Dismantling Quota Restrictions (QR) in International Textile Trade – India's Response

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Abstract: The International trade in Textiles was regulated by Multi – Fibre Agreements (MFA) under General Agreement on Trade and Tariffs (GATT) until the formation of World Trade Organisation (WTO) in the year 1995. The MFA established quotas on import of textile and clothing from more competitive developing countries under the Quota Restrictions (QR) system. It was decided in the Uruguay round to phase out these quota restrictions gradually. The transition was to take place over a period of ten years from 1994 to 2004. During this period the textile industry of the member countries, especially the developing countries who exported textile and clothing to developed countries underwent major changes. There was a lot of restructuring within these industries so as to meet the challenges in the new environment once the quotas were removed. This paper discusses the reforms that took place within the textile industry to face the challenges in the new environment.

KeyWords: Multi – Fibre Agreements, Quota Restrictions, World Trade Organisation, Agreement on Textile and Clothing

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Introduction

Since its formation WTO has taken plenty of measures to regulate international trade in textiles and clothing. The textile trade was governed by Multi-Fibre Agreements (MFA) from 1974 – 1994. There was plenty of violation of GATT principles such as non-discrimination and transparency during this period. The Agreement on Textile and Clothing (ATC) was formed as an attempt to correct the violation and regulate textile trade for 10 years from1994 to 2004 after which trade in textile & clothing was to be completely integrated into WTO. The MFA which established quotas on import of textile & clothing from more competitive developing counties was to be phased out in four stages over a period of 10 years and by Jan 1 2005, the quantitative restrictions were to be completely removed. The integration programme was to take place in four stages as follows[1]

- 16% of the total volume of imports of the listed textiles and clothing products was to be out of quota restrictions on the date of entry of ATC (1^{st} Jan 1995),
- another 17% at the end of the third year (1^{st} Jan 1998),
- another 18% at the end of the seventh year (1^{st} year 2002) and
- the remaining 49% at the end of the 10^{th} year (1^{st} Jan 2005).

The ATC provides a mechanism for supervising the implementation of the agreements by establishing the Textiles Monitoring Body (TMB). A periodic overview at the end of every stage was to be envisaged by WTO council of trade in goods. Apart from this ATC also strengthens the GATT principles through tariff reductions, removal of non-tariff barriers, etc along with the integration process.

The Complete integration of textile and clothing trade into ATC on 1^{st} Jan 2005 was expected to open a new era for the textile and clothing industry in India. Various studies have predicted that India and China will be the two countries to reap maximum benefits out of it because of their strength in textile manufacturing.A review of the performance of the Indian suppliers in the fiercely competitive quota free market against competition from China, Pakistan and others give insight into the emerging trading trends. A Federation of Indian Chamber of Commerce and Industry (FICCI) study noted that though dismantling of the Multi-Fibre Agreement (MFA) quotas had opened a window of opportunity for countries such as India and China with low cost and diversified textile production base, India was yet to exploit its full potential.

Deficiencies in the Indian Textile Sector

The growth of the Indian textile industry right from 1970s was adversely affected by the Quota regime, lack of industry – friendly government policies and technological obsolescence. Yet the industry thrived because of assured business under the quota system. With this system coming to an end on Jan 1, 2005 the Government realised the need to uplift the textile sector in order to enhance its capabilities. Since textile sector is one of the highest foreign exchange earning industry and the second largest employment provider next to agriculture, any set back in this sector would result in considerable loss to the government. Understanding this fact, the Government of India set up an industry reforms process. Accordingly, committees were set up to study the structure of the textile sector and to identify the areas that are to be restructured in order to frame a new textile policy to meet the changing situation.

Too many councils and associations

The Sathyam committee was one such committee set up in 1998. The committee had stated in its report that the textile sector was dominated by a number of councils and associations representing the various segments in the industry. Most of these associations had no permanent organizational set up, and they acted independently of one another and there were also conflicts between them. So whenever they made a demand they lobbied with the government to change the policies in favour of their particular segment not taking into account the common interests of the industry. Also these associations lobbied with the government to redistribute the burden of duties between the various segments in the Industry. Separate taxes were levied on processes like drawing, twisting, texturing, dying, etc., and there was always pressure coming from the representatives of these segments to either reduce or shift the burden of tax to the previous or subsequent processes to reduce their cost. So there was a need to co-ordinate these associations in order to make them stronger and purposeful. The committee recommended that instead of having too many councils representing each segment it was better to have associations representing each fibre. For example it said one association representing cotton fibre, yarn, fabrics, made-ups and garments would be more rational than having an association for each of these segments, this way the associations could function more effectively and the tendency to get things done in favour of their segment alone would subside as they begin to get an insight into the overall activities of the industry. The Indian Cotton Mills Federation (ICMF) emphasized the benefits of the work of strong international association such as American Textiles Manufacturers Institute (ATMI) and the Taiwan Textile Federation (TTF). The TTF was an umbrella federation of the textile industry representing yarns, fabrics, finishingsetc and it is claimed that co-ordination among these segments had helped Taiwan become globally competitive[2]. The ICMF recommended that something similar to TTF should be tried in India. It had also taken initiative to form a representative body of all these segments in the textile sector because as per WTO regulations, any anti dumping inquiry can be taken only by those bodies that represent 25% of the particular industry.

Rigid labour laws

Anotherarea that required reformation was the labour laws. They were too rigid and were to be made more flexible in order to create more employment and thereby to increase production. In India garments are manufactured in three stages

1) Cutting fabrics into patterns usually by power operated cutting machines
2) Sewing the garments on sewing machines either foot operated or power operated
3) Furnishing the garments by trimming checking for dimensions, washing ironing and packaging.

