

Editorial

FT View

Might over right

AN early morning SMS was what alerted most people to the death of underworld drug-leader Mohammed Azmir alias 'Mamazmi,' which according to officials was caused while he was attempting to flee arrest. The Special Task Force (STF) officers then shot him in defence.

While this may gain taciturn approval from the masses it is yet another indication of lapses in the law enforcement system and the rather disturbing trend of custody deaths.

In April last year relatives of a fisherman from Wadduwa who allegedly died in Police custody protested for justice. While Azmir's situation is vastly different, it shares the same desire for justice and the independent implementation of law and order. Criminals are a menace to society, but a civilised community will make space for the law to deal with these oversights. Such deaths are especially suspect given the high level of political patronage metered out to the underworld in Sri Lanka.

Readers will remember many examples including the Dompe youth who died in Police custody and the public outcry that resulted in a standoff between the Police and residents. They may also remember several other incidents of families with men who were killed in Police custody as was this fisherman, who was a 42-year-old father of two. Several officials of the Wadduwa Police Station were transferred but little else was done. Yet, it was never made clear whether the deceased filing a Fundamental Rights petition against the OIC of the police station was a contributory factor to the death – common sense says yes.

Even in previous years the public has stood by as selected underworld figures without political affiliations died in Police custody. All such deaths followed a standard script of trying to escape while being transported by the Police and were accorded tacit approval of the public and the indifference by the media.

A total of 57,000 grave crimes were committed in 2010. Barely 25% reached the courts for prosecution and only 4% led to convictions. With a virtually defunct criminal justice system, the public at large has come to view the extra judicial killings as a rough and ready substitute.

Society, encouraged by the State, finds it easy to think in absolutes – such as the glorification of violence. Within this framework, there is no need for compromises and trade-offs between deterrence and punishment, required for the rehabilitation of criminals, especially when they can be removed swiftly and cleanly from the equation.

Although it is easy to blame the Police for its systemic brutality, the fault is not entirely theirs. An overloaded, sluggish, under-resourced and heavily politicised judicial system that does not care for the poor and victimised has burdened society with the need to find its own justice. So the people do – at a grave cost to everyone else.

Since politicians have time and again made it very clear that they are not concerned with cleaning up this mess, surface solutions such as transfers are metered out. There are no transparent investigations because the dead is an "underworld figure" and as such does not deserve to be treated according to the law.

It is a grievous and dangerous trend to ignore but there is little interest in taking notice or finding a solution by strengthening law enforcement and reducing political interference. Given such situations, the Government cannot expect to promote human rights and indeed even state that the circumstances are improving in post war Sri Lanka.

Asia, global value chains and 21st Century trade policy

TRADE policy has sprung back to life after years of suspended animation. Two 'mega-regional' Free Trade Agreements (FTAs) are being negotiated: The US-led Trans-Pacific Partnership (TPP), and the EU-US Transatlantic Trade and Investment Partnership (TTIP). Talks are slated for a pan-Asian Regional Comprehensive Economic Partnership (RCEP).

President Obama seems to have dragged trade policy from oblivion to somewhere on his priority list at the beginning of his second term. And Roberto Azevedo, the incoming Head of the WTO, has made a year-end "mini-Doha" deal his top priority.

So where should trade policy be heading? "Into the 21st century," is the answer. There is a fundamental disconnect between trade policy today, still geared to the issues of the 1990s, and early 21st-century international trade.

Global Value Chains

Global Value Chains (GVCs) are the defining feature of early 21st-century international trade. Since the mid-1980s, the ICT revolution and the opening of new markets have allowed production to be fragmented across borders.

Through outsourcing, off-shoring and Foreign Direct Investment (FDI), different parts of the value chain are located in different countries. Simultaneously, trade in parts and components, and complex logistics systems, knit production networks together to serve global markets.

GVCs are most visible in manufacturing, especially in ICT products, but they are enabled and glued together by services, notably financial and other business services, telecom services, and transport and logistics services.

Trade in GVCs is the fastest growing part of international trade, and a critical driver of productivity, growth and employment in both developed and developing countries. This is especially true in East Asia, where 62.5% of total manufacturing exports are GVC-related exports, and parts and components account for over half of GVC exports.

Recent research on 'value-added trade' – the value that is added from exports and imports in producing goods and services – gives a more accurate picture of international trade in general and of GVCs in particular.

Three major conclusions arise. First, exports depend more than ever on imports. Import content is about 40% of the total value of exports – double what it was in 1990. Second, services are much more important than hitherto believed. They account for about 40% of international trade on a value-added basis – double the total that shows up in balance-of-payments statistics. Third, bilateral trade balances change dramatically when measured on a value-added basis. The US's trade deficit with China trade shrinks by 25%, for instance.

Policy propositions

Four core policy propositions follow. First, the logic of GVCs is to have a seamless flow through the value chain, from start to finish. That demands open borders and non-discrimination to trade and FDI, secure private property rights, including intellectual property, and an efficient environment for doing business.

Second, they make a nonsense of mercantilist trade policy – "exports good, imports bad" – given that exports depend increasingly on easy, open access to imported inputs. In GVCs, local firms rely on high-quality, cost-competitive imports for their competitiveness; exporters and importers, far from being enemies, are joined at the hip. Among other things, this blows a hole in the trade negotiator's modus operandi of bargaining over export concessions while protecting one's market from imports.

Third, GVCs transform the political economy of trade policy. They increase the range and power of producer interests favouring freer trade, all the better to countervail old-style protectionist interests. Fourth, GVCs severely weaken the case for "industrial policy" in the form of selective protection for favoured sectors and "national champions".

