

# **The Wrong Direction: Why the EU-India free trade agreement will not help India through the economic crisis**

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## Introduction

As the financial crisis that started in developed countries has propelled the global economy into its worst downturn since the second world war, the European Commission and the UK government - in the latter's role as chair of the G20 - have been advocating the conclusion of trade deals as one of the solutions to the economic recession. Most publicly calling for a finalisation of the WTO Doha talks, they have also less visibly but equally actively been seeking to accelerate a series of free trade agreements (FTAs) with emerging economies such as India<sup>1</sup>.

Since 2006, the EU has been negotiating far-reaching FTAs with key countries across Latin America and Asia, seeking to 'keep the EU at the forefront of international competitiveness' by opening these markets for European goods, services and investors<sup>2</sup>. Progress in these FTA negotiations has been slow. Yet as European economies contract, the EU is more eager than ever to ensure access to these large and relatively high-growth markets. European governments and the European Commission are urged on - with an increasing sense of urgency - by corporate lobby groups such as Business Europe, who are calling on them to 'pursue an even more ambitious trade negotiations policy [including] ... the ambitious conclusion of bilateral free trade negotiations with key partners'<sup>3</sup> as a way out of the economic crisis that is facing European business. These calls for further trade and investment liberalisation are accompanied by warnings of the dangers of protectionism - with trade deals presented as a part of the solution not only to Europe's problems but to those of its trade partners as well. Recently the UK Secretary of State for Business, Peter Mandelson, remarked that the "downturn does not reduce the value of a bilateral trade deal, it raises it. The EU and India should call the deal what it would be - a confidence-building economic stimulus package - and sign it before the end of the year"<sup>4</sup>.

However, there is strong evidence to show that the EU-India FTA would not provide any solution for India. On the contrary, this paper outlines how the proposed FTA would increase India's vulnerability in the face of the economic downturn and seriously reduce India's scope to stimulate its own economy, just at a time when Northern governments are pulling out all the stops to shore up theirs.

## Early impacts of the economic crisis for India

While sparked off in developed countries, the impact of the economic crisis has of course been severe in developing countries as well, as demand for their exports plunges and foreign investors turn tail. As a consequence, developing countries are facing job losses on a massive scale, with the International Labour Organisation estimating that an additional 50 million people could be unemployed before the end of 2009<sup>5</sup>.

Countries less dependent upon exporting to developed countries have been less exposed to the downturn. So, India, whose exports only account for about 20% of GDP, has been less hard hit than China, which is far more export dependent. Nevertheless, India is still suffering. Exports from India have fallen every month since October 2008, with a 16% drop in January alone<sup>6</sup>. The decline in orders from the EU - India's most significant trading partner - has played a major role in driving this overall fall in exports<sup>7</sup>. As a result there has been a significant increase in unemployment in the export sector, with the Government of India estimating a loss of 1.5 million jobs from September 2008 to March 2009 alone. While no export sector has been immune from the downturn, the effect has been particularly severe in the labour intensive industries, such as textiles, leather goods, automobiles and gems<sup>8</sup>. Meanwhile, India's short-term investors have pulled money back home, foreign direct investment (FDI) has also severely declined - after several years of sustained increase<sup>9</sup>, - and India's GDP growth rate is forecast to fall to around 5% during 2009, from a high of 9% in 2007<sup>10</sup>.

## **Introducing the EU-India FTA**

Negotiations for an FTA between the EU and India began in 2007, with the intention of reaching a comprehensive and far reaching agreement to liberalise trade, services, investment and a wide range of trade-related issues, going far beyond existing WTO commitments or proposals under the Doha round.

When negotiations were launched, both parties were keen to finalise a deal by the end of 2008. By March 2009, six rounds of negotiations had taken place between the European Commission and the Indian government - but talks were stalled because of disagreements in a number of areas and there remain strong doubts that any deal will be concluded during 2009.

