

**"An ambitious 'Employment and Incomes Policy' must be the top priority for the next government ."**

The U.S. has begun trade skirmishes with India. It objects to India increasing import duties on electronic goods and wants India to reduce duties on U.S.-made motorcycles. Meanwhile the World Trade Organisation seems to be in the intensive care unit. It is time to apply fundamental principles to reshape a trade regime that is fair to all.

### On free trade

The macro-economic case for free trade is that if each person would do only what he or she does better than everyone else and all would trade with each other, everyone's welfare will increase. Also, the size of the global economic pie would be larger because there will be no inefficiencies. The problem is that, at present, many people in the world are doing what others, in other countries, can do better than them. To get to the economists' ideal state, many people will have to stop doing what they are doing and learn to do something else.

Dani Rodrik has estimated that for every unit of overall increase in global income, six or seven units of incomes will have to be shuffled around within. Moreover, according to this theory, people should not start producing what others are already producing, because they will produce less efficiently until they learn to do it well. According to this theory of free trade, Indians should not have bothered to learn how to produce trucks, buses and two-wheelers when the country became independent. They should have continued to import them from American, European and Japanese companies.

Free trade purists say that easy import of products from other countries increases consumer welfare. Consumers everywhere welcome a lowering of import barriers because it brings products into their shops they could only dream of before. Milton Friedman had observed that, in international trade, exports help companies and imports help citizens. Therefore, resistance to free trade does not come from consumers. It generally comes from companies which cannot compete: companies in less developed countries which are not able to compete until their country's infrastructure is improved and they have acquired sufficient capabilities, or even from companies in developed countries when producers in developing countries overtake them.

### Job growth

However, to benefit from easy imports, citizens need incomes to buy the products and services available. Therefore, they need jobs that will provide them adequate incomes. Any government responsible for the welfare of its citizens has to be concerned about the growth of jobs in the country. Domestic producers can provide jobs. Ergo, a developing country needs a good 'industrial policy' to accelerate the growth of domestic production, by building on its competitive advantages; and by developing those capabilities, it can compete with producers in countries that 'developed' earlier.

When the 'no barriers to free trade' movement went into overdrive with the Washington Consensus in the

1990s, the concept of ‘industrial policy’, which had become associated with the idea of ‘protection’ of domestic industries, became a taboo. India liberalised imports in the 1990s and Indian consumers have benefited greatly since then from the variety of products available to them from around the world. However, by 2009, when the second United Progressive Alliance government was formed, the weakness of Indian manufacturing industries had become a great concern. The manufacturing sector in India and China had comparable capabilities in 1990. By 2009, China’s was 10 times larger than India’s, and its capital goods production sector was 50 times larger. Not only was the Indian market being flooded with Chinese hand-tools and toys, China was also selling high-tech electrical and telecommunication equipment to India (and around the world too).

Signs were already visible then that India’s impressive GDP growth was not generating enough employment for India’s large youth population. Whereas India’s economy should have been a powerful job generator, the employment elasticity of India’s growth — the numbers of jobs created per unit of GDP growth — was among the lowest in the world. Some people in government recommended the need for an ‘industrial policy’ to stimulate the growth of domestic production. However, many Indian economists, along with others from the World Bank and the U.S., pushed back. ‘Industrial policy’ was a backward idea associated with Soviet-era planning, they argued. If Indian industry was not growing, it was because India had not ‘reformed’ enough: India should reduce trade barriers further and government should get further out of the way of industry, they said.

### **The next step**

By 2019, it has become clear that India’s policy-makers must find a way for economic growth to produce more income-generating opportunities for Indian citizens. Employment and incomes are the most pressing issues for Indian citizens according to all pre-election surveys of what citizens expect from the next government. All parties are responding in panic with schemes for showering various versions of unearned ‘universal basic incomes’ on people who are not able to earn enough. This approach is unlikely to be economically sustainable. Therefore, an ambitious ‘Employment and Incomes Policy’ must be the highest priority for the next government.

While India seeks to capture larger shares of global markets, India’s own billion-plus citizens’ economy can become a stimulus for growth of millions of enterprises. If citizens earn more, they can spend more. The ‘Employment and Incomes Policy’ should guide the Industrial Policy to where investments are required, and also what is expected from those investments to produce more income-generating opportunities for young Indians.

