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Gradually Intensifying Trade Frictions between the US and India

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In a rising hope for a settlement of the US-China trade frictions, India has emerged as the next target country against the trade frictions of the U.S. On March 4, the Office of the US Trades Representative (USTR) announced that the government would exclude India and Turkey from the designated beneficiaries of Generalized System of Preferences (GSP) program[1]. In tandem with withdrawal from the TPP, renegotiations of the NAFTA and trade negotiations with China, the Trump administration suggested a review of its application of the GSP to developing countries which enjoy lower tariffs on their exports to the US under the system. The government uses a review of GSP eligibility against developing countries as a means to reduce US trade deficits as well as a pressure to improve business environment to the US corporations and make them comply with the intellectual property rights and labor standards.

Through the GSP, advanced economies like the US, Japan and the EU aim at supporting economic development of developing countries by exempting tariffs on the latter's exports to themselves. However, advanced economies have much discretion in providing preferences and also there are divergences from country to country in the coverage of beneficiary countries, items and standards of identifying country of origin. Further, in addition to a graduation clause where the countries are terminated as beneficiaries when their income reaches a certain level, there are cases where countries are excluded from beneficiaries based on the share of the countries in the imports of a GSP provider, situation of intellectual property protection and worker rights in the beneficiary countries. The US GSP program exempts 121 developing countries and regions (about 3500 items) from import tariffs.[2] A review of GSP beneficiaries and items by the US has been made every year based on a petition from trading organizations and workers unions, but since the start of the Trump administration, the government has put

[1] https://ustr.gov/about-us/policy-offices/press-office/press-releases/2019/march/united-states-will-terminate-gsp
The decision on the termination of the GSP application takes effect by the presidential decree after the passage of 60 days from its notification to the US Congress and the government of India.
[2] In addition, the US exempts under the GSP-LDC the customs tariffs on about 1,500 items of imports from 43 Least Developed Countries /Regions (LDC) whose income level is lower among the GSP beneficiaries.

more emphasis on the "fair market access" to the US corporations and established in October 2017 a new system to assess the GSP eligibility of the beneficiary countries under the initiative of the government[3]. The review of the countries has expanded to include countries in Asia/Pacific, Eastern Europe, Middle East and African countries.

India's Gross National Income per capita stood at $1,800 as of 2017, which is far from the graduation level[4] over which a country is terminated from the GSP eligibility. The US trade deficit with India remained at $21.3 billion in 2018, smaller than the deficit of $419.2 billion with China which accounts for about half of the whole US trade deficit. However, the USTR cited as a reason of GSP termination the India's failure of compliance in guaranteeing the US a provision of fair and rational market access. In practice, there had been a long conflict between the US and India over the high customs duties in India and protection of intellectual property rights in the area of pharmaceutical products[5] and there was a background that the government started to review the GSP eligibility of India upon a petition from the US diary product and medical devices industries.[6] In addition, a notification (April 2018)[7] of the Reserve Bank of India (RBI) on the localization of settlement data mandated corporations that provide multilateral settlement services like MasterCard, Visa and other major credit companies to transfer their data of e-commerce into India. Also the Indian government strengthened the regulations on e-commerce (December 2018),[8] which imposed a restriction on the activities of major e-commerce companies like Flipkart which is affiliated with Walmart of the US and Amazon India, a subsidiary of Amazon.com. These all might have exerted influence on the recent decision taken by the US government. While the Modi administration promotes "Make in India" policy by which it aims to further develop the Indian economy especially through revitalization of its manufacturing industry by attracting foreign investment, it has consistently maintained a negative stance to the introduction of foreign investment to wholesale industry since the time of the last election held in 2014. More than 90% of the retail market in India is occupied by small and mom-and-pop stores operated by family and the number of shops amounts to about 12 million with related people including owners and other employees and their families exceeding 100 million. As the votes of these retailers have a decisive influence on the election result, the successive administrations have taken a cautious attitude for them.

