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PARALLEL TRACKS ON TRADE TIES

Relevant for: International Relations | Topic: World Trade, WTO and issues involved

Could it be that the strained trade relations between India and the U.S. are an outcome not of the U.S.'s domestic politics but of India's? The timeline of U.S. President Donald Trump's decision to rescind the benefits Indian exports enjoy under the Generalised System of Preferences (GSP) programme is revealing.

It begins with the change in foreign direct investment (FDI) rules in India. The tightened norms that came into effect on February 1 place several restrictions on e-commerce companies, including Walmart-owned Flipkart and Amazon.

The unexpected changes came after Walmart, the world's largest retailer, paid over $16 billion to acquire Flipkart last May. To raise the resources needed, Walmart put one of its biggest international operations, Asda, on the block for $10 billion.

The calculations behind the $500 billion retail giant's investment in India have gone awry after the change in the FDI rules. The Walmart family are close friends of Mr. Trump. On February 20, Walmart CEO Doug McMillon said the company was disappointed that New Delhi had changed the FDI rules without consultation and hoped for a more collaborative process going forward. Days later, on March 4, Mr. Trump notified Congress of his intention to slap punitive action on India by ending preferential treatment for the country's exports.

Walmart has a reputation for killing small retail businesses with ultra-low prices, a concern that influenced New Delhi's decision to tighten the FDI rules. While the FDI policy might be irreversible, economic diplomacy can still defuse the situation and prevent the removal of the GSP benefits that will not take effect for until at least 60 days after the notifications to Congress and the Indian government.

The simmering tensions go back to April 2018 when the United States Trade Representative (USTR) launched a review of New Delhi's eligibility for the GSP programme. Tensions escalated in June, as New Delhi, in response to Washington's 25% tariff hikes on steel and 10% levies on aluminium, immediately accused it of unfair trade practices, and, seeking to signal a muscular approach, threatened retaliatory tariffs on $235 million of U.S. imports.

Bilateral talks since then have failed to ease tensions and India now stares at losing the GSP benefits. Foreign Secretary V.K. Gokhale returned empty-handed from Washington recently.

India's GSP status came under review after the U.S. medical and dairy industries complained that New Delhi is not providing them "equitable and reasonable access to its market". India's data localisation policies deepened the rift.

New Delhi's use of price control measures against imported drugs and medical devices has grown noticeably. Cardiac stents were put under price controls in February 2016 and knee implants attracted similar action in August 2017, after which trade margins for many medical devices are sought to be capped.

U.S. manufacturers complain that in doing so, New Delhi has meted out differential treatment to them *vis-à-vis* domestic players.

For domestic companies, the price to distributors is considered while in the case of global

manufacturers the base proposed is the landed costs of imports. The U.S. medical device industry wants price controls on cardiac stents and knee implants withdrawn and would like products to be treated on parity with domestic medical devices through a trade margin rationalisation regime.

New Delhi has preferred to act against unreasonable price mark-ups through price controls when exactly the same outcomes can be achieved through other types of policy alternatives. The USTR is right in pointing out that price capping counts as a trade barrier. New Delhi can easily address the concerns by replacing price controls with trade margin rationalisation measures, applying them equally to domestic and foreign manufacturers.

India is the largest beneficiary of the GSP, the largest and oldest U.S. trade preference programme. The GSP is aimed at promoting economic development by allowing duty-free entry of products from designated beneficiary countries. Nearly 4,800 different goods from 129 designated countries enjoy duty-free access under the programme.

The immediate loss for India is preferential access at zero or minimal tariffs to the U.S. in case of about 1,900 products, or about half of all Indian products.

New Delhi has downplayed the impact of the proposed withdrawal of benefits, saying exports worth $190 million only are likely to be affected and that the tariff advantage was 4% or more on only 2,165 of a total of 18,770 tariff lines.

This is an underestimation. The loss to the economy would be much larger than what the Department of Commerce is projecting. While it is true that the actual tariff advantage from the programme works out to a meagre $190 million, which is just 0.4% of the total Indian exports to the U.S., the actual loss will not be limited to the immediate tariff advantage.

Indian exporters are competing for market share in the U.S. with other low-income countries in industries where margins are wafer thin. Even minor price hikes can drive significant drops in export volumes. In which case, losing GSP access will be costlier than the projections.

Among price-sensitive products eligible for higher GSP benefits that risk losing out to competition from other countries are processed food, leather products, plastic products, building materials, tiles, hand tools, engineering goods, cycles and made-ups such as pillow/cushion sleeves and woven women’s apparel.

Many of these are the very industries the new e-commerce FDI rules seek to protect.

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