Even before the financial crisis and global economic downturn, there were serious concerns in India about the development implications for India of such an FTA with the EU<sup>11</sup>. An earlier report by Traidcraft examines how an agreement between such unequal economies would result for India in a loss of jobs and livelihoods, reduced government revenue for social programmes, and a contraction of policy space for developing new industries and for regulating investment in the interests of a balanced, sustainable and equitable economy<sup>12</sup>. Such findings echo a large body of pre-existing literature concluding that North-South FTAs have these in-built problems. For example, UNCTAD's 2007 Trade and Development report outlined in detail the constraints that such FTAs place upon developing country governments, concluding that these agreements tend to 'reduce or fully remove policy options and instruments available to a developing country to pursue its development objectives'<sup>13</sup>.

While the above problems with FTAs have been analysed across a range of literature, the current economic crisis and the policy responses to it demonstrate more clearly than ever the risks for India of entering into an FTA with the EU - especially during a period of downturn. The following sections explain why.

### **The FTA would liberalise financial services – meaning increased risk for India**

It has been widely recognised, at least since the collapse of Lehman Brothers in September 2008, that the increasing globalisation of financial services, together with insufficient regulation of the banking sector, encouraged the kind of high risk behaviour that precipitated the financial crisis. National regulators and supervisors have been discouraged by some governments from placing restrictions or even adequate supervision upon banking operations, lest these limit their global competitiveness. At the same time, as new and increasingly complex financial products have entered the market, regulators often failed to understand or appreciate the risks involved in them. In addition, regulation at a global level – or even co-operation among national regulators – has been insufficient. The current crisis has provided a wake-up call, exposing the need for more sound regulation of the banking sector, nationally and internationally, with such considerations now top of the G20's agenda.

But, meanwhile, the European Commission continues to push for India to further liberalise and de-regulate its financial services, through the proposed FTA.

With the UK leading the charge, the EU has long sought to eliminate foreign equity caps as well as restrictions that currently limit foreign banks to only 12 new branch openings per year in India<sup>14</sup>. The EU has not only sought greater access for more bank branches in India, but also to reduce existing limitations upon the types of banking activities they are allowed to engage in as well as to minimise any form of regulatory restrictions upon them.

In EU requests to India in the WTO<sup>15</sup>, and in much more recently signed bilateral FTAs<sup>16</sup>, the EU has insisted that its banks should face no limitations on introducing new financial products. If similar provisions were introduced in an EU-India FTA, this could allow European banks to export into India more of the most high risk financial products - such as hedge funds or derivatives trading and futures - which are recognised to have contributed to the current crisis in the US and EU. Financial speculation has not only contributed to the financial crisis, but speculation on agricultural commodities through futures trading has also been a key factor in driving up food prices. While the Indian government was able to introduce a ban on derivatives trading in key agricultural commodities in 2008 in order to combat food inflation, it would be restricted from doing so under the terms of an EU FTA.

EU proposals, if adopted, would also restrain India from introducing new regulations or prudential measures for the banking sector that are 'more burdensome than necessary'<sup>17</sup> and would oblige India to consult the EU party (and its stakeholders) before such measures were introduced or tightened<sup>18</sup>. India currently has strong prudential rules, which - in combination with limits on borrowing abroad - has arguably limited the degree to which it has been affected by the global financial meltdown<sup>19</sup>. However, if India accepted the EU's 'no more burdensome than necessary' approach under an FTA, its scope to determine the strength of its own prudential measures in the future could be limited, hence leaving it further exposed<sup>20</sup>.

## **Liberalising financial services – decreasing credit for India's small businesses and producers**

Financial services liberalisation through the FTA is also likely to decrease credit-availability for Indian firms, as European banks cherry-pick the most profitable clients.

In Europe, as credit flows have rapidly contracted, the need to restore credit provision - especially for small and medium businesses (SMEs) - is high on the political agenda. SMEs are the main drivers of the European economy and are responsible for most employment, but without credit they are more vulnerable than big companies. SMEs rely upon accessing working capital from financial institutions to avoid cash flow problems, and can easily collapse when such credit dries up.

Similarly, SMEs are the backbone of the Indian economy and provide millions of jobs. In India, these companies have long faced a credit crunch of their own - and their difficulties in accessing finance have been strongly associated with the increased presence of foreign banks in India. The FTA would exacerbate this trend.