India is the largest beneficiary of the GSP with its share of GSP related imports accounting for a little below 30% in the US and more than 50% in the EU (Figure 1). However, India's

[3] https://ustr.gov/about-us/policy-offices/press-office/press-releases/2017/october/ustr-announces-new-enforcement

[4] In principle, the graduation occurs when countries are classified as high income status (higher than $12,056) by the World Bank classification (as of 2019).

[5] Specifically, the pharmaceutical products have been long placed as products for significant concerns on the "Priority Watch List" in the Annual Special 301 Report (identification of infringement upon the intellectual property rights and sanctions for it) based on the Omnibus Foreign Trade and Competitiveness Act.

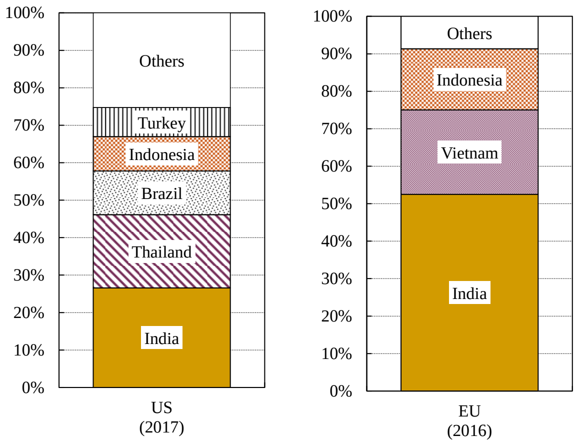
[6] https://ustr.gov/about-us/policy-offices/press-office/press-releases/2018/april/ustr-announces-new-gsp-eligibility

[7] https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11244&Mode=0

[8] The new regulation prohibited, in addition to the previous prohibition of ownership of inventory, e-commerce marketplace entity control of inventory (if more than 25% of sales of a vender is purchased by a marketplace entity), equity participation in a vender, and monopoly of sales of products of a vender. (https://dipp.gov.in/sites/default/files/pn2_2018.pdf)

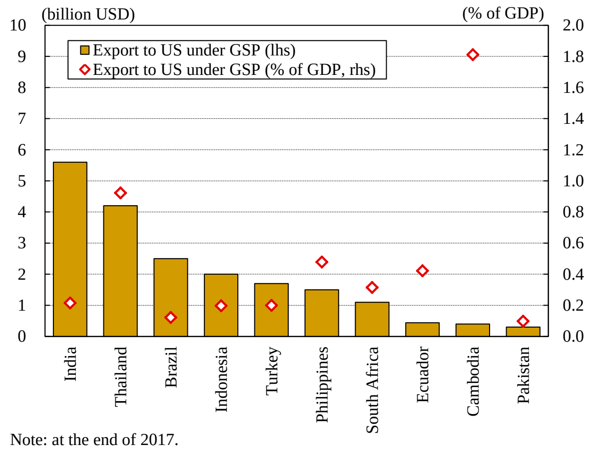
exports to the US accounted for only 16% of total exports in 2017, with its GSP covered exports remaining at 12% (0.2% of GDP). Therefore the impact of the termination of the US GSP treatment on its economy is considered to be limited (Figure 2). But the impact would differ depending on the companies that export GSP covered products like chemicals, car parts and stainless table wares. Going ahead, when the termination of the GSP eligibility spreads to other developing countries that are highly dependent on exports covered by the GSP, there will be a possibility that its impact on those economies become too large to ignore in the process of reviews of business strategies of companies that extend to production, exports and investment plans. The future development of the review of GSP eligibility by the US government should be carefully monitored.

Figure 1: Share of Imports under GSP in US and EU



Source: U.S. International Trade Commission and Eueopean Commission

Figure 2: Top 10 beneficiaries of exports to US under GSP



Note: at the end of 2017.
Source: USTR, IMF