Indian government's opposition to WTO agreement likely based on domestic political considerations

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A deal on the World Trade Organization's Trade Facilitation Agreement is unlikely without India.

### IHS perspective

**Significance**

India has refused to sign the World Trade Organization Trade Facilitation Agreement (TFA) by the deadline of 31 July.

**Implications**

India's opposition is based on wanting a permanent solution to food subsidies to be worked out before it signs.

**Outlook**

Despite the risk of losing international goodwill as well as facing criticism from corporate India, the Bharatiya Janata Party (BJP) government has likely calculated that food subsidies will remain a key domestic political issue that would not be worth compromising on for an international trade agreement.

The World Trade Organization secured agreement on the Trade Facilitation Agreement in Bali in December 2013. However, India has refused to sign up to the deal.

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India's new Bharatiya Janata Party (BJP) government has refused to sign the World Trade Organization (WTO)'s Trade Facilitation Agreement (TFA), with the deadline passing on 31 July. The WTO secured agreement on the TFA during its last summit in Bali in December 2013. The agreement seeks to enhance transparency on customs procedures between WTO members. The new agreement also limits the value of food subsidies at 10% of the value of total food grain production, but with prices calculated at 1986-levels, India determined that it ran the risk of breaching WTO rules. Furthermore, although the Bali roadmap gave India's food subsidies immunity until 2017, by when a permanent solution was sought, the BJP seems to have decided that now was the most opportune time to tie the implementation of the agreement with a favourable deal on food stockpiling.

**Political football?**

At stake was India's food procurement policy, which has been one of the flagship welfare schemes that successive governments have deployed. In September 2013, the previous Congress party-led United Progressive Alliance (UPA) government passed a...
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Landmark food security bill that extended existing food subsidies to cover 75% of the rural population and 50% of the urban population (approximately 800 million people in total) at an annual estimated cost of USD23 billion. Although in opposition the BJP criticised the Food Security Act as an expensive vote-catching ploy by Congress, it nevertheless supported its passage and has not shown any inclination to repeal it since coming to power in May 2014.

According to IHS sources, the new government has assessed that the electoral benefit of food security outweighs the diplomatic cost of blocking the TFA and disrupting the 160-member WTO. As a country without a strong manufacturing base, the TFA was of only marginal interest to Indiabut the deal did risk fueling imports (and thereby the trade deficit) as and when domestic consumption recovered at home. Also, the TFA did not include the services sector in its ambit – an area where India has a competitive advantage. Indian software services continue to face problems in the US and Europe due to a range of non-tariff barriers. So if India was to sign a deal from which it gained little, the thinking was that it might as well seek a better bargain on the food stockpiling issue, which has strong political resonance at home, unlike the TFA.

Or economic trade-off?

Although essential to bring India’s structurally high inflation and chronic fiscal deficits down, food subsidy cuts may also be painful for the overall economy, if implemented too soon. Food accounts for nearly 50% of India’s consumer price basket, making food price increases the major reason for the country’s chronically high overall inflation. Despite a three-year tightening campaign by the Reserve Bank of India (RBI) in 2009–12, inflation has remained sticky, with retail inflation running at near-double-digit rates since 2009.

The BJP government has made reducing electorally unpopular inflation one of its priorities. In the near term, this requires keeping food subsidies in place, particularly as the country is poised for another poor harvesting season as a result of a dry 2014 monsoon. The consumer price index (CPI) inflation moderated to a multi-year low of 7.3% in June and Prime Minister Narendra Modi’s administration is committed to keep prices in check despite the potential food supply shocks, gradually bringing CPI inflation down to 6.0% by January 2016, in tandem with the RBI’s target set in January 2014. India’s near-term economic recovery also highly depends on its inflation profile, as rising prices would force the central bank to further tighten its monetary policy, which would further stall India’s already weak economic growth. Thus, the focus on controlling inflation and stimulating growth make food subsidy cuts highly unlikely in the near term.

The BJP’s first budget released in July 2014 confirms this view, having allocated USD43.4 billion on subsidies for the current financial year ending March 2015, 2% above last year’s spending, equal to 3.2% of GDP. With USD19 billion allocated in the current financial year, food subsidies represent the major item on the government’s overall subsidy bill, also accounting for 6% of the budgeted total spending.

On the other hand, the BJP also committed to bring India’s large fiscal deficit down to 4.1% of GDP in fiscal year (FY) 2014 and further down to 3% of GDP by 2017 (from an average of 5% in 2009-2013). If Modi is serious about his fiscal consolidation pledge, he would be forced to shrink India’s subsidy bill before 2017. However, as already signalled in the current budget, subsidy reform is likely to start with gradual fuel price increases, while the food security programme is likely to remain in place at least until fiscal year 2015. As a result, keeping sufficient political leeway for domestic economic policy flexibility may be seen by the BJP’s government as a necessary trade-off in negotiations with the WTO.

Outlook and implications

The BJP government is likely to continue to support its right to maintain food subsidies, in spite of pressure to accede to the WTO regime. Domestically, the party is likely to maintain the enhanced subsidies under the Food Security Act, despite their costs. Prime Minister Modi has already hinted as much, suggesting in public meetings that the issue was not reducing subsidies, but in fact producing more crops. This stance is contrary to most of the rhetoric that the BJP and its supporters in corporate India have espoused so far. IHS assesses that it is also a key indicator that the BJP wants to establish its credentials as not just the pro-business party, but also as a pro-poor party. The party remains cognisant that in 2004, despite its record of economic reform, the party lost a general election largely on the perception that the party’s much touted economic progress had bypassed the rural poor, and it will not want to repeat the same mistake.

The BJP government is likely to have calculated that if it had accepted the TFA, its leverage in getting the WTO to accept its position on stockpiling would have been substantially reduced. If India did not push for a permanent solution now, it would fail to bring the developed countries to the negotiating table, leaving its food subsidies programme vulnerable in the long term. According to IHS sources, there also seems to be a belief on the Indian side of the government hedging its bets on reaching an acceptable solution to its demands when the WTO reconvenes in September, ahead of Prime Minister Modi’s highly anticipated visit to Washington. With Indian and US officials at loggerheads on a range of trade issues, there seems to be some hope that political intervention at the highest level may help drive some concessions on the American side. This hope seems to be driven by the assumption that the US would not like the summit to be waylaid by differences on trade.

It is unlikely that the TFA will be implemented without India’s agreement, despite some media reports suggesting this. For one, this would require an amendment to the existing WTO rules on consensus-based decision-making, where India would again have a veto. More broadly, if the deal is not revived soon, it could signal the death of the WTO and hasten the implementation of competing trade forums such as the Trans-Pacific Partnership (TPP) and the Trans-Atlantic Trade and Investment Partnership (TTIP).

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