One study on banking liberalisation in India found that firms were 8% less likely to secure a loan after foreign bank entry because of a systematic drop in domestic bank loans<sup>21</sup>. Because foreign banks tend to 'cream-skim' the wealthiest market segments, domestic banks then tend to find it more difficult to service more marginalised sectors. Since foreign banks have entered India, lending to SMEs declined from 15% in 1991 to 11% in 2003, with the majority of SMEs continuing to depend upon informal sources of lending with higher rates of interest<sup>22</sup>. Far from unique to India, this trend has been observed across a number of developing countries. The IMF has noted that 'in poor countries, a stronger foreign bank presence is robustly associated with less credit to the private sector'<sup>23</sup>, while the World Bank has observed that 'most foreign banks are large and stick mostly to the banking needs of larger enterprises and high net worth individuals'<sup>24</sup>.

In the current climate foreign banks, stung by the impacts of their own high-risk lending at home and reluctant to issue new loans to domestic businesses, are even less likely to lend to small businesses and poorer citizens in India. This additional squeeze on credit will further

disadvantage Indian firms which, under the terms of an EU-India FTA, will be increasingly pitted against bigger European companies – some of which are themselves now receiving state aids and subsidised credit from their governments back in Europe.

By promoting the entry of European banks into India, the EU-India FTA would further squeeze credit provision for Indian businesses and rural producers outside all but the most profitable areas. Indeed, the EC-commissioned trade and sustainability impact assessment study has itself concluded that ‘further opening up and liberalisation of the banking and financial sector as a result of the EU-India FTA are not going to help the rural sector [...] As a result of increased competition from foreign banks, domestic banks too would concentrate more on profitable segments of the urban and semi-urban markets’<sup>25</sup>.

Furthermore, the lifting of restrictions upon high levels of cross-border capital movements that typically arises when financial services are liberalised, would bring an additional set of problems for India.

## **FTAs prohibit capital controls – leading to more vulnerability to financial crises**

Capital controls are extremely important in limiting countries’ vulnerability to financial crises. India, along with China, largely escaped from the contagion that hit many East Asian economies during their financial crisis in 1997, in part because it had not liberalised capital controls. Following the East Asian crisis, former World Bank Chief Economist Joseph Stiglitz noted that ‘it is no accident that th[ose] two large developing countries spared the ravages of the global economic crisis both had capital controls’<sup>26</sup>. Jagdish Bhagwati echoed that ‘it is noteworthy that both India and China escaped the Asian financial crisis; they did not have capital account convertibility’<sup>27</sup>. In the context of the current crisis many renowned economists are recommending that capital controls should be retained or, where they have been dismantled, re-introduced as a matter of urgency<sup>28</sup>.

Capital controls can help preserve macroeconomic and financial stability by stemming capital flight and limiting inward surges of investment that lead to inflation. These controls can also help to maintain the value and stability of the national currency, and to counter pressures on exchange rates brought about by high foreign exchange movements. As the IMF has also latterly recognised, India’s capital controls have contributed towards shifting the composition of capital flows away from short-term speculative inflows in favour longer-term investment<sup>29</sup>.

However, the FTAs being pushed by the EU come with serious restrictions upon these very tools. In its investment chapters in FTAs, the EU demands that foreign investors operating in a host country market must be allowed to move capital freely across borders, heavily limiting the use of capital controls<sup>30</sup>. This applies to investments in the financial services sector - a sector which tends to move the largest amounts of money back and forth between host and home countries – but also across all other sectors in which foreign investors are engaged.

The IMF, which led the drive towards eliminating capital controls, has argued that restrictions on capital flows across borders would deter foreign investment from entering countries that operated such controls. Other free market economists disagree. Notably, Jagdish Bhagwati, after studying the role of capital controls in a number of countries, has concluded that there is ‘no persuasive evidence that full capital account convertibility is necessary to bring in direct foreign investment’<sup>31</sup>.

Whilst economists disagree about whether open capital markets increases investment, the risks of such opening are clear and substantial, to the extent that now even the IMF has accepted the

need to bring back capital controls, recently supporting the decision of Iceland to introduce such controls in response to the 2008 collapse of its banking sector<sup>32</sup>.