Out of these three stages the second stage was the most labour intensive part and the firms providing these sewing services were called fabricators. It has been found out from various studies that majority of the firms in the textile sector subcontracted to fabricators and a very less percentage (0.3%) only did complete in house production. Even though subcontracting gives flexibility it affected consistency in quality in case of large volumes and many times it caused delays in delivery schedules. In fact successful garment exporting countries subcontracted much less compared to India. In Hong Kong it was 11%, in China it was 18%, in Thailand it was 20% and in Taiwan it was 36%. But in India it was as high as 74%.[3]. The reason for this was the labour policy in India. Retrenchment was not permitted and for an export oriented firm any kind of work stoppages or strikes would be disastrous. Hence they resorted to outsourcing limiting the number of workers in their organization. The Apparel and Handloom Exports Association (AHEA) argued that the productivity of an Indian worker was the lowest in the world and it asked for disbanding the minimum wage culture to delink the wages from consumer price index and to fix wages based on productivity. The Apparel Export Promotion Council (AEPC) also argued that the Indian garments were 20-30 percent costlier than China and Bangladesh and as a result the country lost its market share in EU and Canada. The Confederation of Indian Industry's Textile Committee also argued for flexibility in labour laws. The garment exporters association had also petitioned the National Labour Commission that work stoppages and strikes ought to be banned on the lines of similar provision in Sri Lanka, Bangaladesh and some other Asian countries. According to major garment manufacturers labour policy in India was one of the major disincentives to operate in this sector.

Primitive Technology

The textile sector was largely characterised by primitive technology. Studies revealed that the cotton farm and ginning sector was highly fragmented with low infusion of technology. Even though India ranked third in the production of cotton, the cost advantage that India was having in the world market was eroded steadily due to high levels of contamination, poor quality of cotton seeds, and low productivity.

Government's response

To improve the quality and productivity of cotton the government launched the Technology Mission on cotton (TMC). Under this incentives were provided for better farm practices, quality seeds and improvement in market infrastructure and modernisation of ginning and pressing sector.

The government established the Textile Upgradation Fund Scheme (TUFS). An exclusive scheme with 5 billion US dollars for improvisation of machinery. It was estimated that approximately 4.9 to 6.6 lakh powerlooms have become inoperational due to tremendous over capacity in weaving [4]. It was expected that larger units with other processing facilities might either lease or takeover these power looms and set up a process house. But this may not be the case for all the powerloom units and those units which are left back may be forced to operate at a lower pace or shut down. To overcome this the above schemes was set up.The government entered into strategic alliances for gaining access to technology. It started promotional schemes through exhibitions and demonstration centres, buyer – seller meets and various other techniques. The Indian government which was backing the decentralized sector so far decided to strengthen the organized sector as it was easy to police this sector to bring about technological upgradation. The government took a decision to revive the competitiveness of the public sector mills through public and private sector participation and to close down the uncompetitive units after giving its workers a VRS option. Further it encouraged setting up large integrated textile complexes and strategic alliances with international textile majors[5].Due to government's efforts there was a phenomenal change in technology and a large number of sophisticated computerised machines for knitting and embroidery, full fledged processing units compacting machines and other required machinery were imported.

The textile industry underwent a reorientation towards other than clothing segment called technical textiles. These technical textiles include items like bed sheets, filtration and abrasive materials, furniture and health care upholstery, thermal protection and blood absorbing materials etc. This segment is growing at a faster pace and now it accounts for more than half of the total textile output. It has also got good export potential considering the growing prospects of technical textile world wide. The government started giving priority to its growth and development. It established Research and Development facilities and focused on the production of raw materials required for this segment [6].

The Government framed the New Textile Policy (NTxP-2000) with the objective of making the Indian textile industry strong and vibrant. Some of the provisions of NTxP [7] that are relevant for the study are discussed below.

- **To improve infrastructure facilities:** The key areas of concern for textile sector are ports, power, highways and telecommunications. Private investment was encouraged in segments like ports and power. Higher budgetary support through the ministry of textiles was sought and the Government was also taking measures to encourage FDIs to provide better infrastructure.To provide the industry with world class infrastructure facilities for setting up textile units a new scheme namely “Scheme for integrated textile parks” was launched by the government by merging the two existing schemes i.e., Textile centres infrastructure development scheme (TCIDS) and Apparel Park for exports scheme (APES) [8]. The government also encouraged the private sector to set up world class, environment friendly integrated textile complexes and textile processing units in different parts of the country. It was taking every step to develop infrastructural facilities in the predominantly textile and apparel export oriented areas in close co-operation with state governments, financial institutions and the private sector.
- **To boost exports:** The government came out with many plans to provide financial help to textile manufacturers and exporters. It assisted the private sector to set up specialised financial arrangements to fund the diverse needs of the industry. The AEPC and other Export Promotion Councils were restructured to play the role of facilitators and professional consultants. They were made capable of devising export strategies, promoting, financing, disseminating information or various aspects of the WTO agreements, extending legal advice to trade and industry in dispute settlements etc., Also all the nine Textile Research Associations under the Ministry of Textiles were to be revamped to give a market and industry driven focus to their Research and Development support. A multidisciplinary institutional mechanism was to be established to formulate policy measures and specific action plans in the wake of WTO measures. A brand equity fund was to be operated exclusively for textile and apparel products to maintain consistency with WTO norms. A suitable mechanism was to be evolved to facilitate industry associations to deal with disputes under the various agreements of WTO.
- **To develop human resource:** To set up a venture capital fund in consultation with and involvement of Financial institutions for the promotion of talented Indian designers, technologists, innovative market leaders and e-commerce ventures. Fashion technology assumed new significance as design, colour and texture have become important factors to attract foreign buyers. Recognising the role of National Institute of Fashion Technology (NIFT) the government decided to assist the institution to grow and progress on innovative lines. The Nodal Centre for Upgradation of Textile Education (NCUTE) was also to be helped to grow into an autonomous National Level Textile Education Resource Centre. Information and expertise available in technical institutes like IITs, TITs and NID was to be used for expansion of programmes to strengthen the knowledge, skills and capabilities of those involved in textile field.
- **To develop information technology (IT):** Recognising the vital role of IT in textiles, the government decided to play a proactive role to adopt IT in textile industry and trade. This would result in speed, efficient and accuracy in the supply of information to those involved in textile business. The government decided to build a strong commercial intelligence network by using IT as the platform. The main objective of this was to make IT an integral part of the entire value chain of textile production and thereby facilitate the industry to achieve international standards in terms of quality, design and marketing.The government encouraged setting up of modern processing units to meet international quality and environmental norms. The network of CAD/CAM, computerised colour matching and testing facilities was to be expanded. Research support was to be extended to achieve ISO 9000 and ISO 14000 standards.
- **Modification of EXIM policy:** In order to strengthen the textile sector the government modified the EXIM policy and also came out with various schemes to meet the situation. To provide easy access to raw materials required for export production the government introduced a scheme of granting Annual Advance Licenses where by the exporters can import their requirements throughout the year and at the same time can export the garments made out of them. This scheme was expected to reduce the time and cost of garment exporters considerably. Same way, various types of trimmings and embellishments were allowed to be imported free of license and import tariffs. Besides this the state governments were asked to set up Apparel parks near the garment production centers so that garment exporters can set up their units and also can relocate to places where they get cheaper labour. This type of arrangement was expected to bring about cluster development which would serve as an instrument for technology upgradation and export culture.

