

India should accept climate change flow obligations, ask for superfund: Jagdish Bhagwati

Quid pro quo in services sector negotiations is needed. But so are rules on hiring and firing.

Jagdish Bhagwati, University Professor at Columbia University and Senior Fellow in International Economics at the Council on Foreign Relations, is regarded as one of the foremost international trade economists of his generation. He has been Economic Policy Adviser to Arthur Dunkel, Director General of GATT (1991-93), Special Adviser to the UN on Globalization, and External Adviser to the WTO. In this interview to The Hindu in Chennai, Professor Bhagwati outlined some of the key challenges that remain for India in the climate change discussions in Copenhagen in December 2009 and the upcoming negotiations on the Doha Round. The edited interview:

Narayan Lakshman

Q: On climate change, how much progress do you think the recent discussions, including agreeing a cap on global temperature rises, represents for countries like India and China? Domestic constituencies that may be hard to convince in terms of required actions to meet targets.

A: That is true, but there are two issues. One is whether you agree an overall target. The other is the distribution of the burden for having to bring about the change. What we have got now is an agreement on essentially what temperature rise we will accept and so forth. The issue is scientific in a way, but it is also not totally scientific. There is also the question of the cost to the world economy. Forget about distribution now, among different countries. That is where the Stern report played a role in shifting the trade-off, saying “We need to do that and we are going to lose less income than we think in bringing this about.”

The scientific consensus has also grown, but more than all that, I would say I am envious coming from trade, because I cannot think of a similar way in which we could proceed. It was not Jim Hansen climate change expert and Columbia University adjunct professor or economists writing about how

we really need to do something about climate change and how it was not going to be that expensive. It was really the pictures of melting glaciers, the endangered polar bears and that French film about the penguins – those three things are what appealed to people. So I am thinking of something similarly dramatic to sell trade. If you say “Freer trade leads to so much gain” people go to sleep or at least start yawning! But if I could show something dramatic, that would be very helpful. The only thing I can think of is a negative example and that is the Smoot-Hawley tariff a 1930s U.S. tariff that might have contributed to the severity of the Great Depression and the whole nuclear winter after that. This was one reason why I was upset with Paul Krugman, who was saying maybe this did not amount to too much. So I said “Do not throw out the one limited example that we have, which we can refer to as against scientific writings on the subject. This should be sacrosanct, whatever myths remain around that should be maintained.”

Carbon sink

That is an issue on which there is consensus. Unfortunately Jairam Ramesh was reported – I am sure misreported – as saying that there was no scientific consensus on global warming. He could never have said that. But we should avoid that area because it is simply clouding the real issue, which is about the burden of doing something to address climate change. If you look back at Kyoto, we have two problems. One is that there is a carbon sink up there and the bulk of it, something like 80 per cent, has come from the West, predominantly from the United States and European Union (EU). So you have that as one fact. The other fact is the current flow obligation. Call the carbon sink the stock problem. Then we have the flow problem because we are currently discharging CO₂ into the air. That is where China in particular, in gross emissions, is almost exceeding the U.S. now and we are the third or the fourth – Russia is sometimes above us, sometimes below. This is total emissions, for the country as a whole. There the compromise arrived at when people said, “You have been doing a lot of polluting in the past, you have damaged the environment, do not blame us, we should have no obligations now,” – that was taken at face value. Tim Wirth, who represented the U.S., Madeleine Albright – all of them agreed that the way to fix this disparity between flow and stock obligations is to say “You do not have to pay anything now.” That was stalled in the Senate. Senator Byrd and Senator Hagel led the fight in the bipartisan debate. But the resolution was passed 95-0; they said “We should not let off India and China; it will affect the competitiveness of our industries”.

Stock and flow problems

If you look at it from the point of view of theory of actual policy, here you are trying to attack the stock problem and the flow problem with one policy instrument. That usually does not work. I came up with the idea that we should address the stock problem separately from the flow problem. We should expect India and China to assume flow obligations but part of that solution has to be that the

stock obligation is fulfilled by the West. Then I found, because I know the domestic pollution literature from my work on fair trade, that the Americans themselves have what they call a “Superfund,” under which the strict liability is assigned for past damage, since the Love Canal episode, which was what the movie Erin Brockovich was also about. Anyone who has been discharging waste that was hazardous had to clean up – they have a tort liability.

