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Understanding India–US Trade Tensions beyond Trade Imbalances

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ABSTRACT The United States (US) has revoked India's benefits under the Generalized System of Preferences (GSP) and imposed Section 232 tariffs on Indian steel and aluminium. In response, India announced retaliatory tariffs. This brief probes the ongoing trade tensions between India and the US, despite a reduction in the trade deficit. It discusses the heightened influence of the office of the US Trade Representative (USTR) and outlines its apprehensions against the three big issues plaguing India–US trade: insistence on data localisation, price caps on pharmaceutical imports, and certification of dairy imports. Finally, the brief recommends ways of de-escalating tensions between the two nations.

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INTRODUCTION

At the 74th Session of the United Nations (UN) General Assembly, US President Donald Trump put forth his nativist ideas, directly contradicting the traditional conception of the office of the US president as the "leader of the free world." Past US presidents had frequently reiterated the merits of the liberal world order, defending—in metrics of both global prosperity and security—globalisation's push for economic interdependence and cultural homogeneity.

Declaring his "America First" worldview, Trump said, "The future does not belong to globalists. The future belongs to patriots."[1] He rejected the standard liberal-internationalist prescription of seeking peace and prosperity by encouraging nations to follow the lode-star of globalisation. "My fellow leaders, the path to peace and progress, and freedom and justice, and a better world for all humanity, begins at home."[2]

In the post-Cold War era, the US was a major proponent of the liberal world order. The US-led global financial institutions and the dominance of the US dollar constituted the "outer perimeter" of American security.[3] Thus, in consolidating gains and sustaining its position at the top of the global economic pecking order, the pursuit for American primacy also encouraged "an Open Door world – a world shaped by America's liberal ideology."[4] This experiment came to be known as globalisation. However, the rise in liberal market economies often eclipsed the country's supplementary mercantilist aim of fully capitalising on new foreign markets.

According to Trump, globalism's "religious pull over past leaders, causing them to ignore their own national interests" has resulted in "4.2 million lost manufacturing jobs and $15 trillion in trade deficits over the last quarter century."[5] His pursuit of the America First "vision for national renewal" is thus "an ambitious campaign to reform international trade."[6] To seek "fair and reciprocal" trade deals, Trump has weaponised the US dollar, leveraging American tariffs against partner nations[7]—both friends and foes. Mexico and Canada were coaxed to renegotiate their terms after being declared national security threats in varying degrees;[8] renewed bilateral deals with Japan and South Korea were sought, after the US momentarily linked its security commitments to inconsistencies on the trade front;[9] and US–China trade tensions have now devolved into a full-fledged "techonomic" conflagration.[10] This shift—away from the model of a global economic interdependency facilitated by the US—has also affected New Delhi's trade relations with Washington.

DEFENCE PARTNERS OR TRADE COMPETITORS?

Under Trump's presidency, the US' outreach to India in the defence realm has progressed unhindered. His administration has duly followed through on the predecessor administration's impetus to the arms sales, and recently, India inducted the US-made Boeing AH-64E(I) Apache Guardian attack helicopters.[11] The US has attempted to clear legislative roadblocks to arms transfers of sensitive platforms by either giving India commensurate designations (e.g. the Strategic Trade Authorisation-I)[12] or exercising executive overrule to negate the preceding administration's concerns[13] (e.g. making India "the first non-treaty partner to be offered a MTCR Category-1 Unmanned Aerial System").[14] The pace of India–US defence interoperability has also increased, with the two countries actively working to resolve differences on the final interoperability agreement on joint access of geospatial maps: the Basic Exchange and Cooperation Agreement (BECA).[15] India continues to conduct more military exercises with the US than with any other country. In November 2019, the first-ever India–US tri-service military exercise (called "Tiger Triumph") was held.[16]

