MOST FAVOURED NATION STATUS – ECONOMY

NEWS: India hamstrung by MFN rules in offering tariff cuts exclusively to US

WHAT'S IN THE NEWS?

India's Dilemma on Import Duties

- The Trump administration's **'America First Trade Policy'** has emphasized protecting American industries and reducing trade deficits. As part of this, the U.S. has been pressuring India to reduce import duties on American goods.
- India, however, is constrained by international trade rules under the World Trade Organization (WTO), which prohibit preferential tariff reductions for one country without extending the same benefits to all WTO members.
- The **Most Favoured Nation (MFN)** principle mandates that India must treat all its trade partners equally in terms of tariffs, preventing any exclusive concessions for the U.S.

Current Deliberations in India

- The Commerce Department in India is actively coordinating with key ministries, such as agriculture and steel, to evaluate the demands from the U.S. and analyze the economic implications of lowering import tariffs.
- These discussions aim to determine the flexibility available to India in reducing tariffs while safeguarding the interests of domestic industries that could be adversely affected by increased competition from imports.

Impact of America's Trade Deficit with India

- The U.S. has consistently run a significant trade deficit with India, which amounted to over **$35 billion in FY24**.
- This imbalance is a key factor driving the Trump administration's demands for reduced tariffs on products where the U.S. has a competitive advantage, particularly in **agricultural goods** like turkey, duck, cranberries, and blueberries.

Challenges with Exclusive Tariff Cuts for the U.S.

- India cannot selectively reduce tariffs for the U.S. without violating WTO rules. According to the **MFN principle**, any tariff cuts must apply equally to all WTO signatories.
- A similar situation occurred last year when India, after reaching an agreement with the Biden administration, reduced import duties on frozen turkey, duck, cranberries, and blueberries. These reductions were extended to all countries under the MFN framework, showcasing India's adherence to global trade rules.

No Bilateral Free Trade Agreement (FTA)

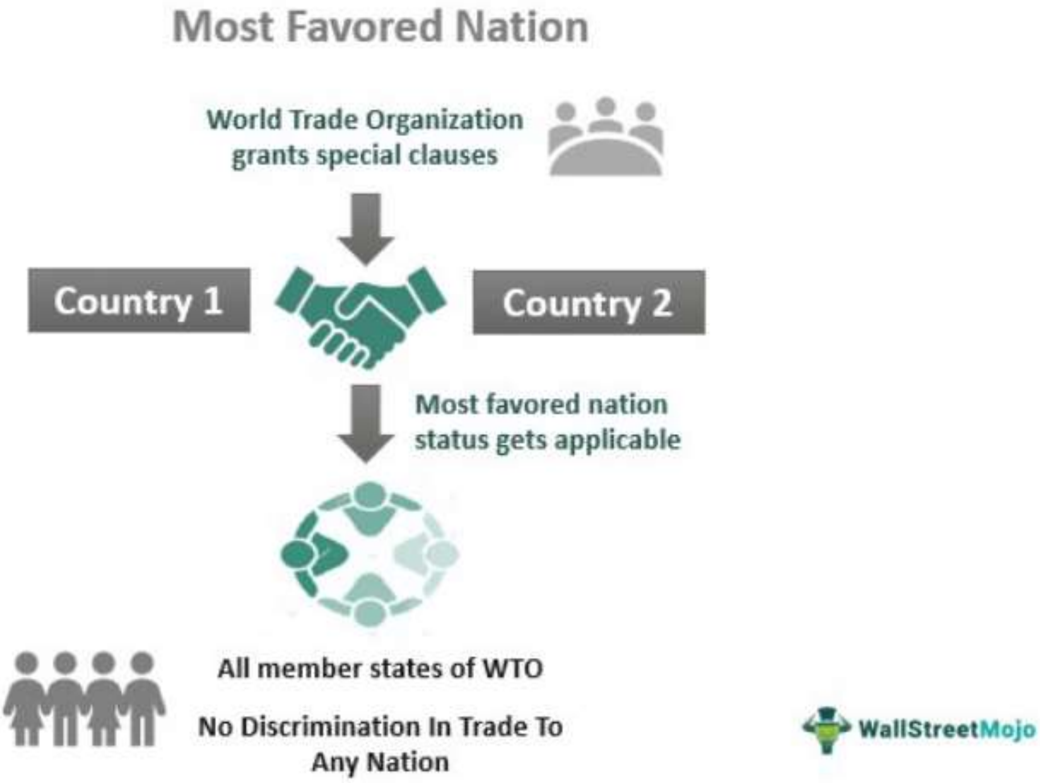
- A **bilateral Free Trade Agreement (FTA)** could provide a legal framework for India to offer exclusive tariff reductions to the U.S. without extending them to other countries.
- However, negotiations for an FTA would require the U.S. to lower its own tariffs on Indian goods, which it has been reluctant to do. This lack of mutual willingness to make concessions limits the scope for such an agreement.

