

Trade Policy Briefing

The SAILA Trade Policy Briefing Series is intended to elicit debate on critical issues relating to South Africa's overall trade strategy. The broad focus of the series is on the political economy of the international trading system and South Africa's strategic responses to it. This covers the full spectrum of our trade strategy, from the multilateral trading system, to strategic regional and bilateral partnerships, and particular issues within the trade agenda.

Anyone wishing to respond to or contribute articles should contact:

*Peter Draper
Research Fellow
Development Through Trade
South African Institute of
International Affairs (SAILA)
Ph: +27-(0)11-339 2021 (General)
Cell: +27-(0)82 786 7983
(Preferred)
Fax: +27-(0)12-998 3491
Email: draperp@mweb.co.za*

JULIUS SEN is completing his PhD on India's trade policy in the Uruguay round at the London School of Economics.

The *Development Through Trade* project at SAILA is funded by DFID and USAID/South Africa through Nathan Associates SEGA/MESP Project (Contract number: 674-0321-C-00-8016-22).

ISSN Number: 1729-5815

No 8 November 2004

Negotiating Trade Agreements with India: The Reality Below the Water Line

by Julius Sen

Introduction

India's trading partners often wonder at her attitude to trade. They wonder why she doesn't see that in many parts of Asia and elsewhere trade has been the engine of economic growth and development, particularly in trade-dependent economies. They also wonder why there is no broad vision informing Indian trade policy priorities. On the contrary, it sometimes appears that India is uncomfortable with both the multilateral process and the concepts of liberalisation built into the multilateral trading order. Even bilateral and regional agreements are few and far between, and there are clear indications that this determination to steer clear of trade commitments is a deliberate policy.

The mystery deepens further when one considers India's international record. From the time of her gaining independence in 1947, India has tried to be a good international citizen, espousing the principles of the new United Nations and steering clear of Cold War alliances. She has been conspicuously active in the international arena, especially in international treaty-making. Yet with trade it is so different. India positively does not like to have to deal with these issues in either a multilateral, bilateral or regional context. It appears that India's aim is to reduce the level and number of trade commitments that she may have to assume. There are several simple and interconnected reasons why this is so, and why the Indian system appears to be so schizophrenic. A few are discussed here to give a sense of the problem. This analysis is then applied to how this

may affect the prospects of the mooted India-South Africa free trade agreement (FTA).

The domestic process

The first reason that trade agreements with other countries are not policy priorities for India is that the entire process is government and not business-driven. Trade and industry are still broadly excluded from the formative phase of policymaking, which is perhaps a legacy of India's colonial administrative traditions.

Secondly, the ministry that negotiates international trade agreements is different from the ministry that shaped India's post-independence foreign policy — the Ministry of External Affairs (MEA). Trade policy and trade negotiations are the responsibility of the Ministry of Commerce and Industry (MOCI), part of the domestic administrative machine which has deep roots in India's domestic political culture. Thirdly, it is precisely this political culture, with its peculiar insularity, that has created a distinct development model to which both the federal and state governments subscribe. (The model, described in greater detail in the section that follows, promotes the domestic production of all essential goods and services, to create self-sufficiency.) This consensus, which is also constitutionally shaped, prioritises social and economic reform and explicitly requires that economic policy serve reformist social and political objectives.

To shift the consensus away from this position and towards a trade and export oriented model of economic growth

would require the creation of a similar degree of unanimous support. However, whenever the government has ventured down this path, the main elements of the prevailing consensus have been reaffirmed. All that has been gained has been some minor concessions to promoting greater global economic integration in very limited sectors.

Within this insular policy culture, the MOCI is often accused of isolating itself from other ministries of the government in order to protect its special privileges, and of being too enthusiastic about globalisation at the expense of domestic policy concerns, which are perceived to have far greater political legitimacy. Paradoxically, the MOCI is often thought to be too like the MEA, though it is frequently at odds with the foreign policy establishment.

A peculiar feature of many post-colonial systems compounds the situation. The traditions and institutions of the bureaucracy often predate those dedicated to politics and commerce. To the general public the civil service enjoys a sort of residual pre-eminence in many complex policy debates. This breeds a sense of exclusivity in the MOCI that translates into a certain disdain for any need to consult outside sources. In the past, bureaucrats have actually avoided consultation. This means, in simple terms, that the ministry that negotiates trade agreements internationally (the MOCI) is part of a political culture that does not apply free trade principles internally. Policy, therefore, has to be made in a twilight world that is deeply schizophrenic: it is expected to engage constructively with the international community with respect to the multilateral process while simultaneously appearing not to.

