An India-US FTA: Free Trade for America?

By Shefali Sharma
EQUATIONS, Bangalore
September 1, 2004

There are rumours that the Congress-led Government is set to decide upon a potential free trade agreement (FTA) with the US government. Strong lobbies such as NASSCOM (National Association of Software Companies) are pushing an FTA for services with the belief that it will resolve their BPO (business process outsourcing) problems. Those painting glowing "all gain, no loss" scenarios of an FTA where Indian companies can "render unhindered services in the US" and where Indians "can take up jobs without worrying about H1B visas"[1] seem to be utterly ignorant of the complex politics and legal loopholes of trade negotiations (much less of internal US politics and the global competitiveness of Indian services). A reality check is in order.

While India has played cautiously in the WTO on services and investment, a potential India-US FTA now could undermine its work in the WTO and handicap government (and industry) ability to pursue longterm development strategies. Insight into how the US has treated its "FTA partners" both weak and strong can give us an ex-ante look at what India can expect when the US comes to the "negotiating table." This article presents a brief and preliminary look at implications of an India-US FTA through a wider lens. It addresses the India-US economic relationship, the US FTAs with other countries and lessons India can draw from potential impacts on the economic, political and social fronts.

India and US economic relations: A balance of payments?

According to a Businessline[2] article, the US now accounts for 28% of India's trade. The total value amounts to $18 billion/year. Two lakh Indians are currently employed through BPO, most for US companies. The US is also India's biggest investor at 20% of the total FDI. On the other hand, India accounts for less than 1% of the US global trade. Apparently India's "untapped retail market" values at $180 billion and is predicted to double by 2010. The implication, according to this Businessline article, is that India needs the US much more than the other way around, especially when it comes to trade and investment.

However, the reality of who benefits from whom might be something else. In agriculture (a sector India is keen to promote in the export market), the trade to the US in edible fruits and nuts declined by 13% and from coffee and tea by 4% in 2003.[3] On the other hand, US trade to India in fertilizers increased by 206% in the same year. India's cotton yarn and fabric trade to the US dropped by 12% while from the US increased by 40% to India. India is the next biggest destination for US products after China with a growth of over 22.5% in 2002. In the same year, services exports (though economists admit that statistics are hard to track) from the US to India were double those from India to the US in with US accruing $6.8 billion and India, $3.5 billion. Perhaps, the US "needs" India more than we think it does. The US has a $300 billion services industry that is eager to get its hands on India's growing market. What will happen to the Indian Services industry when the flood gates open?

The Businessline article asks: "Can New Delhi afford to antagonise Washington however much its backlash on BPO seems unreasonable and against the tenets of free trade?" The solution proposed is an FTA. However, before jumping on the FTA bandwagon, perhaps India needs to weigh how other US FTA partners have fared in this game.

The US Negotiation Agenda in FTAs: A look at the weak and strong

The US has been steadfast and unrelenting in its commercial interests in FTAs, acquiring commitments from both strong and weak nations that far surpass any commitments the US is able to get through the WTO. The European Union is playing a similar game. The race is on between the two major powers on who can capture developing country markets faster. Covering all areas-- intellectual property; agriculture; services; manufacturing; investment and even government procurement--the US has negotiated well for its multinational companies. Here are some key areas where the US has been able to gain:

Agriculture

Hiding behind the European Union, the US is actually one of the biggest contributors of low world prices of major agriculture commodities (wheat, corn, cotton, soybeans, rice etc.). A US based NGO, the Institute for Agriculture and Trade Policy (IATP) calculates US "dumping" (the selling of products below the cost of production) of crops as 57% below the cost of production for cotton from 1990-2001, 30% below the cost for corn and 40% below the cost for wheat[4]. The mass quantities of these crops distributed by powerful US agribusinesses in turn put local farmers in developing countries out of business because they can no longer compete with the cheap imports from the US. These imports also crowd out developing country exports.