### **The East Asian experience**

The major financial crisis affecting several East Asian countries in the late 1990s was largely attributed to the rapid liberalisation of financial and capital markets. Because of the lack of controls, investors were able to abruptly pull out billions of dollars worth of short-term investments, causing currency devaluations and plummeting stock markets across Asia and into other regions.

In Malaysia, the restoration of capital controls, including temporary restrictions on outward capital transfers by foreigners, played a key part in resolving the crisis, with the IMF concurring that 'in conjunction with other macroeconomic and financial policies, the controls helped to stabilize the exchange rate. ... [T]here have been no signs that a parallel or non-deliverable forward market is emerging; and no significant circumvention efforts have been reported.'<sup>33</sup> Bhagwati agreed that 'Malaysia did well to use capital controls'<sup>34</sup>.

However, under an EU FTA, commitments to eliminate capital controls would be binding and irreversible, preventing India from maintaining or extending capital controls in response to the current or future crises.

### **An EU-India FTA would increase dependency on external financing – during a credit crunch**

A further problem for India if it enters an FTA with the EU, is that this would increase its current account deficit - thus increasing its dependency upon foreign capital at a time when such finance is scarce.

UNCTAD has observed that FTAs between developed and developing economies have tended to worsen the developing country's trade balance with the developed country trade partner<sup>35</sup>. After South Africa began to cut tariffs extensively on imports from the EU – under the terms of an FTA between the two parties (the Trade, Development and Co-operation Agreement) – its total current account deficit increased from 1.1% of GDP in 2003 to 6.5 % of GDP in 2006, with its trade with the EU playing a significant part<sup>36</sup>.

The European Commission's own estimates suggest that India's trade deficit would increase under the FTA. Their study concluded that India's imports would increase by \$17-18 billion whereas its exports would only increase by \$5 billion<sup>37</sup>. This assessment was made in 2007, before the current economic crisis and the consequent reduction in India's exports to the EU, and so it is likely that the imbalance would be even greater<sup>38</sup>. This would put further strain on India's already existing current account deficit, increasing its dependency on foreign capital inflows – a serious risk, especially during a credit crunch. The World Economic Forum's 2008 risk report for India, produced in collaboration with the Confederation of Indian Industry, observed that 'India's dependence on capital inflows to finance its current account deficit is a macroeconomic risk and the global crisis could generate a sharp increase in capital outflows and a reduction in the availability of finance'<sup>39</sup>.

Too much reliance on foreign capital presents a number of problems for developing country recipients, even when capital is available. Host countries are often under pressure to lower labour or environmental standards or to offer tax breaks in order to compete for the desired foreign direct investment. Short-term investors can leave abruptly putting pressure on exchange rates. Further, dependency on capital inflows during a credit crunch is a particularly bad idea, for the additional reason that the very availability of foreign capital is diminishing.

Facing a liquidity crunch at home, foreign banks have cut credit in emerging markets such as India. Foreign portfolio investors who in 2007 put \$17.4 billion into India have since turned tail<sup>40</sup> with even Tata Motors reportedly struggling to lay its hands on capital<sup>41</sup>.

## **The FTA would put further strain on India's budget – limiting scope for stimulus packages**

India, in line with other governments around the world in a position to act, has initiated a series of measures to stimulate its economy. However, its budget deficit (6% of GDP and rising) limits its options, and its new stimulus measures add up to no more than \$14 billion<sup>42</sup>, which is minimal compared to the equivalent programmes of China, the US and across Europe. The proposed FTA with the EU would place even more strain on the Indian government's budget through the loss of trade taxes that would result from far reaching tariff cuts. According to the OECD, India is reliant on income from trade taxes for 24.1% of total tax revenue<sup>43</sup>. A study from the Carnegie Foundation estimates that the EU-India FTA would reduce the Indian government's tariff revenue by nearly one third<sup>44</sup>.

Moreover, as jobs are lost as a consequence of the economic downturn and as a result of the increased EU imports precipitated by an FTA, government spending on social protection schemes and other social programmes would be more important than ever. Loss of revenue from trade taxes could be seriously damaging, therefore. In the 1990s reductions in applied tariffs led to a fall in customs revenue<sup>45</sup>. As this revenue fell, so too did government spending (from 17.2% to 15.8% of GDP), while taxes rose (direct taxes from central government rose from 1.9% to 3% of GDP)<sup>46</sup>. Such trends tend to have regressive impacts – hitting the poorest households worst.

