantage of the new high profits and consequently an increase in employment in the industry.

vi. Tariffs create trade distortions by disregarding comparative advantage and prevent countries from enjoying gains from trade arising from comparative advantage. Thus, tariffs discourage efficient production in the rest of the world and encourage inefficient production in the home country

vii. Tariffs increase government revenues of the importing country by the value of the total tariff it charges.

Trade liberalization in recent decades, either through government policy measures or through negotiated reduction through the WTO or regional and bilateral free trade agreements, has diminished the importance of tariff as a tool of protection. Currently, trade policy is focusing increasingly on not so easily observable forms of trade barriers usually called non-tariff measures (NTMs). NTMs are thought to have important restrictive and distortionary effects on international trade. They have become so invasive that the benefits due to tariff reduction are practically offset by them.

NON – TARIFF MEASURES (NTMS)

From the discussion above, we have learnt that tariffs constitute the visible barriers to trade and have the effect of increasing the prices of imported merchandise. By contrast, the non- tariff measures which have come into greater prominence than the conventional tariff barriers, constitute the hidden or 'invisible' measures that interfere with free trade.

Non-tariff measures (NTMs) are policy measures, other than ordinary customs tariffs, that can potentially have an economic effect on international trade in goods, changing quantities traded, or prices or both (UNCTAD, 2010).Non-tariff measures comprise all types of measures which alter the conditions of international trade, including policies and regulations that restrict trade and those that facilitate it. NTMs consist of mandatory requirements, rules, or regulations that are legally set by the government of the exporting, importing, or transit country.

It should be kept in mind that NTMs are not the same as non-tariff barriers (NTBs). NTMs are sometimes used as means to circumvent free-trade rules and favour domestic industries at the expense of foreign competition. In this case they are called non-tariff barriers (NTBs). In other words, non-tariff barriers are discriminatory non-tariff measures imposed by governments to favour domestic over foreign suppliers. NTBs are thus a subset of NTMs that have a 'protectionist or discriminatory intent'. Compared to NTBs, non-tariff measures encompass a broader set of measures.

According to WTO agreements, the use of NTMs is allowed under certain circumstances. Examples of this include the Technical Barriers to Trade (TBT) Agreement and the Sanitary and Phytosanitary Measures (SPS) Agreement, both negotiated during the Uruguay Round. However, NTMs are sometimes used as a means to circumvent free-trade rules and favour domestic industries at the expense of foreign competition. In this case they are called non-tariff barriers (NTBs). It is very difficult, and sometimes impossible, to distinguish legitimate NTMs from protectionist NTMs, especially because the same measure may be used for several reasons.

Depending on their scope and/or design NTMs are categorized as:

I. Technical Measures: Technical measures refer to product-specific properties such as characteristics of the product, technical specifications and production processes. These measures are intended for ensuring product quality, food safety, environmental protection, national security and protection of animal and plant health.
II. Non-technical Measures: Non-technical measures relate to trade requirements; for example; shipping requirements, custom formalities, trade rules, taxation policies, etc.

These are further distinguished as:

a) Hard measures (e.g. Price and quantity control measures),
b) Threat measures (e.g. Anti-dumping and safeguards) and
c) Other measures such as trade-related finance and investment measures.

Furthermore, the categorization also distinguishes between:

i. Import-related measures which relate to measures imposed by the importing country, and
ii. Export-related measures which relate to measures imposed by the exporting country itself.
iii. In addition, to these, there are procedural obstacles (PO) which are practical problems in administration, transportation, delays in testing, certification etc which may make it difficult for businesses to adhere to a given regulation.

TECHNICAL MEASURES

I. Sanitary and Phytosanitary (SPS) Measures: SPS measures are applied to protect human, animal or plant life from risks arising from additives, pests, contaminants, toxins or disease-causing organisms and to protect biodiversity.

These include ban or prohibition of import of certain goods, all measures governing quality and hygienic requirements, production processes, and associated compliance assessments. For example; prohibition of import of poultry from countries affected by avian flu, meat and poultry processing standards to reduce pathogens, residue limits for pesticides in foods etc.

II. Technical Barriers To Trade (TBT): Technical Barriers to Trade (TBT) which cover both food and non-food traded products refer to mandatory 'Standards and Technical Regulations' that define the specific characteristics that a product should have, such as its size, shape, design, labelling / marking / packaging, functionality or performance and production methods, excluding measures covered by the SPS Agreement. The specific procedures used to check whether a product is really conforming to these requirements (conformity assessment procedures e.g. testing, inspection and certification) are also covered in TBT. This involves compulsory quality, quantity and price control of goods before shipment from the exporting country.

Just as SPS, TBT measures are standards-based measures that countries use to protect their consumers and preserve natural resources, but these can also be used effectively as obstacles to imports or to discriminate against imports and protect domestic products. Altering products and production processes to comply with the diverse requirements in export markets may be either impossible for the exporting country or would obviously raise costs, hurting the competitiveness of the exporting country. Some examples of TBT are: food laws, quality

standards, industrial standards, organic certification, eco-labelling, and marketing and label requirements.

NON-TECHNICAL MEASURES

These include different types of trade protective measures which are put into operation to neutralize the possible adverse effects to imports in the market of the importing country. Following are the most commonly practiced measures in respect of imports:

i. Import Quotas: An import quota is a direct restriction which specifies that only a certain physical amount of the good will be allowed into the country during a given time period, usually one year. Import quotas are typically set below the free trade level of imports and are usually enforced by issuing licenses. This is referred to as a binding quota; a non-binding quota is a quota that is set at or above the free trade level of imports, thus having little effect on trade.

