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Distance Learning Programme

UPSC Mains

International Relations

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INTERNATIONAL RELATIONS

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India & The World Trade Order

Chapter 8

Trade between the countries of the world has always been the most important channel of interaction and communication. Trade has been used by various countries of world for creating wealth and also for using that wealth for the purpose of increasing their political influence over other countries. The modern world, however, is characterized by the various themes which have set the tone of the trade and investment. Some of the important themes prevalent in the world have also impacted India and hence, have become a part of India's economic relations with the world.

Prominent Themes of Global Trade

Emergence of Regional Groupings

The emergence of regional economic groupings like the ASEAN, APEC, EU, etc., particularly in the post War years is a significant phenomenon in the global economic architecture. Although this has been something which has been in existence since times immemorial, yet it has been aggressively taken up by the countries of the world in a big away after the Second World War. This has been mainly because of the need to withstand competition and reap the benefits of synergies of cooperation.

By definition, all trade blocs work on the basis of bias; the whole point of a trading bloc is to have a closer trading relationship with certain countries over others. Member countries get to share equally in the benefits and are treated better than non-members supposedly.

Non-members of trading blocs face financial and non-financial restrictions on their exports to these blocs, such as tariffs, quotas and even embargoes. As a result, it is difficult for any country to survive outside one of these blocs and the world is splitting into expanding groups of trading nations promoting free trade between themselves, at the same time as they are restricting it to those countries outside of their blocs

The Need to Withstand Competition: Post-War years witnessed the phenomenon of decolonization in a big way when the colonial powers withdrew from their colonies and as a result, a number of newly independent countries were founded. These countries, though politically independent, were very poor economically as during their colonial years, they have been largely used as sources of raw materials by their colonial masters and very little attention was paid to their socio-economic and industrial development. Therefore, in this new environment, it was very difficult for them to compete with the developed countries of the world and developed countries tend to impose their conditions on these countries, which they had to necessarily comply or else face the risk of isolation.

In such circumstances, these countries found strength and security in creating alliances and groupings which can synergize their strengths both in terms of trade capabilities and also in terms of creating larger markets which act as attractive investment destinations for the flow of both public and private capital from the developed world to these countries, thereby creating jobs as well as developing their industrial capabilities. This idea has not only been attractive to the developing countries, but also to the countries of the developed world which have instituted groupings like the EU or the NAFTA to unleash and unlock the potentialities of coordinated and unified approach in creating wealth and prosperity for the participating nations.

The Strict Conditionalities of the International Funding Agencies: Another aspect of this phenomenon is an extension of the aforesaid logic. In the post war years, the developed countries of the world, mainly led by the US, embarked upon the programme of building the economies of the newly independent countries through the help of various international funding institutions like the IMF, IBRD etc.

One of the objectives of the Bank states that it shall assess the repayment prospects of its loans, and for this purpose, will take into account the availability of natural resources, the country's past debt record, etc. The manifestation of this objective was in the form of various conditionalities imposed by the bank to influence the economy of the borrower country in the form of reducing fiscal deficit, reducing their current account deficit, devaluation of their currencies, etc., which on most occasions became difficult to adhere to. As a result, the countries resorted to such regional groupings through which they could participate in trade on their mutually agreed terms and conditions rather than being dictated by the international institutions.

The Need to Reap Synergies of Cooperation: Another reason for the proliferation of these regional groupings is that the member countries can unlock a number benefits from the synergies of these groupings by making free trade arrangements or preferential trade agreements within these groupings, which can help in capitalizing and developing upon their core and individual strengths, thus making them competitive vis-à-vis the developed countries in the long run.

All in all, these regional groupings can play a meaningful role in harmonizing international, economic and cultural relations and thereby international politics itself. In fact, in contemporary times a large number of regional functional organizations have been acting as important instruments for the conduct of international economic relations.

The Question of Energy Security

Energy security, particularly seen from the point of view of hydrocarbons is an area which has been the soft belly of India. It is mainly because of the fact that India imports 80% of its requirement for oil and this requirement is not expected to reduce in the near future. Given the fact that most of its oil is sourced from the Middle East and West Asia, India always has to keep an eye on the Middle East and West Asia affairs and any confrontation or unrest in that region becomes a matter of concern for India. Moreover, apart from the Arab-Palestine conflict which never seems to be ending in the near future, there are serious other challenges which the area is facing. While Turkey is now being effectively ruled by a dictator, Syria has been waging against a civil war for more than 7 years now. Iraq has been battling ISIS since the withdrawal of the US troops from Iraq. Yemen is facing a civil war since 2015 and recently with the announcement of the US withdrawal from the Joint Comprehensive Plan of Action" (JCOPA), (the multilateral accord aimed at limiting Tehran's disputed nuclear program in exchange for relief from international sanctions in 2016), and imposition of sanctions on it, the US-Iran relations are again on the boil.

