

EU-India free trade: make or break

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»» The context of the EU-India relationship has changed radically with a spiralling eurozone crisis and a recent fall in India's growth rate. The global environment has become more volatile and unstable. The EU-India relationship cannot now be assessed in hermetic isolation. Slow paced relations incur a higher cost. While India has genuine concerns over what free trade will do to vulnerable poor communities, in overall terms trade liberalisation with Europe will be beneficial. The partnership must begin delivering with urgency to help generate new growth, market confidence and mutual prosperity. In its fifth year of negotiations, the EU-India Bilateral Trade and Investment Agreement (BTIA) must move forward from a long drawn out 'final stage' to conclusion. This brief charts the grounds for resolving outstanding concerns to the mutual benefit of both the EU and India.

THE POLITICAL ANALYSIS

While the EU-India relationship has been branded a strategic partnership, it has become increasingly difficult to identify what exactly makes the relationship strategic in comparison to the EU's relationships with other non-strategic partners. Set against its potential, the relationship has under-delivered. Its main aspirations include the BTIA, an EU-India Security Roadmap and cooperation on climate change and renewable energy.

Highlights

- Worsening economic conditions in both Europe and India make conclusion of free trade talks more necessary.
- India has genuine concerns over what free trade will do to vulnerable poor communities.
- There are ways to solve outstanding concerns to the mutual benefit of both the EU and India.



Progress on all these fronts remains elusive. On global issues too, divergences remain significant: on climate change, UN reforms, the Arab spring, Afghanistan and Iran. There is no apparent positive change in global affairs that can be attributed specifically to the EU-India strategic partnership.

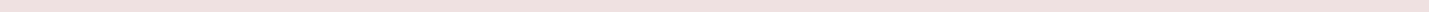
The EU-India free trade area would be the largest globally, encompassing a market of a quarter of the world's population. It is projected to increase bilateral trade to the tune of €150 billion by 2015. The agreement remains ambitious, aiming to set a predictable framework for years to come. It would slash duties on over 90 per cent of bilateral trade. But in the five years since negotiations began in June 2007 both the EU and India have concluded other free trade agreements with other partners. And other free trade agreements have emerged which would be more far-reaching than the EU-India accord, like the Trans Pacific Partnership. The fact that the BTIA has missed a number of deadlines for completion has undermined confidence and bred lethargy in the overall partnership.

But is the BTIA still so vital? In reality, EU member states compete against each other in India for trade deals. In turn, India prefers to deal with member states rather than with an increasingly loose and complex political bloc like the EU. The BTIA would only set the framework for commercial relations. The potential to boost trade would depend on the current shape and competitiveness of both European markets and that of India. New projections of a doubling of bilateral trade by 2015 seem implausible.

But such a framework is still important, especially for European interests, as a means of generating more predictability on commercial rules. For India, it would drop tariffs across 27 (soon 28) countries instantaneously. Both politically and economically, the BTIA is crucial. Not only would it create greater confidence in the EU domestically and internationally; it would also strengthen the EU's role as a global actor and revive market confidence in the ailing eurozone – given that trade is Europe's forte. A successful conclusion would increase both partners' competitiveness on the global stage. It would also advance international efforts towards trade liberalisation by creating another stepping stone to a multilateral break-through. But a failure to conclude five years of negotiations would engender a deep lack of confidence in the India-EU relationship.

The EU now appears more in need of a speedy, successful conclusion of the BTIA than India. This is so for a number of reasons. First, the agreement could provide a degree of relief to the worsening financial crisis in the EU. To boost domestic growth and create jobs at home, Europe must tap into emerging economic powerhouses and exploit complementarities. Job creation in the EU remains an urgent priority.

Second, international market confidence in the EU and in the euro would receive a large boost. Europe's financial crisis has starkly exposed divisions in Europe. A far reaching accord like the BTIA could have a potentially cohesive effect on the EU, while reinforcing its viability as a global player. Third, the BTIA would contribute greatly towards



The partnership must begin delivering with urgency to help generate new growth

strengthening the EU's role and commercial hold in Asia, especially as China is unseating the EU from its position as leading trade partner to a number of Asian economies. The BTIA would be a prompt for the EU to gain lost ground. India remains on track to achieve its own export targets of around \$500 billion by 2014 by pursuing a strategy of reaching out to newer markets in Asia, Africa and Latin America under an initiative called the Focus Market Scheme.