   Import quotas are mainly of two types: absolute quotas and tariff-rate quotas. Absolute quotas or quotas of a permanent nature limit the quantity of imports to a specified level during a specified period of time and the imports can take place any time of the year. No condition is attached to the country of origin of the product. For example: 1000 tonnes of fish import which can take place any time during the year from any country. When country allocation is specified, a fixed volume or value of the product must originate in one or more countries. Example: A quota of 1000 tonnes of fish that can be imported any time during the year, but where 750 tonnes must originate in country A and 250 tonnes in country B. In addition, there are seasonal quotas and temporary quotas.

   With a quota, the government, of course, receives no revenue. The profits received by the holders of such import licenses are known as 'quota rents'. While tariffs directly interfere with prices that can be charged for an imported good in the domestic market, import quota interferes with the market prices indirectly. Obviously, an import quota always raises the domestic price of the imported good. The license holders are able to buy imports and resell them at a higher price in the domestic market and they will be able to earn a 'rent' on their operations over and above the profit they would have made in a free market.

   The welfare effects of quotas are similar to that of tariffs. If a quota is set below free trade level, the amount of imports will be reduced. A reduction in imports will lower the supply of the good in the domestic market and raise the domestic price. Consumers of the product in the importing country will be worse-off because the increase in the domestic price of both imported goods and the domestic substitutes reduces consumer surplus in the market. Producers in the importing country are better-off as a result of the quota. The increase in the price of their product increases producer surplus in the industry. The price increase also induces an increase in output of existing firms (and perhaps the addition of new firms), an increase in employment, and hence an increase in profit.

ii. Price Control Measures: Price control measures (including additional taxes and charges) are steps taken to control or influence the prices of imported goods in order to support the

domestic price of certain products when the import prices of these goods are lower. These are also known as 'para-tariff' measures and include measures, other than tariff measures, that increase the cost of imports in a similar manner, i.e. by a fixed percentage or by a fixed amount. Example: A minimum import price established for sulphur.

iii. <u>Non-automatic Licensing and Prohibitions:</u> These measures are normally aimed at limiting the quantity of goods that can be imported, regardless of whether they originate from different sources or from one particular supplier. These measures may take the form of non-automatic licensing, or complete prohibitions. For example, textiles may be allowed only on a discretionary license by the importing country. India prohibits import/export of arms and related material from/to Iraq. Further, India also prohibits many items (mostly of animal origin) falling under 60 EXIM codes.

iv. <u>Financial Measures:</u> The objective of financial measures is to increase import costs by regulating the access to and cost of foreign exchange for imports and to define the terms of payment. It includes measures such as advance payment requirements and foreign exchange controls denying the use of foreign exchange for certain types of imports or for goods imported from certain countries. For example, an importer may be required to pay a certain percentage of the value of goods imported three months before the arrival of goods or foreign exchange may not be permitted for import of newsprint.

v. <u>Measures Affecting Competition:</u> These measures are aimed at granting exclusive or special preferences or privileges to one or a few limited group of economic operators. It may include government imposed special import channels or enterprises, and compulsory use of national services. For example, a statutory marketing board may be granted exclusive rights to simport wheat: or a canalizing agency (like State Trading Corporation) may be given monopoly right to distribute palm oil. When a state agency or a monopoly import agency sells in the domestic market at prices above those existing in the world market, the effect will be similar to an import tariff.

vi. <u>Government Procurement Policies:</u> Government procurement policies may interface with trade if they involve mandates that the whole of a specified percentage of government purchase should be from domestic firms rather than foreign firms, despite higher prices than similar foreign suppliers. In accepting public tenders, a government may give preferences to the local tenders rather than foreign tenders.

vii. <u>Trade-Related Investment Measures:</u> These measures include rules on local content requirements that mandate a specified fraction of a final good should be produced domestically.

a) requirement to use certain minimum levels of locally made components, (25 percent of components of automobiles to be sourced domestically)
b) restricting the level of imported components, and
c) limiting the purchase or use of imported products to an amount related to the quantity or value of local products that it exports. (A firm may import only up to 75 % of its export earnings of the previous year)

viii. Distribution Restrictions: Distribution restrictions are limitations imposed on the distribution of goods in the importing country involving additional license or certification requirements. These may relate to geographical restrictions or restrictions as to the type of agents who may resell. For example: a restriction that imported fruits may be sold only through outlets having refrigeration facilities.

ix. Restriction on Post-sales Services: Producers may be restricted from providing after- sales services for exported goods in the importing country. Such services may be reserved to local service companies of the importing country.

x. Administrative Procedures: Another potential obstruction to free trade is the costly and time-consuming administrative procedures which are mandatory for import of foreign goods. These will increase transaction costs and discourage imports. The domestic import-competing industries gain by such non- tariff measures. Examples include specifying particular procedures and formalities, requiring licenses, administrative delay, red-tape and corruption in customs clearing frustrating the potential importers, procedural obstacles linked to prove compliance etc.

xi. Rules of origin: Country of origin means the country in which a good was produced, or in the case of a traded service, the home country of the service provider. Rules of origin are the criteria needed by governments of importing countries to determine the national source of a product. Their importance is derived from the fact that duties and restrictions in several cases depend upon the source of imports. Important procedural obstacles occur in the home countries for making available certifications regarding origin of goods, especially when different components of the product originate in different countries.

xii. Safeguard Measures: These are initiated by countries to restrict imports of a product temporarily if its domestic industry is injured or threatened with serious injury caused by a surge in imports. Restrictions must be for a limited time and non – discriminatory.

xiii. Embargos: An embargo is a total ban imposed by government on import or export of some or all commodities to particular country or region for a specified or indefinite period. This may be done due to political reasons or for other reasons such as health, religious sentiments. This is the most extreme form of trade barrier.