The US Sanctions on Iran: The US has issued a deadline for its allies, including India, to restrict their trade relations with Iran. India is one of the largest consumers of Iranian oil and Iran is only next to Saudi Arabia in terms of largest oil exporting countries to India.

Therefore, the relations with the countries of that region have always been important for India and in the present context the relations with Iran need a serious reconsideration. With new sanctions set to take effect in November, what does President Trump's withdrawal from JCOPA (Joint Comprehensive Plan of Action or Iran Nuclear Deal) mean for India and Indian companies conducting business with Iran?

Post November, the most direct consequence will likely be a reduction in Iranian oil exports to India. Less than ten years ago, Iran accounted for nearly 17% of India's crude imports. Sanctions imposed on Tehran by the Obama Administration in 2012, however, forced India to curtail its imports of Iranian oil by half their previous levels or otherwise risk jeopardizing its companies' access to the U.S. banking system as a result of secondary sanctions. New Delhi ultimately secured numerous sanctions waivers from Washington, permitting the smaller oil purchases, but Iran's share of India's imports fell to less than 7%. Although exports of Iranian oil to India surged by more than 110% after sanctions were lifted following implementation of, American withdrawal from the accord has found India back in a familiar position: forced to either slash its oil imports from Iran or risk exposure to U.S. sanctions.

Indian officials recently announced that India does not recognize, and would not abide by, unilateral American sanctions, effectively pledging to maintain current import levels. However, as Arvind Subramaniam puts it, the costs of not adhering to the U.S. are quite stiff. Essentially what it means is that you can't be part of the dollar based international system where almost everything takes place in the dollar. It's the role of the dollar that is so all permeating, not just in trade, but as a payment mechanism and an instrument of finance that makes the cost of noncompliance very high. Furthermore, New Delhi made similar pronouncements in 2012. But if the past is any indication of the future, India is still likely to experience a reduction in crude imports for several reasons.

Firstly, Indian refiners have already begun to voluntarily reduce Iranian imports. On May 30, for example, Reliance Industries, owner of the world's largest oil refining complex and chief purchaser of Iranian crude, announced it would cease oil imports from Iran in October or November as a result of the sanctions risk from the United States. Reliance's decision will reduce Iran's exports to India by more than 15% alone. The question that arises is whether India's other major private and state-owned refiners, including Essar Oil, Indian Oil and HPCL-Mittal Energy Ltd., will follow suit.

Secondly, refiners seeking to maintain present crude import levels will now have to contend with global shipping and insurance companies increasingly unwilling to engage in Iran-related transactions because of the looming sanctions risk. Without tankers to transport the oil and coverage to insure the cargo, oil trade will inevitably suffer.

Thirdly, payment for crude imports will resurface as a serious obstacle for both countries. Moreover, some immediate consequences of President Trump's decision to pull out from the Iran deal have already started showing their effect. For instance, the news of the withdrawal was followed by the rupee's weakening against the dollar, increased foreign exchange outflows and higher gas prices at pumps across India because of higher oil import bills.

All in all, the oil trade between India and Iran is likely continue, but at diminished levels despite demands by the Trump Administration that imports be cut completely. However, Indian companies with commercial ties with Iran must now address a host of formidable challenges to continue conducting business with the country.

Way Forward: Under the given scenario, what is the way forward for India, more importantly in terms of maintaining its energy security. There are various options available before India, which needs to be evaluated thoroughly to decide the course of action.

Firstly, without access to the U.S. financial system, India and Iran will have to devise workarounds to facilitate and preserve their commerce in oil. Although Iranian crude exports to India continued after 2012 at reduced levels, New Delhi was forced to pay for them through a complex combination of Euros, Rupees and barter system. Resurrecting a similar arrangement will be a formidable task, however, especially given that several Indian banks have already instructed their commercial clients to complete their financial transactions with Iran before sanctions take effect.

Secondly, given the sad state of India-Pakistan relations, Iran alone can provide India access to Afghanistan and Central Asia. India is deeply engaged in the development of the Chabahar Port and associated projects that give India such access. In 2017, India exported wheat to Afghanistan through Chabahar. This port development project is part of a much larger North-South Transport Corridor. If India stops oil imports, Iran might respond by stalling India's participation in the Chabahar Port project. China has control over the neighbouring Gwador port in Pakistan, which is of some geopolitical concern to India.

