SUMMARY SHEET

INTERNATIONAL ECONOMIC ISSUES

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1 Introduction

Let us understand, what is international economics, its components and associated issues.

- **International economics** deals with the economic activities of various countries and their consequences.
- In other words, international economics is a field concerned with economic interactions of countries and effect of international issues on the world economic activity.
- **International trade** involves the exchange of goods or services and other factors of production, such as labour and capital, across international borders.
- **International finance** studies the flow of financial assets or investment across borders. International trade and finance became possible across nations only due to the emergence of globalization.
- The **Globalization** can be defined as an integration of economics all over the world. It involves an exchange of technological, economic, and political factors across nations due to advancement in communication, transportation, and infrastructure systems.
- The **scope of international economics** is wide as it includes various concepts, such as globalization, gains from trade, pattern of trade, balance of payments, and FDI. Apart from this, international economics describes production, trade, and investment between countries.

2 Components of International Economics

1. Microeconomics vs Macroeconomics
2. International trade
3. International finance
4. International Taxation.
5. World trade organization, International monetary fund, and World Bank. (International institutions)

3 Issues related to its components

3.1 Issues related to International trade:

We shall be discussing the following issues related to this topic

1. Global Value Chain
2. US-China trade war
3. Trade and Development
4. Impact of Covid-19 Pandemic on Globalization

3.1.1 Global Value Chains

World bank released World Development Report titled "Trading for Development in the Age of Global Value Chains".

What is a Global value Chain (GVC)?

- A value chain refers to the "full range of activities that firms and workers do to bring a product from its conception to its end use and beyond".
- When the value chain is distributed across different firms in different countries, it means that these activities are divided among different countries. This phenomenon where value chain is spread across the globe- it is called GVC.
  For example, a bike assembled in Finland with parts from Italy, Japan, and Malaysia and exported to the Arab Republic of Egypt is a GVC.
- The global value chains today account for nearly 50 per cent of trade worldwide.

However, in the aftermath of COVID-19, there is an environment of uncertainty as utility of GVCs has come under scrutiny.

Why are GVCs important?

- **Hyper-specialization**: GVCs promote hyper-specialization, which improves efficiency. By breaking up complex production process, GVCs allow countries to specialize in specific parts or tasks of production.
  - E.g., China's "Button Town," where hundreds of factories produce more than 60 percent of all buttons on Earth.
- **Productivity gains**: In traditional trade, where products cross borders only as finished products. In GVC trade, intermediate inputs cross border, and domestic firms get access to greater variety of higher-quality or less costly intermediate inputs increasing productivity.
  - ➢ Studies suggest a 10 percent increase in the level of GVC participation is estimated to increase average productivity by close to 1.6 percent.
  - ➢ GVCs are vehicles for technology transfer: Unlike in traditional trade in which firms in different countries compete, GVCs are networks of firms with common goals. GVCs involve longer-term firm-to-firm relationships.
  - ➢ This nature of GVCs makes them a particularly powerful vehicle for technology transfer and sharing know-how along the value chain.
- **Better jobs**:
  - ➢ Through firm-to-firm relationships, GVC play an important role in on-the-job learning, and employer sponsored training within GVCs can be an effective mechanism for skill development.
  - ➢ GVCs promote capital-intensive production as it allows large scale production and precision of parts. This generates quality jobs, and there's overall increase in jobs because of the large boost to exports. GVCs pull workers out of less productive tasks into more productive jobs.

Concerns associated with GVCs

- Gains from GVC participation are not distributed equally across and within countries.
  - Countries which are part of trade deal agreements have comparative advantage over other countries because they have to pay less or no tariff.
- Synchronization of economic activity across countries makes domestic economies vulnerable to external shocks.
  - Pandemic has highlighted how shut down in one element of supply chain will impact other parts as well and lead to closure of entire operations, creating vulnerabilities for the domestic economy.
- GVCs amplify the costs of protectionism for trade and growth.
  - Hyper specialization of GVC has led to loss of jobs in the domestic country, which has accentuated the call for protectionism across the globe.
- Policy uncertainty is costlier under GVCs as foreign players are reluctant to participate until the uncertainty is resolved.
- **Environmental effects:** GVCs are associated with more waste and more shipping in the aggregate, both of which have environmental costs.
  - ➢ However, GVCs can also promote improvements in production techniques. The knowledge flows, technology transfers among countries can enable the development or quicker application of more environmentally friendly techniques.

How can countries reap benefits from GVCs?

- Countries should exploit their comparative advantage by eliminating barriers to investment and ensuring that labor is competitively priced, by avoiding overvalued exchange rates and restrictive regulations.

- Promote linkages between domestic small and medium enterprises (SMEs) and GVC lead firms by coordinating local suppliers, providing access to information about supply opportunities, and supporting training and capacity building of SMEs.
- Improving customs and border procedures, promoting competition in transport services, improving port structure and governance, and improving information and communication technology (ICT) connectivity— all are strategies that can reduce trade costs related to time and uncertainty.
- GVCs thrive on the flexible formation of networks of firms. Contract enforcement, stable and predictable legal arrangements, protecting intellectual property rights, strengthening national certification, and testing capacity to ensure compliance with international standards etc.
- Developing countries need policies to spread gains from GVC participation across society. Access to childcare for women, and training programs for youth, assistance to smallholders, such as extension services and access to finance etc. will ensure inclusion.
- Global cooperation on the environment and working conditions. Standardized international data will help expose poor production practices and induce firms to improve.

3.1.2 US-China Trade War – Implications and Opportunities for India

Issue

Recently a study by the UN trade and investment body has said that India has emerged as a winner amidst the US-China trade war.

Background

- According to the **World Bank's Global Economic Prospect**, the global economy has slowed to its lowest pace in three years because international trade and investment have been weaker than expected. International trade has been severely affected by the trade war between the US and China.
- Over the course of 2018, the US administration started implementing a series of trade measures to curtail imports, first targeting specific products (steel, aluminum, solar panels and washing machines) and then specifically targeting imports from China.
- In the early summer 2018, US and China raised tariffs on about $50 billion worth of each other's goods. This escalated further in September 2018 when the US introduced an additional 10% to cover $200 billion worth of Chinese imports, to which China retaliated by imposing tariffs on imports from the US worth an additional $60 billion.
- **In June 2019, the US increased the tariffs further, to 25%.** China responded by raising the tariffs on a subset of products that were already subject to tariffs. In September 2019, the US imposed 15% tariffs on a large subset of the remaining $300 billion worth of imports from China not yet subject to tariffs.
- **India gained about $755 million in additional exports**, mainly of chemicals, metals, and ore, to the US in the first half of 2019 due to the trade diversion effects of Washington's tariff war with China, according to a study by the UN trade and investment body.

Analysis

- Trade war is a subset of Trade Protectionism.
- It is a conflict between two or more nations regarding trade tariff imposition on each other’s goods.
- A trade war is usually initiated when a nation imposes tariffs or quotas on imports and foreign countries retaliate with similar forms of trade protectionism. As it escalates, a trade war reduces international trade.
- A trade war starts when a nation attempts to protect a domestic industry and create jobs. In the short run, it may work. But in the long run, a trade war costs jobs and depresses economic growth (by suppressing demand for goods as they become expensive) for all countries involved.
- It also triggers inflation when tariffs increase the prices of imports.

- Imposing tariffs protects the economy from foreign competitors. This provides the new companies time to develop their own competitive advantages.
- Protectionism also temporarily creates jobs for domestic workers.
- The protection of tariffs, quotas, or subsidies allows domestic companies to hire locally.
- However, these benefits end once other countries retaliate by erecting their own protectionist measures.