The US is an aggressive agriculture negotiator in FTAs, demanding extremely low or zero tariffs on commodities and regulatory changes in agriculture schemes. Mechanisms targeted are often those that protect countries from US dumping. This is clearly visible in the case of Mexico and Chile.

In Mexico, there are at least 2 million corn producers. Mexico was importing 2.5 million tons of corn prior to NAFTA (1994). By 2001, it was importing 6 million tons of corn that the US sold at 30% below the cost of production. Mexican corn prices paid to farmers fell by 70% after large quantities of US yellow corn was dumped on the Mexican market. Even as Mexican farmers (who had no other employment alternatives) produced 18 million tons of corn in 2001, 3 million went unused[5]. This has created immense political problems for the Mexican government and contributed to severe poverty amongst corn and other farmers in Mexico who comprise 70% of the Mexican population.

Chile[6] used to have a “price band” system that would stabilize the prices of cheap imports such as wheat and sugar in order to support its 200,000 farmers who specialize in products such as wheat, dairy, beats (which they primarily sell to their domestic market). The US agribusiness sold wheat to the world market at 44% below the cost of production in 2001. When Chile negotiated its FTA with the US, it was forced to remove this price band.

Intellectual Property: Access to Medicines

Another area of key US interest is intellectual property (IP) rights and thus markets for its pharmaceutical and biotech industry. The US typically demands monopoly rights of patents up to 20 years. It also demands provisions that limit governments from enacting laws that promote cheap generics and issuing compulsory licenses to combat epidemics. Such licensing allows rapid and cheap distribution of drugs in times of crisis. In country after country, the US has targeted IP laws and forced governments to adopt WTO-plus commitments thereby violating the WTO declaration that recognizes the right of governments to regulate in the interest of public health.

In the Australia-US FTA, Australia is fighting to preserve its Pharmaceutical Benefits Scheme (PBS) which the US congress might find objectionable[7]. Immense pressure has been put on Australia to change its scheme that allows consumers to benefit from affordable medicines. Negotiations between the US and Bahrain[8] are resulting in similar conditions placed on Bahrain that would limit its ability to bring and market generics for Bahrainian consumers. It is generic medicines that induce competition for lower priced medicines. AIDS anti-retrovirals that once cost up to $15,000 now cost $140/year/patient. The US is demanding similar provisions in FTAs with Australia, Chile, Morocco, Singapore and in the Latin America-wide Free Trade Agreement of the Americas (FTAA).

Investor to State

An important feature in the US approach towards international investment agreements (IIAs), is Investor-State dispute settlement. Under these rules (enshrined in NAFTA, in many bilateral investment treaties and in the most recent US FTAs), investors can sue host country governments for an alleged breach of IIA rules and obligations. The claim can be brought either to the ICSID (the International Center for Settlement of Investment Disputes, at the WorldBank), UNCITRAL (United Nations Commission on International Trade Law or other arbitration bodies. Under these systems, the companies and governments fight it out behind closed doors, the public unaware of the proceedings.

As a result of such an “Investor-State” suit under NAFTA, Mexico was ordered to pay around $16.7 million to an American company (Methalclad Corp) because Mexico’s local administration prohibited the company to build a toxic-waste dump in the area[9]. The company saw this as “expropriation”—denying the company profits that it felt it was owed. In another case, the US’s United Parcel Service (UPS) challenged Canada for denying it similar treatment as was granted to the Canadian Postal Service (essentially UPS claimed that Canada denied it market opportunity for delivering packages).[10]

These examples show that local and national laws and regulations could be subject to court claims if they are considered to violate IIA rules and obligations. These could also include obligations to refrain from using certain performance requirements (a policy tool essential to ensure that countries benefit from FDI) regardless of the public good they may provide. Essentially, Investor-State processes grant more powers to foreign companies than to governments and their national interests. Such processes are an essential feature of recent US FTAs, such as the Singapore-US.