EXPORT-RELATED MEASURES

i. Ban on exports: Export-related measures refer to all measures applied by the government of the exporting country including both technical and non- technical measures. For example, during periods of shortages, export of agricultural products such as onion, wheat etc. may be prohibited to make them available for domestic consumption. Export restrictions have an important effect on international markets. By reducing international supply, export restrictions have been effective in increasing international prices.

ii. Export Taxes: An export tax is a tax collected on exported goods and may be either specific or ad valorem. The effect of an export tax is to raise the price of the good and to decrease exports. Since an export tax reduces exports and increases domestic supply, it also reduces domestic prices and leads to higher domestic consumption.

iii. Export Subsidies and Incentives: We have seen that tariffs on imports hurt exports and therefore countries have developed compensatory measures of different types for exporters like export subsidies, duty drawback, duty-free access to imported intermediates etc. Governments or government bodies also usually provide financial contribution to domestic producers in the form of grants, loans, equity infusions etc. or give some form of income or price support. If such policies on the part of governments are directed at encouraging domestic industries to sell specified products or services abroad, they can be considered as trade policy tools.

iv. Voluntary Export Restraints: Voluntary Export Restraints (VERs) refer to a type of informal quota administered by an exporting country voluntarily restraining the quantity of goods that can be exported out of that country during a specified period of time. Such restraints originate primarily from political considerations and are imposed based on negotiations of the importer with the exporter. The inducement for the exporter to agree to a VER is mostly to appease the importing country and to avoid the effects of possible retaliatory trade restraints that may be imposed by the importer. VERs may arise when the import- competing industries seek protection from a surge of imports from particular exporting countries. VERs cause, as do tariffs and quotas, domestic prices to rise and cause loss of domestic consumer surplus.

Over the past few decades, significant transformations are happening in terms of growth as well as trends of flows and patterns of global trade. The increasing importance of developing countries has been a salient feature of the shifting global trade patterns. Fundamental changes are taking place in the way countries associate themselves for international trade and investments. Trading through regional arrangements which foster closer trade and economic relations is shaping the global trade landscape in an unprecedented way. Alongside, the trading countries also have devised ingenious policies aimed at protecting their economic interests. The discussions in this unit are in no way comprehensive considering the faster pace of discovery of such protective strategies. Students are expected to get themselves updated on such ongoing changes.

SUMMARY

- Trade policy encompasses all instruments that governments may use to promote or restrict imports and exports.
- Trade policies are broadly classified into price-related measures such as tariffs and non-price measures or non-tariff measures (NTMs).

- Tariff, also known as customs duty is defined as a financial charge in the form of a tax, imposed at the border on goods going from one customs territory to another. Tariffs are the most visible and universally used trade measures.
- A specific tariff is an import duty that assigns a fixed monetary tax per physical unit of the good imported whereas an ad valorem tariff is levied as a constant percentage of the monetary value of one unit of the imported good.
- Mixed tariffs are expressed either on the basis of the value of the imported goods (an ad valorem rate) or on the basis of a unit of measure of the imported goods (a specific duty), depending on desired yields.
- Compound Tariff or a compound duty is a combination of an ad valorem and a specific tariff and is calculated on the basis of both the value of the imported goods (an ad valorem duty) and a unit of measure of the imported goods.
- Tariff rate quotas (TRQs) combine two policy instruments namely quotas and tariffs.
- MFN tariffs are what countries promise to impose on imports from all members of the WTO, unless the country is part of a preferential trade agreement (such as a free trade area or customs union).
- Preferential tariff occurs when a country imposes tariffs lower than its MFN rate on another country's products.
- The bound tariff rate is specific to individual products and represents the maximum level of import duty that can be levied on a product imported by that member.
- An 'applied tariff' is the duty that is actually charged on imports on the most-favoured nation (MFN) basis.
- Escalated tariff structure refers to the system wherein the nominal tariff rates on imports of manufactured goods are higher than the nominal tariff rates on intermediate inputs and raw materials, i.e. the tariff on a product increases as that product moves through the value-added chain.
- A prohibitive tariff is one that is set so high that no imports will enter.
- Trigger-price mechanisms are quick responses of affected importing countries upon confirmation of trade distortion to offset the distortion. E.g. Anti-dumping duties.
- Dumping occurs when manufacturers sell goods in a foreign country below the sales prices in their domestic market or below their full average cost of the product. It hurts domestic producers.
- Anti-dumping measures are additional import duties so as to offset the foreign firm's unfair price advantage.
- Countervailing duties are tariffs to offset the artificially low prices charged by exporters who enjoy export subsidies and tax concessions offered by the governments in their home country.

- Tariff barriers create obstacles to trade, reduce the prospect of market access, make imported goods more expensive, increase consumption of domestic goods, protect domestic industries and increase government revenues
- Non-tariff measures (NTMs) are policy measures, other than ordinary customs tariffs, that can potentially have an economic effect on international trade in goods, changing quantities traded or prices or both
- Technical Barriers to Trade (TBT) are 'Standards and Technical Regulations' that define the specific characteristics that a product should have, such as its size, shape, design, labelling / marking / packaging, functionality or performance and production methods, excluding measures covered by the SPS Agreement.
- Non-technical measures relate to trade requirements; for example; shipping requirements, custom formalities, trade rules, taxation policies, etc.
- SPS measures are applied to protect human, animal or plant life from risks arising from additives, pests, contaminants, toxins or disease-causing organisms and to protect biodiversity
- An import quota is a direct restriction which specifies that only a certain physical amount of the good will be allowed into the country during a given time period, usually one year.
- The objective of financial measures is to increase import costs by regulating the access to and cost of foreign exchange for imports and to define the terms of payment.
- Government procurement policies may interfere with trade if they involve mandates that the whole of a specified percentage of purchases should be from domestic firms rather than from foreign firms
- In the case of investments, local content requirements that mandate that a specified fraction of a final good be produced domestically may act as a trade barrier.
- Rules of origin are the criteria needed by governments of importing countries to determine the national source of a product.
- Safeguard measures are initiated by countries to temporarily restrict imports of a product its domestic industry is injured by the surge in imports while an embargo is a total ban imposed by government on import or export of some or all commodities to particular country or region for a specified or indefinite period.
- An export tax is a tax collected on exported goods and may be either specific or ad valorem. An export subsidy includes financial contribution to domestic producers in the form of grants, loans, equity infusions or some form of income or price support. Both distort trade.
- Voluntary Export Restraints (VERs) refer to a type of informal quota administered by an exporting country voluntarily restraining the quantity of goods that can be exported out of that country during a specified period of time. It is imposed based on negotiations to appease the importing country and to avoid the effects of possible trade restraints