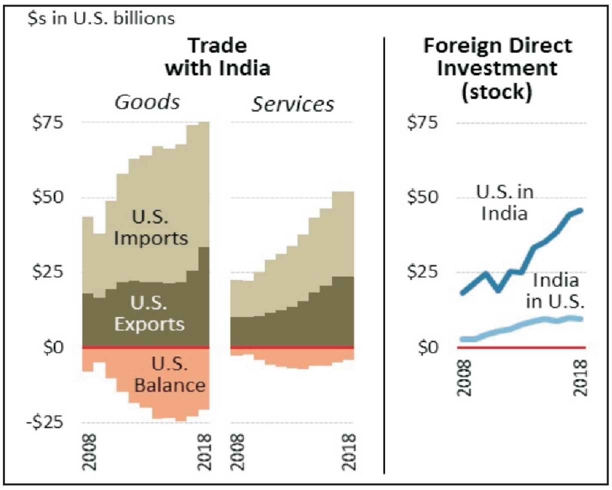
However, on the trade front, tensions are brewing. In seeking "fair and reciprocal" bilateral trade deals,[17] the Trump administration has relegated India's position to that of a competitor, as is the case with other US partners and even formal treaty allies. The first punitive US action came in March 2018. In a bid to arrest the decline of its domestic steel and aluminium industries, the US levied across-the-board import tariffs[18] of 25 percent and 10 percent, respectively. National security was offered as a rationale for this protectionist move. In invoking Section 232 of the Trade Expansion Act of 1922, which dates back to the times of the General Agreement on Tariffs and Trade (the predecessor to the World Trade Organization), the Trump administration claimed that increased US imports of steel and aluminium had "impaired national security."[19]

While the US' primary concern was the threat posed by the surplus of Chinese steel and aluminium in global markets,[20] including India (which supplies only 1.3 percent of steel and 3.4 percent of aluminium)[21] in the group of tariffed countries signalled the Trump administration's intent to act on its frustrations regarding the US–India trade.

Despite this, India had deferred imposing retaliatory tariffs against the invocation of Section 232, in the "hopes of averting a trade war and bridging economic differences."[22] For the US' part, trade tensions had been largely expressed as off-handed diatribes by President Trump on specific American exports to India. An example of this is Trump's comments during a February 2018 White House meeting with US governors, in reference to a conversation with PM Narendra Modi, where the latter had spoken about how India's "100 percent tax" on imported motorcycles had become a contention.[23] Trump said, "When Harley Davidson sends a motorcycle to India, as an example, they have to pay 100 percent tax. […] Now, the Prime Minister, who I think is a fantastic man, called me the other day and he said we are lowering it to 50 percent. I said okay, but so far, we're getting nothing. So we get nothing, he gets 50 [percent], and they think like they're doing us a favour. That's not a favour."[24]

After the 2019 general elections in India, however, trade tensions escalated beyond verbal derision. The Trump administration ended India's status under the GSP,[25] of which India was the biggest beneficiary, with Indian exports to the US accounting for "over a quarter of the goods that got duty-free access into the US in 2017."[26] Over 12 percent (worth US$5.58 billion) of all Indian exports to the US in 2017 had benefitted under the GSP scheme.[27] New Delhi responded by levying duty on 28 US goods. The duty on walnuts went up

Figure 1: Overview of US Imports from and Exports to India



Source: https://fas.org/sgp/crs/row/IF10384.pdf.

to 120 percent, while the duty on chickpeas and some lentils were raised to 70 percent.[28]

At first, these frictions were considered a consequence of the clash between Trump's "America First" worldview and Modi's "Make in India"[29] initiative. For instance, in late 2017 and early 2018, the Modi government took steps to heighten "import tax on electronics products such as mobile phones and television sets" and "on 40 more items, ranging from sunglasses to auto component."[30] However, data shows that Make in India has not had an adverse impact on India's imports from the US, and American exports to India have increased in the Modi–Trump era.

According to USTR figures, the US–India goods and services trade was "an estimated $142.6 billion in 2018,"[31] with the US' exports and imports at US$58.7 billion and US$83.9 billion, respectively. Goods exports to India stood at "$33.5 billion, up 30.6% ($7.9 billion) from 2017 and up 89.5% from 2008,"[32] while services exports was "an estimated $25.2 billion in 2018, 6.6% ($1.6 billion) more than 2017, and 151% greater than 2008 levels."[33]

Thus, Trump's central contention of the US having "almost an $800 billion a year trade deficit with other nations"[34] does not apply to India. With other nations, the US' trade deficit has grown "by $119 billion in the two years since Trump took office."[35] However, from 2017 to 2018, its trade deficit with India has decreased: by nine percent (US$2.1 billion) for

Figure 2: Overview of Total (Goods and Services) US Trade Deficit with India (in US$ billion)

	1995	2000	2008	2013	2014	2015	2016	2017	2018
Total	11.2	19.1	66.1	97.3	104.6	109.4	114.4	126	142.6
Exports	4.6	6.5	27.7	35.1	36.8	40	42.2	49.3	58.7
Imports	6.6	12.6	38.4	62.2	67.8	69.4	72.2	76.8	83.9
Balance	-2	-6.1	-10.6	-27.1	-31	-29.4	-30	-27.5	-25.2

Source: https://ustr.gov/countries-regions/south-central-asia/india.