Services

Similarly, US FTA negotiations on services are extremely ambitious and demand drastic and unconditional cuts on tariffs while major elements of services negotiations are still ill-defined and unclear in the WTO GATS negotiations (such as classification, government regulation and rules regarding government procurement and subsidies). The US services industry usually knows exactly which national and sub-national laws of any given country to target for market access—this is obvious from the few leaked US GATS requests in Geneva. Meanwhile, understanding US national, state and municipal laws and regulations on various services sub-sectors requires expertise that the Indian services industry and the government is currently ill-prepared to handle.[11]

Industry pundits such as CII's Senior Advisor, TK Bhaumik[12] rightly suggests that most of India's services are still unorganized and the time has not yet arrived to engage in a sweeping services agreement with the US. He notes: one or two strong sectors (i.e. software) "does not make the whole sector competitive." Importantly, he suggests that an FTA on services would have implications for other sectors such as industrial goods—another area of aggressive market interests for the US.

Implications for India

Economic and Social Consequences

In February of this year, US Trade Representative (USTR) Robert Zoellick stated that India's average applied tariff in agriculture is 38%, three times the level of the United States and the US manufacturing tariff at 3% compared to India's 20%[13]. And he wants further reductions from India. Given that the WTO has taken away other types of border measures, tariffs are the last remaining resort for India to collect revenues and to protect its domestic agriculture and manufacturing industries. In an FTA, these applied rates would drastically come down with the US having to make little compromise from its own minimal tariffs. Meanwhile, agriculture dumping and protection of its steel and other manufacturing sectors would continue.

India boasts of having protected its small farmers and allowed for potential to export agriculture into the world market through its new deal at the WTO in July of this year.

The reality is that actual details are yet to be negotiated in the WTO and will do nothing to curb US agriculture dumping on Indian farmers since all of the US support schemes come under “non-distorting” or “minimally trade distorting” categories in the WTO. Over 60% of India’s population depends directly or indirectly on agriculture and currently the countryside is in deep trouble.

Rural farmers are being “squeezed between falling output prices and rising input prices” with limited support from India’s banking structure for credits. As a result, numerous farmer suicides and increased landlessness in the last six years have occurred[14]. It has, in turn, drastically reduced the purchasing power of 60% of the Indian population, even to purchase foodgrains. This phenomenon led to the famous “60 million tonnes” of foodgrain stocks in 2002 even as many in the countryside went hungry. During the following year and half, India exported 17 million tones of foodgrains. According to Utsa Patnaik’s research, the latest NSS survey of 1999-2000 cites 75% of the rural population in India as suffering from poverty. In Andhra Pradesh, one of the largest agriculture producing states, as much as 84% of the rural population was in poverty.

Before India engages in further tariff reductions in goods or services (as it continues under-investing in the agrarian sector and/or is prevented from doing so through FTAs and multilateral agreements), it might want to reconsider the dire economic and social consequences for the majority of the Indian population. Without purchasing power, there is no Indian market to speak of, be it for domestic or foreign companies.

Political Consequences

An FTA with US will have broader political impacts. In May of this year, the US named India once again on its “Special 301 Priority Watch List” for “weak protection and enforcement of its intellectual property rights laws.”[15] From 1992-2001, the US removed India from its Generalized System of Preferences (GSP) scheme which allowed duty-free entry to Indian products valued up to $1.1 billion. It did so, on the grounds of “inadequate intellectual property rights protection”[16].

Clearly, though India has made its intellectual property laws WTO compatible, the US is watchful of its IP interests and is targeting India. The more dependent India is on the US market (as opposed to numerous markets in demand of India’s cheap medicines), the more vulnerable India will be to economic and political pressures by the US. This is at a time when India’s AIDS epidemic is just coming to light (5.1 million Indians recorded as infected as of 2003). India’s ability to produce and distribute cheap drugs is essential.