Four Methods of Trade Protectionism

1. One way is to enact tariffs **that tax imports.** That immediately raises the price of the imported goods. They become less competitive when compared to local goods. This method works best for countries with a lot of imports, such as the United States.
2. A second way of protecting trade is **when the government subsidizes local industries**. This makes the products cheaper even when shipped overseas. Subsidies work even better than tariffs. This method works best for countries that rely mainly on exports.
3. A third method is to **impose quotas on imported goods.** This method is more effective than the first two. No matter how low a foreign country sets the price through subsidies, it cannot ship more goods.
4. Fourth type of **trade protectionism is subtle**. It is a deliberate attempt by a country to lower its currency value. This would make its exports cheaper and more competitive. This method can result in retaliation and start a currency war.

Criticism of US Action

- On January 22, 2018, US imposed tariffs and quotas on imported Chinese solar panels and washing machines. China is a world leader in solar equipment manufacturing. The World Trade Organization ruled that the United States acted unfairly in levying the tariff.
- The head of the U.S. Chamber of Commerce said Trump's trade war could cost 2.6 million U.S. jobs.
- Eight countries have filed formal complaints with the World Trade Organization. Many of these countries, like Canada, India, and the European Union, are allies. The countries have argued that the US cannot justify the tariffs on the basis of national security.

Implications

- **Sharp decline in bilateral trade:**
  - Higher prices for Chinese consumers, losses for US exporters and trade gains for other countries. Of the $35 billion Chinese export losses in the US market, about $ 21 billion (or 62%) was diverted to other countries, while the remainder of $14 billion was either lost or captured by the US producers.
- **Higher prices for consumers**:
  - Tariffs imposed by the United States on China are economically hurting both countries and consumers in the US and China. The analysis shows that US tariffs caused a 25% export loss, inflicting a $35 billion blow to Chinese exports in the US market for tariffed goods in the first half of 2019
- **Trade diversion effects**:
  - Increased imports from countries not directly involved in the trade war.
  - The trade diversion effects of the US-China tariff war for the first half of 2019 at about $21 billion, implying that the amount of net trade losses corresponds to about $14 billion.
  - These trade diversion effects have brought substantial benefits for Taiwan (province of China), Mexico, and the European Union.
  - Trade diversion benefits to Korea, Canada and India were smaller but still substantial, ranging from $0.9 billion to $1.5 billion
  - The US tariffs on China resulted in India gaining $755 million in additional exports to the US in the first half of 2019 by selling more chemicals ($243 million), metals and ore ($181 million),

electrical machinery ($83 million) and various machinery ($68 million) as well as increased exports in areas such as agri-food, furniture, office machinery, precision instruments, textiles and apparel and transport equipment.

Opportunities

- India has an increasingly widening trade gap with China. Ongoing trade war may be an opportunity for India to reduce it significantly.
- India can export the surplus agricultural products such as soybean to China after decrease in the export from USA.
- India can become China's software industry partner, as it looks to replace the US hegemony of technology companies. India needs some strong pegs to pitch to China, and India's software industry is capable of graduating to a higher level.
- Growing trade tensions between China and the US could enhance the flow of Chinese investment towards India.
- India can explore opportunities to export the demands of goods by the US after restricted entry of Chinese goods in the US economy. Of the $300 billion in Chinese exports that are subject to US tariffs, only about 6% will be picked up by firms in the US, according to a report released by the UN Conference on Trade and Development (UNCTAD). Here, India can be benefited along with other nations.
- India may be able to increase its exports in textiles, garments, and gems, and jewellery to US if Chinese exports to the US slow down.

Disadvantages

- In the long term, trade protectionism weakens the industry. Without competition, companies within the industry have no need to innovate.
- Eventually, the domestic product declines in quality and becomes more expensive than what foreign competitors produce.
- Increasing protectionism can further slow down economic growth (weak consumer demand owing to inflation). It would cause more layoffs, not fewer.
- If the country closes its borders, other countries will do the same. This could cause layoffs among the workers who owe their jobs to exports.
- Trade war in the long term would hamper global economy due to reduced trade volumes among nations. The IMF noted that the US-China trade tension was one factor that contributed to a "significantly weakened global expansion" in 2018, as it cut its global growth forecast for 2019.
- The trade tensions could result in an increasingly fragmented global trading framework, weakening the rules-based system that has underpinned global growth, particularly in Asia, over the past several decades.

Concerns

- America has a trade deficit with every nation of the G7 grouping and that deficit has been increasing each year. With India, the US has a trade deficit of $21.3 billion, which on the contrary is a trade surplus (FOREX earning) for India, which is at risk due to the ongoing trade war.
- US wants duty reduction from India in Harley Davidson bikes, stents, knee implants and medical devices and dairy and poultry products among others. India has already reduced duty on high-powered bikes to 50% from 75%. However, further pressure for duty reduction can affect the domestic production.
- India should remain cautious of China's intention of dumping its overproduction of steel and aluminium due to restrictions imposed by the US.
- The rising price of oil threatens to widen India's current account deficit, impacting India's macroeconomic stability.
- India's already struggling currency may further decline in value due to the ongoing trade war.

Conclusion

Even though it is a lengthy and time-consuming process, the settlement of disputes through international conventions and rules is the need of the hour.

- WTO dispute settlement resolution mechanism should be approached instead of unilateral decisions. The benefit of the WTO process is that it prevents the damaging consequences of trade protectionism. Nations can resolve their disputes through WTO instead of raising tariffs.
- India can derive maximum benefits of the opportunities created by the ongoing trade war between the US and China. However, it should remain careful and prepare for the challenges arising out of the trade war.

3.1.3 Trade and Development

UNCTAD recently released an update on Trade and Development Report, 2019 titled From the **Great Lockdown to the Great Meltdown: Developing Country Debt in the Time of Covid-19**.

Issues faced by developing countries vis-à-vis trade

- High and rising developing country indebtedness: which could lead to sovereign defaults across the developing world.
    - In 2020 and 2021 alone, repayments on their public external debt are estimated to be nearly $3.4 trillion.
    - At end-2018 the total debt stocks of developing countries (external and domestic, private, and public) stood at 191 per cent of their combined GDP which is the highest ever recorded.
- This situation has been exacerbated due to the COVID-19 linked economic crisis in developing countries due to reasons such as:
    - Negative impact on their commodity and service exports, remittances etc. which bring in foreign currencies required to meet external debt obligations.
    - Capital outflows and depreciation of their currencies: which can cause steep increase in the value of their foreign-currency-denominated debt.

Global efforts to relieve developing countries' debt burdens:

- Support amounting to at least $2.5 trillion will be required for developing countries to deal with the Covid-19 crisis.
- A few global initiatives in this direction include
    - Cancellation of due debt repayments by IMF for the 25 poorest developing economies (estimated to be around $215 million) for the next six months.
    - Debt Service Suspension Initiative for Poorest Countries announced by G20 leaders.
    - Both the IMF and the World Bank have announced enhanced lending facilities for developing country members to help deal with the crisis.

3.1.4 Impact of Covid-19 Pandemic on Globalisation

- **Globalization refers to international trade and investment flows among economies often enabled by technological developments**. But today globalization stands at a crossroads.
- From Brexit to protectionist policies by the USA, from western against immigrants to new snags in the world's path to free trade, this era of world politics is being called de-globalization today.
- The global order is regularly facing a challenge as we've never seen before. All multilateral institutions in the world are today collapsing from the burden of their contradictions.
- The shock of the coronavirus to the global economy, which was already struggling, has also eroded the possibility of increased inflows of money, goods, and people around the world.

