

Fragmentation of global trade leads to sub-optimal outcomes

Last week, the relations between China and the United States worsened following the visit of Nancy Pelosi, the Speaker of the US House of Representatives, to Taiwan. An angry China conducted live-fire drills around Taiwan and even fired some missiles into the exclusive economic zones in the waters of Taiwan and Japan. How will these developments affect global trade?

The military drills around Taiwan have forced shipping lines to reroute the voyages of the ships in one of the world's busiest waterways. The disruptions can impact supply chains and result in delays in reaching the cargo to its destinations. Taiwan said over 50 international flights had been cancelled due to China's live-fire drills. So, the supply of sophisticated electronic products and semi-conductors from Taiwan may be affected. But, the impact may not be significant unless the drills continue for a longer period.

Most analysts do not expect serious escalation of hostilities as China has said its

drills will last only for four days but the chances of a prolonged blockade of Taiwan cannot be ruled out. China is fully committed to the One-China policy where Taiwan cannot remain independent. So, the problem will not go away anytime soon.

The tensions near Taiwan go up at a time when the relations between Russia and the US and its allies are at rock bottom. After the Russian invasion of Ukraine, the western countries have imposed severe financial sanctions on Russia and supplied arms to Ukraine to fight Russia. The world trade in oil, food, and fertilisers, besides many other commodities, has been severely disrupted. Many countries are facing economic slowdown and even recession.

Global trade is slowing down due to gradual withdrawal of the pandemic-induced fiscal stimulus in many countries. Now, the hostilities in Ukraine and Taiwan are slowly leading to fragmentation of the global trade. The western

countries are trying to isolate Russia from global trade and some backlash against China's belligerence cannot be ruled out. Of course, China is the leading trade partner with over 100 countries and is a part of the Comprehensive Economic Partnership in the East. However, unless the tensions are defused quickly, the world may slowly drift back to similar days when the Eastern and Western blocks usually traded among themselves.

During the cold war, the western countries substantially brought down the trade barriers and cut their tariffs

through several rounds of trade negotiations under the auspices of the General Agreement on Trade and Tariffs (GATT). The US was not part of the GATT negotiations till the launch of the Uruguay Round in 1986 but still unilaterally cut its tariffs substantially. The financial markets were also liberalised. So, the western countries grew faster than the East European block.

Since the collapse of the Soviet Union and the end of the cold war in 1989, global trade has been powered by multilateral trade agreements that helped lift millions of people around the world out of poverty. In the past few years, the backlash against globalisation and resentment against the rise of China as a global economic and trading power have resulted in a retreat from multilateralism. Many countries have opted for Regional and Bilateral Trading Agreements. At this stage, further fragmentation of global trade can only lead to sub-optimal outcomes.



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