The experience of African governments in the WTO shows that tremendous trade/aid dependency on the US or the EU leaves these governments virtually powerless to assert their own national interests. Though India is not there yet, it may want to consider whether it wants more or less vulnerability to the US government and its commercial interests. Isn’t allowing the US dominated World Bank into the Planning Commission’s consultative committees for the Xth Five Year Plan (2002-20007) enough?

Academics and World Bank officials suggest that an FTA with the US could "strengthen India's hand in its broader strategic engagement with the U.S. by creating a stake for American business in India."[17] On the other hand, a stronger hand of US business could also force India to increasingly cater towards US interests at the threat of economic sanctions. It is a double-edged sword.

Clearly, the US unashamedly used the trade weapon with Chile during the finalization of the Chile-US FTA when Chile refused to support the US war in Iraq. The formal signing of the agreement was held up for several months when Chile refused to give its support to the US at the UN. USTR's Zoellick was quoted as saying "the U.S. government expects 'cooperation—or better—on foreign policy and security issues' from its potential partners in trade agreements"[18].

Final Comment

Given these preliminary considerations, perhaps India should consider taking care of its business at home first with its "$180 billion market." Rather than eagerly sitting down with the US at the "negotiating table," India might be wiser to continue building South-South relations as it is doing with China, Brazil, South Africa and in its own backyard.

(The author is temporarily researching with EQUATIONS (www.equitabletourism.org) and formerly managed the Geneva office of the Institute for Agriculture and Trade Policy [2000-2003], monitoring WTO trade negotiations.)

Endnotes:

[1] http://jroller.com/trackback/sumith/Weblog/indo_us_free_trade_agreement
[2] S. Majumder "India-US BPO spat—Answer may lie in FTA" Businessline, April 14, 2004
[3] Data in this paragraph from the FICI website: www.fici.org : "India-US Economic and Commercial Relations"
[4] Ritchie, Mark et al. "US Agriculture Dumping on World Markets" Cancun Paper Series No. 1, 2003, www.tradeobservatory.org
[5] Public Citizen. "NAFTA Truth and Consequences: Corn" March 31, 2004, www.citizen.org
[6] Langman, Jimmy. "Chilean Farmers Protest Trade Pact" Miami Herald, June 11, 2003
[7] Australian Associated Press. "US Free Trade Deal Locked In." August 12, 2004
[8] Data in this paragraph from Center for International Environmental Law (CIEL). Report of the TEPAC on The US-Bahrain Free Trade Agreement, July 12, 2004, www.ciel.org/Publications/TEPAC_Bahrain_14Jul04.pdf
[9] De Palma, Anthony "NAFTA's Powerful Little Secret" New York Times, March 11, 2001
[10] Ibid
[11] Bhaumik, TK. "Take Stock of the Pros and Cons: An Indo-US FTA in Services is an Idea Whose Time Hasn't Come Yet" http://www.financialexpress.com/fe_full_story.php?content_id=66139

[12] Ibid

[13] USTR. Robert Zoellick's Press release: "US has a 9 billion $ deficit with India and a $500 billion deficit in the world"

[14] Data in this paragraph from Utsa Patnaik, "Principle Task on the Agrarian Front" India: An Economic Agenda for 2004. SAHMAT: July 2004

[15] Kronstadt, Alan. "India: Chronology of Recent Events" CRS Report for Congress, US State Department, July 28, 2004

[16] FICI website: www.fici.org "India-US Economic and Commercial Relations"

[17] From India/South Asia Roundtable: *India-U.S. Economic Relations: A Free Trade Area of the Democracies?* Speakers: Aaditya Mattoo, The World Bank and Arvind Subramanian, Harvard University at the Brookings Institute

[18] Hansen-Kuhn, Karen, "FTAA Fails to Gain Support from Citizens and Governments Across the Region" Foreign Policy In Focus. Policy Brief: *Volume 8, Number 3, November 2003, www.fpif.org*