De-Globalization Trend

- Since the global economic crisis of 2008-09, the world was constantly moving in this direction and stood at the turn of the current global economic turmoil. This can be understood through the following data:
- There are several causes for the great stagnation in the globalization of goods and capital. It became increasingly apparent that not all countries, societies, and people were benefitting equally from globalization, and that soon began to be reflected in national and international politics.

Category	Before Globalization	After Globalization (1991)	After the global economic crisis of 2008-09
Trade as a percentage of global GDP	39%	61%	59% (in 2018)
Net Foreign Direct Investment inflows	Under 1% of global GDP	4%	1.4%
Net international energy trade	1.5 billion tonnes of oil equivalent	2.5 billion	2.8 billion
Similarly, personal remittance flows, previously on the rise, flattened to around 0.75% of global GDP.			

COVID19 Pandemic and Globalization

- Disrupting global supply chains and international trade
  - According to an analysis by the United Nations Department of Economic and Social Affairs (UN DESA), the Coronavirus (COVID-19) epidemic is disrupting global supply chains and international trade. The World Trade Organization (WTO) has estimated that in a worst-case scenario, global trade could dip as much as 32%.
- Restricted movement of people and the pace of tourism
  - During the past month, about 100 countries have closed their national border, which has completely stopped the movement of people and the pace of tourism, which has hampered global growth. Developed countries as well as many in the Asia Pacific economies that are highly dependent on tourism and commodities trading will shrink.
- Job crisis and stimulus packages
  - According to DESA, "millions of workers in almost all countries of the world are facing a job crisis. Besides, various governments are considering large stimulus packages to deal with the outbreak of coronavirus, which may further affect the global economy."
- Import substitution
  - Countries are facing difficulties in getting medical supplies; some find their manufacturing can't run as value chains are linked with China.
  - Countries will reconfigure their economies to look at import substitution with greater clarity now, as the perils and pitfalls of overdependence on foreign supplies become clear.
- Disillusion with the role of multilateral institutions
  - Trade rules have worked best when the global economy is booming and isn't facing a crisis. Position of Multilateral Institutions like WTO is going to get worse because if countries need to bring their domestic industries back, they would need space for policy flexibility and WTO will be redundant there — for instance, on the issue of subsidies for small industries, no country will like the WTO to be telling them what to do or what not to do.
- **Indian Context**
  - The world is becoming fragmented every day, the challenge of reviving support for globalisation will be bigger. This is a major problem for countries like India, which have benefited greatly from the vigor of globalisation. Because of the free flow of information, ideas, jobs, and people has given Indian citizens an unprecedented opportunity to prosper.

- But, now that the world scenario is changing rapidly, India's policymakers will have to find a way to make the most of the new emerging opportunities in India. Because today the old global supply chains are being disrupted and replaced by a new system of trade and investment.

Way Forward

- The impact of the severity of coronavirus (COVID-19) on the global economy will depend primarily on two factors: a period of restriction on people's movement and economic activity in major economies; and the real size and effectiveness of fiscal measures for the crisis.
- According to analysts, there is a need for a properly designed fiscal stimulus package to mitigate the impact of the virus on the global economy, which includes prioritizing health expenditure to prevent the spread of the virus and providing financial assistance to families affected by the epidemic.
- According to the Secretary-General for Economic and Social Affairs, all nations need some immediate policy measures that not only work towards preventing epidemics and saving lives but also help protect the weakest person in society from the economic crisis and maintain economic growth and financial stability.

3.2 Issues related to International Finance

We shall be discussing the following issues related to this topic

1. International Climate Financing
2. The Financial Crisis So Far

3.2.1 International climate financing

- Ahead of the United Nations Conference of Parties (COP24), the BASIC (Brazil, South Africa, China, and India) countries said that they would push developed countries on their commitment to providing $100 billion annually from 2020 as climate finance.
- However, countries till now haven't even agreed on what constitutes climate finance, which is blocking the funding to vulnerable countries.

What is Climate Finance?

- Climate finance refers to local, national, or transnational financing—drawn from public, private and alternative sources of financing.
- It seeks to support mitigation and adaptation actions that will address climate change.
- The UNFCCC, the Kyoto Protocol and the Paris Agreement call for financial assistance from countries with more financial resources to those that are less endowed and more vulnerable.
- It is in accordance with the principle of "common but differentiated responsibility and respective capabilities".
  - **Common but differentiated responsibilities (CBDR)**, principle of international environmental law establishing that all states are responsible for addressing global environmental destruction yet not equally responsible.
  - The principle balances, on the one hand, the need for all states to take responsibility for global environmental problems and, on the other hand, the need to recognize the wide differences in levels of economic development between states.

Background

- Through **the Cancun Agreements** in 2010 developed countries committed to a goal of mobilizing jointly **USD 100 billion per year by 2020** to address the needs of developing countries.
- **The Green Climate Fund (GCF)** was established in Cancun Agreement and designated it as an operating entity of the financial mechanism.
- **Under the Paris Agreement in 2015**, developed countries confirmed this goal and agreed that prior to 2025 a new collective quantified goal from a floor of USD 100 billion per year shall be set.

Need for Climate Finance

1. **Globally the scale of needed investment**
    - The World Economic Forum projects that by 2020, about $5.7 trillion will need to be invested annually in green infrastructure.
    - The current commitment of $100 billion annually is only a small piece of the $5.7 trillion puzzle.
    - Therefore, funding is needed to meet the investment needs in 2020 and beyond.
    - Mitigation – Large-scale investments are required to significantly reduce emissions.
    - Adaptation – Significant financial resources are needed to adapt to the adverse effects and reduce the impacts of a changing climate.
    - It is also critical to support developing countries to build resilience to worsening climate impacts and to catalyzing private sector climate investment.
    - Climate Finance is needed to transition the world's economy to a low-carbon path, as direct government funding is scarce in these countries.

2. **The scale of needed investment in India:**
    - Under Paris Accord, India has planned to reduce its carbon emission intensity – emission per unit of GDP – by 33-35%. To achieve these targets and build its renewable capacity India needs climate finance.
    - In September 2019, India announced its target to reach 450 GW of renewable energy generation capacity by 2030, making it one of the most ambitious targets in the world.
    - India's Nationally Determined Contribution (NDC) estimates that the country will require ~INR 162.5 lakh crores (USD 2.5 trillion) from 2015 to 2030, or roughly INR 11 lakh crores (USD 170 billion) per year for climate action as per climate policy initiative.
    - India's energy sector is one of the fastest growing in the world and has been attracting substantial investments, meeting the country's climate goals will require proportionate, transformative investment increases at sectoral level.
    - Strong financial support and timely policy interventions from the Government of India have played a crucial role in accelerating the growth of the country's renewable energy sector.
    - But given current rates of penetration and the overall health of the sector combined with slowdown created by the COVID-19 pandemic, the government will have to find new and alternative ways to finance the transition and incentivize private sector participation to scale up investments for a sustainable and transformational impact.
    - Hence there is a need of international climate finance for developing countries like India.

Principles of Climate Finance

1. **Polluter Pays**
    - The 'polluters pays' principle is the commonly accepted practice according to which those who produce pollution should bear the costs of managing it to prevent damage to human health or the environment.
    - This principle underpins most of the regulation of pollution affecting land, water and air formally known as the 1992 Rio Declaration.
    - It has also been applied more specifically to emissions of greenhouse gases which cause climate change.
2. **Common but Differentiated Responsibility and Respective Capability (CBDR–RC)**
    - CBDR–RC is a principle within the United Nations Framework Convention on Climate Change (UNFCCC).
    - It acknowledges the different capabilities and differing responsibilities of individual countries in addressing climate change.