Given India's limitations in using resource-intensive approaches to get out of recession – and to cushion it most vulnerable citizens from the worst impacts - holding on to other policy tools becomes more important than ever. Yet policy space too would be drastically curtailed under an EU-India FTA – such as through obligations to grant foreign investors 'national treatment'.

## **An FTA would not reverse the drop in foreign investment, but would come with strings attached**

Even before the proposed EU FTA, foreign investment has been flooding into India - attracted by its high growth levels. In the first quarter of 2008 inward FDI was worth \$10bn, more than twice the equivalent figure from the previous year<sup>47</sup>. The downturn has hit this growth hard, with inward direct investment to India more than halving in the third quarter of 2008-9, compared to the first quarter of the year<sup>48</sup>. It is too early to say how far this trend will continue. But, what is clear is that the involvement or otherwise of developing countries in FTAs that grant foreign investors national treatment within their markets, is not a strong determinant of FDI inflows – even when capital is flowing more freely. Other factors, such as size and growth of the domestic market, natural resource availability, decent infrastructure and access to cheap and/or skilled labour are considered more important determinants<sup>49</sup>.

While an FTA with the EU will not guarantee increased investment for India, it would certainly make it more difficult to place limitations and regulations upon foreign investment in the interests of securing national development objectives. Investment provisions in EU FTAs require host countries to grant national treatment to investors, making it difficult to attach conditions upon them to provide local employment, skills upgrading, technology transfer or other benefits to the local economy.

Left to its own devices FDI tends to concentrate in large corporations that do not automatically spread decent jobs, skills or technology to the wider economy<sup>50</sup>. In February 2009, the Indian Chambers of Commerce and Industry (FICCI) observed that FDI in manufacturing had not benefited SMEs with technology transfer to the expected degree<sup>51</sup>, which is one indication that such benefits do not flow automatically, unless governments put in place the necessary requirements. Conversely, where FDI is well directed by governments it can bring benefits - for example, the Indian government drove the development of its auto-component sector by requiring multinational automobile companies to achieve 70% of domestic content within three years, which obliged them to source from local firms.<sup>52</sup> Investment provisions under the FTA would prohibit similar kinds of policies, such as obligations upon foreign investors to enter into joint ventures.

An FTA would also make it difficult to limit the levels of FDI allowed into a particular sector if it was found that foreign multinationals were crowding out domestic companies in a way that was damaging, as is a predicted outcome of the EU-India FTA from the EC's own trade and sustainability impact assessment study.<sup>53</sup>

Without an FTA with investment provisions, the Indian government can still put in place unilateral policies to seek to attract more investment – as it is currently doing. For example, it recently lowered restrictions on FDI that it previously had in place in order to promote domestic firms and limit foreign dominance in strategic sectors. Notably, in the retail sector – one of the largest sources of employment in India - a 49% cap on FDI in single-brand and a 100% ban on FDI in multi-brand retail, is intended to curb the over-concentration of large retail chains that have had damaging consequences for domestic firms in other countries, such as Thailand and Malaysia, when foreign chains have entered<sup>54</sup>. In February 2009 the government announced a new method of calculating the foreign equity component – such that investments routed through companies in which the majority ownership and control is in the hands of Indians would be treated as fully domestic equity – effectively allowing the limits on FDI to be bypassed. Such unilateral policies could be reversed by the government or by future governments, if the effects of this were found to be negative. However, under an FTA with the EU, these policies would be locked in and extremely difficult to reverse.

Tying the hands of the Indian government to regulate FDI is just one of the ways in which policy space would be narrowed for India under the EU's FTA.

## **The EU-India FTA would prevent India from using the measures it needs, especially during an economic crisis**

At a time of economic difficulty alternative policy tools are all the more important for supporting domestic economies, livelihoods and food security. However, a number of these options would be closed to India under the proposed FTA with the EU, even though European governments could continue to bolster their own economies through the major multi-billion dollar stimulus packages and state aids that have recently been introduced.

