

## Jagdish Bhagwati and India's Trade Strategy Today

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Professor Jagdish Bhagwati--theoretician, policy wonk, scourge of protectionists, purveyor of dulcet prose,<sup>2</sup> and intellectual colossus--gives us yet another contribution to the debate on trade liberalization: *Going it Alone: The Case for relaxed Reciprocity in Freeing Trade* (2002, MIT Press). More accurately, the contribution is by trade experts from around the globe, describing liberalization experiences in different countries and sectors, some of them fascinating accounts of the challenges faced and overcome.

But the imprimatur of Bhagwati, even in an edited volume such as this one, is unmistakable. His introduction draws together all the arguments, analyzing, clarifying, and taxonomizing with characteristic lucidity. Many of the contributors are students or collaborators. The insightful ideology-interests-institutions trichotomy for thinking about trade policy that he first provided in his earlier volume *Protectionism* (1988, MIT Press) is deployed with great success by many of the contributors. And the broad message that they convey has been his for a long time: unilateral or rather non-reciprocal trade liberalization, the "Going It Alone" of the title, can work.

For the purposes of this essay, two propositions associated with Bhagwati are relevant.<sup>3</sup> First, trade liberalization is overwhelmingly beneficial for countries. And, second, non-discriminatory trade liberalization—done on one's own or in the context of multilateral negotiations—is overwhelmingly superior to regional trade agreements whereby countries

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<sup>2</sup> A good example of Bhagwati's ability to explain ideas through wit is his brother-in-law analogy to highlight the distinction between rent-seeking behaviour and corruption. When you lobby for rents and use up resources, it is a directly unproductive (DUP) activity. But if there is a brother-in-law lurking in the background to whom the rents are inevitably headed, nobody will bother to lobby. In this case, there is corruption but no DUP activity. Unless, of course, some far-sighted crook devotes resources to court the sister in order to become the brother-in-law in order to get the rents.

<sup>3</sup> See Pravin Krishna's review of Bhagwati's book *Free Trade Today* in the EPW for an excellent summary of his other contributions.

reduce their barriers in favor of some but not all partner countries.<sup>4</sup> Do it alone, Do it in Geneva, Professor Bhagwati will exhort us, but the Seuss-like admonitions will quickly follow: not in Brussels, not in Washington, not in Tokyo, or even in Wellington.

Should India today adhere to Bhagwati's injunction against regional trade agreements? This essay will argue that it is time for India to consider departing from the principle of nondiscrimination that is so dear to him. However, even as India seeks to negotiate regional agreements, it must evaluate these departures and design their implementation always mindful of the benchmark of nondiscriminatory trade liberalization. One ignores Bhagwati at one's own peril.

### **India's Trade: The Changing Landscape**

A number of developments render opportune a strategic review of India's trade strategy.

- The dramatically altered foreign policy and security landscape in the aftermath of 9/11;
- The widely shared perception that the growth engine in India is sputtering as the pace of reforms has slackened;
- The uncertain prospects for a successful conclusion of the Doha Round in the wake of the near-standstill in the agriculture negotiations, which many believe hold the key to the success of the Doha Round;
- The frenetic pace with which regional agreements are being negotiated by the U.S. in particular which have the serious risk of undermining India's export prospects;
- The entry of China into the WTO, further underlining the competitive threat to India; and, finally,
- India's gambit toward ASEAN, with the curious choice of regional partner, suggestive of a reflex response aimed at neutralizing China's inroads into Asia rather than a considered departure from India's time-honored embrace of multilateralism.

### **Multilateral, Unilateral, or Regional?**

Against this backdrop, the choice for India is whether reliance on unilateral liberalization and/or multilateral liberalization in the context of the Doha Round is sufficient to achieve its objectives of furthering trade liberalization. Economic theory overwhelmingly supports nondiscriminatory trade liberalization based on the most-favored-nation (MFN) principle. In fact, the insights of Smith and Ricardo embodied in the principle of comparative advantage, which Nobel laureate Samuelson dubbed the only proposition in economics that is both true

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<sup>4</sup> The terms "regional trade agreement" and "free trade agreement" are used interchangeably in this essay but Professors Bhagwati and Srinivasan are correct in highlighting the trace of Orwellian doublespeak in the latter: they lead to freer trade for some but less free trade for others.

and non-trivial, applies to nondiscriminatory trade liberalization. The question is whether there are limitations to these approaches, which require complementary actions on the regional front. Professor Bhagwati would insist that the choices must be mutually exclusive with regional agreements being the ones excluded. Is this right for India today?