Discriminatory policies, e.g. local-content and technology-transfer requirements, FDI and public-procurement restrictions, lax intellectual-property protection, and trade-distorting subsidies, disrupt cross-border supply chains.

Companies and their supply chains will go elsewhere, or, as in the case of China, balk at



Overall, there is huge potential for the spread of GVCs – sectorally in manufacturing, services, agriculture and energy, and geographically beyond the present hubs of NAFTA, the EU and East Asia. The big geographic prize is the extension of GVCs to South Asia, where much labour-intensive manufacturing production could be located

locating higher-value activities where such restrictions apply. Moreover, the complexity and dynamic of GVCs today place even more demands on the "superior" knowledge, competence and honesty of governments to engineer market outcomes (always a questionable supposition).

In sum, GVCs reward governments that get the policy basics right, especially "horizontal", non-discriminatory policies for competitive markets, and punish those that pursue restrictive trade and industrial policies.

Main policy barriers

What are the main policy barriers to GVCs? Average import tariffs are now fairly low, but they impose higher costs on GVCs due to intermediate goods making multiple border crossings. Companies pay duty twice – once on imported inputs, and again on their exports.

Still, non-tariff barriers impose much higher costs. Complex, duplicative standards are especially burdensome for small and medium-sized enterprises. Protectionism in services sectors is much higher than on trade in goods. Then come FDI restrictions.

Not least, onerous customs procedures cause delays at border entry and exit points. They account for about 10% of trade costs – double the cost of import duties. Simplifying procedures – automation, single windows, pre-arrival clearance, for example – would reduce trade costs by 10% in OECD countries – and much more in developing countries.

Let's turn to what this means for trade policy on different tracks.

Just do it!

Start with unilateral measures, i.e. what governments do autonomously, outside trade negotiations. This has been the main driver of trade and FDI liberalisation outside the West in recent decades.

Decentralised liberalisation and competitive emulation, not trade agreements, are how East Asian countries opened up, inserted themselves into GVCs and became "Factory Asia". But unilateral liberalisation has slowed down since the late 1990s, with a creeping increase in protectionism since the global financial crisis. That leads many to argue that reciprocity – trade negotiations – must be the main vehicle for future trade reforms.

I disagree. First, recent pro-market trade reforms, both border and non-border regulatory measures, have been the result of unilateral measures more than reciprocity. Second, the existence of GVCs should make unilateral liberalisation more feasible, given that more producer interests have a stake in open and freer trade. The Nike strategy should apply: "Just Do It!" – don't wait for trade negotiations.

The WTO can, however, be a useful complement to unilateral measures. The Doha Round is silent on 21st-century trade issues – save for one item, "trade facilitation", which covers customs procedures. That should be the main priority for a mini-Doha package by the end of this year.

Plurilateral decision-making

Looking beyond Doha, the WTO should tackle at least three items of relevance to GVCs: a more ambitious Information Technology Agreement; deeper commit-

ments in services; and new rules on FDI.

None of this is going to happen without "plurilateral" decision-making, whereby subsets of like-minded members from the OECD and emerging markets forge ahead. About 10 WTO members (counting the EU as one) account for 70% of international trade. In the most important services sectors, the top eight trading countries (again counting the EU as one) account for about 80% of relevant world GDP. The leading Asian trading powers should be in these "coalitions of the willing". Indeed, they could constitute half or more of the membership of some of them. If such plurilateralism proves impossible inside the WTO, it should be taken outside it.

That leaves FTAs. They discriminate against non-members, and their proliferation has created a "spaghetti bowl" of overlapping, bureaucratic trade procedures. This contradicts the basic logic of GVCs – to expand seamlessly across borders. Furthermore, the vast majority of FTAs, including most Asian FTAs, are "trade-light". At best they eliminate tariffs on most products, but they hardly tackle the regulatory barriers that bedevil GVCs.

Now come three mega-regionals: TPP, TTIP and RCEP. Trade-light mega-regionals would do little to facilitate GVCs, but their discriminatory elements could disrupt them. RCEP risks heading in this direction. "Deep integration" mega-regionals, however, could spur GVCs by seriously tackling non-tariff and regulatory barriers, especially if rules are "multilateralised", i.e. applied in a non-discriminatory manner. This is more likely with TPP and TTIP than with RCEP, though they could easily turn

in a defensive direction that disrupts GVCs.

In essence, GVCs reinforce the case for free trade – on economic, moral and political grounds. They create and spread wealth. They enlarge the freedom and life-chances of those who work in them as well as of end-consumers. And, by uniting countries through the bonds of commerce, they help to defuse international and regional political tensions – they are a force for peace. Moreover, they are a force for both regional and global integration – not either-or, for they link the two.

Future of GVCs

What of the future of GVCs? There is now much talk of "reshoring" – bringing production back to national and regional hubs. Some argue this will put GVCs into reverse gear. I doubt it. Technology cuts both ways, on occasion favouring reshoring, but on many other occasions favouring continued fragmentation of production. Further policy liberalisation, especially in emerging markets, would definitely favour further fragmentation.

Overall, there is huge potential for the spread of GVCs – sectorally in manufacturing, services, agriculture and energy, and geographically beyond the present hubs of NAFTA, the EU and East Asia. The big geographic prize is the extension of GVCs to South Asia, where much labour-intensive manufacturing production could be located.

(The author is Visiting Associate Professor of the Lee Kuan Yew School of Public Policy, National University of Singapore.)

My View

Global Economics
By Razeen Sally

Value-added trade

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