India-U.S. Trade Relationship

- The U.S. is India's largest trading partner, reflecting a strong economic relationship.
- India's exports to the U.S. have shown remarkable growth, increasing from **$53.1 billion in FY20** to **$77.5 billion in FY24**, representing a **46% growth** over four years. This highlights the importance of maintaining and expanding trade ties with the U.S.

What is MFN Status?

- **About: MFN** refers to a **trade status** granted by one country to another, ensuring **non-discriminatory trade** between them.
    - It does not mean **preferential treatment**, but guarantees that the recipient country will not face disadvantages compared to other trade partners of the granting country.
- **MFN and WTO**: MFN is a key principle of **World Trade Organization (WTO) rules**.
    - Under WTO rules, if a country grants special status to one trade partner, this status **must be extended to all WTO members**.
- **Non-Discriminatory Trade:** MFN ensures that countries treat each other equally by offering the **same trade conditions** including:
    - **Lowest** possible **trade tariffs** and trade barriers.
    - **Highest import quotas**
    - Increased market access
    - Improved conditions for the flow of goods



- **Exceptions to MFN:**
  - **Free Trade Agreements (FTAs):** Countries in a **FTA** offer **special concessions** to each other, excluding non-members.
  - **Regional Trade Agreements (RTAs):** Member countries negotiate **better terms** among themselves, often excluding non-members.

Significance of MFN

- **Rules-based framework**:
  - It seeks to replace the frictions and distortions of power-based (bilateral) policies with the guarantees of a rules-based framework where trading rights do not depend on the individual participants' economic or political clout.
  - Rather, the best access conditions that have been conceded to one country must automatically be extended to all other participants in the system.
- **Increases free trade:**
  - The Most Favoured Nation clause increases trade creation and decreases trade diversion, essentially encouraging more free trade between countries.

- It allows more efficient outcomes since the lowest cost producers can export goods to areas with the highest demand without government intervention.

- **Equal treatment of disadvantaged countries:**
  - The Most Favoured Nation clause allows smaller countries to participate in advantages that they may not normally receive since they are overlooked among the large global trade players.
  - The clause helps the small countries to negotiate favorable trade terms that they normally would not receive.
- **Access to a bigger market:**
  - The nation's industries can enhance their goods by catering to this sizable market.

Challenges

- **May lead to dishonest business practices:**
  - Sometimes, nations provide financial aid to their native industry without checking the fundamental values of the business.
  - Thus, supported businesses can export their goods for low prices.
  - In addition, dumping is a practice that can get a country into an issue with the WTO.
- **Same benefits to all nations:**
  - Another MFN status disadvantage is that the nation must provide the same trade benefits to all other MFN agreement's members or the WTO.
- **High import taxes for developing nations:**
  - The WTO has received reports from developing nations stating that they continue to deal with tariff peaks on goods like textiles, clothes, and fish products.
- **Challenge for India's case:**
  - The beneficial treatment of dividends varies across the treaties.
  - It is more generally available to all investors in a treaty with one nation, whereas for others, restrict the rate to five per cent for investments of more than 10 per cent in the capital and 15 per cent otherwise.
  - The tax department must clarify the exact tax treatment before its application.

Source: https://www.thehindubusinessline.com/economy/indian-hamstrung-by-mfn-rules-in-offering-tariff-cuts-to-satisfy-trump/article69132488.ece