### **Multilateralism**

There are two problems with using the multilateral approach to impart impetus to India's trade reform. First, the prospects for the current multilateral round of trade negotiations appear uncertain, if not bleak. The more important point is that the WTO is unlikely to be a forum where significant progress can be made to further India's market access interests in labor-intensive manufacturing (textiles and clothing) and in skills-based services. These are the areas in which India has a comparative advantage and in which, at this juncture, India needs access to help revive the flagging growth momentum. Even if the Doha Round "succeeds," it is quite probable that India's export interests will remain largely unaddressed.

The second problem with an exclusive reliance on multilateralism, is that the space of pure multilateral trade is fast shrinking. The US, EU, and even Japan are striking regional deals galore. The EU has negotiated deep integration agreements with countries in Eastern Europe and North Africa. Mexico has FTAs with the US and the EU. The US is negotiating the Free Trade Area of the Americas (FTAA), which will include Brazil and Argentina. The US and Japan are similarly striking deals with Singapore and other Asian countries. As a result of these, India's major developing country competitors are gaining a competitive advantage over India in the major industrial country markets. And China, by joining the WTO, has caught up with India in terms of its treatment by trading partners. To use a cricketing metaphor, when the world around us has chosen to have the freedom of playing on the front-foot or the back-foot, should India continue to grope forward on principle, oblivious to the flight and pitch of the ball?

### **Unilateralism**

Another approach would be to liberalize unilaterally. Professor Bhagwati's book contains interesting experiments in liberalization from Chile, Taiwan, Australia, New Zealand, Singapore. India, too, has liberalized impressively in recent years, and the explanatory power of Bhagwati's trichotomy is evident. As the vanes of ideology veered against interventionism with the collapse of communism, the rise of China as an economic power, and India's own crisis in the early 1990, the votaries of state activism in India went into retreat. Interests were at work too, as was clearly seen when the US and other trading partners forced India, using the WTO dispute settlement mechanism, to abandon its quantitative restrictions on consumer goods imports.

Looking ahead, while the desirability of unilateral liberalization is not in doubt, the question is whether further trade reforms can proceed unilaterally. At this juncture, the problem of unilateral trade liberalization is essentially a political economy one. How can pro-

liberalization forces/interests be harnessed to overcome the opposition from vested interests resistant to reform?

Indeed, if one reads the experiences in this volume, there seem to be few convincing examples of purely unilateral liberalization. In the case of Taiwan, Arvind Panagariya argues that US pressure and Taiwan's susceptibility to it as a result of political weakness, provided the major impetus for liberalization. For other developing countries in Latin America, the liberalization was unilateral but there was reciprocity in terms of financial assistance under World Bank and IMF adjustment programs. Crisis also seems to have been a powerful stimulus to reform: as Professor Bhagwati quips, "Nothing succeeds like (previous) failure."

With unilateral liberalization, the game is one-sided, loaded against reform. International negotiations help overcome this political economy problem by harnessing the power of export interests, with a stake in these negotiations, who can help counter the resistance from import-competing interests. Douglas Irwin's chapter documents how the institutional change in the United States, whereby tariffs were transformed from a purely domestic issue into an international bargaining issue, fundamentally altered the imbalance that favored protectionists over liberalizers. But this multilateral bargaining route appears less promising for the moment.

Even the most die-hard of optimists like Professor Bhagwati would concede that prospects for multilateralism are not bright. In response they would say that we should simply go ahead and liberalize unilaterally without "binding" these reforms multilaterally in the WTO. This appears to have the apparent merit of securing liberalization without frittering away bargaining chips for any future WTO negotiations.

However, this approach is not entirely persuasive. For two reasons. First, the question of how liberalization will be achieved and how the opposition to reform will be overcome in India remains unanswered. Advocating unilateral liberalization is the Nike approach to policy advice—Just Do It—catchy but somewhat unhelpful to Indian policy-makers, who are grappling with the *how* of reforms.

The second problem with the "liberalize but do not bind" view is that it exaggerates the value of this multilateral bargaining chip. Trading partners seek lower barriers (the liberalization aspect) *and* the security that these barriers will not be raised again (the binding aspect). A country's bargaining chip comprises the sum of these two. By liberalizing, a country loses most of these chips in any case. And the more durable the unilateral liberalization, the less partners value the "binding," or the multilateral commitment, because they can be more confident that reforms will not be reversed.