3. **Predictability**
    - Climate finance must be predictable to ensure sustained flow of climate finance.
    - It can be done through multi-year, medium-term funding cycles (3 – 5 years).
    - This allows for an adequate investment program to scale up the country's national adaptation and mitigation priorities.
4. **Adequacy & Precaution**
    - In order to take precautionary measures to prevent or minimise the causes of climate change as a stated goal under UNFCCC, the level of funding needs to be sufficient to keep a global temperature within the limits possible.
    - A better level of adequacy might be increased in the national estimates of the needed climate funds, this will help build planned investments with respect to INDC.

Challenges

At Global levels:

- There is a gap between national needs and climate finance under Nationally Determined Contribution, there is need for additional international financial support.
- Least Developed Countries receive much less approved funding in per-capita terms from the multilateral climate funds.
- The rate of approvals is time taking, due to which the drawee nation has insufficient funds to complete its target and leads to stalling of projects.
- The uncertainties such as, the recent refusal of US to pay $2 billion of its pledge this has created shortage of funds at available GCF.

At National levels:

- In India the local market to climate finance is insufficiently involved in financial products that support climate change adaptation.
- There is imminent failure in securing viability-gap funding either from governments, or multilateral development banks.
- Projects in climate change has longer gestation period which deter financial institutions from investing in them.
- Shortage of funds due to insufficient budget allocation are often interfered due to any excess or additional grants which leads to stalling of green projects.

Way Forward

- An analytical framework is necessary to combine potential climate risks with a systematic cost-benefit analysis.
- Favorable policy and institutional actions are important for successful introduction or scaling up of financial instruments.
- Climate finance should be equipped with non-institutional financial services such as market funds, private, etc.

Additional Information

Kyoto protocol has already established in place many mechanisms to reduce carbon emissions. Let us understand the functioning of Kyoto protocol mechanisms.

Global Climate Financing

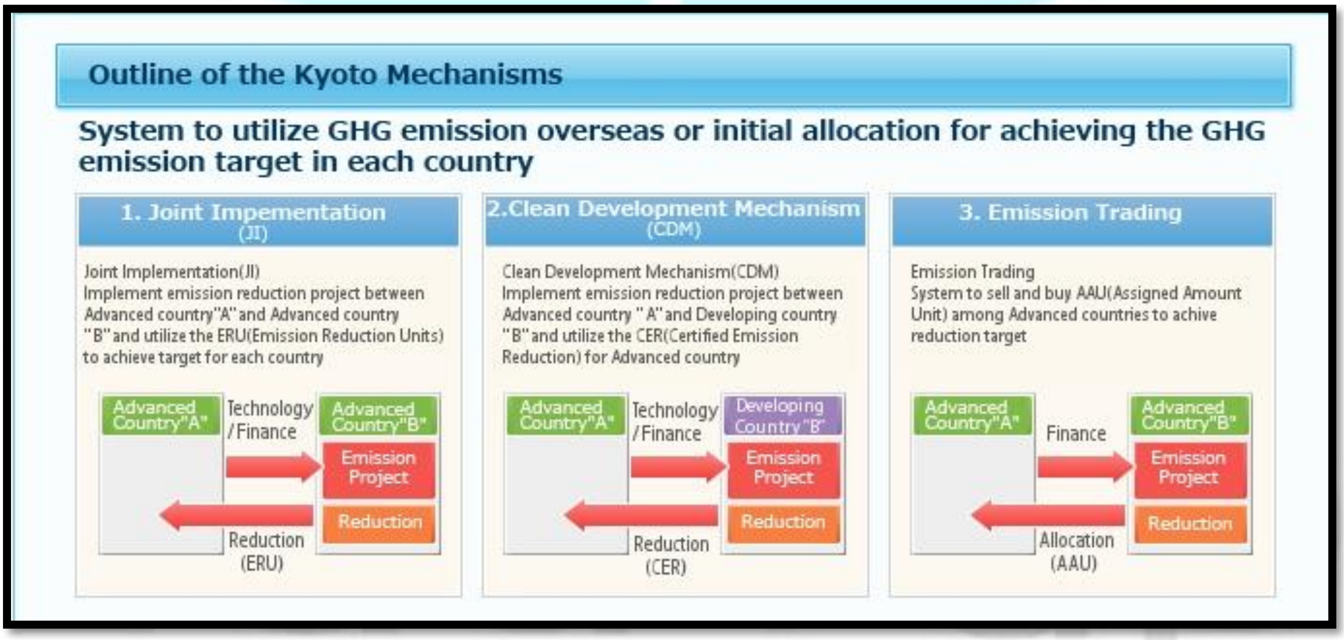
1. **The different mechanism of climate financing under Kyoto Protocol**

Clean Development Mechanism (CDM) – Kyoto Protocol

- CDM allows a country with an emission-reduction or emission-limitation commitment under the Kyoto Protocol (Annex B Party- Developed country) to implement an emission-reduction project in developing countries.
- **Hypothetical E.g., of CDM:** Australia takes up or finances some environment benefitting project in India (solar power projects, wind power projects, afforestation etc.) and earns some carbon credits (certified emission reduction credits). Now it shows these earned carbon credits to the world and tells them how it is working towards meeting its Kyoto targets.
- Such projects can earn saleable certified emission reduction (CER) credits, each equivalent to one tonne of CO_2, which can be counted towards meeting Kyoto targets.
- In simple terms: Developed countries emit more and lose carbon credits. They provide financial assistance to developing and least developed countries to create clean energy (solar, wind energy etc.) and gain some carbon credits thereby meeting their Kyoto Quota (Kyoto units) of emissions without violations.
- Suppose a developed country has a Kyoto Quota of 100 Carbon Credits, it can emit 100 tonnes of CO_2.
- Due to negligence, it emits 110 tonnes of CO_2, i.e., 10 carbon credits are lost (Kyoto Quota violation).
- Now the country has to make up for its lost carbon credits to avoid penalty.
- So, it invests some money (equal to 10 carbon credits) in developing and LDCs to build clean energy infrastructure like solar plants, wind farms, etc., and will make up for its 10 lost carbon credits and avoid penalty.

Joint Implementation (JI) – Kyoto Protocol

- Joint implementation is a mechanism where the Advanced country implements the project in the advanced country unlike in a clean development mechanism where an advanced country implements the project in a developing country.
- The mechanism known as “joint implementation,” allows a country with an emission reduction commitment under the Kyoto Protocol (Annex B Party- Developed country) to earn emission reduction units (ERUs) from an emission-reduction project in another Annex B Party, each equivalent to one tonne of CO_2, which can be counted towards meeting its Kyoto target.
- Joint implementation offers Parties a flexible and cost-efficient means of fulfilling a part of their Kyoto commitments, while the host Party benefits from foreign investment and technology transfer.



2. Different types of funds for financing

- **Green Climate Fund (GCF)** was established to limit or reduce greenhouse gas (GHG) emissions in developing countries and to help vulnerable societies adapt to the unavoidable impacts of climate change.
- **Adaptation Fund (AF)** was established under the Kyoto Protocol in 2001 and has committed US$ 532 million to climate adaptation and resilience activities.
- **Global Environment Fund (GEF)**
  - GEF has served as an operating entity of the financial mechanism since the Convention came into force in 1994.
  - It is a **private equity fund** focused on seeking long term financial returns by investments in clean energy under climate change.