Following the global meltdown of 2008, India developed the Focus Market Scheme under its foreign trade policy. It seeks to limit India's reliance on the principal traditional markets of the US and Europe. Instead of waiting for demand to revive in these economies, India endeavoured to diversify its trade partners. The scheme now covers 112 markets globally, and has, according to the Indian Minister of Commerce and Industry, delivered substantial dividends in just three years: India's exports to Asia, Africa and Latin America in 2011 totalled \$188 billion, or 62 per cent of India's total export.

THE ECONOMIC RATIONALE

The FTA must seek to build on complementarities which have surfaced as a result of the crisis. This widens the scope for a positive sum scenario. While most of the free trade

details and negotiations have not been made public, communication to citizens needs to be stepped up to dispel fears and clarify issues which have been addressed.

India was much less affected by the crisis in 2008, but no longer remains immune. Industrial growth shrunk by 3 per cent in April 2012 and agricultural growth has also declined sharply from the targeted 4 per cent to 1.7 per cent. Despite a good cereal harvest this year, demand has not been met for many food items - dairy products, fruits, vegetables, poultry and pulses. The resulting price rise has fuelled inflation; the newly constructed Consumer Price Index rose to 10.3 per cent in April 2012. The current account deficit has also widened to nearly 4 per cent of GDP. The Ministry of Commerce has presented a package of incentives to boost flagging exports. Wide scope exists for India to expand its exports to the EU, India's biggest trade partner.

The fear persists of an import surge of subsidised agricultural products from the EU into the Indian market. But the accord would help India improve its agricultural sector, where there is an urgent need for higher public investment to improve irrigation facilities, rural roads and storage. A cash strapped government is already battling an expanding fiscal deficit at 5.7 per cent, with austerity measures in place. Sensitivities must be borne in mind while pressing for further opening up of the Indian agriculture sector, especially when set against the EU's Common Agricultural Policy (CAP) which heavily subsidises agriculture. But there are still mutually beneficial opportunities. India has the highest number of malnourished children in the



world under the age of five; 42 per cent of children are malnourished and 59 percent experience stunted growth. The image of European farmers spilling milk outside of EU institutions in protest could instead be replaced by cheap exports of dairy products to India.

Regarding agricultural exports from India, the long standing demand has been for easier access to the EU market especially for fruit, vegetables and fishery products. The FTA would eliminate non-tariff barriers. Moreover, with the help of technical assistance from the EU, Indian exporters can attain higher standards.

Lingering suspicion regarding the manufacture of generic drugs must be dispelled because the EU has withdrawn its data exclusivity clause. Much of the problem regarding data exclusivity has been resolved. However, street protests continue amidst widespread fears of enforcement of a stricter intellectual property rights regime, and a hike in the price of essential life saving drugs.

India's demand has been for easier visa access of its IT experts to European countries and their free movement across borders within the EU so that they can take up temporary residence with their families. The EU's service sector exports to India are much smaller than India's exports of services to the EU. Efforts to create a level playing field through economic reforms will have to be made by the government of India.

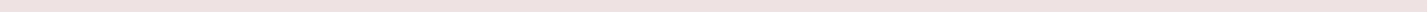
Regarding the 'Singapore issues', involving competition policy, investment, trade facilitation and government procurement, India

was uncomfortable even at the WTO. In the area of public procurement, there are problems because each of the 28 Indian states has its own public procurement policy. They may not agree to open bidding, wanting to favour a particular party in order to fulfil development priorities. Involving the states in the negotiations would have helped. The EU's demand for investment protection can also clash with the state's environmental and development policies.

CONCERNS

The EU-India free trade area would be asymmetrical because the EU is a bloc of industrialised countries with a very comprehensive welfare system. India's poor are more vulnerable to deprivation in the case of job losses than are low income groups in the EU. Around 92 per cent of India's poor are employed in the informal sector. If their livelihood is affected by the EU-India FTA, there will be widespread public protests.

Various sticking points have been identified regarding Non Agricultural Market Access (NAMA). Duties on manufactured goods have been reduced on the Indian side except for automobiles and wines and spirits. The Society of Indian Automobile Manufacturers (SIAM) fears a further loss in competitiveness if import duties are halved, given the already high costs of inputs due to inflation and the rupee's depreciation against the dollar. Moreover, India's auto parts industry also suffers from the cascading effects of various taxes. This indigenous industry employs thousands of small scale units and risks being wiped out if duty is reduced to zero. The



scale of auto parts manufacturing is much bigger in Europe, which makes the sector there more competitive. Duty reduction on wines and spirits faces a moral roadblock: allowing a 'sinful product' to enter at reduced duties. But this issue can be resolved by a mutually acceptable duty cut.