The government took initiative to liberalise the labour laws which was a long standing demand of the textile industry. According to Ministry of Labour sources, it explored the possibility of changing the labour laws to allow extension of working hours and a provision to allow women to work in night shifts. It is to be noted that women constitute around 50% [9] of the total textile industry workforce.The International Textile Garment and Leather Workers Foundation (ITGLWF) visited Tirupur and Coimbatore to study the operation of the code of conduct in labour practices adopted by global garment sourcing companies.

Conclusion

With the kind of attention this sector was receiving the textile exports of India was expected to increase by leaps and bounds achieve.A readymade garment made in India fetches a profit of upto 300%. This shows the enormous foreign exchange earning potential of the textile export segment of India. But so far the investment in textile sector has not been large enough to meet the target. Attracting fresh investments remain a challenge to India. The Foreign Direct Investment (FDI) in the textile sector is very less compared to its counterparts like China, Bangladesh, Sri Lanka, Pakistan etc.

The tax concessions and other incentives given in the past to the SSI sector had fragmented the textile sector and had adversely affected the setting up of large scale production capacity and modernization. The SSI reservation was promoted by the Government in order to prevent growing inequalities. But in the long run it had actually handicapped the development of efficient economies of scale, and had reduced the abilities of the firms to compete. The Indian government has made changes in the economic policy to phase out the SSI reservations. Accordingly, the government deserved many industries from SSI category and textile industry is one among them. The government has also permitted 100 % FDI into textile. This is expected to result in large readymade garment manufactures entering into this sector leading to modernization of this segment.

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- Thrust areas for the organised mill sector:
  - i. integration of production efforts on technology driven
  - ii. Encouragement to setting up of large integrated textile complexes
  - iii. strategic alliances with international textile majors with focus on new products and retailing strategies.
  - iv. Creation of awareness and supportive measures for application of IT for upgradation of technology, enhancement of efficiency, productivity and quality, better working environment and HRD.

- Thrust areas for made up sector:
  - i. Make available defect free and colour fast processed fabrics
  - ii. Facilitate product development, production and marketing arrangements
  - iii. Place emphasis on quality and packaging and
  - iv. Expand facilities for machine dyeing and finishing of the yarn that is used for made ups from handloom fabrics.

- Thrust areas for Power loom industry:
  - i. Upgradation of technology
  - ii. Modernization of Power loom service centres and testing facilities
  - iii. Clustering of facilities to achieve optimum levels of production
  - iv. Welfare schemes for ensuring a safe and healthy working environment for the workers

- Thrust areas for Knitting industry:
  - i. dereservation of this sector from SSI
  - ii. Encouragement to Technology Upgradation and expansion of capacity
  - iii. Introduction of support systems for commercial intelligence, design and fashion inputs

- To improve processing and finishing:

While there existed a substantial gap in exports from India and China to the US in the top eight segments of US textiles and apparel imports during January – April 2004, the study reveals that in the post – MFA, this difference has further accentuated in favour of China. For example, in 'women's/girl's outerwear' segment, the lead of $528 million which China enjoyed over India during January – April 2004 increased to $983 million during January – April 2005.According to the study, any substantial push into the US market would require India to increase its share in the apparel and accessories segment. The study also finds that while China's textile exports to US have zoomed in the post-QR, India has just managed to cling on to its share. In the first four months of post-QR, US imports of textiles and apparel were worth $29.4 billion and represented a 10.2 per cent increase over the January-April 2004 value of $26.7 billion. While China grabbed the opportunity and increased its exports from $4893 million to $7421 million, a growth of nearly 52 per cent, India's exports to the US registered a growth of 27 per cent rising from $1379 million to $1746 million during the same period.[1]

The TEXPROCIL Chairman had emphasised the need to regulate the tax structure for the textile sector. He stated that it was highly imbalanced and that there was an urgent need for a proper scheme to refund the indirect taxes levied by state governments, municipalities and other local authorities. As per current estimates these taxes contributed to a cumulative burden of around 10%[2]. Similarly a report of the Task Force on Transaction costs stated that they were too high and needed to be reduced. It accounted for nearly 10% of the FOB value.

The report of N. K. Singh committee which said that

Changing structure of textile industry:

In India so far the focus of the textile policy has been on issues such as dereservation, modernization and other such things that would make the industry more competitive. But the sector had to move beyond just suppliers of the garments and take up various other activities in the supply chain such as distribution, retailing and other marketing activities to have a competitive edge over others. Fortunately many big firms in India have recognized this and they have expanded their activities by establishing forwared and backward linkages in the supply chain. Some of them have also moved into production of high value added clothing such as heat resistant and acid resistant textiles. Joint ventrues and branding are also taking place in this sector.[3] The Singapore based Crocodile International has set up a joint venture with Shivram Associates and Lee in US is having a licensed agreement with Arvind Mills. Raymond is looking forward to acquire a Europe based garment manufacturing unit along with its brand rights so as to export semi-processed fabric from India which could then be further processed and sold under a Made- in -Europe label. Branding which began with the menswear segment is now gradually moving on to women's wear, sports wear, semi-formal and casual wear segments. TCNS Clothing Co Pvt Ltd from Bangalore has launched 'W' a workwear brand for women which focuses mainly on the 'Salwar Suits' category. Reliance industries Ltd has entered into an alliance with Indus League for manufacture of its branded garments line Reance. Raymond Ltd is set to acquire Color Plus a top garment exporter to Gap, Banana Republic etc. But the high price for the branded garments had made it impossible for the firms to move to smaller cities. In India branded garments generally concentrate only in the top 20 cities. The only group to break this trend is the Siyarams whose brand oxemberg began by targeting smaller cities first and then moved on to bigger cities. It is now planning to venture into the western region also. Even though strong brands in India such as Madura garments and Raymonds have the capacity to with stand competition from imports as the trade opens up it would be still difficult for them to compete with countries like Sri Lanka and China where the price of garments is still lower. Super Spinning Mills, a major cotton manufacturer has announced plans to integrate forward and backward into knitting, processing and garmenting and as well as into yarn production. Similarly Prem Exports, a major garment exporter is venturing into spinning.