UNIT - III
TRADE NEGOTIATIONS

INTRODUCTION

The recent years have seen intense bilateral and multilateral negotiations among different nations in the international arena. India, for example, has already become part of 19 such concluded agreements and is currently negotiating more than two dozens of such proposals. Major events in the year 2020, such as Britain's exit from the European Union, the new free trade agreement [which is a successor of the North American Free Trade Agreement (NAFTA)] concluded between Canada, Mexico, and United States, namely United States–Mexico–Canada Agreement (USMCA) and many other unpredictable developments in the trade front due to trade war between the US and China and the global pandemic, make trade negotiations a highly relevant area of study.

International trade negotiations, especially the ones aimed at formulation of international trade rules, are complex interactive processes involving different countries having competing objectives. Trade negotiations are not just face to face discussions; rather they are multilevel or network games and involve intricate and time-consuming processes. They usually involve many parties who have conflicting interests and objectives. National governments are not the sole stakeholders in a trade negotiation. Many interest groups, lobbying groups, pressure groups and Non-Governmental Organizations (NGO) exert their influence on the process. As anyone can guess, the positions taken by each of the negotiating parties would represent their underlying agenda of interests. For example, in trade negotiations, when one of the parties seems to be bargaining for market access through reduction in tariffs, the other (s) may be clamouring on the issue of possible grant of protection to domestic industries.

Before we go into the discussion on multilateral trade negotiations and the related institutions, it is relevant to understand the nature of regional as well as free trade agreements which evolve through negotiations.

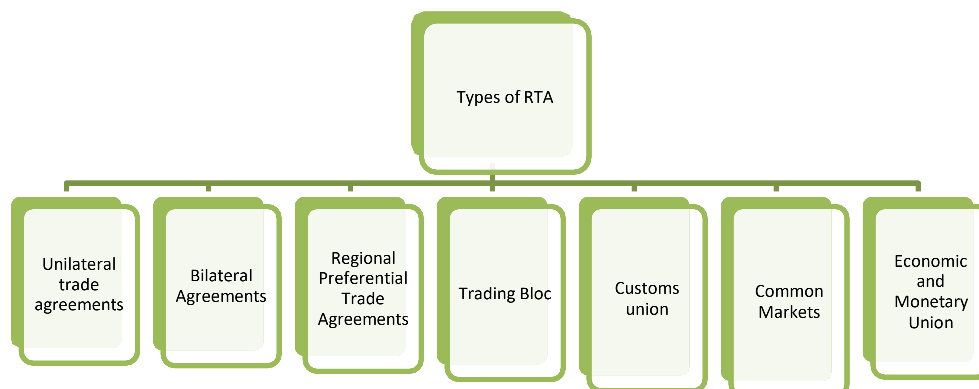
TAXONOMY OF REGIONAL TRADE AGREEMENTS (RTAS)

Regional Trade Agreements (RTAs) are defined as groupings of countries (not necessarily belonging to the same geographical region), which are formed with the objective of reducing barriers to trade between member countries. In other words, a regional trade agreement (RTA) is a treaty between two or more governments that define the rules of trade for all signatories. As of 1 February 2021, 339 RTAs were in force.

Trade negotiations result in different types of agreements which are shown in the chart below-

1. Unilateral trade agreements under which an importing country offers trade incentives in order to encourage the exporting country, to engage in international economic activities that will improve the exporting country's economy. E.g. Generalized System of Preferences

2. <u>Bilateral Agreements</u> are agreements which set rules of trade between two countries, two blocs or a bloc and a country. These may be limited to certain goods and services or certain types of market entry barriers. E.g. EU-South Africa Free Trade Agreement; ASEAN–India Free Trade Area.
3. <u>Regional Preferential Trade Agreements</u> among a group of countries reduce trade barriers on a reciprocal and preferential basis for only the members of the group. E.g. Global System of Trade Preferences among Developing Countries (GSTP)
4. <u>Trading Bloc</u> has a group of countries that have a free trade agreement between themselves and may apply a common external tariff to other countries. Example: Arab League (AL), European Free Trade Association (EFTA)
5. <u>Free-trade area</u> is a group of countries that eliminate all tariff and quota barriers on trade with the objective of increasing exchange of goods with each other. The trade among the member states flows tariff free, but the member states maintain their own distinct external tariff with respect to imports from the rest of the world. In other words, the members retain independence in determining their tariffs with non-members. Example: USMCA.
6. <u>A customs union</u> is a group of countries that eliminate all tariffs on trade among themselves but maintain a common external tariff on trade with countries outside the union (thus, technically violating MFN).The common external tariff which distinguishes a customs union from a free trade area implies that, generally, the same tariff is charged wherever a member imports goods from outside the customs union. The EU is a Customs Union; its 27 member countries form a single territory for customs purposes. Other examples are Gulf Cooperation Council (GCC), Southern Common Market (MERCOSUR).
7. <u>Common Market:</u> A Common Market deepens a customs union by providing for the free flow of output and of factors of production (labour, capital and other productive resources) by reducing or eliminating internal tariffs on goods and by creating a common set of external tariffs. The member countries attempt to harmonize some institutional arrangements and commercial and financial laws and regulations among themselves. There are also common barriers against non-members (e.g., EU, ASEAN)
8. <u>Economic and Monetary Union:</u> For a common market, the free transit of goods and services through the borders increases the need for foreign exchange operations and results in higher financial and administrative expenses of firms operating within the region. The next stage in the integration sequence is formation of some form of monetary union. In an Economic and Monetary Union, the members share a common currency. Adoption of common currency also makes it necessary to have a strong convergence in macroeconomic policies. For example, the European Union countries implement and adopt a single currency



There has been significant growth in international trade since the end of the Second World War, mostly due to multilateral trade system which is both a political process and a set of political institutions. It is a political process because it is based on negotiations and bargaining among sovereign governments based on which they arrive at rules governing trade between or among themselves. The political institutions that facilitate trade negotiations, and support international trade cooperation by providing the rules of the game have been the former General Agreements on Tariffs and Trade (GATT) and the World Trade Organization (WTO).