Additional Information

✓ Private equity is an alternative form of private financing, away from public markets, in which funds and investors directly invest in companies or engage in buyouts of such companies.

✓ Private equity firms make money by charging management and performance fees from investors in a fund.

✓ Among the advantages of private equity are easy access to alternate forms of capital for entrepreneurs and company founders and less stress of quarterly performance. Those advantages are offset by the fact that private equity valuations are not set by market forces.

- **In addition to providing guidance to the GEF and the GCF, parties have established two special funds**
  - The Special Climate Change Fund (SCCF) and the Least Developed Countries Fund (LDCF).
  - Both funds are managed by the GEF.

Climate Financing in India

- **Intended Nationally Determined Contributions (INDCs)** are nationally binding targets adopted under UNFCCC. India has to reduce GHG emissions under this, which requires climate financing.
- **National Clean Energy Fund:**
  - The Fund was created to promote clean energy, funded through an initial carbon tax on use of coal by industries.
  - Governed by an Inter-Ministerial Group with the Finance Secretary as the Chairman.
  - Its mandate is to fund research and development of innovative clean energy technology in the fossil and non-fossil fuel-based sectors.
- **National Adaptation Fund:**
  - The fund was established in 2014 with a corpus of Rs. 100 crores with the aim of bridging the gap between the need and the available funds.
  - The fund is operated under the Ministry of Environment, Forests and Climate Change (MoEF&CC).
- **Clean Development Mechanism (CDM):**
  - It allows emission-reduction projects in developing countries to earn certified emission reduction (CER) credits, each equivalent to one tonne of CO2.
  - The CDM is the main source of income for the UNFCCC Adaptation Fund.
  - The Adaptation Fund is financed by a 2% levy on CERs issued by the CDM.
- **Internal Programmes:**
  - Compensatory Afforestation Fund Management and Planning Authority (CAMPA), Disaster Management Fund, etc.
  - A Climate Change Finance Unit was set up by the Department of Economics in the Ministry of Finance to advise and guide the MoEF&CC as well as to lead on global climate finance issues.

3.2.2 The financial crisis so far

- Financial crises are historically associated with the **"4 deadly D's". Downturn, Deficit, Debt, and Downgrades (and sometimes default).** An examination of the aftermath of severe financial crises shows deep and lasting effects on asset prices, output, and employment.
- Unemployment rises and housing price declines extend out for five and six years, respectively. Even recessions sparked by financial crises do eventually end, albeit almost invariably accompanied by massive increases in government debt. The crises, more often than not, adversely impact sovereign creditworthiness, as reflected in a higher risk premium. The effects, however, do not appear to be "permanent."
- **The global nature of the crisis** makes it far more difficult for many countries to grow their way out through higher exports. The growth slowdown is amplified in world commodity markets, as many emerging markets face steep declines in their terms of trade. If historical patterns hold, the current lull in sovereign defaults or restructurings in emerging markets will likely come to an end, particularly if the recovery process in the world's largest economies is delayed. Ecuador has already defaulted, and others are teetering on the brink.
- The Crisis has its impact across the globe because of the interconnected and interdependence nature of the economies. The analysis of the impacts can be discerned at two levels. One is within the economy and the other is across the economies. Now let's understand what a financial crisis is and the way it unfolds by analyzing a few crisis from history.

What Is a Financial Crisis?

- Financial crisis is when asset prices see a steep decline in value, businesses and consumers are unable to pay their debts, and financial institutions experience liquidity shortages.
- A financial crisis is often associated with a panic or a bank run during which investors sell off assets or withdraw money from savings accounts because they fear that the value of those assets will drop if they remain in a financial institution.
- Banking panics were at the genesis of several financial crises of the 19th, 20th, and 21st centuries, many of which led to recessions or depressions.
- Stock market crashes, credit crunches, the bursting of financial bubbles, sovereign defaults, and currency crises are all examples of financial crises.
- A financial crisis may be limited to a single country or one segment of financial services but is more likely to spread regionally or globally.

What Causes a Financial Crisis?

- A financial crisis may have multiple causes. Generally, a crisis can occur if institutions or assets are overvalued and can be exacerbated by irrational or herd-like investor behaviour.
- For example, a rapid string of selloffs can result in lower asset prices, prompting individuals to dump assets or make huge savings withdrawals when a bank failure is rumoured.
- Contributing factors to a financial crisis include systemic failures, unanticipated or uncontrollable human behaviour, incentives to take too much risk, regulatory absence or failures, or contagions that amount to a virus-like spread of problems from one institution or country to the next.
- If left unchecked, a crisis can cause an economy to go into a recession or depression. Even when measures are taken to avert a financial crisis, they can still happen, accelerate, or deepen.

Financial Crisis Examples

1. **Stock Crash of 1929:**
    - This crash, starting on Oct. 24, 1929, saw share prices collapse after a period of wild speculation and borrowing to buy shares. It led to the Great Depression, which was felt worldwide for over a dozen years. Its social impact lasted far longer.

- One trigger of the crash was a drastic oversupply of commodity crops, which led to a steep decline in prices. A wide range of regulations and market-managing tools were introduced as a result of the crash.

2. **1973 OPEC Oil Crisis:**
   - OPEC members started an oil embargo in October 1973 targeting countries that backed Israel in the Yom Kippur War. By the end of the embargo, a barrel of oil stood at $12, up from $3.
   - Given that modern economies depend on oil, the higher prices and uncertainty led to the stock market crash of 1973–74, when a bear market persisted from January 1973 to December 1974 and the Dow Jones Industrial Average lost 45% of its value.

3. **Asian Crisis of 1997–1998:**
   - This crisis started in July 1997 with the collapse of the Thai baht. Lacking foreign currency, the Thai government was forced to abandon its U.S. dollar peg and let the baht float.
   - The result was a huge devaluation that spread to much of East Asia, also hitting Japan, as well as a huge rise in debt-to-GDP ratios. In its wake, the crisis led to better financial regulation and supervision.

4. **The 2007-2008 Global Financial Crisis:**
   - This financial crisis was the worst economic disaster since the Stock Market Crash of 1929. It started with a subprime mortgage lending crisis in 2007 and expanded into a global banking crisis with the failure of investment bank Lehman Brothers in September 2008.
   - Huge bailouts and other measures meant to limit the spread of the damage failed and the global economy fell into recession.

Now let's understand a few of the important financial crisis in detail.

3.2.2.1 The Asian Financial Crisis

- In 1997–1998, Asia experienced its worst financial crisis of the 20th century. A period of exceptional economic growth and substantial capital inflow in the mid-1990s was punctuated by a crisis which engulfed economies including Indonesia, the Republic of Korea, and Thailand.
- The problems began in Thailand in June 1997. Foreign money flooded into the country and fueled speculative markets in real estate and stocks and heavy domestic consumption that contributed to a massive current account deficit. Thailand tried to defend the value of its currency but was forced to allow it to float in July and its value plummeted.
- In the following weeks, the contagion spread to Malaysia and the Philippines, to Indonesia and the Republic of Korea over the next months, and eventually around the world to Brazil and the Russian Federation, and to the United States (US) through the near collapse of Long-Term Capital Management, then the world's largest hedge fund.