Moreover, India's claim to be a great power will be questioned if it meekly accepts the US' demand. If at all there is a situation wherein it seems impractical to resist US sanctions, India could enter the 'transactional' mode, in the sense that it can ask the Trump administration for 'waivers' against conforming to the sanctions. This could include convincing Saudi Arabia and UAE which are friends to the US, to offer attractive discounts to India, against an increased oil purchase from them.

Politically, it is far more prudent for India to toe the US-Saudi-UAE-Israel alliance in the region. This is important not only from the point of view of oil imports, but also with regard to flow of remittances and bilateral trade. Moreover, it is in India's interests to strengthen its relationship with countries championing pluralism and religious moderation such as the UAE. It is also crucial in our fight against Islamic radicalism in South Asia. In the emerging scenario, it is in India's national interest to take a clear stand and reduce levels of engagement with Iran. The perception that the US is internationally isolated because of its withdrawal from the deal is erroneous. The US, with its enormous power and influence over international institutions, continues to set the global agenda and drive the international order. Some mega companies within Europe, including TOTAL, the oil giant, have announced the cancellation of projects with Iran in view of the likelihood of imposition of sanctions against Iran. This is an indication of what is to come. Pragmatism demands that India stands by the forces of stability in West Asia rather than pursuing an ambivalent policy that lacks both clarity and integrity.

Role of International Agencies and MNCs/TNCs

Both the International agencies as well as MNCs cast a deep impact over the economy of the world, so much so that it will not be an exaggeration if we call that these institutions have shaped the economy of the world in the post war years. Together, they are responsible for shifting the balance of economic power in favour of the developed countries.

Role of MNCs/TNCs: The growth of multinational corporations as powerful non-state economic actors, playing a key role in international relations, particularly economic relations, has been phenomenal. Their emergence has played a key role in changing the world scenario. The MNCs have emerged as sources of transfer of capital, industry, technology and know-how from the developed World to the developing World. On the one side, these offer opportunities for the developing countries to develop with their help and expertise and on the other hand, these have tended to be a source of neo-colonial control over their economies and policies. Even for the countries of their origin, like the US, UK or Japan, the MNCs have been instruments of profit and health for their economies.

These MNCs have exhibited the tendency to remain free from the control of the government of the state as well as to become a source of employment. All this has made the multinational corporations the object of both support as well as opposition. The impact of MNCs can be gauged by the estimate that by the year 2002, half or more of all industrial production in the world was accounted for by a relatively handful of MNCs. The United States, Britain and Germany have control over half of these corporations. The United States alone accounts for more than a quarter. Although the growth of transnational corporations is a global phenomenon, the major part of all transnational business is located in the developed areas of North America, Western Europe and Japan. Though the MNCs are non-governmental, private, profit making economic enterprises, these indirectly strengthen the control of their home countries over the economies and policies of the developing countries.

Firstly, the MNCs satisfy the foreign investment needs of the developing nations. Secondly, they pay higher wages, keep more honest records, pay more taxes, and provide more managerial know-how and training than do local domestic industries. Thirdly, the MNCs usually provide better social services for their workers, and certainly provide fancy career opportunities. Fourth, these constitute the main channels through which the developed technology flows from the developed to the developing countries.

However, there is also a different aspect to this proposition. MNCs are profit-making organizations and they always seek to maximize profits of their shareholders who mostly reside in the parent countries. The capital flow from the developing to the developed countries is excessive and is largely not reinvested in the host countries where production occurs. The fees MNCs charge for transferring the technology, giving know-how and granting licenses is exorbitant and constitute a big strain on the economies of the host countries. The 'transfer' pricing mechanism is another device used by multinationals that can effectively increase the MNCs profits while minimizing their tax burdens. The raw, semi processed or finished materials produced by a parent's subsidiaries located in different countries are in effect traded among the subsidiaries. Since the same company is sitting on both sides of the transaction, the safe or 'transfer' prices of these import-export transactions can be manipulated so as to benefit the parent firm. The net effect of all this is increased capital flow from the host countries to the parent countries.

While analyzing the ill effects of the activities of the MNCs on the developing states, Joan Edelman Spero observed: "Multinational corporations often create highly developed enclaves which do not contribute to the development of the larger economy. These enclaves use capital-intensive technology, which employ few local citizens; acquire supplies from abroad, not locally; use transfer prices and technological agreements to avoid taxes and send earnings back home. In welfare terms, the benefits of the enclave accrue to the home country and to a small part of the host population allied with the corporation." In this way they become strong agents of neo-colonialism for the developed countries and increasingly sharpen the income disparity not only between the rich countries and the poor countries but also within the host countries.