THE GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT)

Despite wide ranging benefits, a number of countries hinder the free flow of international trade by imposing trade barriers. It was felt necessary that all countries embark on cooperative economic relations for establishing mutual self- interest. The General Agreement on Tariffs and Trade (GATT) provided the rules for much of world trade for 47 years, from 1948 to 1994; but it was only a multilateral instrument governing international trade or a provisional agreement along with the two full-fledged "Bretton Woods" institutions, the World Bank and the International Monetary Fund. The original intention to create an International Trade Organization (ITO) as a third institution to handle the trade side of international economic cooperation did not succeed for want of endorsement by some national legislatures, especially the US.

Eight rounds of multilateral negotiations known as "trade rounds" held under the auspices GATT resulted in substantial international trade liberalization. Though the GATT trade rounds in earlier years contemplated tariff reduction as their core issue, later on the Kennedy Round in the mid-sixties, and the Tokyo Round in the 1970s led to massive reductions in bilateral tariffs, establishment of negotiation rules and procedures on dispute resolution, dumping and licensing. The arrangements were informally referred to as 'codes' because they were not acknowledged by the full GATT membership. A number of codes were ultimately amended in the Uruguay Round and got converted into multilateral commitments accepted by all WTO members. The eighth, the Uruguay Round of 1986-94, was the last and most consequential of all rounds and culminated in the birth of WTO and a new set of agreements.

The GATT lost its relevance by 1980s because

- It was obsolete to the fast-evolving contemporary complex world trade scenario characterized by emerging globalisation
- International investments had expanded substantially
- Intellectual property rights and trade in services were not covered by GATT
- World merchandise trade increased by leaps and bounds and was beyond its scope.
- the ambiguities in the multilateral system could be heavily exploited
- efforts at liberalizing agricultural trade were not successful
- there were inadequacies in institutional structure and dispute settlement system
- It was not a treaty and therefore terms of GATT were binding only insofar as they are not incoherent with a nation's domestic rules.

THE URUGUAY ROUND AND THE ESTABLISHMENT OF WTO

The need for a formal international organization which is more powerful and comprehensive was felt by many countries by late 1980s.Having settled the most ambitious negotiating agenda that covered virtually every outstanding trade policy issue, the Uruguay Round brought about the biggest reform of the world's trading system. Members established 15 groups to work on limiting restrictions in the areas of tariffs, non-tariff barriers, tropical products, natural resource products, textiles and clothing, agriculture, safeguards against sudden 'surges' in imports, subsidies, countervailing duties, trade related intellectual property restrictions, trade related investment restrictions, services and four other areas dealing with GATT itself, such as, the GATT system, dispute settlement procedures and implementation of the NTB Codes of the Tokyo Round, especially on anti- dumping.

The Round started in Punta del Este in Uruguay in September 1986 and was scheduled to be completed by December 1990. However, due to many differences and especially due to heated controversies over agriculture, no consensus was arrived at. Finally, in December 1993, the Uruguay Round, the eighth and the most ambitious and largest ever round of multilateral trade negotiations in which 123 countries participated, was completed after seven years of elaborate negotiations. The agreement was signed by most countries on April 15, 1994, and took effect on July 1, 1995. It also marked the birth of the World Trade Organization (WTO) which is the single institutional framework encompassing the GATT, as modified by the Uruguay Round.

THE WORLD TRADE ORGANIZATION (WTO)

The most important outcome of the Uruguay Round agreement was the replacement of the General Agreement on Tariffs and Trade (GATT) secretariat with the World Trade Organization (WTO) in Geneva with authority not only in trade in industrial products but also in agricultural products and services. The bulk of the WTO's present operations come from the 1986-94 negotiations called the Uruguay Round and earlier negotiations under the General Agreement on Tariffs and Trade (GATT).

Despite the fact that the WTO replaced GATT as an international organization, the General Agreement still exists as the WTO's umbrella treaty for trade in goods, updated as a result of the Uruguay Round negotiations.

The principal objective of the WTO is to facilitate the flow of international trade smoothly, freely, fairly and predictably.

The WTO has six key objectives:

1. to set and enforce rules for international trade,
2. to provide a forum for negotiating and monitoring further trade liberalization,
3. to resolve trade disputes,
4. to increase the transparency of decision-making processes,
5. to cooperate with other major international economic institutions involved in global economic management, and
6. to help developing countries benefit fully from the global trading system.

The objectives of the WTO Agreements as acknowledged in the preamble of the Agreement creating the World Trade Organization, include "raising standards of living, ensuring full employment and a large and steadily growing volume of real income and effective demand, and expanding the production of and trade in goods and services. The WTO, whose primary purpose is to open trade for the benefit of all, does its functions by acting as a forum for trade negotiations among member governments, administering trade agreements, reviewing national trade policies, assisting developing countries in trade policy issues, through technical assistance and training programmes and cooperating with other international organizations

THE STRUCTURE OF THE WTO

The WTO activities are supported by a Secretariat located in Geneva, headed by a Director General. It has a three-tier system of decision making. The WTO's top- level decision-making body is the Ministerial Conference which can take decisions on all matters under any of the multilateral trade agreements. The Ministerial Conference meets at least once every two years. The next level is the General Council which meets several times a year at the Geneva headquarters. The General Council also meets as the Trade Policy Review Body and the Dispute Settlement Body. At the next level, the Goods Council, Services Council and Intellectual Property (TRIPS) Council report to the General Council. These councils are responsible for overseeing the implementation of the WTO agreements in their respective areas of specialisation. The WTO Secretariat maintains working relations with almost 200 international organisations in activities ranging from statistics, research, standard-setting, and technical assistance and training. Numerous specialized committees, working groups and working parties deal with the individual agreements and other areas such as the environment, development, membership applications and regional trade agreements.