Super fund principle

Q: But this addresses the side, only the flow side...

A: Yes. So I said if we have damaged in the past, there is nothing like a clean-up yet, without trying to recover carbon and so on. But that is years ahead. So it is not complete peril, but you have to pay for your past damage. In the U.S. legislation, that applies even if you were not aware at the time of pollution in terms of science that you were actually damaging the environment. If you just happened to damage the environment, whether you knew about it or not, you were still liable for the clean-up. So there is a tort and a moral obligation. I asked why we have this super-fund principle here, and what are the tort payments? That is a difficult question on how much you need to pay.

Q: But many of the institutions that polluted earlier might not even exist now, so tracking the exact amounts might be difficult...

A: Yes, so now we talk about countries and say this is what the States owe. That transition has to be made. Just as you have corporations within the U.S. we talk about the U.S. within the world community, the way we do in international trade. So that was the basic idea. Cass Sunstein, who is one of the President’s advisors on regulation, wrote to me a rave letter the next day saying this was the best article he had ever read. A lot of people wrote in saying they liked the idea because it as a conceptual idea. If we say, as we are right now, that the West has to give us money for us to adopt new technologies, why should they want to do that? They are all saying “No” right now. But if you say “You have got to pay for past damages if you want us to accept current obligations;” that is fair and equitable. Then that money, once the super-fund is established, can be used for exactly the kind of things India is asking for – for mitigation, for accommodation, and for financing the creation of public goods – just like we created seeds from the public money of foundations and so on. So that is the kind of thing we can do.

What India needs to do

I have also tried hard to get the Indian side to accept this. I have sent my paper to the Prime Minister. Sometimes they say, "But we have already asked for funds." But that is not the issue. If you simply ask for funds, that sounds like asking for aid. This is not aid – it is really a matter of what the West owes if they want us also to do something. That is fair and equitable. So that is an area where you can really make progress on this issue. We will also have to decide what the current flow obligations we take on are. On the stock side, it should really be a way to get at this problem.

India and China are always pegged together. I have been to meetings where Shyam Saran has talked and the general reaction is that the Indians argue things a lot better than the Chinese in terms of the stock-flow obligations. So maybe something has penetrated through. Right now we need to work at it in terms of the right principle because it appeared in the Senate that it was like some progressive income tax principle and the poor countries like India and China were trying to get away with zero obligations because they were poorer and because they had made no stock contribution. I have read the proceedings and nobody ever explained the case that way. That was bundled out as a result. Clinton and Gore also never took up the matter after that. They just retreated from the scene and then they said they would work at getting India and China to actually accept their obligations. So they accepted the Senate's approach and that is what you see in what they are doing.

Dealing with the EU

One of the problems we are going to run into also is that the EU might go along with the approach that the Americans have taken. The EU is a little more understanding even if a bit unpredictable. But the U.S. has taken the approach of the Waxman-Markey bill, which was just passed in the Congress House. They are going to use cap and trade, which is the quantitative equivalent of a carbon tax. If India, for example, does not have a similar carbon tax, then they will put in a tax adjustment, meaning essentially it is a tariff against the Indians, thereby making them pay for it. At one level it is a matter of intimidation. I do not think it will work when we are objecting to it. This is exactly what the French were trying to do to the Americans under Villepin, by saying "You have not signed the Kyoto agreement, therefore your energy is too cheap." Peter Mandelson of the UK said the French could not impose a tariff on these grounds as they would have a WTO war breaking out. Ultimately that approach is something we have to look out for. Jairam Ramesh has said we are not going to do that. But the only way to answer that is not through WTO action because it is quite conceivable that the WTO panel might find in favour of the U.S. Anything is possible.