The scope of ‘industry’ must be broadened to include all sectors that can build on India’s competitive advantages. For example, the tourism and hospitality industry, taking advantage of India’s remarkable diversity of cultures and natural beauty, has the potential to support millions of small enterprises in all parts of the country. By building on India’s competitive advantage of large numbers of trainable youth, and with digital technologies to increase the reach of small enterprises, manufacturing and services can provide many domestic and export opportunities that India has so far not seized.

There are lessons India can learn from its own history. With the government’s insistence in the pre-liberalisation era that production and technology must be indigenised in phased manufacturing programmes, India’s automobile sector was able to provide Indian consumers with good products. It now provides millions of people with employment and incomes in widespread domestic supply chains. Moreover, Indian auto-component producers and commercial vehicle producers export to the world’s most competitive markets.

In contrast, the Indian electronics sector has languished, while China's has flourished. India signed the Information Technology Agreement of WTO in 1996 and reduced import duties on IT-related manufactured products to zero. China withheld for some time until its electronic sector was stronger. Now the U.S. and Europe are trying to prevent China's telecom and electronic goods in their markets.

To conclude, the WTO's governance needs to be overhauled to promote the welfare of citizens in all countries, especially poorer ones, rather than lowering barriers to exports of companies in rich countries in the guise of free trade idealism. And Indian economists, distracted by the mathematics of universal basic incomes, should return to the fundamentals of economic growth — more opportunities to earn incomes from productive work with development of new capabilities. A robust 'Incomes and Employment Policy', supported by an imaginative Industrial Policy, must guide India's trade policy.

## GS World Team...

### Free trade

#### Why in the discussion?

- Recently, US President Donald Trump has asked India to respond to his officials while charging India of Putting huge duty of money on American goods.
- Trump, who has termed India as one of the 'high tariff nation', has termed American business with India as a 'stupid business'.
- Earlier, US President Donald Trump had said that he would put of India outside the list of countries which are taking advantage of the generalised system of preferences (GSP) program.
- This benefit is obtained on products that are exported to the US.
- According to the US, these steps have been taken steps due to not making proper business cooperation by India.

#### What is it?

- The first account of free trade has been done by Adam Smith in his excellent book 'The Wealth of Nations' written in 1776.
- Free trade is a policy created between two or more countries that allows unlimited exports or imports of goods or services among partner countries.
- Trade agreements occur when two or more nations agree on terms of trade between themselves. These agreements determine tariffs

and surcharges imposed on import and export. All trade agreements affect international trade.

- To make such an agreement, countries or union of the countries do not have to come under the WTO, so if they are interrupted by the WTO rules, then they can move forward with the help of the FTA.
- Ends free trade tariffs and makes corporation more competitive in overseas markets.
- FTA usually covers goods (such as agriculture or industrial products) or services (such as banking, construction, trading, etc.).
- FTA can also cover other areas such as intellectual property rights (IPR), investment, government procurement and competitive policy etc.

#### Why the need?

- With the elimination of tariff and some non-tariff barriers, FTA partners get easy access to each other's markets.
- Exporters prefer FTA to multilateral trade liberalization because they get preferential advantage over non-FTA member country's competitors. For example, in ASEAN case, ASEAN has FTA with India but not with Canada.
- FTAs are likely to increase foreign investment, while the FTAs promote free trade and investment flows.
- FTA encourages business productivity and innovation. This encourages regional integration.
- FTA can help developing countries, and this make the business environment dynamic.

### Expected Questions (Prelims Exams)

1. Consider the following statements-
1. Generally trade of goods and services is covered in FTA.
  2. FTA can cover Intellectual property Right, investment procurement and competitive policies etc.

Which of the above statements is/are correct?

- (a) Only 1
- (b) Only 2
- (c) Both 1 and 2
- (d) Neither 1 nor 2

2. Consider the following statements regarding 'Free Trade'-

1. It was first mentioned by Adam smith.
2. It is that policy between two countries which enables the unlimited export and import of goods and services.

Which of the above statements is/are correct?

- (a) Only 1
- (b) Only 2
- (c) 1 and 2
- (d) Neither 1 nor 2

### Expected Questions (Mains Exams)

- Q. Observing the increasing dispute between India and America in the trade sector, which type of strategy should India adopt. (250 Words)

**Note:** Answer of Prelims Expected Question given on 24 Apr. is 1(a), 2 (a)