Causes of the Asian Financial Crisis

1. **Economic strategy of export led growth**: The crisis was rooted in several threads of industrial, financial, and monetary phenomena. In general, many of these relate to the economic strategy of export led growth that had been adopted across developing East Asian economies in the years leading up to the crisis.
2. **Lax government regulations**: The export-led growth strategy involves close government co-operation with manufacturers of export products, including subsidies, favorable financial deals, and a currency peg to the U.S. dollar to ensure an exchange rate favorable to exporters.
3. **Risky Adventure**: The above strategies benefited the growing industries of East Asia, it also involved some risks, which are
   - Explicit and implicit government guarantees to bail out domestic industries and banks.

- Cozy relationships between East Asian conglomerates, financial institutions, and regulators, and
- Deluge of foreign financial inflows with little attention to potential risks, all contributed to a massive moral hazard in East Asian economies, encouraging major investment in marginal, and potentially unsound projects.

4. **The crack that caused the collapse:**
   - **What is Plaza accord?**
     - The Plaza Accord was a 1985 agreement among the G-5 nations—France, Germany, the United States, the United Kingdom, and Japan—to manipulate exchange rates by depreciating the U.S. dollar relative to the Japanese yen and the German Deutsche mark.
     - The intention of the Plaza Accord was to correct trade imbalances between the U.S. and Germany and the U.S. and Japan, but it only corrected the trade balance with the former.
   - **Why was the accord reversed?**
     - With the reversal of Plaza Accord in 1995, the governments of the U.S., Germany, and Japan agreed to coordinate to let the U.S. dollar appreciate relative to the yen and the Deutsche Mark.
   - **The impacts of the reversal**
     - This also meant the appreciation of East Asian currencies that were pegged to the U.S. dollar, which led to major financial pressures accumulating in these economies as Japanese and German exports became more and more competitive with other East Asian exports.
     - Exports slumped and corporate profits declined. East Asian governments and connected financial institutions found it increasingly difficult to borrow in U.S. dollars to subsidize their domestic industries and also maintain their currency pegs.
     - These pressures came to a head in 1997 as one after another they abandoned their pegs and devalued their currencies, which led to the crisis.

3.2.2.2 The Global Financial Crisis

- The global financial crisis (GFC) refers to the period of extreme stress in global financial markets and banking systems between mid-2007 and early 2009.
- During the GFC, a downturn in the US housing market was a catalyst for a financial crisis that spread from the United States to the rest of the world through linkages in the global financial system.
- Many banks around the world incurred large losses and relied on government support to avoid bankruptcy.
- Millions of people lost their jobs as the major advanced economies experienced their deepest recessions since the Great Depression in the 1930s.
- Recovery from the crisis was also much slower than past recessions that were not associated with a financial crisis.

Main Causes of the GFC

1. **Excessive risk-taking in a favourable macroeconomic environment**
   - In the years leading up to the GFC, economic conditions in the United States and other countries were favourable. Economic growth was strong and stable, and rates of inflation, unemployment and interest were relatively low. In this environment, house prices grew strongly.
   - Expectations that house prices would continue to rise led households, in the United States especially, to borrow imprudently to purchase and build houses.
   - A similar expectation on house prices also led property developers and households in European countries (such as Iceland, Ireland, Spain and some countries in Eastern Europe) to borrow excessively.
   - Many of the mortgage loans, especially in the United States, were for amounts close to (or even above) the purchase price of a house.

- A large share of such risky borrowing was done by investors seeking to make short-term profits by 'flipping' houses and by 'subprime' borrowers (who have higher default risks, mainly because their income and wealth are relatively low and/or they have missed loan repayments in the past).
- Banks and other lenders were willing to make increasingly large volumes of risky loans for a range of reasons:
  - Competition increased between individual lenders to extend ever-larger amounts of housing loans that, because of the good economic environment, seemed to be very profitable at the time.
  - Many lenders providing housing loans did not closely assess borrowers' abilities to make loan repayments. This also reflected the widespread presumption that favourable conditions would continue.
  - Additionally, lenders had little incentive to take care in their lending decisions because they did not expect to bear any losses. Instead, they sold large amounts of loans to investors, usually in the form of loan packages called 'mortgage-backed securities' (MBS), (Securitization) which consisted of thousands of individual mortgage loans of varying quality. Over time, MBS products became increasingly complex and opaque but continued to be rated by external agencies as if they were very safe.
  - Investors who purchased MBS products mistakenly thought that they were buying a very low risk asset: even if some mortgage loans in the package were not repaid, it was assumed that most loans would continue to be repaid. These investors included large US banks, as well as foreign banks from Europe and other economies that sought higher returns than could be achieved in their local markets.

2. **Increased borrowing by banks and investors**

- In the lead up to the GFC, banks and other investors in the United States and abroad borrowed increasing amounts to expand their lending and purchase MBS products. Borrowing money to purchase an asset (known as an increase in leverage) magnifies potential profits but also magnifies potential losses. As a result, when house prices began to fall, banks and investors incurred large losses because they had borrowed so much.
- Additionally, banks and some investors increasingly borrowed money for very short periods, including overnight, to purchase assets that could not be sold quickly. Consequently, they became increasingly reliant on lenders – which included other banks – extending new loans as existing short-term loans were repaid.

3. **Regulation and policy errors**

- Regulation of subprime lending and MBS products was too lax. In particular, there was insufficient regulation of the institutions that created and sold the complex and opaque MBS to investors. Not only were many individual borrowers provided with loans so large that they were unlikely to be able to repay them, but fraud was increasingly common – such as overstating a borrower's income and over-promising investors on the safety of the MBS products they were being sold.
- In addition, as the crisis unfolded, many central banks and governments did not fully recognise the extent to which bad loans had been extended during the boom and the many ways in which mortgage losses were spreading through the financial system.

Impact of the Crisis

The international financial crisis originated in the sub-prime mortgage crisis. This would have remained as a purely mortgage market crisis but for the fact that these sub-prime mortgages were securitized and packaged into products that were rated as investments grade.

- As a result, it started affecting a host of institutions which had invested in these products. These institutions were not confined to the US alone. Financial institutions in Europe and to a much lesser extent in East Asia had such assets on their books.

- There was mutual distrust among the financial institutions which led to freezing up of several markets including the overnight inter-bank market.

Global Impact

The crisis rapidly spread into a global economic **shock**, resulting in **several bank failures**. Economies worldwide slowed during this period since credit tightened and international trade declined. Housing markets suffered and unemployment soared, resulting in evictions and foreclosures. Several businesses failed.

- Indeed, from 2010 through 2014, multiple European countries—including Ireland, Greece, Portugal, and Cyprus—defaulted on their national debts, forcing the European Union to provide them with "bailout" loans and other cash investments.
- These countries were also compelled to implement "austerity" measures—such as tax increases and cuts to social benefit programs (including healthcare and retirement programs)—to repay their debts.
- The impacts of the crisis on the financial and real sectors of the economy were also not uniform across the countries.
  - While some economies that were **structurally strong were able to better withstand the crisis**, others had to be bailed out with extensive and multiple stimulus packages to overcome the adverse effects on the domestic economies.
  - The consensus opinion was that countries that curtailed the use of risky assets and encouraged domestic investment and savings were less affected by the crisis.
  - The countries that did not adequately penalize risky behaviour and those that had high rates of consumption were more severely affected.

3.3 Issues related to International Taxation

Let's discuss the following issues related to the topic

1. Global Corporate Tax And India
2. Double Taxation Avoidance Agreement.

3.3.1 Global Corporate Tax and India

The Finance Ministers of the G7 advanced economies secured a landmark deal on taxing multinational companies by fixing a Global Minimum Corporate Tax Rate (GMCTR). The decision would be placed before the G20 countries, a group of developing and developed nations, in July 2021.