This raises two questions. First, why was the MOCI given the responsibility for these negotiations rather than the MEA, especially following the Uruguay round? This has indeed been asked, but a number of factors have combined to thwart any attempt to answer it by changing the responsibilities assigned to these ministries. The second question concerns why India alone seems to find it so difficult to manage the divide between domestic and international relations, when other countries similarly placed (such as Brazil) have managed to create a reasonably effective system

that bridges this policy gap. One line of thinking is that it is India's foreign policy that is actually the aberration, while its domestic policy orientation enjoys a far wider legitimacy. According to this argument, India's natural political centre of gravity is to be insular, self-sufficient and withdrawn from the world.

Whatever the reason for this state of affairs, several harmful consequences flow from it. Consultation with the 28 state governments of the Indian federation rarely proceeds to any detailed analysis of the implications of negotiating proposals (whether these come from India or anywhere else), except perhaps where defensive positions are taken. More complex issues pertaining to the environment, employment, migration, regional development, social equity and so on are rarely, if ever, explored in a trade context through detailed exchanges between the national and the state governments.

Part of the problem is that many state governments lack the organisational capacity to address these issues internally in any systematic way. And given India's size, it would be far too cumbersome and unwieldy to attempt to do this solely at the national level.

Furthermore, the political centre of gravity in the Indian system has shifted steadily towards state governments over the past few years. As a consequence, the Union government is often reluctant to open a debate on some of the larger issues lest they lead to demands for greater state autonomy, which in time could threaten national unity.

At the same time — and largely because of the contradiction between India's development consensus and the demands of the multilateral system — everyone now watches the MOCI's activities with the closest possible attention. As a result, negotiating flexibility, which is so vital to the whole multilateral process, is being replaced by a certain rigidity that is born of the inherent caution and suspicion that the Indian system feels about undertaking any binding international obligations with respect to international trade.

Coalition politics at the national level impart a further contradictory dynamic to the whole process. Some state chief ministers are indeed able to influence the national policy debate, sometimes at the expense of their peers in other states, but

this power is not systematically exerted and depends largely on their influence within the ruling coalition. State chief ministers prefer to use their influence quietly and through party and coalition structures rather than through formalised consultation procedures.

The MOCI is thus hampered in three different ways in dealing with national politics and with state governments. First, it is trying to operate a trade policy for which there is little or no business initiative. Second, it is trying to discuss trade policy options that run counter to the prevailing policy consensus. And thirdly, it is trying to consult systematically and widely in a large and complex domestic system that is not equipped to deal constructively with this process at either the national or state levels.

The cumulative effect of these difficulties is to constrain the construction of effective negotiating positions. These need to be more than just broad political endorsements, and must leave enough latitude for negotiators to deal with the proposals and ideas that are generated by the negotiating process in Geneva as they emerge.

These problems also carry over to the broader consultative process, where some additional characteristics of the Indian system are perhaps relevant.

Trade and business associations should be the key demandeurs in Indian trade policy formulation. To be sure they are widely consulted, but they are by no means the initiators or driving force for the generation of ideas or of negotiating options (though this situation is slowly changing). They are used as a sounding board for ideas and as a way to build a domestic consensus in favour of a position that the government has already taken, rather than as institutions capable of putting forward negotiating ideas.

The reasons for the minor role allotted to representatives of trade and business are largely historical, and to an extent cultural. Trade associations were set up mainly to lobby the government in support of domestic policy measures designed to help their members. They remain largely outside the real decision-making system, and have no legal right to be consulted. They thus tend to approach the government as humble supplicants in the colonial tradition — though of course this characterisation will be fiercely disputed. Until the Uruguay round these

representatives of the economic sector had virtually no interest in international trade. And even then, their approach replicated the government's in looking at trade policy in general economic terms rather than in specific sectoral terms.

In terms of value-added inputs, or usable negotiating material, the contribution of business and trade organisations has been limited. As already noted, their role has been confined to building broad support amongst the business community for positions taken by the government.