Figure 3: Overview of US Goods Trade with India (in US$ billion)

	1995	2000	2008	2013	2014	2015	2016	2017	2018
Total	9	14.4	43.4	63.6	66.9	66.2	67.7	74.2	87.9
Exports	3.3	3.7	17.7	21.8	21.5	21.5	21.6	25.6	33.5
Imports	5.7	10.7	25.7	41.8	45.4	44.8	46	48.5	54.3
Balance	-2.4	-7	-8	-20	-23.9	-23.3	-24.4	-22.9	-20.8

Source: https://ustr.gov/countries-regions/south-central-asia/india#.

Figure 4: Overview of US Servives Trade with India (in US$ billion)

	1995	2000	2008	2013	2014	2015	2016	2017	2018
Total	2.2	4.7	22.7	33.7	37.8	43.2	46.7	51.8	54.8
Exports	1.3	2.8	10	13.3	15.3	18.5	20.6	23.6	25.2
Imports	0.9	1.9	12.7	20.4	22.4	24.7	26.2	28.2	29.6
Balance	0.5	0.9	-2.6	-7.1	-7.1	-6.1	-5.6	-4.6	-4.4

Source: https://ustr.gov/countries-regions/south-central-asia/india#.

goods[36] and 3.7 percent for services.[37] Moreover, in 2018, Indian manufacturing trade in the US reached US$50.1 billion for the first time, surging by approximately US$6 billion over the 2017 figures.[38] This near-balancing of trade has been in spite of a surge in US foreign direct investment in India, to peak at "$46.0 billion in 2018, a 3.4% increase from 2017."[39]

Despite these upward trends, the India–US trade tensions have escalated, indicating that American apprehensions with India stem from factors beyond trade imbalances.

THE OFFICE OF THE USTR: TIP OF THE 'AMERICA FIRST' SPEAR

In 2019, the India–US trade negotiations were marred by repeated stalemates. India sought to reduce trade tensions by addressing the broad issue of trade deficit, with PM Modi's government stressing on the long-term inevitability of India raising imports from the US in three main sectors:

1. Defence Platforms: The US has become India's second-largest arms supplier.[40]

2. Civil Aviation Aircrafts: India is poised to order a record 2,300 new planes, possibly from US manufacturers such as Boeing, over the next 20 years.[41]

3. Energy Imports: India's import of US crude rose threefold in early 2019.[42]

From the US perspective, however, some longstanding issues have persisted. Trump's intent to "fix" America's trading relations via renewed bilateral deals resonates with conservative interests in the US trade community. Here, the influence of the USTR is key. Trump's inclination towards Robert

Lighthizer's expertise is well known, since tariffs are a "focal point" of his administration's approach.[43] Consider, for example, the President's intent to renegotiate the North American Free Trade Agreement (NAFTA), which he once referred to as the "worst trade deal ever."[44] The reworked agreement—called the United States-Mexico-Canada Agreement (USMCA)—now includes necessary provisions for the digital economy. The biggest changes, however, pertain to the outlook of the office of the USTR. According to Edward Alden (Council on Foreign Relations), the US premise in the USMCA talks under Lighthizer was "radically at odds with how traditionalists view trade negotiations … as mutually beneficial."[45] Instead, Lighthizer sought an agreement that aligns with the conservative interests of increased market access and sovereignty against foreign litigation.

Trump's renegotiation of the NAFTA was accompanied by the withdrawal of the US from the Trans-Pacific Partnership (TPP), a multilateral trade framework comprising the Pacific Rim countries including Mexico and Canada. Under the USMCA, the US persuaded Canada to open its dairy market, "starting with a six-month phase-in of access that goes up to nearly 4 percent—an amount just slightly above that which was negotiated in the TPP."[46] The USTR then successfully influenced the USMCA to eliminate provisions under which investors could sue the American government.[47]

While Trump is politically motivated to seek a balanced trade with "tariff king" India,[48] the USTR's apprehensions are rooted in a conservative outlook on trade. These have now come to the fore.