Global Minimum Corporate Tax Rate (GMCTR)

- **Corporation tax:** It is a direct tax imposed on the net income or profit that enterprises make from their businesses.
- The G7 Finance Ministers have called for a global minimum corporation tax rate of at least 15%.

Need of GMCTR:

- **Low Tax Jurisdictions**: MNCs follow the system of locating the headquarters wherever the tax is the lowest so that the company ends up paying the tax at a much lower rate. Therefore, the smaller countries such as Ireland were at advantage, but the bigger countries lost out on tax revenues.
  - ➢ G7 countries have announced a minimum 15% tax rate on all MNCs irrespective of whichever place they are so that the advantage of country shifting does not remain.
  - ➢ There GMCTR must be fixed to avoid countries undercutting each other.
- **To Bring Uniformity**: GMCTR will end a decades-long race to the bottom in which countries have competed to attract corporate giants with ultra-low tax rates and exemptions. And it will bring uniformity in corporate taxation worldwide.
- **Multilayering by MNCs for Profits**: Digital giants such as Apple, Alphabet, and Facebook, as well as many other major corporations typically, rely on complex webs of subsidiaries to hoover profits out

of major markets into low-tax countries such as Ireland or Caribbean nations such as the British Virgin Islands or the Bahamas, or to central American nations such as Panama.

GMCTR and India

- **Bringing Equality**: In the Indian context, the GMCTR will bring equality to those people maybe operating in India but not located in India and therefore not paying any taxes.
- **Attract Investments**: India is likely to benefit from the global minimum 15% corporate tax rate pact as the effective domestic tax rate (other than in Special Economic Zones) is above the threshold.
  - Probably, the concessional Indian tax regime would still work, and India would continue to attract investments.
- **India at Advantage**: Due to India's tax rates too, it will be in an advantageous position because Indian tax rates have come at a position where India can afford to give concessions to big companies and yet not fall down at the international tax rates.
- **Challenge**: Although the 15% GMCTR will not affect the current investments in India, setting up more SEZs or giving incentives to companies to invest in India will be a challenge.

Challenges Associated

- **Bringing Global Consensus**: Bringing all the major nations on the same page, especially since the pact impinges on the right of the sovereign to decide a nation's tax policy.
  - A global minimum rate would essentially take away a tool that countries use to push policies that suit them.
- **Issues to Smaller Countries**: Countries like Ireland, which has a tax rate of 12.5%, has come out against the global minimum tax, arguing that it would be disruptive to its economic model.
- **Issues to Developing Countries**: IMF and World Bank data suggest that developing countries with less ability to offer mega stimulus packages may experience a longer economic hangover than developed nations.
  - Considering the countries like Bangladesh which do not have too many advantages to offer besides a Special Economic Zone, this decision of G7 countries might not be very conducive.
- **Tackling Tax Evasion**: A lower tax rate is a tool the countries can use to alternatively push economic activity. Also, a global minimum tax rate will do little to tackle tax evasion.
- **Rigidity in Rules**: Once an international commitment has been made for 15%, it will be very difficult for the national governments to say who stays on 15% and who doesn't. It will introduce rigidity in the rules which might not be as favorable for countries' economies.

Way Forward

- **Effective Implementation**: The idea of fixing a GMCTR is good, but it needs to be ensured that the way it is implemented is transparent, so it doesn't involve people looking for leverage for different loopholes.
- **Proper Coordination**: There should be appropriate coordination between the application of the new international tax rules including the Digital Services Taxes. Any final agreement could have major repercussions for low-tax countries and tax havens
- **Way Ahead for India**: Once this deal comes through, India shall be at an advantageous position at the G20 summit to negotiate its double taxation avoidance agreements. India shall take the opportunity that will be provided by this agreement as India's double tax avoidance agreements have not been signed by many countries in the west with which India has been negotiating for years.

Conclusion

- This initiative of the G7 countries is a welcome move to address the different challenges that many countries are facing.
- Putting in place a global corporate tax at the minimum slab fixed by the G7 will majorly impact the developing economies.

3.3.2 Double Taxation Avoidance Agreement

Double Taxation Avoidance Agreements (DTAA) is a treaty signed between two or more countries and is applicable in cases where a taxpayer residing in one country has to earn his/her income from another country. India has signed Double Taxation Avoidance Agreements or DTAAs with 88 countries, out of which 85 have become effective.

What Is DTAA?

- Double Taxation Avoidance Agreements is a treaty signed between two countries, which, through the elimination of international double taxation, promotes the exchange of goods, services, and investment of capital between the two countries.
- This implies that there are consented tax rates and jurisdiction on specified kinds of incomes arising in one country to a tax resident of another nation. The taxpayers in these 88 countries can avoid being taxed twice for the same income.
- Double taxation is an issue related to the taxation of income that crosses boundaries. DTAA can either cover all types of income or can target a specific type of income depending upon the types of businesses/holdings of citizens of one country in another. The following categories are covered under the Double Taxation Avoidance Agreements (DTAA):

    1. Services
    2. Salary
    3. Property
    4. capital gains
    5. savings/fixed deposit accounts

Mr. X, a resident of India works in the United States. In turn, for the work done, Mr. X is given some remuneration in the United States. Now, the US Government levies the Federal Income Tax on the income earned in the US.

However, there is a possibility that the Indian Government also charges income tax on the same sum, i.e., the remuneration earned abroad as Mr. X is a resident of India.

To save innocent taxpayers like Mr. X from the harmful effects of double taxation, the Governments of two or more countries may enter into an agreement known as **the Double Taxation Avoidance Agreement (DTAA).** Thus, Governments enter into a Double Taxation Avoidance Agreements with the intent of providing relief to the taxpayers:

- By either exempting the income earned abroad in its entirety, (In our example, the entire income earned by Mr. X in the US will be exempt in India).
- By providing credit to the extent of tax already paid in the US (The tax paid by Mr. X in the US will be eligible for deduction in India).

The DTAA applies to the residents of the contracting states i.e., India and USA, subject to certain exceptions.

Why DTAA is needed?

1) There will be no double taxation on the investor.
2) To ensure the availability of exchange of information between the countries.
3) Ensure that there is no tax evasion.

Outcomes

1) There will be clarity on taxation front.
2) It will promote bilateral investment.
3) It provides clarity on investment.
4) It promotes Global trade.

Benefits of Double Taxation Avoidance Agreements

- Sections 90 and 91 under the Income Tax Act 1961 offers specific relief to taxpayers to avoid double taxation. Section 90 deals with those provisions involving taxpayers who have paid tax to another country with which India has a DTAA.
  Section 91 is for those countries with which India does not have a DTAA. In effect, India provides relief to both types of taxpayers.
- Some of the major benefits of Double Taxation Avoidance Agreements (DTAA) are mentioned below:
  - The countries under the DTAA are provided relief from double taxation. Relief on double taxation is provided by the exemption of incomes earned abroad from tax in the resident country or by providing credit to the extent taxes that have already been paid abroad.
  - In some cases, the DTAA also provide concessional rates of tax.
  - DTAA can become an incentive for even legitimate investors to route investments through low-tax regimes to sidestep taxation. This leads to a loss of tax revenue for the country.
  - DTAA also provides tax certainty to the various investors and businesses of both the countries through the clear allocation of taxing rights between the contracting states by Agreement.

3.4 Issues related to international institutions

Note: The static nature of the topic has already been covered in the topic of international institutions, kindly refer to the chapter for the detailed information.