It has been India's NGO community and parts of the media that have done most of the really effective analytical and policy work on trade policy. They have generally drawn from the stock of knowledge within the international NGO and business communities, and made highly effective use of parallels and comparisons to create reasoned analyses that are relevant to the Indian policy situation. NGOs also have two other great advantages that governments and business lack: they can link economic and non-economic issues together in analytical frameworks that are credible and usable, and they know how to present their findings to the media and the political community. But their basic mindset is still consistent with the development consensus described in the next section. Their inputs therefore tend to reinforce the defensive stance taken by the Indian trade negotiators instead of helping to shift their approach to a more participatory one.

Indian trade policymaking is thus the product of a peculiar relationship. Most of the key ideas and the detailed analyses originate from the MOCI or the NGO community. These are then essentially taken over by business, and fed back to the government. A look at prevailing debates shows the government responding most readily to concerns raised by the NGOs, whether these have to do with Trade Related Intellectual Property Rights (TRIPS), investment, agriculture, or services. In very few of these debates is the business community the prime mover; nor does it articulate that community's ideas and concerns. State governments, who, with the other ministries, should be central to the policymaking process, play a somewhat peripheral role, exerting their influence through party and coalition networks.

Colliding worlds: Domestic processes and the international arena

So in what direction are Indian trade policymakers moving, if they are so uncomfortable with the multilateral process? Do they have an alternative approach that is based on regional or bilateral goals? Or is their orientation fundamentally directed towards internal trade management issues, relegating dealings with the outside world to the fringes of the system?

These issues have taken on greater relevance since Cancun. Specifically, is the regional, preferential or bilateral option to be preferred to the multilateral process in these (new) circumstances?

Recent reports suggest that India is prepared to negotiate a new generation FTA with South Africa.¹ Does this agreement to negotiate represent a policy change for India, and are we seeing the emergence of a strategy alternative to the multilateral process? It is obviously premature to draw conclusions at this stage, but a look at the broad evolution of India's trade policy suggests some possibilities.

Until the Uruguay round, India viewed international trade as something that operated only at the fringes of the domestic system. The strategy — referred to earlier in the paper as the development model — was to ensure domestic production of vital goods and services (which was thought both desirable and possible given India's history and the potential size of her domestic market) and to reduce India's reliance on the outside world.

Although the government's approach was not supported by the business community as a whole, it was generally adopted by the larger industrial and commercial interests. A policy of technology transfer and self-sufficiency fitted well with their own plans for expansion and growth within India's huge domestic markets.

Something of an austere Gandhian ethic underpinned this development approach. Satisfying consumer choice was thought to be both wasteful and a diversion from the task of building the nation and addressing India's appalling social inequalities. Investments in large-scale infrastructure, engineering and heavy industrial projects were thus encouraged — an approach which

again suited the big industrial and commercial corporations.

Given this situation, all trade agreements based on GATT principles, and which entailed reciprocal and enforceable commitments, were considered to be an unwanted challenge to the autonomy of India's domestic policy.

However, a strange sort of *realpolitik* descended on Indian foreign policy following the end of the Cold War. It was also the result of the effective irrelevance of the Non-Aligned Movement. Alternative political groupings based on better regional and neighbourhood relationships, often with better trading relations as the centrepiece, became something of a policy priority. India made overtures to China, Central Asia, the Association of South East Asian Nations (ASEAN) and Russia in succession.

Efforts were also made to create a regional trade agreement for South Asia (SAFTA). But because India was by far the largest country and economy in the region, her interest in pushing for deeper market integration with her neighbours was of minor concern to the country's private sector: its focus was on the larger markets of Asia, North America and Europe. Politically the regional initiatives were viewed with suspicion by India's neighbours because of historical tensions with Pakistan and Bangladesh, and with some apprehension by Nepal and Sri Lanka, because of huge disparities in size between those countries and India. Managing a regional trade agreement with such deep levels of mistrust and such low levels of common business interest was always going to be difficult.

As with many other regional endeavours, the political side of the SAFTA process was more important than the trade side of things, which is broadly what the Indian government wanted, given her aversion to trade agreements separate from political agreements. However, recent international political developments have thrown all these calculations into disarray, creating a situation that has yet to be sorted out. One strong element in the Indian system is pressing for closer relations with the US across a wide front, including a military alliance. This is still not the predominant sentiment, particularly given that US policy is so manifestly unstable and

unpredictable. A more powerful instinct is to develop strategies on several fronts, while essentially conducting a holding operation with respect to the US until some clarity emerges as to what its policy really is. This means working towards improved relations with China, Russia and the European Union while fostering strong links across the developing world, which are particularly relevant in the context of the broader international trade policy challenges facing this rather amorphous grouping.