The WTO accounting for about 95% of world trade currently has 164 members, of which 117 are developing countries or separate customs territories. Around 24 others are negotiating membership. The WTO's agreements have been ratified in all members' parliaments.

THE GUIDING PRINCIPLES OF WORLD – TRADE ORGANIZATION (WTO)

Right from its inception, the WTO has been driven by a number of fundamental principles which are the foundations of the multilateral trading system. Followingare the major guiding principles:

1. Trade without discrimination: Most-favoured-nation (MFN): Originally formulated as Article 1 of GATT, this principle states that any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be extended immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties. Under the WTO agreements, countries cannot normally discriminate between their trading partners. If a country lowers a trade barrier or opens up a market, it has to do so for the same goods or services from all other WTO members. Under strict conditions, various permitted exceptions are allowed. For example; countries may enter into free trade agreements and trading may be done within the group discriminating against goods from outside; a country can raise barriers against products that are considered to be traded unfairly from specific countries; or they may give special market access to developing countries.

2. The National Treatment Principle (NTP): The National Treatment Principle is complementary to the MFN principle. GATT Article III requires that with respect to internal taxes, internal laws, etc. applied to imports, treatment not less favourable than that which is accorded to like domestic products must be accorded to all other members. In other words, a country should not discriminate between its own and foreign products, services or nationals. For instance, once imported apples reach Indian market, they cannot be discriminated against and should be treated at par in respect of marketing opportunities, product visibility or any other aspect with locally produced apples.

3. Free trade: Lowering trade barriers for opening up markets is one of the most obvious means of encouraging trade. But by the 1980s, the negotiations had expanded to cover non-tariff barriers on goods, and to the new areas such as services and intellectual property. Since these require adjustments, the WTO agreements permit countries to bring in changes gradually, through "progressive liberalization". Developing countries are generally given longer time to conform to their obligations.

4. Predictability: Investments will be encouraged only if the business environment is stable and predictable. The foreign companies, investors and governments should be confident that the trade barriers will not be raised arbitrarily. This is achieved through 'binding' tariff rates, discouraging the use of quotas and other measures used to set limits on quantities of imports, establishing market-opening commitments and other measures to ensure transparency. A country can change its bindings, but only after negotiating with its trading partners, which could mean compensating them for loss of trade.

5. Principle of general prohibition of quantitative restrictions: One reason for this prohibition is that quantitative restrictions are considered to have a greater protective effect than tariff measures and are more likely to distort the free flow of trade.

6. Greater competitiveness: This is to be achieved by discouraging "unfair" practices such as export subsidies, dumping etc. The rules try to establish what is fair or unfair, and how governments can take action, especially by charging additional import duties intended to compensate for injury caused by unfair trade.

7. Tariffs as legitimate measures for the protection of domestic industries: The imposition of tariffs should be the only method of protection, and tariff rates for individual items should be gradually reduced through negotiations 'on a reciprocal and mutually advantageous' basis. Member countries bind themselves to maximum rates and the imposition of tariffs beyond such maximum rates (bound rates) or the unilateral raise in bound rates are banned.

8. Transparency in Decision Making: The WTO insists that any decision by members in the sphere of trade or in respect of matters affecting trade should be transparent and verifiable. Such changes in matters of trade or of trade related rules have to be invariability and without delay be notified to all the trading partners. In case of any opposition to such changes, they should be appropriately addressed and any loss occurring to the affected members should be suitably compensated for.

9. Progressive Liberalization: Many trade issues of a controversial nature similar to labour standards, non-agricultural market access, etc. on which there was general disagreement among trading partners were left unsettled during the Uruguay Round. These are to be liberalized during consecutive rounds of discussion.

10. Market Access: The WTO aims to increase world trade by enhancing market access by converting all non- tariff barriers into tariffs which are subject to country specific limits. Further, in major multilateral agreements like the Agreement on Agriculture (AOA), specific targets have been specified for ensuring market access.

11. Special privileges to less developed countries: With majority of WTO members being developing countries and countries in transition to market economies, the WTO deliberations favour less developed countries by giving them greater flexibility, special privileges and permission to phase out the transition period. Also, these countries are granted transition periods to make adjustments to the not so familiar and intricate WTO provisions.

12. Protection of Health &Environment: The WTO's agreements support measures to protect not only the environment but also human, animal as well as plant health with the stipulation that such measures should be non- discriminatory and that members should not employ environmental protection measures as a means of disguising protectionist policies.

13. *A transparent, effective and verifiable dispute settlement mechanism:* Trade relations frequently involve conflicting interests. Any dispute arising out of violation of trade rules leading to infringement of rights under the agreements or misunderstanding arising as regards the interpretation of rules, are to be settled through consultation. In case of failures, the dispute can be referred to the WTO and can pursue a carefully mapped out, stage- by-stage procedure that includes the possibility of a judgment by a panel of experts, and the opportunity to appeal the ruling on legal grounds. The decisions of the dispute settlement body are final and binding.