3.4.1 Issues related to WTO

3.4.1.1 Challenges Faced by the WTO

The **World Trade Organization (WTO)** has been the cornerstone of the multilateral rules-based global trading system since its inception in 1995.
However, even before the Covid-19 pandemic, all three of the organization's functions were facing challenges. The functions are

1. Providing a negotiation forum to liberalize trade and establish new rules,
2. Monitoring trade policies, and
3. Resolving disputes between its 164 members.

Moreover, with trade tensions increasingly politicized and Covid-19 creating huge economic challenges, a modernized and fully functioning WTO is more essential than ever.

Issues Related to WTO

- **China's State Capitalism**: The nature of China's economic system, combined with the size and growth of its economy, has created tensions in the global trading system.
  1. China's **state-owned enterprises** present a major challenge to the free-market global trading system.
     - Backed by a thicket of subsidies and industrial policies, a domestic market that restricts foreign competition in strategic sectors, and **aided by generous state lending**, China's private firms have been propelled into the global market and
     - Now vie with U.S. and European firms for leadership in cutting-edge technologies, including robotics, artificial intelligence, biotechnology, and telecommunications.

2. However, a critical part of the problem is that the rulebook of the WTO is inadequate for addressing the challenges that China presents in respect of intellectual property, state-owned enterprises and industrial subsidies.

- **Institutional Issues**: The Appellate Body's operations have effectively been suspended since December 2019, as the US's blocking of appointments has left the body without a quorum of adjudicators needed to hear appeals.
- **Lack of Transparency**: There is a problem in WTO negotiations as there is no agreed definition of what constitutes a developed or developing country at the WTO.
  - Members can currently **self-designate** as developing countries to receive 'special and differential treatment' – a practice that is the subject of much contention.
- **E-commerce & Digital Trade**: While the global trade landscape has changed significantly over the past 25 years, WTO rules have not kept pace.
  1. In 1998, realizing that e-commerce would play a growing role in the global economy, WTO members established a WTO e-commerce moratorium to examine all trade-related issues relating to global electronic commerce.
  2. Recently, however, the moratorium has been called into question by developing countries because of its implications for collecting revenue.
  3. Moreover, as the Covid-19 pandemic accelerates the shift to e-commerce, rules to regulate online trade will be more important than ever. But in contrast to trade in goods and services, few international rules govern cross-border e-commerce.
- **Agriculture and Development**: The WTO Agreement on Agriculture, which came into force in 1995, was an important milestone.
  1. Agreement on Agriculture targets reform of subsidies and high trade barriers, which distort agricultural trade.
     -Ex: Before the inception of WTO, Advanced economies like USA and Europe heavily subsidized the agriculture production which was barrier to free trade. The subsidized goods are cheaper than unsubsidized goods, threatening the global free trade
  2. However, agreement on agriculture is facing issues due to food security and development requirements for developing countries like India.
     -The rigid rules of WTO have not taken into consideration the difficulties of developing countries like India, where subsidies have exceeded the de- minimis level. But India is subsidizing it for food security needs and not for export purpose.
- Lack of WTO initiative towards climate change.

Way Forward

- **New Set of Rules**: Modernizing the WTO will necessitate the development of a new set of rules for dealing with digital trade and e-commerce.
  1. WTO members will also have to deal more effectively with China's trade policies and practices, including how to better handle state-owned enterprises and industrial subsidies.
- **Environmental Sustainability:** Given the pressing issues around climate change, increased efforts to align trade and environmental sustainability could help to both tackle climate change and reinvigorate the WTO.
  1. Trade and the WTO have key roles to play in efforts to achieve the UN Sustainable Development Goals (SDGs) and the Paris Agreement climate goals.
  2. For example, at the Buenos Aires Ministerial Conference in 2017, a coalition of 12 WTO members led by New Zealand called on the WTO 'to achieve ambitious and effective disciplines on inefficient fossil fuel subsidies that encourage wasteful consumption'.
- **Categorization:** The WTO also needs to come up with better measures to categorize the countries as developing and developed.

- **Dispute settlement:** Streamlining of the appointments to the appellate body is need of the hour so that dispute settlement mechanism is not hindered by any one country.
- **Adaptability**: The organization needs to adapt to the changing ecosystem and frame the rules accordingly. Ex: Coming up with rule-based order for E-commerce, which is the future of global trade.

Conclusion

In future, WTO members will have to strike a balance between moving forward with negotiations on 21st-century issues and keeping sight of the unresolved 'old trade issues' such as agriculture and development.

3.4.1.2 WTO Peace Clause

Why in news?

India has invoked the peace clause of WTO for exceeding the ceiling on support it can offer farmers for rice, marking the first time any country that has used this clause.

- India informed WTO that the value of its rice production was $43.67 billion in 2018-19 and it gave subsidies worth $5 billion which is 11.46% of the value of production.
- However, the Agreement on Agriculture (AoA) under WTO has a limit pegged at 10% for developing countries, which is a de-minimis level.
  - De minimis level is **minimal amount of domestic support that is allowed even though they distort trade.**
- Hence, India used peace clause and reasoned that:
  - The government does not undertake exports on a commercial basis from public stockholdings.
  - Further, the stocks under the programme are acquired and released in order to meet the domestic food security needs of India's poor and vulnerable population, and not to impede commercial trade or food security of others.

<u>What is Peace Clause?</u>

- After **Uruguay Rounds of WTO in 1994**, the **Agreement on Agriculture came into existence** which provided **guidance on domestic support commitments** and general disciplines on domestic support.
  - Under the agreement, to limit trade distorting support measures, members agreed to curb their policies by **quantifying and gradually reducing all domestic support measures** through the **Aggregate Measurement of Support (AMS) or Amber box.**
    - Further, this **subsidy should not exceed 10% de minimis level** for developing countries and **5% for developed countries**.
  - Also, an important provision of the AoA was the **Due Restraint or 'Peace Clause' under Article 13**, which **temporarily shielded countries providing domestic support measures** in accordance with the AoA provisions from being challenged at the WTO.
- The peace clause **protects a developing country's food procurement programmes** against action from WTO members **in case subsidy ceilings are breached.**

Issue with Peace Clause

- The term 'peace clause' has been a cause of disquiet ever since India dug in its heels on the issue of **domestic food security** in the World Trade Organization (WTO) negotiations of 2013, leading to a deadlock.
- Should the WTO have a say in India's policy of buying food grain at a fixed price from farmers and supplying it below cost to the poor? India thinks not, but developed nations disagree.
- After the developing and emerging nations clashed on the issue in 2013, they cobbled together a temporary 'peace clause' in Bali.
- The 'peace clause' said that no country would be legally barred from food security programmes even if the subsidy breached the limits specified in the WTO agreement on agriculture. This 'peace clause'

was expected to be in force for four years until 2017, by which time the protagonists hoped to find a permanent solution to the problem.

- India's worry is that if the clause expires **before a permanent solution** is in place, food security programmes and policies to protect farmers, such as Minimum Support Prices, would come under siege.
- The limited window offered by the Western powers for the peace clause was seen by India as insufficient assurance. The clause also requires full disclosure of MSPs and annual procurement for food security programmes, which the Government fears would leave India open to questioning by other countries on domestic matters.
- **The developed nations see India** as a huge market for food grains and other products, but their produce is rendered uncompetitive when the government is willing to subsidise farmers, purchase their produce for a minimum support price and then sell it at a loss through the public distribution system and other channels.
- Later, the **Nairobi Ministerial Conference** of the **WTO** held in **December 2015** reaffirmed, with consensus, the **Interim Peace Clause would remain in force until a permanent solution is agreed and adopted.**