## **Regionalism**

The possibility that the Doha Round may well flounder does not of course mean that India should not continue to engage seriously in the WTO negotiations. Nor does the difficulty of

securing unilateral liberalization mean that policy-makers should ease up on their efforts at moving ahead with domestic reform. But the analysis does imply that India should be considering the regional option as a serious complementary effort to securing further liberalization at home and abroad. Thus, depart from Professor Bhagwati's advice we must.

India has recently signaled its willingness to depart from an exclusive reliance on the multilateral approach by announcing its desire to negotiate a free trade agreement with ASEAN countries. Thus, India has already fired the regional salvo. Perhaps the curious choice of ASEAN as India's preferred regional trade partner is justified under the current circumstances. But it raises the question whether there has been a considered and strategic assessment of the desirability of pursuing regional integration agreements and, if so, with whom.

A much stronger case can be made for India seeking to negotiate an FTA with the United States because it would address a number of problems that arise from the developments described above.

### **Why an India-US Free Trade Agreement?**

That the world's two largest democracies with so much in common—pluralist politics, a free vibrant press, rule of law, secular in spirit, and home to spectacular diversity—should yet be so far apart remains one of the anomalies of the post-war world order. Can an India-US Free Trade Area (USINTA) provide the starting point for restoring this relationship to its deserved and long-overdue normalcy? This question merits debate now because of some fundamental changes on both sides: a stronger sense of common strategic and foreign policy interests in the aftermath of 9/11 and a break by India with its dirigiste past.

Consider first the benefits for India. India has become a victim—as an outsider—of free trade areas negotiated by the larger trading partners. Under NAFTA, for example, Mexico has benefited from preferential access to the US market, at the expense of countries such as India. Although India is currently quota-constrained in the textiles and clothing sector, once quotas are dismantled, Indian exporters will be disadvantaged by margins varying from 15 to 40 percent.

When the negotiation of the Free Trade Area of the Americas between the US and Latin America is completed, this disadvantage of India's in the US market would be extended relative to countries such as Brazil and Argentina. And because other big traders such as the EU quickly follow suit in negotiating agreements with regional partners of the US, India's disadvantage would be extended to more markets. A future agreement with the US would reverse most of these costs. And as a preferential exporter to the US, a USINTA would also confer an advantage on India vis-à-vis countries such as China. Maintaining this advantage could become an existential necessity for Indian industries that compete with Chinese exports. It would also buy India some time to implement the much-needed domestic reforms to enable India to become competitive in global markets.

But why not reverse this trade diversion against India by eliminating the preference at source, that is, by seeking to eliminate the MFN tariff in the US in areas of key export interest to India? In the textiles and clothing sector, the US remains doggedly protectionist. To expect the industry to stomach further multilateral tariff reduction after the quotas are eliminated, especially with China integrated into the WTO, is wishful thinking.<sup>5</sup> However, a more limited opening to Indian exports could be contemplated as part of a broader deal that provides other benefits to the US. In other words, it might be easier for India to gain market access to the US in the clothing sector bilaterally than multilaterally, since in the latter case the US would be obliged to extend benefits also to China.

The second opportunity that could be created is increased temporary mobility for high-skilled Indian technical personnel. Currently, Indian software programmers gain limited access to the US under the H-1B visa program. But there is reason for such temporary movement of personnel to be more fully exploited by lawyers, doctors, nurses, accountants etc.

Again the key point here is that from India's perspective, it will be easier to secure improved mobility for high-skilled labor bilaterally in the context of an FTA with the US than it will be through the WTO. This is a very important point that merits elaboration. From the US perspective, imports of labor, although beneficial, will give rise to political and social costs. To minimize these, importing countries would prefer to target the source of the labor, for example, to ensure that they get high-skilled, English-speaking labor. India offers itself as a natural source. In the WTO, however, targeting sources would be difficult, because the importing country would be under pressure from the most-favored-nation principle to extend to other countries the benefits accorded to India. Similarly, for the labor-exporting country, (as, indeed, for the importing country) there might be a desire to ensure that the labor movement is not always permanent for fear of the usual brain-drain. A bilateral cooperative framework is the most efficient way of addressing this concern.

Further, in a bilateral context, such as a free trade agreement, it would be easier for India and the US to work toward the removal of regulatory barriers that impede trade in skills-based services, which are often very country-, sector-, and situation-specific. An agreement on high-skilled labor with the US could then serve as the model for similar initiatives with other European countries, whose need for Indian labor is perhaps even greater than that of the US.