OVERVIEW OF THE WTO AGREEMENTS

The WTO agreements cover goods, services and intellectual property and the permitted exceptions. These agreements are often called the WTO's trade rules, and the WTO is often described as "rules-based", a system based on rules. (The rules are actually agreements that the governments negotiated). The WTO agreements are voluminous and multifaceted. The 'Legal Texts' consist of a list of about 60 agreements, annexes, decisions and understandings covering a wide range of activities. (The list of WTO agreements is given at the end of this unit).
Following are the important agreements under WTO. Since a thorough discussion on the features of each agreement is beyond the scope of this unit, only the major provisions are given below:

1. Agreement on Agriculture aims at strengthening GATT disciplines and improving agricultural trade. It includes specific and binding commitments made by WTO Member governments in the three areas of market access, domestic support and export subsidies.
2. Agreement on the Application of Sanitary and Phytosanitary (SPS) Measures establishes multilateral frameworks for the planning, adoption and implementation of sanitary and Phytosanitary measures to prevent such measures from being used for arbitrary or unjustifiable discrimination or for camouflaged restraint on international trade and to minimize their adverse effects on trade.
3. Agreement on Textiles and Clothing replaced the Multi-Fibre Arrangement (MFA) which was prevalent since 1974 and entailed import protection policies. ATC provides that textile trade should be deregulated by gradually integrating it into GATT disciplines over a 10-year transition period.
4. Agreement on Technical Barriers to Trade (TBT) aims to prevent standards and conformity assessment systems from becoming unnecessary trade barriers by securing their transparency and harmonization with international standards. Often excessive standards or misuse of standards in respect of manufactured goods, and safety/environment regulations act as trade barriers.
5. Agreement on Trade-Related Investment Measures (TRIMs) expands disciplines governing investment measures in relation to cross-border investments. It stipulates that countries receiving foreign investments shall not impose investment measures such as requirements, conditions and restrictions inconsistent with the provisions of the principle of national treatment and general elimination of quantitative restrictions. For example: measures such as

local content requirements and trade balancing requirements should not be applied on investing corporations.

6. Anti-Dumping Agreement seeks to tighten and codify disciplines for calculating dumping margins and conducting dumping investigations, etc. in order to prevent anti-dumping measures from being abused or misused to protect domestic industries.
7. Customs Valuation Agreement specifies rules for more consistent and reliable customs valuation and aims to harmonize customs valuation systems on an international basis by eliminating arbitrary valuation systems.
8. Agreement on Pre-shipment Inspection (PSI) intends to secure transparency of pre-shipment inspection wherein a company designated by the importing country conducts inspection of the quality, volume, price, tariff classification, customs valuation, etc. of merchandise in the territory of the exporting country on behalf of the importing country's custom office and issues certificates. The agreement also provides for a mechanism for the solution of disputes between PSI agencies and exporters.
9. Agreement on Rules of Origin provides for the harmonization of rules of origin for application to all non-preferential commercial policy instruments. It also provides for dispute settlement procedures and creates the rules of origin committee.
10. Agreement on Import Licensing Procedures relates to simplification of administrative procedures and to ensure their fair operation so that import licensing procedures of different countries may not act as trade barriers.
11. Agreement on Subsidies and Countervailing Measures aims to clarify definitions of subsidies, strengthen disciplines by subsidy type and to strengthen and clarify procedures for adopting countervailing tariffs.
12. Agreement on Safeguards clarify disciplines for requirements and procedures for imposing safeguards and related measures which are emergency measures to restrict imports in the event of a sudden surge in imports.
13. General Agreement on Trade in Services (GATS): This agreement provides the general obligations regarding trade in services, such as most- favoured- nation treatment and transparency. In addition, it enumerates service sectors and stipulates that in the service sectors for which it has made commitments, a member country cannot maintain or introduce market access restriction measures and discriminatory measures that are severer than those that were committed during the negotiations.
14. Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS): This agreement stipulates most-favoured-nation treatment and national treatment for intellectual properties, such as copyright, trademarks, geographical indications, industrial designs, patents, IC layout designs and undisclosed information. In addition, it requires member countries to maintain high levels of intellectual property protection and to administer a system of enforcement of such rights. It also stipulates procedures for the settlement of disputes related to the agreement.

15. Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU) provides the common rules and procedures for the settlement of disputes related to the WTO agreements. It aims to strengthen dispute settlement procedures by prohibiting unilateral measures, establishing dispute settlement panels whose reports are automatically adopted, setting time frames for dispute settlement, establishing the Appellate Body etc. (for details of India's disputes at the WTO, refer box1 below)
16. Trade Policy Review Mechanism (TPRM) provides the procedures for the trade policy review mechanism to conduct periodical reviews of members' trade policies and practices conducted by the Trade Policy Review Body (TPRB).
17. Plurilateral Trade Agreements: Multilateral negotiations are those negotiations involving the entire WTO contracting parties. The Plurilateral trade agreements involve several countries with a common interest but do not involve all WTO countries. Not all the plurilateral agreements are negotiated within the WTO framework. When started within the WTO context, these agreements may come from the failure to find agreement among the entire WTO contracting parties and therefore a smaller group of countries decide to conclude the agreement between them.

- Agreement on Trade in Civil Aircraft: The Agreement on Trade in Civil Aircraft entered into force on 1 January 1980. It now has 32 signatories. The agreement eliminates import duties on all aircraft, other than military aircraft, as well as on all other products covered by the agreement.
- Agreement on Government Procurement: The fundamental aim of the GPA is to mutually open government procurement markets among its parties. This agreement requires national treatment and non- discriminatory treatment in the area of government procurement and calls for fair and transparent procurement procedures. The agreement covers the procurement of services (in addition to goods) and the procurement by sub-central government entities and government- related agencies (in addition to central government).

All the above-mentioned agreements entered into by the members are not static; they are renegotiated from time to time and new agreements evolve from negotiations. Example: Many agreements were negotiated under the Doha Development Agenda, launched by WTO trade ministers in Doha, Qatar, in November 2001.

THE DOHA ROUND

The Doha Round, formally the Doha Development Agenda, which is the ninth round since the Second World War was officially launched at the WTO's Fourth Ministerial Conference in Doha, Qatar, in November 2001. The round seeks to accomplish major modifications of the international trading system through lower trade barriers and revised trade rules. The negotiations include 20 areas of trade, including agriculture, services trade, market access for non-agricultural products (NAMA), trade in services, trade facilitation, environment, geographical indications and certain intellectual property issues. The most controversial topic in the Doha Agenda was agriculture trade.