Another progress that is taking place in the garment sector is that some of the firms have started shifting their production facilities to offshore factories. In this system the US and EU buyers place order with the Indian firms who in turn shift some of their production to an offshore factory from where the finished goods are directly delivered to foreign buyers. This arrangement reduces cost considerably as the offshore factories are set up in places where there is cost advantage. Raymond and Indian Rayon are setting up manufacturing facilities in China and Grasim Industries of the Adithya Birla group is exploring the possibility to follow them. The Lalbhai group's Arvind Mills has announced setting up of a joint venture with the Mauritius based Ganesha Ltd. The joint venture is to be based in Mauritius and would undertake export and import of readymade garments in segments such as sportswear, jeanswear and formalwear. Many other firms which heavily depend on US market are exploring the chance of setting up factors in the Caribbean countries to take advantage of the location. Recently the Union Textile Minister visited Mauritius to find out the possibility of using it as a gateway to African markets after the removal of Quotas. Similarly the Powerloom Development and Export Promotion Council is exploring the West African countries to capture market for powerloom fabrics. Mozambique had recently invited Indian textiles and garment manufacture to take advantage of its duty and quota free access to US market under the African Growth and Opportunity Act for Exports. Following the de reservation some large firms are examining the possibilities of amalgamating their businesses. The same is the case with many companies located in Tirupur which is considered to be bastion of knitwear industry. Some new players are also expected to enter into the knitwear business. For instance the Bangalore based Gokuldas exports, India's largest apparel exporter has firmed up plans to set up knitwear manufacturing units. According to industry sources many overseas players are also likely to enter into knitwear business in India. So long the government was keeping foreign investment out of the textile sector in order to protect the home industry. But now in the context of liberalisation it is gradually eliminating these restrictions. As a result the European investors led by Italians and Germans are all set to emerge as big investors in India's booming textile sector. Already the Italian fashion apparel firm Benetton SpA in collaboration with Benetton Holdings NV of Netherlands is planning to set up an integrated manufacturing unit for producing knitwear products. Another Italian garment manufacturing Major, Carrera is planning to invest nearly Rs.1000 crores in Maharashtra for setting up manufacturing units across multiple locations. One more Italian group is carrying out feasibility studies for setting up a full-fledged 'ItalianFashionVillage' near Kochi,.VestergaardFrandsen a Danish speciality textile major has received approval for setting up a wholly owned

[1]China ahead in textile exports to United States, article published in the online edition of 'The Hindu'July 25, 2005 **

[2]TEXPROCIL Chairman speech, op. cit.,

[3]Errol D'Souza, op. cit.,

subsidiary for the same purpose. Further the government sources also indicate that a few German investors have picked up stakes i Indian trading firms Shiv Exports and Janan Exports. The above developments are likely to increase FDI in India considerably.[4]

I.The Pattern of International Trade Before GATT

The Pattern of international trade that the world economies observed during the 16th and 17th centuries was mercantilism. This system advocated that countries should encourage exports and restrict imports simultaneously. By keeping the exports higher than the imports each country would be able to maintain a trade surplus and in course of time this would result in accumulation of national wealth which in turn would increase status and prestige of a country. In order to achieve this many nations designed their trade policies to boost exports and restrict imports. The imports were restricted by tariffs and quotas while the exports were subsidised. The main drawback of this theory was that it assumed world trade to be a zero sum game where the gain of one country will result in a loss to another country. It was Adam Smith who first attacked the mercantilist assumption. In his theory of absolute advantage[5] he explained how countries can benefit out of free trade. In his book, The Wealth Of Nations, he argued that countries differ in their ability to produce goods efficiently. Therefore Smith's basic argument was that countries should never produce goods which they can buy from other countries at a lower cost. According to him countries should specialize in the production of goods in which they have absolute advantage in the form of climate, soil, labour force, etc. and then sell them in exchange for the goods they lack. Thus by specializing in the production of goods in which countries have absolute advantage, all the countries can benefit by engaging in trade. In that case the world trade would not be a zero sum game but a positive sum game where all countries can benefit simultaneously, argued Smith. David Richardo's comparative advantage theory and HeckscherBertilOhlins, Hekscher – ohlin theory built on Adam smith's work also argued how unmeasured free trade would benefit the whole world.[6]

David Richardo has gone one step ahead of Adam Smith by exploring what might happen if one country had an absolute advantage in the production of all goods. While Smith's absolute advantage suggested that such a country might not derive any benefit from international trade, Ricardo in his book, Principles of Political Economy, showed that was not the case. According to Ricardo's comparative advantage theory, it makes sense for a country to specialize in the production of those goods in which it has absolute advantage and to buy the goods which it produces less efficiently from other countries even though it could produce those goods more efficiently itself. This would increase world production and maximize consumption. Ricardo considers world trade to be a positive sum game in which all participating countries realize economic gains. (This could be explained through an example. [7] Let us take two countries Ghana and South Korea and assume that the total resource available in each country is 200 units. Let us assume that Ghana has absolute advantage in the production of cocoa and rice. Suppose if the country takes 10 resources to produce one ton of cocoa and 131/3 resources to produce one ton of rice, the country can produce 20 tons of cocoa and no rice or 15 tons of rice and no cocoa or any other combination. If South Korea takes 40 resources to produce one ton of cocoa and 20 resources to produce one ton of rice, it can produce 5 tons of cocoa and no rice or 10tons of rice and no cocoa or any other combination. Again let us assume that without trade each country uses half of its resources to produce rice and another half to produce cocoa. In that case Ghana will produce 10 tons of cocoa and 7.5 tons of rice while South Korea will produce 2.5 tons of cocoa and 5 tons of rice for their own consumption without any trade between them. With absolute advantage on its side Ghana has no need to trade with South Korea. But to understand the significance of comparative advantage one must realize that although Ghana has absolute advantage in production of both cocoa and rice, it has comparative advantage only in the production of cocoa. Ghana can produce 4 times as much cocoa as South Korea but it can produce only 1.5 times more rice which makes Ghana comparatively more efficient at producing cocoa than rice. Now, in a situation without trade the combined production of cocoa and rice would be 12.5 tons each. But by engaging in free trade the two countries can not only increase the combined production of the two products but can also help the consumers in both the nations to consume more of the two goods. That is, if Ghana decides to exploit its comparative advantage in cocoa and increases its output from 10 tons to 15 tons it will be utilizing 150units of its resources leaving 50 units for the production of 3.75 tons of rice. Similarly if South Korea decides to specialize in rice by increasing its production to10 tons, then the combined production of cocoa and rice would go up to 15 and 13.75 tons which is higher than the output before trade. Also now if both the countries decide to exchange cocoa and rice on a one to one basis, then the consumers of both the nations would get higher quantities of cocoa and rice for consumption. For example if both the countries decide to exchange 4 tons of cocoa for 4 tons of rice, then Ghana would have 11 tons of cocoa and 7.75 tons of rice for consumption which is higher than its production without trade. Similarly South Korea would now be left with 4 tons of cocoa and 6tons of rice which is also higher than its production without trade.) Ricardo's theory suggested that even countries without absolute advantage in any product can consume more if there are no restrictions in trade.