Third, an interesting pro-reform dynamic could be unleashed by a USINTA. The EU and others are likely to seek to negotiate similar agreements with India, spurred by the competitive disadvantage that their suppliers will face as a result of USINTA (the recently concluded agreement between the EU and Mexico illustrates this dynamic). As a result, the discrimination against India in these markets would be eliminated, while India's own trade liberalization would be broadened. Finally, a future agreement would serve to strengthen

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<sup>5</sup> Indeed, it is not even clear that there will be a timely elimination of the MFA quotas

India's hand in its broader strategic engagement with the US by creating a stake for American business in India.

What about the likely costs to India? As against the gains of increased trade and investment flows, preferential liberalization by India will impose costs in terms of lost tariff revenue because imports will be sourced from less efficient suppliers in the US rather than their competitors elsewhere in the world. These costs will need to be assessed, but can be contained if the kind of liberalization dynamic mentioned above is set in motion. In other words, while it is true that India's high tariffs create the risk of trade diversion, the likelihood that other major trading partners will seek similar access to India will make India's liberalization less discriminatory.

Then there is the misplaced fear that Indian industry will suddenly be exposed to competition from the US. To be sure, credible deadlines for implementing liberalization will be set in an FTA with the US. But the liberalization will be gradually phased in, typically over a period of 10 years, allowing domestic firms time to adjust to the prospective changes.

Second, in a post-NAFTA, post-Seattle world, where the old, innocent ceremonies of trade liberalization have been drowned, a USINTA will entail agreements on non-trade issues such as labor and environmental standards. Indeed, the Congressional legislation granting authority to the President (Trade Promotion Authority) to negotiate international trade agreements mandates the inclusion of labor and environment standards. And there will inevitably be linkages with other strategic issues such as India's nuclear capability. On these non-trade issues, while there are real differences of views, the scope for finding a middle ground should not be ruled out, especially with a Republican administration and a Republican-controlled Congress for whom government regulation through labor and environmental standards is as anathema as it is in India.

What's in a future agreement for the US? The commercial benefits of gaining access to the Indian market could be substantial. It would only take a few more years of the high rates of growth that India has posted in the 1990s for American business to see an early entrée into the Indian market as a good bet for the future. Even for the present, a USINTA could confer enormous benefits on American business because of India's high trade barriers—they would be favored insiders in highly protected markets.

A free trade agreement would also present other non-economic benefits to the US. The "soft power" that underpins current US preeminence sits uneasily with forging convenient alliances with non-democratic states while spurning democratic ones. A future agreement could begin to rectify this anomaly. Post 9/11, there is general recognition that while the US will find many tactical allies, India remains one of its long-term strategic partners, especially in the fight against terrorism.

Would a future agreement be feasible? In India, of course, there will be opposition to it. But three sets of actors can be relied upon to help overcome this opposition. First, exporters of labor-intensive manufactures, who will face the adverse consequences of India being left out

of the proliferating network of regional agreements. Second, exporters of high-skilled services, who will seek the expanded opportunities to enlarge their market access opportunities in the US. Third, the Indian foreign policy and defence establishments, which are increasingly coming to recognize the importance of closer cooperation with the US.

And in the US, too, the weight of the strong private sector interest, the Indian diaspora, and enlightened foreign policy considerations could underpin support for an initiative toward India. The Indian diaspora yearns for a mechanism to institutionalize closer cooperation between the two countries. A free trade agreement between the two countries could satisfy this yearning.

### **Conclusions**

Professor Bhagwati commands our admiration, of course for his intellectual contributions, but especially for his steadfast propagation of the cause of free trade even and particularly when it was unfashionable to do so. Easy indeed it was for a free trader to be alive and spreading the gospel in the heady years of enchantment with globalization. But in the dark days of Indian infatuation with intervention and controls in the 1970s, he was there, systematically and presciently highlighting intervention's ills in the famous NBER volumes of 1978. And in these days of the backlash against globalization, he is again in the vanguard, valiantly fending off attacks from a motley crowd, including Joe Stiglitz, Vandana Shiva, the pharmaceutical industry, and Oxfam, among many others.

Moreover, as he makes clear in the introduction to this book, there are good ways and bad ways of market opening. In the late 1980s and early 1990s, his ire and pen were directed at the deployment of unilateral methods by the US in particular to extract market opening in developing countries and even Japan.

More recently, regional agreements have been his bete-noire also for representing a less-than-desirable way of market opening. It is therefore unlikely that Professor Bhagwati will actively bless the case made in this essay for India pursuing regional agreements. Shedding a lifetime's addiction is not easy. But he did leave open the possibility that regional agreements could be building blocs leading to the ultimate goal of global free trade. This essay has attempted to build such a case for India today. Could we have his benign, even indulgent, acquiescence?