So the motivation for India in broad policy terms has less to do with economics per se than with creating political networks that will provide some support and stability in an uncertain world. This in turn implies that trade agreements, should they emerge in either a bilateral or regional form, would be part of a broader political accord. Trade relations, therefore, would remain shallow and insubstantial — except perhaps for government-to-government purchases of arms, oil and other strategic materials.

Regional endeavours, particularly for the South Asian region, have thus lost priority on the agenda. The weak commercial advantages likely to result from such an arrangement are also becoming increasingly apparent. India has less to gain from market access to these relatively small economies than they have from obtaining market access to India's economy. The business community in India is therefore wary of such an arrangement, even if the government sees some political virtue in it.

Prospects for an India-South Africa Free Trade Agreement

This brings us to the issue of bilateral or preferential trade agreements of the sort being discussed with South Africa. In the context described above, the Indian approach will accord far more importance to the political implications of such an agreement than to its trade particulars. The outcome at Cancun will reinforce this perception, even if doubts remain about the true extent of the solidarity between developing countries across the full range of trade issues. At one level India will realise the importance of comprehensive bilateral trade agreements, both as an

alternative to the multilateral process and as a way to acquire skills in the management of intrusive agreements. There are other reasons to doubt the capacity of the Indian side to handle an extensive bilateral agreement, which may ultimately affect her willingness or otherwise to pursue such a policy. Quite apart from the fact that there is no real commercial demandeur driving the process within India, she has no experience of the practical side of operating a bilateral agreement with deep and binding commitments. She also lacks the institutional arrangements (such as a dispute settlement tribunal) that would be needed to support such an agreement, or any structure to monitor or police the system.

The very low volume of trade between South Africa and India further compounds the problem. Though trade has been increasing over the years, it still represents only a tiny percentage of trade volumes on either side — just over 1%. Would the costs of monitoring and implementing an FTA be worth it in the long run unless these volumes could be radically stepped up? This is of course possible, particularly if trade is taken to include defence-related equipment, some forms of high technology, strategic minerals and so on, but these are normally excluded from the purview of such agreements.

Then there is the vexed issue of Rules of Origin. How would the Indian side police an agreement with South Africa when she has a customs union with her neighbours and is also a member of several regional trade groupings? South Africa is also negotiating a series of FTAs with very large markets. In the Indian context this is a recipe for policy confusion, not to mention significant operational corruption. From the South African perspective there would be similar concern about products of Indian origin being passed off as South African when sold on to other markets in the region or abroad. And of course both sides would need to address the problems raised by security in this context, particularly where goods are sold on to the US.

But supposing these problems could be overcome, what would India's negotiating preferences be? The problem here is that India has no consultative mechanisms to consider her trading interests with just one country other than

her bilateral chambers of commerce, which are of very limited utility in these circumstances. There would need to be extensive consultation with business, state governments, trade unions, NGOs and other civil society groups to elicit their preferences. However, this could happen only if a fairly detailed agenda, together with a clear scenario, was put to them to consider. The absence of consultative systems appears to be a result of India's lack of experience in negotiating bilateral agreements.

There is thus a clear lack of domestic institutional capacity in India. Also, few of the key actors are capable of assessing the impact of trade proposals in both economic and non-economic terms, and this is likely to result in somewhat vague official expressions of interest in liberalising trade, but an insistence on a minimum of binding commitments.

Overall, therefore, one can envisage the Indian government negotiating a bilateral trade agreement that is politically weighted (involving such matters as agreement to consult frequently, some undertaking on defence materiel, minerals and other strategic priorities, exhortations to step up trade in certain sectors where potential is perceived to be substantial), but is commercially shallow and lacking binding reciprocal commitments. This would fit with her current set of political priorities at three levels: with her interests in terms of the broader international context; with her need to build alliances with other developing countries post-Cancun; and with her interest (limited but still significant) in building good relations with countries that have large Indian populations.

In this overall calculus, however, it is evident that trade and industry interests would be of limited concern to the negotiators. This reflects, yet again, the dominant role of the state in these matters.

Endnote

¹ This would entail a traditional FTA covering trade in goods, plus trade in services.

Copies of SAIIA trade publications are available at SAIIA. Contact Elizabeth Stanley at 27-11-339-2021 for publications orders. Also see www.saiia.org.za.