1. Grafting New Bones of Contention on to Old Ones

Under the Obama administration, American foreign policy towards India was shaped by the latter's long-term strategic potential in the Indian Ocean and Indo-Pacific region. The unstated dictum of the Carter mantra ensured that the US focused on harnessing strategic avenues without letting divergences on other fronts (e.g. trade) crowd out "minimal-yet-positive developments."[49] One such fundamental divergence was regarding India's barriers to market access, which was underplayed then.

Under the Trump administration, this underplaying has been reversed. During a Congressional hearing in early 2019, testifying to the House Ways and Means Committee, USTR Lighthizer alleged that India has the "highest tariffs of any country you can imagine."[50] However, according to WTO data, India's tariff barriers are only higher than developed economies. In 2018, the average tariff rate for India was 17.1 percent, while for US, Japan and the EU, it ranged from 3.4–5.2 percent.[51] In terms of trade-weighted average tariff (the average of all the tariffs collected against total volume of imports), India figures at 11.7 percent (2017), against Brazil's 10 percent and South Korea's 8.1 percent.[52]

The USTR has not only taken action but also broadened its scope to address Indian market access issues by including non-tariff areas, e.g. the emerging contention on digital commerce. Consider, for instance, the USTR's 2019 National Trade Estimate (NTE) on the key barriers to digital trade. In deriding foreign governments' imposition of "unnecessary barriers to cross-border data flows" or limitations to "foreign digital services," the NTE deemed India's requirements for data-localisation to be "onerous."[53] It also views the "broader restrictions included in India's draft Personal Data Protection law and draft e-Commerce Policy" as a way to "undermine the digital economy."[54] Regarding the e-commerce changes to limit US retailers such as Amazon to being a "marketplace for sellers and buyers," New Delhi's rationale is that the move is meant to protect small, local Indian retailers from "predatory pricing."[55]

In September 2019, the US panned India's insistence on requiring foreign payment service suppliers (e.g. Visa and Mastercard) to locally store all information on electronic payments by Indian consumers. Deputy US Trade Representative Jeffrey Gerrish warned India that "finalising data localisation policies could be (a) deal-breaker across the board between the two countries."[56] India has attempted to prevent this conflict from affecting trade talks, by announcing that the data protection issue will be handled by India's IT ministry and kept out of the e-commerce policy draft.[57]

However, such conflicts have exacerbated the differences over market access, compelling the USTR to address Indian barriers that go beyond tariffs.

2. Chinese Bait-and-Switch on Large Markets

Another major source of tension in ongoing trade talks has been India's price caps on the US' pharmaceutical imports, which has lowered the prices of coronary stents and knee implants by 85 percent and 65 percent, respectively.[58] India justifies this action as an attempt to prevent exorbitant pricing from adversely affecting the Indian consumer, a largely middle-income base. To ensure fair returns for American manufacturers, India has directed them to its large market, away from per-unit margins. American negotiators, however, insist on a "trade margin" computed at the first point of sale, instead of landed cost.[59]

India's reasoning is much like China's when the latter successfully acquired the US' MFN status via the Permanent Normal Trade Relations Act of 2000 by offering its large consumer market.[60] However, with China, America's experience of giving up unit margins has not been encouraging. Riding on its predatory practices, theft of intellectual property and state-driven market economics, China became a near-peer economic competitor to the US.

Much of India's argument for instituting price caps on pharmaceutical imports relies on its status as a developing country, i.e. "to maintain higher levels of protection as compared to the developed countries."[61] Thus, the USTR's demand for the review—and subsequently, the termination—of India's designation as a beneficiary "developing" country under the GSP[62] reflects a strategy to weaken India's argument in favour of price caps.