Role of the International Funding Agencies: When we talk about international funding agencies, we mainly talk about those constituted around the Second World War. Though of late the regional groupings and bilateral aid have largely diluted the role of these funding agencies, but still these institutions like the IMF and the World Bank are key players in the international financial system and their impact certainly deserve a mention.

These institutions maintain a large pool of financial resources that they make available to members temporarily and subject to conditions to enable them to carry out programmes to remedy their payment deficits. These agencies claim that the policy adjustments that countries make in connection with the use of these resources, is geared to improve and support credit-worthiness with other official sources and private financial markets. Further, the agencies claim that they also help members to coordinate their national economic policies internationally as the focus of the fund is not only on the problems of individual countries but also on the structure of the international monetary system.

However, this perspective is not totally acceptable to the developing countries. Tiago Stichelmans advocate that it is perfectly acceptable that donors set conditions in terms of good management of resources, or that relate to internationally agreed human rights principles. What is not acceptable are imposing conditions on structural economic reforms. The World Bank's main lending facility has eligibility criteria, which are up to the World Bank to decide. That is problematic because the Board 's voting powers lie with developed countries, not those receiving the loans.

Further, the IMF works with a letter of intent written by the government receiving the programme. This letter requires prior actions, quantitative performance criteria, and structural benchmarks to be approved. The first two are not particularly controversial. However, structural benchmarks do contain a lot of sensitive structural economic reforms, often including privatization, labour reform, etc. Though the IMF does not consider this as conditions because they are not legally binding, but these countries have strong reasons to include measures in their letter of intent that the IMF recommends, mainly to maintain good relationships with the IMF.

In this way, any relationship with these institutions controlled by the developed countries tend to extend their hegemonic influence to the economies of the developing countries thereby giving these developed nations a handle to control their sovereignty. Most of the time, it results in the governments of the developing countries being forced to compromise on their welfare and social infrastructural programmes and open their markets and economies for free access to the MNCs originating from the developed countries which eventually systematically exploit these countries to create wealth for their parent countries.

The Indian Dimension: India embraced liberalization of the economy in a big way after 1991, mainly after it came under Structural Adjustment Programmes sponsored by the IMF. Initially the economy was liberalized with a cap on foreign investments on almost all sectors. However, gradually as the indigenous industry became mature and competitive, these restrictions were largely relaxed and as of now, to attract higher levels of FDI, the Government has put in place a liberal policy on FDI, under which FDI up to 100% is permitted under the automatic route in most sectors/activities.

With almost 30 years post liberalization, India today has evolved considerably on the issue as to how to deal with the international funding agencies and the MNCs. With the advent of foreign capital from the FDI and FII channels, the need to seek finances from the international agencies has shrunk considerably. Of late, India has looked upon foreign investment as an opportunity to bring in new technology and jobs apart from generating exports and earning foreign exchange. In the same reference, there has been a literal competition with other countries like China to woo more and more foreign investment.

Nevertheless, India too is not totally immune from the negative impact of the foreign investments unleashed by the MNCs. The MNCs have brought in several problems along with them. There are problems related to lopsided development, regional disparity in development, problems of displacement, acquisition of land producing unrest among the farmers, increasing income gap between the rich and the poor, and concentration of wealth are a few of the socio-economic problems.

However, there have been instances of these companies abusing and manipulating the laws of the country to extract wrongful privileges and gains for themselves. One of the famous examples is the Vodafone tax case wherein Vodafone International Holdings BV decided to expand its footprint in the Indian mobile phone market by buying out Hutchison Essar. But it decided to take the roundabout route; its subsidiary exchanged cash for shares with a similar holding company for Hutchison Essar, in far off Cayman Islands. The deal was almost entirely sewn up offshore, where the Indian tax authorities had no say. The government suspected that the entire exercise was a part of the standard methods employed by global companies of reducing the locally declared profits and shifting their profits to lower-tax locations.

Although the government eventually lost the case in the Supreme Court, yet after this incident Governments around the world woke up to this trend, referred to as base erosion and profit shifting (BEPS). In order to curtail such tendencies, the government in the 2012 budget announced General anti-avoidance rule (GAAR) as an anti-tax avoidance Rule of India. It is targeted at arrangement or transactions made specifically to avoid taxes. It was considered controversial because it had provisions to seek taxes from past overseas deals involving local assets retrospectively. However, during the 2015 Budget presentation, Finance Minister Arun Jaitley announced that its implementation will be delayed by 2 years.