Even though 100 per cent FDI is allowed in wholesale, there is much resistance from some quarters and the Chief Minister of West Bengal in particular, to the opening up (from 51 per cent to 100 per cent FDI) of the multi-brand retail trading sector, which employs 18 million people. Similarly the opening up of other services like postal, insurance, legal, banking, maritime, security and accounting services will be problematic. In banking, European banks may not be able to fulfil the mandatory Priority Sector Lending Requirement. In 2010, not a single one of 213 branches of European banks had gone out into the rural areas. India doubts that such banks will be able to go to the villages and lend to the numerous microenterprises and self help women's groups. If credit to micro enterprises is stopped, many women would be adversely affected.

India remains uncomfortable about the EU's insistence on legally binding sustainable development clauses regarding human rights, environmental issues and labour standards. Many believe it would pave the way for foreign interference in domestic political affairs. India remains keen on eliminating child labour but admits to limitations. As a vast, emerging but still developing country with a massive population, implementation becomes problematic. Pervasive poverty in both rural and urban India renders difficult

the enforcement of already existing laws against child labour. These children (around 8 million) can instead be given vocational training in which the EU has expertise. With marketable skill training for children over a number of years, child labour would decline.

However, India remains an attractive partner for a trade deal. From the point of view of EU businesses, India offers a huge market in which there are 69 dollar billionaires and 153,000 dollar millionaires. The middle class of over 200 million Indians has a rising demand for luxury goods and cars. European brands are fast becoming a favourite with the burgeoning middle class. By 2015, there are likely to be 411,000 dollar millionaires who will have strong buying power for European goods. By 2020, the average Indian will be only 29 years old as compared to the average Chinese who will be 37. There will be 726 million people below the age of 30 whose demand for goods and services will grow along with their spending power.

India is considered a stable country for foreign direct investment despite the temporary glitches and the recent downgrade by Standard & Poor. India has vast raw material resources and comparatively cheap labour which can be trained easily. India also has a vast pool of highly educated skilled technical personnel. Barring a few areas, foreign investment can be made in all sectors under the Automatic Route under which foreign investors only need to inform the Reserve Bank of India within 30 days of bringing their investment and within 30 days of issuing any shares.

In most sectors foreign investment is permitted up to 100 per cent of the paid up capital



and only in some areas is investment subject to sectoral caps on account of security or strategic reasons. FDI up to 100 per cent is allowed under the Automatic Route for drugs and pharmaceutical manufacturing, the tourism sector and for Mass Rapid Transport systems in all metro cities including associated commercial development of real estate. FDI up to 100 per cent is permitted in rubber, coffee, the mining of diamonds and precious stones, the development of new airports, export trading, the laying of natural gas pipelines, petroleum infrastructure, and captive mining of coal and lignite. FDI up to 49 per cent from all sources is permitted in the banking sector. FDI limits have been raised to 74 per cent from 49 per cent in telecom services.

India has been the second most important foreign investment destination after China for many years. UNCTAD considers India a dominant host country for FDI in Asia and the Pacific. The free trade deal will ease entry of EU exports into an already high-potential India. In the short run alone India is expected to gain €5 billion and the EU over €4 billion. For both parties the FTA would be greatly beneficial in these hard times.

Indian firms such as Tata and Reliance are also increasingly investing in the EU in order to gain brand equity and a world presence. Outbound foreign investment was \$17 billion in 2011. This also offers some respite from the economic crisis as EU and Indian firms can increasingly strike up joint ventures.

The revenue losses due to the tariff reductions in India would have to be made up by the gains from the transfer of technology, productivity enhancing know-how and assistance in the

health, sanitation, transport, education and low cost housing sectors. Clearly India will have to incur costs for entering into the FTA with the EU but there will be many benefits. Had there been a public debate, it would have been easier to overcome the hurdles sooner.

CONCLUSION

From the February 2012 EU-India summit in New Delhi, it was clear that further progress has been made towards conclusion of the agreement. The ministerial meeting on trade (due for 25 June 2012) will seek mutually acceptable solutions to the outstanding issues. Progress on these issues remains slow but will require deeper engagement at all levels including policy makers, business and civil society. A balanced package by the end of 2012 can provide a new thrust to the bilateral trade, investment and economic cooperation. Big businesses and dynamic entrepreneurs on both sides coupled with increased synergies between EU officials and Indian politicians can break bureaucratic bottlenecks. The BTIA will not only help alleviate the effects of the unprecedented financial crisis, but also bolster the global case for economic cooperation against protectionism.

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