3. Abhorrence for WTO Dispute Resolution Mechanisms

Before the World Trade Organization (WTO) was established, nations would often sort out issues via diplomacy, instead of international law.[63] Stemming from American conservatism's abhorrence for multilateral authority, a return to that erstwhile approach would entail the US employing its relative leverage of being the world's largest economy. This includes tactics such as "punishing tariffs" and persuading foreign countries to "voluntarily" curb such exports to the US that threaten "highly valued US industries with competition."[64] Further, the USTR has sought to weaken the WTO's dispute resolution mechanisms, with Lighthizer being accused of "blocking the appointment of appellate judges," weakening the "body's ability to resolve international trade clashes."[65]

American officials have long construed India to be a "sovereignty hawk" at the global high table, especially when it "comes to defending what it sees as rights imperilled by 'the West'."[66] Negotiators also point to India's slow compliance on WTO rulings. In 2012, the US sought the WTO's support regarding India's 2007 country-wide ban on importing American poultry over avian influenza concerns. The organisation ruled in favour of the US in 2015, but India began allowing American poultry in small amounts only in mid-2018.[67] Thus, in the case of India, America's recognition of WTO rulings are only useful so long as they facilitate compliance in favour of their "sovereignty."

On some longstanding differences in the India–US trade, New Delhi could have the upper hand at the WTO, due to scientific evidence and precedents with other trading partners. For instance, an irritant in the trade negotiations is the entry of US-made dairy products in the Indian market. New Delhi has cited "cultural and religious sentiments" to take a "non-negotiable" stand against Washington's demand for market access for US-made dairy products.[68] India insists that American manufacturers must first certify that "the source animals have never been fed" blood-meal, "a protein-rich dietary supplement for cattle that utilises blood from slaughtered animals."[69] India's stance against blood-meal is backed by scientific evidence that links the use of such supplements to the outbreak of Bovine Spongiform Encephalopathy (Mad Cow Disease). Reportedly, the World Organisation for Animal Health, as well as countries such as Australia have imposed "a total ban on feeding any form of ruminant feed containing animal tissue or blood-meal" to ruminant mammals.[70] India's insistence holds further credence in light of the European Union (EU) agreeing to ensure the certification of its dairy exports into India.[71] Finally, India's demand for due consideration of "cultural and religious sentiments" stands well in-line with Article 20 (a) of the General Agreement on Tariffs and Trade, under which members can "adopt or enforce measures that are necessary to protect public morals."[72] Consequently, this contention has been kept out of ongoing trade talks.[73]

These USTR apprehensions, rooted in conservative thought, have exacerbated the divergence between the US and India, vis-à-vis trade talks.

RECOMMENDATIONS FOR NAVIGATING DIVERGENCES

In the run-up to the "Howdy, Modi!" rally in Houston in September 2019, speculations were abound regarding a partial trade deal between India and the US, also known as the "early harvest" deal. While some reports have indicated that the deal fell through after the US refused to reinstate GSP benefits to India,[74] others suggest that it has merely been delayed. A deal could include further cutting Indian duties on Harley-Davidson motorbikes and easier access to the US for some Indian farm products such as mangoes.[75] However, regardless of the scale of the impending deal, some of the most contentious issues, e.g. data localisation, are expected to persist.

Going forward, India must recognise that its trade tensions with the US stem from factors that go beyond issues of trade imbalances. It must avoid overstating the role of increased Indian import of US defence platforms, civilian aircraft and energy supplies. While such purchases—often amounting to billions of dollars—help in underscoring year-on-year progress, they are small determinants in the broader India–US bilateral trade trajectory.

Consider, for instance, the India–US defence trade. From nearly zero in 2008, it has increased to over US$15 billion in 2018[76]—a significant development. However, its impact on the broader India–US trade trajectory is minimal, in light of the increase in the bilateral trade (goods and services) —from approximately US$66 billion in 2008 to over US$140 billion in 2018.[77]

Defence trade can certainly be a major driver of India–US trade ties, but only once the bilateral dynamic shifts from a traditional "buyer–seller" dynamic to one of "co-production and co-development." This would aid the US' intent to pursue global production relocation (e.g. their offer to relocate F-16 production lines to India) and India's intent to oversee crucial technology transfers and increase domestic production under the "Make in India" initiative. Towards this complete actualisation of defence trade, the US and India recently signed the Industrial Security Annex, a crucial precursor to pursuing collaborative projects under the US–India Defence Technology and Trade Initiative (DTTI).

The negotiations between India and the US have been locked in a stalemate for over a year now. Some recommendations for resolving this impasse and de-escalating trade tensions are discussed in the following paragraphs.