So the WTO-legality of charging an additional tariff might be accepted. The President himself thinks it is WTO-illegal, but the situation is more ambiguous than that. Supposing we lose this debate – do we then surrender? We cannot go against the WTO but the only thing we have to and should say is, “We can also take WTO action against you, if you start playing this game.” For one thing, we can say our petroleum tax is much higher than that of the U.S. and we can call it a carbon tax as it does relate to carbon also. So we can say “We will put a tax on your exports to us.” We can do that. We can play the same game within the carbon game or we can shift the two nuclear reactor sites under the G8 to the French or the Russians. We are now big enough, in my opinion, to contemplate such options. The one thing that the Americans, at the Congressional level, listen to is cash. They have principles but they also have cash. Cash is one of the principles also! I think the Prime Minister is too nice to take this approach! You need to be quite strategic-minded in this situation. We need to handle the U.S. strategically because there are so many dimensions along which we are interacting with them. Otherwise these issues will be decided by default. My fear is that the Chinese strike their own deals as they are very practical and strategic. They are not going to worry about being in solidarity with us. So we also have to take that downside scenario into account. It is just a matter of working out different scenarios and understanding what it is that we really want.

Europeans and superfund

The Europeans are more likely to support the idea of a superfund. I recently met Swedish ministers who were sympathetic but said that India would not get anything by way of transfer of technology for free unless they first made commitments. We ought to say, “You have to make commitments too,” but citing a principle like the superfund. If we just ask them to give us technology for free, they are not going to do that because their private sector will refuse to do that. We have to say that it has to be done simultaneously and the free or subsidised technology has to come from the superfund and be available to us. You could actually say that our total per capita carbon emissions are low; the Chinese emissions are very high and expanding rapidly. We understand that they have huge reserves – they do not need subsidised technology. They should be able to buy their own. Some arguments like that need to be made but we need to think this through with a group of realistic people who understand, China, the U.S. and India. The Americans on the whole are well-inclined towards us. So confrontation is not a good idea, but working out these things and saying “These are the dimensions of the issue and this is what is fair” is important. Americans believe in fairness, even if they do not believe in justice. If we plug the line of fairness and emphasise that they have to accept obligations also, then we can work out how to use that for mitigation as well.

WTO legality

Q: Recent reports have indicated that 83 new measures that go against free trade principles have been enacted across countries. Are you not worried that these will be difficult to roll back, especially because such moves often represent governments responding to pressures from their domestic constituencies?

A: Most of the actions reported are safeguard actions, anti-dumping actions and so on. Those are actions where you are exercising your rights. One wishes they were not doing so, but you cannot really object to them as such exit strategies are built into WTO rules, at least on a temporary basis. Especially when things get rough – and right now they are – the ability to toe the line is being strained in many democratic countries. So that part does not really bother me that much. But if you go beyond that and look at protectionist interventions where you are violating your obligations, by doing things that you agreed not to do, that is something that is still not on a scale that you need to worry about. But we insist on talking about it simply because then everybody will be careful and aware that it is going on.

There is one downside risk which people have observed, which is that if you collect all these interventionist actions, whether they belong to the first group (WTO-legal) or the second group (WTO-illegal), it will be harder to hold to the line in some countries because people will say, “The United States has done that taken these actions so what about us doing it?” So increased transparency may make it more difficult rather than less difficult. This is more a political science kind of reaction and there is something to that because a lot of people are simply unaware of what is going on, except those who are being hit, the victims of this! So this kind of exercise should be held in a low-key.

Doha stakes

Q: In terms of effects on trade, are they any different from actions that violate WTO rules?

A: The effect would be identical. But the effect in terms of the prospective impact may not. When you undermine rules, people feel they can do a variety of things and they are not constrained. Therefore the expectations you set up are important. This is the problem about settling the Doha trade negotiations. If you do not settle Doha and it drags on, say even another year then people will feel that multilateralism is dead. Therefore the rules such as we have built in, based on the 1930s experience of free-for-all, those rules will get undermined. That is what people are worried about –

the effect on the system. It is hard to quantify that because that is actually a matter of how the situation will unfold. There is no doubt that the trade system has managed to do reasonably well because we have had rules. This is the reason why the G20 and the G8 keep repeating that we must settle Doha and not let it go. Even though they do not expect to liberalise they hope to at least underline to the public that they believe in the system rather than its role in further liberalising trade. I think they understand that liberalisation can be hard.