The are also other instances of MNCs using their clout and violating the Competition laws of the country. For instance, in July 2016, Mylan Pharmaceuticals and Biocon Limited had approached the Competition Commission of India alleging that Roche was indulging in anti-competitive practices to protect its monopoly on the drug. The complaint also alleged that Roche, the second largest pharmaceutical company in the world by revenue, tried to influence regulatory authorities, indulged in anti-competitive activities such as raising unwarranted concerns regarding the safety and efficacy of biosimilars – (biological products that are almost identical to another but manufactured by a different company and clinically no different in terms of safety and effectiveness).

Upon investigation, the CCI made similar observations and stated that: "The practices adopted by the Roche Group to create an impression about the propriety of the approvals granted, the safety and efficacy of biosimilars, the risk associated and the outcome of the on-going court proceedings in the medical fraternity, including doctors, hospitals, tender authorities, institutes, etc. prima facie appear to be aimed at adversely affecting the penetration of biosimilars in the market."

All in all, it can be said that MNCs are big and influential players which have the capacity to make a significant impact over the economy for good or for the bad. Therefore, there is a need to ensure that they operate within an efficient regulatory framework, which shall take care of the fact that they conform to the legal requirements of the host country thereby minimizing their demerits.

WTO and the Issues of Disputes in International Trade

The WTO is perhaps one institution which is of supreme importance when we talk about international trade. This is mainly because the WTO is the top regulator of multi-lateral trade around the world. The WTO deals with regulation of trade in goods, services and intellectual property between participating countries by providing a framework for negotiating trade agreements and a dispute resolution process aimed at enforcing participants' adherence to WTO agreements, which are signed by representatives of member governments and ratified by their parliaments. The WTO prohibits discrimination between trading partners, but provides exceptions for environmental protection, national security, and other important goals. Trade-related disputes are resolved by independent judges at the WTO through a dispute resolution process.

The Issue of Subsidies and Tax: From 1947 to 1994, the GATT provided rules for trade policies affecting goods moving in international commerce. Certain nondiscrimination policies are provided ("national treatment" and "most favoured nation" treatment), as well as limitations prohibiting certain subsidies for trade in goods. Since 1995, however, the GATT has become the WTO's "umbrella" agreement for trade in goods, and its disciplines with respect to subsidies have largely been superseded by the Agreement on Subsidies and Countervailing Measures (SCM). The SCM provides disciplines on the use of subsidies and also regulates the actions countries may take to counter the effect of subsidies. The SCM defines the term "subsidy" as "government revenue that is otherwise due that is foregone or not collected (e.g., fiscal incentives such as tax credits)". Consequently, it is clear that tax measures may be within its ambit and subject to its disciplines. Along with the definition of a "subsidy," the SCM introduces the concept of "specific" subsidies – those which are available only to an enterprise, industry, group of enterprises, or group of industries in the country that gives the subsidy. The SCM only applies to specific subsidies, which can be either domestic or export subsidies. Subsidies that are not specific are thus non-actionable. Prohibited subsidies, however, are automatically deemed to be specific, because they are particularly harmful to international trade.

The SCM further defines two separate categories of subsidies: "prohibited" and "actionable". Prohibited subsidies are those that require the recipients to meet certain export targets, or to use domestic goods in place of imported goods. These types of subsidies are prohibited precisely because of their high potential to distort trade and the consequent allocation of resources within an economy. Prohibited subsidies can be challenged through the WTO dispute settlement procedure. If the dispute settlement procedure determines that a subsidy is prohibited, it has to be withdrawn immediately; if not, the country bringing the complaint is allowed to take certain "countermeasures". Also, when domestic producers are hurt by the import of subsidized products, countervailing duties may be imposed.

Actionable subsidies, in contrast, are those for which the complaining country must show that the subsidy adversely affects its interests; otherwise the subsidy is permitted. With respect to prohibited subsidies, the SCM provides that prohibited export subsidies specifically include those listed in Annex I of the agreement. This is where the connection to tax measures becomes most obvious. The fifth item of the list refers to "the full or partial exemption, remission, or deferral specifically related to exports, of direct taxes or social welfare charges paid or payable by industrial or commercial enterprises". A footnote to that item provides additional guidance on the definition of direct tax subsidies, including an important limitation on the transfer pricing policies which may be adopted by WTO member countries.