Swedish economists Eli Hecksher and Bertil Ohlin have put forth a different explanation for comparative advantage. While Ricardo's theory stressed that comparative advantage rose from differences in productivity i.e how effectively a country utilized its resources, the

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[6] ibid, pp.148-159

[7] ibid, p. I44.

Heckscher – ohlin theory argued that it arose from differences in national factor endowments i.e the extent to which a country is blessed with resources such as land, labour and capital. The more abundant a factor, the lesser will be its cost. The Hekscher – ohlin theory believes that countries will export those goods that make intensive use of factors that are locally abundant and import those goods that require factors which are locally scarce. Like Ricardo's theory Hekscher – ohlin theory also recognizes the benefit of free trade but argues that international trade is determined by differences in factor endowments rather than by differences in productivity.

Even though there were strong economic arguments and theories in favour of free trade, many governments were unwilling to lower their trade barriers for fear that other nations might not do so. Many times governments intervened in international trade for economic and political reasons. They generally did this through policies that promoted exports and restricted imports, for the main motive of any government was to protect its domestic producers and jobs from foreign competition while increasing the foreign market for its domestic products. In recent years social issues such as labour laws, health and environmental standards have also become causes for intervention. The range of policy instruments used by governments to intervene in international trade could be broadly classified into tariff and non-tariff barriers. While tariff is a direct instrument for restricting imports there are several other indirect measures for restricting trade which are known as non-tariff barriers. They are briefly explained below.

Tariff Barriers

Tariffs are the oldest and the simplest form of trade barrier. It is a tax levied on imports and they fall into two categories- specific and ad volerum. If the tax is levied on the quantity of the goods imported it becomes a specific tariff, on the other hand if it is levied on the value of the goods imported it becomes ad valorem tariff. A tariff discourages import by raising its cost, thus protecting the domestic producers. Besides it is also a source of revenue for the government. But tariffs are anti consumer, for the increased price of the domestic goods as a result of restricting foreign goods is ultimately borne by the consumers. Also tariffs reduce the overall efficiency of the world economy because a protective tariff encourages domestic firms to produce goods that could have been produced more efficiently abroad which eventually results in inefficient utilization of resources at world level.

Non-tariff barriers

1. Subsidies:

A subsidy is a government payment to a domestic producer. It may be in the form of cash grants, low interest loans, tax holidays and government equity participation for domestic firms. By lowering production costs subsidies help domestic firms to compete against foreign goods and to gain export markets as well.

2. Import quotas (or) Quantitative Restrictions (QR)

It is a direct restriction on the quantity of some good that may be imported into a country. It is usually enforced by issuing import licenses to group of individuals or firms. Sometimes, the right to sell is directly given to the governments of exporting countries. An import quota restricts the amount a foreign buyer can sell in a domestic market. If the domestic industry lacks the capacity to meet demand then such import quotas tend to increase the prices of both domestic and imported goods.

3. Voluntary Export Restraint (VER)

It is a quota on trade imposed by the exporting country at the request of the importing country's government. Exporters agree to VERs because they fear more punitive tariffs or import quotas might follow if they do not. As in the case of other trade restrictions VERs do not benefit consumers and many times they end up in raising the domestic price of an imported good.

4. Local content requirements

It is a requirement that some specific fraction of a good be produced domestically. The requirement can be expressed either in physical terms or in value terms. Local content regulations have been widely used by the developing countries to upgrade their manufacturing base from mere assembly of products whose parts are manufactured elsewhere into a local manufacturer of component parts. Just like an import quota local content regulations provide protection to a domestic producer by limiting foreign competition.

5. Administrative policies

It is an informal trade barrier that restricts imports and boosts exports. Administrative trade policies are bureaucratic rules that are designed to make it difficult for imports to enter a country. Japanese are supposed to be the experts in imposing this kind of trade barrier. For example in Japan, customs inspectors insisted on checking every tulip bulb imported into their country by cutting it across which madeNetherlands, the largest exporter of tulip bulbs to withdraw from exporting to Japan.Administrative policies, like any other trade barrier protect domestic producers and hurts consumers by denying access to superior foreign goods.

6. Antidumping policies

Antidumping policies are designed to punish foreign firms that engage in dumping. Dumping is defined as selling goods in a foreign market at below their cost of production or selling it below their fair market value.[8] Fair market value includes a fair profit margin and so it is normally higher than the cost of production. Dumping is viewed as a method by which firms unload their excess production in foreign markets. Sometimes it is also the result of predatory behavior of firms where they utilize profits from their home markets to subsidize prices in the foreign

[8]Charles W.L. Hill,op.cit,pp.181-186

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markets in order to drive domestic competitors out of the market. Though antidumping policies differ from country to country, the ultimate aim is to protect domestic producers from unfair foreign competition. If investigations prove that a particular product is being dumped into another country then antidumping duties (countervailing duties) are imposed on that product. These duties are fairly large and can remain in force for even upto five years.