25 YEARS OF THE WTO ACHEIVEMENTS AND CONCERNS

The WTO has helped transform international economic relations to a great extent over the past 25 years of its existence.

There has been spectacular growth in world trade in goods and services. Since 1995, the dollar value of world trade has increased nearly four-fold, while the real volume of world trade has expanded by 2.7 times. This is commendable as it outstrips the two-fold increase in world GDP over that period. The average tariffs have almost halved, from 10.5% to 6.4% during this period.

The remarkable increase in global value chains (GVCs) has been made possible by the predictable market conditions fostered by the WTO along with improved communication. Businesses, being assured of the possibility of movement of components and associated services across multiplelocations, have been able to disaggregate manufacturing production across countries and regions. At present, trade within these value chains accounts for almost 70% of total merchandise trade.

The rise of global value chains has been a significant factor in enabling rapid catch-up growth in developing economies. Also, these have resulted in increased purchasing power and consumer choice in all countries. For the economies that joined the WTO after its creation, accession involved far-reaching reforms and market-opening commitments and research suggests that these have enabled a lasting boost to national income.

Over the past 25 years, there has been the fastest poverty reduction in history: in 1995, over one in three people living around the world fell below the World Bank's $1.90 threshold for extreme poverty. Today the extreme poverty rate is less than 10%, the lowest ever.

However, in recent years, apprehensions have been raised in respect of the WTO and its ability to maintain and extend a system of liberal world trade. The major issues are:

- **i.** The progress of multilateral negotiations on trade liberalization is very slow and the requirement of consensus among all members acts as a constraint and creates rigidity in the system. As a result, countries find regionalism as a plausible alternative. Moreover, contemporary trade barriers are much more complex and difficult to negotiate in a multilateral forum. Logically, these issues are much easier if discussed on bilateral or regional level.
- **ii.** The complex network of regional agreements introduces uncertainties and murkiness in the global trade system.
- **iii.** While multilateral efforts have effectively reduced tariffs on industrial goods, the achievement in liberalizing trade in agriculture, textiles, and apparel, and in many other areas of international commerce has been negligible.
- **iv.** The negotiations, such as the Doha Development Round, have run into problems, and their definitive success is doubtful.
- **v.** Most countries, particularly developing countries are dissatisfied with the WTO because, in

practice, most of the promises of the Uruguay Round agreement to expand global trade has not materialized.

vi. The developing countries have raised a number of concerns and a few are presented here:

- The developing countries contend that the real expansion of trade in the three key areas of agriculture, textiles and services has been dismal.
- Protectionism and lack of willingness among developed countries to provide market access on a multilateral basis has driven many developing countries to seek regional alternatives.
- The developing countries have raised a number of issues in the Doha Agenda in respect of the difficulties that they face in implementing the present agreements.
- The North-South divide apparent in the WTO ministerial meets has fuelled the apprehension of developing countries about the prospect of trade expansion under the WTO regime.
- Developing countries complain that they face exceptionally high tariffs on selected products in many markets and this obstructs their vital exports. Examples are tariff peaks on textiles, clothing, and fish and fish products.
- Another major issue concerns 'tariff escalation' where an importing country protects its processing or manufacturing industry by setting lower duties on imports of raw materials and components, and higher duties on finished products.
- There is also possible erosion of preferences i.e. the special tariff concessions granted by developed countries on imports from certain developing countries have become less meaningful because of the narrowing of differences between the normal and preferential rates.
- The least-developed countries find themselves disproportionately disadvantaged and vulnerable with regard to adjustments due to lack of human as well as physical capital, poor infrastructure, inadequate institutions, political instabilities etc.
- In recent times, the World Trade Organization and the global trading system are facing serious challenges in terms of unilateral measures and counter measures by some members. Over the past two years, governments have introduced trade restrictions and protectionist actions covering a substantial amount of international trade, affecting $747 billion in global imports in 2019 alone.
- The rising uncertainty about market conditions is causing businesses to postpone investment, weighing on growth and the future potential of our economies. Many areas of trade such as e-commerce are still outside the WTO.
- There are mounting trade tensions as some members do not adhere to the WTO's established procedures. The unilateral tariffs threatened by the U.S. and China are examples. Countries are using the permissible clause of 'national security' as a justification for tariffs.

- There is an ongoing stalemate in the appointment of members of the Appellate Body of WTO's dispute settlement mechanism. The appellate body is nearly paralyzed because it does not have the three panellists required to sign rulings.

A SUMMARY OF AGREEMENTS IN THE FINAL ACT OF THE URUGUAY ROUND

1. Agreement Establishing the WTO
2. General Agreement on Tariffs and Trade 1994
3. Uruguay Round Protocol GATT 1994
4. Agreement on Agriculture
5. Agreement on sanitary and Phytosanitary Measures
6. Decision on Measures concerning the possible Negative Effects of the Reform programme on Least-Developed and Net Food-Importing developing Countries.
7. Agreement on Technical and Clothing (terminated on 1 January 2005)
8. Agreement on Technical Barriers to Trade
9. Agreement on Trade-Related Investment Measures
10. Agreement on Implementation of Article VI (Anti- dumping)
11. Agreement on Implementation of Article VII (Customs valuation)
12. Agreement o Pre Shipment Inspection
13. Agreement on Rules of Origin
14. Agreement on Import Licensing Procedures
15. Agreement on Subsidies and Countervailing Measures
16. Agreement on Safeguards
17. General Agreement on Trade in Services.
18. Agreement on Trade-Related Aspects of Intellectual property Rights, Including Trade in Counterfeit Goods
19. Understanding on Rules and Procedures Governing the Settlement of Disputes
20. Decision of Achieving Greater Coherence in Global Economic Policy-Making.