What U.S. and India must do

I suspect we are going to move in the next few months into a mode where we will decide that somehow we have to settle Doha. We have been so close to an agreement; but now we can take that final step. But the onus for the way it has developed is unfortunately just on the U.S. and India right now. The U.S. having more control of the media makes it seem as though it is India which is the problem. We could equally say that it is the U.S. which is the problem. They both have to make a move, in my judgment.

Q: In the 1930s there was a rollback of stimulus-type moves too early, and that offset some of the progress made. Now do you think there is a chance that some of the WTO rules may actually come into conflict with the stimulus package measures, some of which are protectionist? You might have this in the U.S., for example. These moves would still be WTO-legal but they would be in the wrong direction from the point of view of the WTO. Do you see a risk of that happening, because we are still not out of the woods yet?

Stimulus & fiscal deficits

A: The first lesson from what happened in the 1930s is at the level of the stimulus itself. In terms of the impact on the trading system the idea that you need rules is pretty well understood right now. That is a lesson we have learned and that is embodied in the GATT (General Agreement on Trade and Tariffs) and so on. But from the point of view of the macroeconomic aspects, it is pretty well understood now that the stimulus really works. After all, Keynesianism came about as a result of the great crash of 1929. At that time there was no fiscal policy! We were supposed to balance the budget and so on. Now, as a result of the crash and from the economics of Keynes, we know that fiscal policy plays an important role as an instrument. So that is one lesson we have.

But equally there is always the temptation to say like Bush did when he landed on an aircraft carrier that we have won; and if the war is still going on, you are in deep trouble. That is something we know because around 1937-38 we moved backwards a little too soon so we got a further dip in the

economy. I was not aware of this myself, not being familiar with the macroeconomics of that period. That is something that is now widely understood. So I think Obama is going to be very clear on that and not going to allow the economy to contract too soon.

But the real problem is that Angela Merkel and the Germans who agreed to the stimulus are worried about what the heavy hand of the budget deficit and debt-to-GNP ratio does portend with regards to future inflation. German history, so dramatically reminiscent of hyperinflation and of how the Nazis came in, has made them very risk-averse on spending. They are very worried about when they will next have to contract and be able get back to some normalcy. So they will simply not move but Americans do not have that history. Besides Americans have the onus to act – I mean everybody knows that Americans were the cause of the crisis. Therefore equally there is a moral obligation on their part to refloat the economy. They may protest if Angela Merkel does not come on board but they cannot really afford to let go. Besides, their own welfare is very heavily dependent on that. So they are into that but at the same time they are worried about what may happen down the road. The main problem for them is going to be how to go into reverse at that point.

Yet Americans are a really practical lot and this is the second point – they do not play chess, they do not look ahead. They cut and run. So they prefer the sequential to the strategic approach. They have decided “We have to spend the money and fix the economy. We will handle the inflation if and when we get there.” I think it is not such a bad idea.

Protectionist moves & Doha

Q: “Buy American” clauses have been associated with the bailout funds and there are similar measures in other countries. Given that there is no single supra-national body to decide on the rules do not you think all these protectionist moves are going to stall the Doha process further?

A: It has not gone that far at all. I do not think so. If you look at all these actions, it is a matter of what value of trade they cover. Look at anti-dumping actions, which most of us economists deplore, because they are supposed to be fair trade actions but everybody knows they are unfair trade and they are used as a way of interfering with free trade. They are already in the system and therefore they are part of your rights, but these are rights that you would rather not see, having been built in.

But you find, typically in the literature, the argument that India is the worst user of anti-dumping actions, not the U.S. or the EU. But when you actually look at the value of trade you discover that it

is minuscule compared with what the U.S. and the EU are doing. So you have to put it into some perspective like that. I do not think in the value of the trade covered or the intimation in terms of what future actions might break out amounts to anything very substantial. With policies like “Buy American”, they are going to realise that as soon as they are out of trouble, this is not really what they want to do because there has been so much criticism of it. Even Obama, because of all these criticisms coming particularly from people who are worried about export markets, like Caterpillar and GE and so on, put in a rider or qualifier saying it has to be consistent with our WTO obligations.

Of course, the devil is in the detail and despite that provision you can actually have erosion of the WTO obligation. But it will not last forever. As soon as the pressure eases, assuming we do not make the mistake of reversing too soon, that will tend to disappear. What I find lacking in the G20 and G8 statements is any awareness of these kinds of problems remaining endemic after we pull out of the recession. We will have to have a game plan also that says, “Wherever there is ambiguity, we need to be absolutely tough-minded and say we should light a bonfire under these things,” but by collaborative action.