II. Pattern of International Trade under GATT

It was Great Britain in the year 1846 which first officially embraced free trade as a Government policy. Britain had corn laws that placed high tariff on import of foreign corn, in order to protect domestic producers as well as to increase government revenues. The country experienced considerable hardship when there was a harvest failure followed by threat of famine in Ireland. Recognizing the value of free trade at this point the British Government officially announced free trade as its policy.[9] But this move of the British Government was not followed by its trading partners. But still the British Government kept this policy open because being the world's largest exporter it had little to lose from a trade war. By 1930 the world trade was crushed under the Great depression. Great depression was the result of the failure of the world economy to have a sustained recovery after the end of World War I in 1918. Things became worse when the US stock market collapsed in 1929. In order to reduce the rising unemployment and to protect the domestic industries the US Government passed the smoot – Hawley tariff. This erected an enormous wall of tariff barriers and it had a damaging effect on employment abroad.[10] The world countries reacted to this by raising their own tariff barriers and the world further slid into the great depression followed by the Second World War.The United States emerged victoriously from the war but the economic damage caused by the great depression and the impact of the second world war on the world economy made the US government to change its trade policy in favour of free trade. Many other Governments also recognized the value of free trade at this point and they decided to negotiate a set of rules with their trading partners to lower the trade barriers among them.

Formation of GATT

At this stage the world economies felt the need for an independent body to act as a referee, to monitor the cross border trade among them and to impose sanctions on a country if it violates the agreed set of rules. Accordingly the General Agreements of Trade and Tariffs (GATT) were established in the year 1947 under the leadership of the US.[11] The main objective of GATT was to liberalize international trade by eliminating tariffs, quotas, subsidies, etc. It was not an easy task to do because the international trade was influenced by the political, economic, legal and cultural systems of each country. Hence GATT tried to achieve its objective by conducting rounds and rounds of talks. In each round of talk the member countries would negotiate with each other to reduce tariffs and finally fix a rate which all member countries agreed to impose. No member country was allowed to raise the tariff rates above the negotiated one. In case it happens, the affected country could file a complaint with GATT. GATT would investigate the case and if the complaint was found true, then all the other member countries would pressurize the offending country to change its policies failing which it might get expelled from GATT. GATT was very successful in its early years. Its membership grew from 23 to more than 120 nations[12] from its establishment in 1947 to until it was superseded by WTO in 1995. There have been eight rounds of talk during that period. GATT helped to establish a strong and prosperous multilateral trading system through rounds of trade negotiations. The details of those negotiations are briefly given below.

Table- 14
GATT Trade Rounds

Sr. No	Year	Place	Subjects Covered	Participating Countries
1.	1947	Geneva	Tariffs	23**
2.	1949	Annecy	Tariffs	13
3.	1951	Torquay	Tariffs	38
4.	1956	Geneva	Tariffs	26
5.	1960 - 61	Geneva (Dillon Round)	Tariffs	26
6.	1964 - 67	Geneva (Kennedy Round)	Tariffs and Anti-Dumping Measures	62
7.	1973 - 79	Geneva (Tokyo Round)	Tarifffs, non-tariff measures and 'framework' agreements	102
8.	1986 - 94	Geneva (Uruguay Round)	Tariffs, non-tariff measures, rules, services, intellectual property rights, dispute settlement, textiles and clothing, agriculture, establishment of the WTO etc.,	123

(Source : WTO website, www.wto.org)

9 Charles W.L. Hill,op.cit,p.194

10 Enacted in 1930 by the US Congress, this tariff erected a wall of barriers against imports into the United States.

11 Charles W.L. Hill, op.cit,p.195

12 see Appendix***

1947 The first round at Geneve. On 30th October, the General Agreement on Tariffs and Trade (GATT) was signed by 23 nations and GATT was born. The Agreement contained tariff concessions agreed during the first multilateral trade negotiations and a set of rules designed to prevent these concessions from being disturbed by restrictive tade measures. This first round of negotiations resulted in 45000 tariff concessions affecting $10 billion of trade which was about one fifth of the world's total trade then.

1949 Second Round at Annecy. From April to August at Annecy, France, the contracting parties exchanged some 5,000 – tariff concessions.

1950 – 51 Third Round at Torquay. From September 1950 to April 1951, the contracting parties exchanged some 8,700 tariff concession in the English town, yielding tariff reductions of about 25 percent in relation to the 1948 level.

1956 Fourth Round at Geneva, completed in May, the round produced some $2.5 billion worth of tariff reductions.

1960 – 62 Dillon Round, Named in honour of the US Under-Secretary of State Douglas Dillon who proposed the negotiations, the fifth Round was divided into two phases. The first was concerned with negotiations with EEC member states for the creation of a single schedule of concessions for the community, and the second was further tariff negotiations, which resulted in about 4,400 tariff concessions covering $4.9 billion of trade.

1964 – 67 Kennedy Round. For the first time, negotiations departed from product by product approach to an across the board of linear method of cutting tariffs for industrial goods. The working hypothesis of a 50% target cut in tariff level was achieved in many areas. The negotiations brought about a GATT Anti-Dumping Agreement. During this round concessions covered an estimated total value of trade of about $40 billion.

1973 – 79 Tokyo Round was launched in the Japanese capital with 102 countries participating. The seventh round resulted in tariff reductions and bindings covering more than $300 billion of trade. As a result, the weighted average tariffs on manufactured goods in the world's nine major industrial markets declined from 7.0% to 4.7%, Agreements were reached on subsidies and countervailing measures, technical barriers to trade, import licensing procedures, government procurement, custom valuation, a revised anti-dumping code, trade in bovine meat, diary products and civil aircraft.