1. Stress on the Strategic Merits of India's GSP Status

As the US–China trade war continues, India must argue for the reinstatement of GSP benefits, especially from the standpoint of its strategic relevance for the Trump administration's approach to China. Stakes are expected to rise regardless of the US–China Phase 1 deal,[78] putting to test whether Washington or Beijing can hold out longer. While China's trade surplus may further hurt its position, for the US, costs "may trickle down to local manufacturers that source cheaply from, and export finished products to China, levying the brunt of tariffs on Americans from both ends."[79]

Here, India's GSP status can help wean American manufacturers off Chinese goods. According to a report by the Coalition for GSP (a group of American companies and trade associations), with US imports of certain products from China having decreased in the aftermath of the Section 301 tariffs, imports of some of those products from GSP-designated countries "have increased the most in the first quarter of 2019."[80] The report observes that from India, "97 percent of increased 2019 GSP imports are on the China Section 301 lists." Thus, from amongst the Section 301 tariff list products, imports from India "increased by USD 193 million (18 percent)."[81]

2. Set a Precedent of Delinking Issues

The tendency of both India and the US to link trade tensions to other avenues of cooperation has further fuelled tensions. In 2019, the US reportedly considered capping the issuance of H1B visas to about 15 percent for any country that "does data localisation."[82] The news was not well-received by India's US$150 billion IT sector, as 70 percent of the 85,000 H1B visas issued every year go to applicants from India.[83] Moreover, the prospect of any caps on H1B visas calls into question India's longstanding demand for a "totalisation agreement" to coordinate social security for "workers who split their careers between the two countries."[84]

Similarly, the implementation of the Homeland Security Presidential Directive (HSPD-6)—an agreement on exchanging terrorist screening information between the US Terrorist Screening Centre and India's Intelligence Bureau—was momentarily "taken off from the agenda."[85] Reportedly, this was done due to Indian agencies suggesting that, "in return of signing of the agreement, India must secure from the US side progress to the internet related data held by US-based services."[86]

Such actions hamper avenues of cooperation and possibly diminish prospects of future resolution of trade divergences. Therefore, both countries must work towards delinking issues.

3. Focus on Middle-of-the-Road Solutions

Long-term resolution to divergences can be best achieved through compromise. The US must consider middle-of-the-road solutions. Consider the disagreement over the Indian duty of 20 percent on Information Communication Technology (ICT) products. The US has pressed for the reduction/ elimination of tariff on seven ICT lines, which include telecommunications network equipment, radio receivers, high-end mobile phones, mobile phone parts, certain print circuit assemblies and smartwatches.[87]

Of these, a compromise could materialise for high-end mobile phones. While the US considers as "high-end" those phones that cost upwards of INR 10,000, India insists on a higher rate of designation. India's apprehension is that conceding to the US demand for across-the-board duty reduction on imported high-end phones will benefit cheaper Chinese phones penetrating the Indian market.[88] Given the high cost of American products such as the Apple iPhone, the US' share in the intended tariff reduction is a mere US$0.41 billion (two percent) of India's imports of those products.[89] In the face of absolutist approaches, targeted middle-of-the-road solutions to cater to American imports can help in the long-term resolution of trade divergences.

CONCLUSION

India's ties with the US in the strategic realm, particularly defence trade and force interoperability, are now at an all-time high, but trade tensions persist. So far, they have not drastically hindered the India–US strategic cooperation, which is in keeping with the Carter mantra of the Obama administration. However, there has been a significant departure from that dictum when it comes to trade differences playing out in the open: from Trump's remarks about India being "tariff king" to the USTR considering a Section 301 review of India. The latter holds ominous prospects for the India–US bilateral dynamic, as evident from the continually escalating US–China trade war triggered by a similar Section 301 probe. At a juncture when India's strategic ties with the US are improving, a renewed trade conflict will be a major setback, especially in their efforts to ensure a free and open Indo-Pacific.

To some extent, this paradox—of increasing defence cooperation but worsening trade relations—is a natural consequence of the lack of standardisation in the India–US relationship, which is a crucial aspect of formal alliance partnerships. In searching for a template appropriate for the unique characteristics of the India–US dynamic, the centrality of a vibrant trade relationship as a precursor to a sustained strategic partnership must be recognised. Both nations must actively work towards de-escalating trade tensions. In the short term, this can be achieved by stressing on the strategic relevance of India's GSP status in the US–China trade conflict, setting a precedent of delinking trade issues from the convergence areas and focusing on middle-of-the-road solutions. ORF

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