No need for supra-national authority

But there is no supra-national authority which is required for this; it is just a matter of the main players making sure they comply. In fact the protection is in a lot of other areas, where there are no rules. For example if you want to look at labour markets and immigration issues, which are related, you now have in many countries a great demand, including in England and in the U.S., to hire domestic workers first and to fire foreign workers first as well. There is no rule in the WTO on that. There is no rule on foreign investment. There is no rule on services. So what worries me is not trade protection, because there we do have a system and rules in place. It is a matter of recovering sanity on the political feasibility.

Obama & Sarkozy

But there are a whole lot of things, including foreign investment, where President Obama says value should not flow to Bangalore but should stay in Buffalo. Now that is a kind of protectionism. And Sarkozy goes even further and he actually said that French firms should not invest abroad, like in Prague for Renault and Citroen; they should come back. Now that is carrying it too far in terms of protectionism.

So for trade protection we fortunately have the WTO and the whole history of that and we have the rules and we have the system, such as it is. But there are whole areas where you do not have that. In

the banking sector in particular, markets are getting segmented. If the Royal Bank of Scotland can have no access to American funds and the same way over there in the UK, that is a massive issue. So I had written to Prime Minister Gordon Brown before the last G20 meeting that what he should talk about is not just containing trade protectionism and the advantages of a freer trade system, but to talk about the advantages of an open world economy because that is a much broader theme.

India and OECD code

In India we used to be worried about direct foreign investment, about the dependency complex and so on. We have learned that we can use foreign investment well – not portfolio investment, which is unstable and volatile but direct foreign investment. We can use that, we can use trade, this is where you get high rates of return, but you do not have any rules at all on things like direct foreign investment because the OECD code was one-sided. It was just on the rights of multinationals, it did not make any sense. It wrote about the obligations of multinationals on corporate social responsibility and so on. What about the rights of receiving nations? Those two were completely ignored. So there should be a tripod but it was a one-legged stool. So it did not get anywhere, so it was thrown out. Then it was devalued by that opposition, mainly by NGOs, and we have never gone back to it.

In Cancun both Robert Zoellik and Pascal Lamy, U.S. and EU, said “We will give it up.” It does not mean that it does not belong to WTO rules. We can come up with something so long as it is balanced. You cannot have one stakeholder in the system, namely the rich countries, and then multinationals, driving a code. The code has to reflect a variety of interests and that was the problem with it. So we need to extend these things. But what I really missed in the G20-G8 statements was, as I said to the Prime Minister’s special advisor: “Make sure it is not just trade – much as I love trade! – make it more about the open economy.” That is what has led to the great gains. That is also where the weaknesses are because in trade we are still reasonably well off and we know how to handle them.

Essence of open world economy

Q: What would be the elements of the open world economy? You mentioned trade and investment and the movement of natural persons.

A: What we are talking about is temporary immigration. We should be able to export services, but embodied in people. That is what we call the movement of natural persons. We are talking about service transactions. So the second leg is GATS, the General Agreement on Trade and Services. Look at medical reform. I have been writing repeatedly on how you could reduce costs. Take comprehensive coverage. There are two problems. Schwarzenegger in California ran into problems on the cost side – it was very expensive. Where do you draw the line on what people would be able to get access to? Where you could not contain the costs, comprehensive coverage was seriously handicapped. Take the Massachusetts case where costs were more reasonably contained and that was Mitt Romney and a democratic majority state legislature. That programme ran into the problem of scarcity of medical personnel. If you are now insured and you are indigent otherwise, where do you get a doctor? Doctors' availability became a big issue because many doctors were unwilling to sign on to patients like that.

Medical lobbies against competition

Since I know international trade and GATS I said many years ago in an article: “export patients and import doctors” (exporting patients is what we call medical tourism now) and the cost savings would be enormous. If something like 40% of the procedures could be done on this basis, it would save something like \$60-70 billion per annum – far in excess of what the President was talking about in terms of computerisation of patient records and so on. In terms of also finding medical personnel, foreign doctors on visitor visas are required to go back; under former U.S. President Lyndon B Johnson they were allowed to stay on if they went to Appalachia and so on, where doctors were not available. So I recalled that and talked about that and said you could attack both problems. But not one person in this administration has ever picked up the idea, including Paul Krugman, to whom I wrote.