From 1948 to1994 GATT provided the rules for much of the world trade and it saw some of the highest growth rates in international commerce. From 1953 – 1964 the world trade grew at an annual rate of 6.1 % and the world income grew at an annual rate of 4.3%. GATT's performance still improved between1963 – 1973 and during this period the world trade grew at 8.9% annually and the world income grew at 5.1% annually.[13] The average tariff rates also declined during this period. But during the late 80's and early 90's the functioning of GATT was disturbed by the increased pressure for protectionism around the world. There were three reasons for this. First, Japan which was in ruins when GATT was signed emerged as the world's second largest economy and a major exporter. Even though Japan's tariff rates and subsidies were lower they managed to close their markets to imports and foreign direct investment (FDI) through administrative trade barriers. The success of Japan thus strained the world trading system. The second reason was the persistent trade deficit in the US which was the world's largest economy. It had about $45 billion trade deficit with Japan alone in the year 1992. In order to solve the issue the US Government made adjustments with its creditor nations in industries such as automobiles, machine tools, semi conductors, steel and textures. This step made its domestic producers lose their market share to foreign competitors and the US Government faced increased pressure for protection from its domestic producers. The Third reason was that many countries had found ways to get around the GATT regulations. GATT's success in reducing tariffs to low levels combined with a series of economic recessions in 1970s and early 1980s drove many governments to devise other forms of protection for sectors that faced increased foreign competition. High rates of unemployment and constant factory closures made them enter into Bilateral Voluntary Export Restraints (VERs) to conduct trade of their own order outside the GATT agreements. Here neither the importing country nor the exporting country complained to GATT and without any complaint from either side GATT could not do anything. These VERs were considered to be non tariff trade barriers and soon the world trade was dominated by many such VER agreements. The World Bank in its report said about 13% of the imports of industrialized countries were subjected to such non-tariff barriers in 1981. Soon this rate increased to 16% by 1986.[14]These changes undermined GATT's credibility and effectiveness. Soon GATT was no longer as relevant to the world trade as it was in 1940s. The world trade became far more complex and globalization of the world economy was underway. International investment had expanded and trade in services which was not covered under GATT became an issue of major interest to many nations. The loopholes in the multilateral trading system were heavily exploited and GATT's institutional structure and its dispute settlement system became areas of serious concern.

Against such a background the GATT members conducted the eighth round of talks in 1986 popularly called as the **Uruguay round**. This was supposed to be the most difficult round of talks because the GATT members sought to extend the GATT rules to cover trade in services

[13]Charles W.L. Hill, op.cit, p. 195

[14]World Bank , World Development Report,1987

in addition to manufactured goods. They also sought to write up the rules governing intellectual property, to reduce agricultural subsidies and to strengthen GATT. This Uruguay round dragged on for seven years and finally an agreement was reached by 1993. The agreement was formally signed in 1994 and it came into effect from July 1, 1995.

The results of the Uruguay round were: [15]

1. Tariffs on industrial goods were to be reduced by more than one-third and Tariffs were to be scrapped on over 40% of manufactured goods.
2. Average tariff rates imposed by developed nations on manufactured goods were to be reduced to less than 4% of value, the lowest level in modern history.
3. Average increase of tariff binding from 21 to 73 percent for developing countries, from 78 percent to 99 percent for developed countries and from 73 to 98 percent for transitional economies[16]
4. A comprehensive program of agricultural reform.
5. Phasing out of quantitative restrictions on textiles and clothing.
6. New agreements on trade and services, Trade Related Intellectual Property rights (TRIPS), Sanitary and Phytosanitary (SPS) measures and Trade Related Investments Measures (TRIMs)
7. More strengthened agreements on safe guards, technical barriers, customer valuation, import licensing, state trading, subsidies and anti-dumping measures and dispute settlement systems.
8. Creation of the World Trade Organisation (WTO).

III. Emerging Pattern of International Trade under WTO

The Uruguay round of talks created WTO in the year 1995 to replace GATT. The GATT agreements were amended and incorporated into WTO agreements and it was established as a more powerful organization than GATT. WTO constituted a permanent legal institutional framework for the multilateral trading system which GATT did not have. Unlike GATT, WTO operates with its own secretariat and it covers trade in services and trade related intellectual property rights in addition to trade in goods. The dispute settlement mechanism under WTO was also strengthened considerably. Now WTO is the only international body dealing with the rules of trade among nations. At its heart are the WTO agreements negotiated and signed by majority of the world's trading nations. These agreements are contracts that give important trade rights to member countries. They also bind the governments of member countries to keep their trade policies within agreed limits for everybody's benefit. (WTO's top level decision making body is the ministerial conference which meets atleast once in two years. Below this there is a General council which meets several times in a year at the headquarters in Geneva. The General council also acts as the Trade policy Review Body and dispute settlement body. The goods council services council and TRIPS Council operate at the next level and they report to the General council. In addition to this there are numerous speciailsed committees, working groups and working parties to deal with individual agreements and other areas of operation such as environment, development membership applications and regional trade).

WTO operates with three main purposes.

- first, to help trade flow as freely as possible
- second, to provide a forum for trade negotiations and
- third, to settle disputes arising between members countries.

The performance of WTO is quiet impressive and its membership has increased to 148 countries as on Feb 2005, which constitute nearly 97% of world trade.[17] Another 30 countries are negotiating membership with WTO. As far as membership in WTO is concerned it is open to any state or territory that is willing to accept the above principles and agreements of WTO. The acceptance also means willingness to negotiate with other current WTO members on various trade related issues.

From the date of establishment, plenty of agreements relating to agriculture, textiles, banking, telecommunications have been signed under WTO. A brief description of the agreements relevant for this study is given below.

i. Agreement on Sanitary and Phytosanitary Measures

This agreement concerns the application of sanitary and phytosanitary measures – in other words food safety and animal and plant health regulations. The agreement recognizes that governments have the right to take sanitary and phytosanitary measures but that they should be applied only to the extent necessary to protect human, animal or plant life or health and should not arbitrarily or unjustifiably discriminate between members where identical or similar conditions prevail.

ii. Agreement on Textiles and Clothing (ATC)

Agreement on Textiles and Clothing is an instrument to dismantle the MFA over a transitory period of 10 years, ending on 31st December 2004, after which all the trade in textiles and clothing will stand automatically integrated into GATT and thus, within the multilateral frame work that GATT represents.

[15] WTO Website - www.wto.org

[16] Textiles Committee, Ministry of Textiles, GOI , a report 0n Understanding the WTO , Mumbai, 2005

[17] Textiles Committee, Ministry of Textiles, GOI , a report 0n Understanding the WTO , Mumbai, 2005

iii. Agreement on Technical Barriers to Trade (TBT)

This agreement will extend and clarify the Agreement on Technical Barriers to Trade reached in Tokyo Round of GATT. It seeks to ensure that technical negotiation and standards as well as testing and certification procedures do not create unnecessary obstacles to trade. However, it recognizes that countries have the right to adopt standards as they consider appropriate to protect human, animal or plant life or health or environment and for other consumer interests. The members are accorded the right to take necessary measures to ensure that their standards are met.