In the end it is the medical lobbies that they are worried about because the doctors, like anybody else, do not like competition. This is competition. It is actually helping the poor who are going to be insured. If anybody suffers it will be the doctors. But that is the elite, even if you control for their payments. So this is partly a movement of natural persons. There are four modes of transactions for services: the provider goes to the user, the user goes to the provider, online, and by establishing services in a local area. So those are the things we wrote about, which are a part of GATS. While the administration talks about lobbies and insurance companies, it is never really addressing these issues. These are some of the issues that can be put into the Doha Round but so far we have no real concessions on these issues.

Go for quid pro quo

But we could actually have some quid pro quo on this and it is an area where we could gain quite a lot in my view. It is something which could be taken up by the Indian administration. These are some of the issues that could be put into the Doha Round but so far we have got no real concessions on that issue either. But against that you have to give something in the services sector. What would we give? In areas like banking and insurance we are sufficiently developed and resilient to be able to offer something. It is difficult to offer, in my view, any entry subject to a given level of protection simply because we do not have a safeguard clause in the services sector.

India and service sector negotiations

Q: Why is not there a safeguard clause?

A: Supposing you open up banking and 10 banks come into the economy. Then our banks are in trouble. In this case a safeguard comes in the form of a market disruption clause. What do you do? Do you get three banks to go back? It is very difficult for that reason and they have never been able to negotiate something. With goods entry you can just shut off trade by putting on a tariff and that will reduce it. So they have not been able to negotiate this. My view is Europeans certainly, Japanese yes, Americans less willing, but they would all come on board – we just say they accept more commitments, quantity commitments. Not rule commitments. Then we allow a certain number of banks to open per year. So we can offer something, just as they are never going to say “Subject to these rules, any number of doctors can come in.” So they are going to put in automatic caps or something.

So this is what we could do but we could have a service sector quid pro quo, where both countries would be better off. Actually we might want to offer that. The free trade area is very different and they would never agree to that and they would impose all kinds of other conditions on us, which are not doable. But that could be part of a new paradigm: we could just say we are going to transact in this way and give each other mutual concessions. That would be in the services sector so service people might also be a bit happy. But we need to go in that direction and we need rules also on hiring and firing because that is where everybody is going now. Even in India there is great pressure. Is not that what the recent trouble in the airline industry is about? Everybody is facing that everywhere: why should we discharge our own people when in fact particular extraneous money is involved.

Don't beggar thy neighbour

But if we want to get protection for our labour, the French are going to ask for protection, on the same grounds. Someone else is going to ask for protection, say the U.S. This is exactly the story of the 1930s: I divert world car demand to me using protection. You do that in turn and you are diverting my demand back to you, and so on. So this was called beggar-thy-neighbour policy. It is much better to have a subsidy on the purchase of cars, if you really want to support that sector. Each country may provide whatever support, say \$1500 per car. Then let them compete. But otherwise you are just adding protection over each other and doing nothing for the industry as such. The main problem is lack of car demand. So at the national level, if you lack aggregate demand, Keynes was the first person to say you should use tariffs because tariffs divert a given demand to our goods.

Similarly if you use devaluation, that also does the same thing on the exports side because the exports become cheaper and you have diverted foreign sales to your export markets. In neither case is anyone better off. Keynes himself came round to the view that the first-best policy view was to revive aggregate demand and that is what we are doing right now. If we were not implementing the stimulus package right now, we would be seeing much more protectionism for sure. So that is also our safeguard. Each individual industrialist is looking at it from his or her perspective – they can only take a micro decision for themselves for their own protection. But the government and the G20 and the G8 have to look at what in fact is the overall policy framework within which this game is to be played. You want to minimise the competitive game, which is really not the way to address the issue. As you were asking, to unwind these positions also takes time – and that is what happened in the 1930s in a big way. It was very difficult and you really had a nuclear winter at that time.