However, in order to take down the diversity, members are encouraged to use standards whatever appropriate without having to change levels of protection.

iv. Agreement on Trade Related Aspects of Investment Measures (TRIMS)

The agreement recognizes that certain investment measures restrict and distort trade. It provides that no contracting party shall apply any TRIM inconsistent with Articles III [national treatment] and XI [prohibition of quantitative restrictions] of the GATT. The list of TRIMs agreed to be inconsistent includes measures which require particular levels of local procurement by an enterprise (“local content requirements”) or which restrict the volume or value of imports such an enterprise can purchase or use to an amount related to the level of products it exports (“trade balancing requirements”).

v. Agreement on Implementation of Anti Dumping

The agreement provides for the right of contracting parties to apply anti dumping measures i.e., measures against imports of a product at an export price below its “normal value” (usually the price of the product in the domestic market of the exporting country) and if such dumped exports cause injury to a domestic industry in the territory of the importing contracting party.

vi. Agreement on Implementation of customs valuation

The decision on customs valuation would give customs administration the right to request further information of importers where they have reason to doubt the accuracy of the declared value of imported goods. If the administration maintains a reasonable doubt, despite any additional information, it may be deemed that the customs value of the imported goods cannot be determined on the basis of the declared value, and customs would need to establish the value taking into account the provisions of the Agreement.

vii. Agreement on Pre shipment Inspection (PSI)

Pre shipment Inspection (PSI) is the practice of employing specialized private companies to check shipment details – essentially price, quantity, quality of goods ordered overseas. Used by governments of developing countries, the purpose is to safeguard national financial interests (prevention of capital flight and commercial brand as well as customs duty evasion) and to compensate for inadequacies in administrative infrastructure.

Pre shipment inspection, the practice of engaging independent entities to check shipment details, is permissible to GATT disciplines and obligations. These disciplines and obligations include non-discrimination, transparency, protection of confidential business information, avoidance of unreasonable delay ,etc.,

viii. Agreement on Rules of Origin

The agreement aims at long term harmonization of rules of origin, other than rules of origin relating to the granting of tariff preferences and to ensure that such rules do not themselves create unnecessary obstacles to trade. The agreement sets up a harmonization programme, based upon a set of principles, including making rules of origin objective, understandable and predictable.

ix. Agreement on Subsidies and Countervailing Measures

The agreement contains a definition of subsidy and introduces the concept of specific subsidy – a subsidy available only to an enterprise or industry or group of enterprises or industries within the jurisdiction of the authority granting the subsidy.

The agreement establishes three categories of export subsidies, eg., Red, Amber and Green. Red export subsidies are prohibited. Examples are exemption of export profits from income tax and interest rate concession on export credit as compared with interest rates on domestic credit. Red subsidies are actionable by trading partners. Red subsidies are subject to dispute settlement procedures. If it is found that the subsidy is indeed prohibited, it must be immediately withdrawn. Amber export subsidies are not prohibited, but are actionable by trading partners. Actionability* may arise if subsidization can lead to following damages:

i. One country’s subsidies have domestic industry in an importing country
ii. Subsidies have rival exporters from another country while competing in a 3rd market.
iii. Domestic subsidies in one country have exporters trying to complete in the subsidizing countries domestic market.

Green subsidies are permissible and not actionable by trading partners. It includes specific or non-specific subsidies involving assistance to industrial researches pre-competitive developmental activity, assistance to disadvantage in regions or certain type of assistance for adopting existing facilities to new environmental requirements imposed by laws and / or regulations.

x. Agreement on Safeguards

The agreement allows a member to take a "safeguard" action to protect a specific domestic industry from an unforeseen increase of imports of any product which is causing or which is likely to cause, serious injury to the industry. The agreement breaks major ground in establishing a prohibition against so called "grey area" measures, and in setting a "sunset clause" on all safeguard actions. The agreement stipulates that a member shall not seek, take or maintain any voluntary export restraints, orderly marketing arrangements or any other similar measures on the export or the import side. Any such measure in effect at the time of entry into force of the agreement would be brought into conformity with this agreement, or would have to be phased out within four years after the entry into force of the agreement establishing the WTO.

xi. Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPs), Including Trade in Counterfeit Goods

The agreement recognizes that widely varying standards in the protection and enforcement of intellectual property rights and the lack of a multilateral framework of principles, rules and disciplines dealing with international trade in counterfeit goods have been a growing source of tension in international economic relations. Rule and disciplines were needed to cope with these tensions. To that end, the agreement addresses the applicability of basic GATT principles and those of relevant international intellectual property agreements; the provision of adequate intellectual property rights; the provision of effective enforcement measures for those rights; multilateral dispute settlement; and transitional agreements.

All the above agreements are framed upon certain fundamental principles which are the foundation of the multilateral trading system.

- The first is extending the most favoured nation (MFN) treatment to all, which means member countries of WTO cannot discriminate between their trading partners. Whenever a member country opens up a market or lowers a trade barrier it has to do so for the same goods or services from all its trading partners whether they are weak or strong, rich or poor. Exceptions to this principle is allowed under very strict conditions.
- The Second principle is national treatment which means treating imported goods and locally produced goods equally. This treatment applies to goods and services once they enter the market of a country and not before. The imported goods must be charged with the same kinds of duties and taxes as that of the locally produced goods.
- The third principle is achieving free trade by lowering the trade barriers gradually through negotiations. Trade barriers here mean customs duties and measures such as import bans and quota restrictions. As a result of negotiations the member countries are now opening up their markets gradually. But this process requires lot of adjustments and so WTO generally allows countries to introduce the changes gradually through progressive liberalization WTO usually gives more time for developing countries to undergo the change.
- The fourth principle is predictability through binding. A promise not to raise a trade barrier is as important as lowering one, because it gives a clear view of the future opportunities, investment is encouraged, jobs are created and consumers can fully enjoy the benefits of competition under WTO when member countries open their markets and bind their commitments. Binding here means that a member country will not charge tariff on goods and services beyond the bound rates. It can change its bindings only after negotiating with its trading partners. The Uruguay round increased the number of trade under binding commitments.
- The fifth principle is promoting fair competition between countries. WTO agreements require governments to disclose their policies and practices publicly. The trade policy review mechanism conducts regular surveillance of trade policies which promotes transparency both at the domestic and multilateral level. Also the WTO rules try to establish what is fair or unfair in matters such as dumping, rules of origin, subsidies, etc. Though these issues are complex, the WTO rules help governments of member countries to effectively respond.