## Measures taken in Europe to support domestic industry and jobs

**Fiscal stimulus packages:** Several countries have introduced significant economic stimulus packages, with central banks sharply cutting interest rates, governments injecting billions of dollars of liquidity into financial markets through re-capitalisation schemes and billions of dollars being invested in infrastructure projects.

**Government support for lending to small businesses:** Governments, such as in the UK, have introduced conditions upon banks that require them to lend to small businesses in return for further state backing. For example, in January 2009 the UK government announced measures to encourage banks to start lending, especially to small businesses, by insuring them against potential further losses<sup>55</sup>.

**State aids for strategic sectors:** The US Congress agreement to bail out Chrysler, Ford and General Motors in 2008 was followed by similar plans to support the auto industry in France, Germany, Sweden and the UK; the latter is borrowing £2.3 billion from the European Investment Bank and providing credit guarantees worth a further £1.3 billion to support its industry. Because some of these state aids arguably flouted the EU's own competition rules, those rules were relaxed in December 2008 to allow member states to offer subsidised interest rates on loans and state guarantees<sup>56</sup>.

**Export subsidies to support farmers:** In January 2009 the European Commission re-introduced export subsidies for butter, cheese, and whole and skimmed milk powder in response to a fall in prices for EU dairy producers.

**Measures to encourage local content:** The US government plans to spend billions of dollars on public programmes through its Buy America scheme, which contains clauses that require the procurement of iron, steel and manufactured inputs to be sourced from domestic firms.

While EU governments and the US have been engaged in these policy measures to rescue their economies, many of the instruments that are more easily available and suitable for India would be curbed under the FTA.

**Tariffs.** A core component of any FTA is the elimination of tariffs on 'substantially all trade' between the parties – and in the EU-India FTA this has been interpreted to include at least 90% of trade. Yet, tariffs are a vital policy tool for safeguarding jobs in important sectors that are most vulnerable to competition from imports, for protecting agricultural livelihoods, and for strategically promoting the development of new industries. Existing analysis has already predicted that India would very quickly face serious job losses as a result of tariff liberalisation in an FTA with the EU, in sectors including processed foods, paper products, plastics, machine tools and auto-parts, among others<sup>57</sup>.

Since the economic down-turn began the Indian government has raised tariffs on steel, iron and soybean oils – and it may need to selectively use tariffs for shorter or longer periods to support other sectors. Raising tariffs would be increasingly difficult under any proposed FTA with the EU, with limited exemptions from liberalisation and standstills preventing the raising of tariffs even on products not scheduled for full liberalisation. Even so-called 'infant industry clauses' in the EU's recent FTAs are heavily restricted and difficult to use.

India may carefully identify a number of products to exclude from liberalisation, but in doing so would sacrifice the scope to use tariffs to promote other sectors. Governments can plan for the future but cannot predict it – as we have seen recently with European and the US governments' surprise at the financial crisis and in the defensive moves they have had to take to deal with it.

In the WTO context, countries such as Brazil have pointed to the hypocrisy involved in developed countries requesting developing countries to limit the use of tariffs in the current climate. In defence of retaining the scope to use tariffs, it has been noted that 'protectionism is not only about raising tariffs and controlling imports. It's also about subsidies and stimulus packages which could have a tremendous effect on trade, and which are available mostly to countries that have the resources to apply them. Developing countries do not have the means to adopt these kinds of measures. All they have are tariffs<sup>58</sup>.' Under FTAs with the EU – just as under current WTO proposals – developing countries would largely lose tariffs as well.

**Conditions on banks to lend to SMEs.** One of the ways in which the Indian government has tried to encourage credit availability for SMEs is by obliging banks to direct a percentage of their lending to small businesses and other marginalised borrowers<sup>59</sup>. However, in the WTO, the EU has requested that other emerging economies eliminate existing obligations to lend to marginalised or poorer sectors such as domestic SMEs<sup>60</sup>. Now, at a time when many European governments are taking steps to encourage their banks to lend to small businesses back home, it would be ironic if the EU were still seeking to eliminate such obligations upon its banks in foreign markets like India, through the proposed EU-India FTA.

**Government procurement.** Government procurement can be an effective tool to stimulate the domestic economy in times of crisis as it provides a route for governments to try to spend their way out of recession. The size of the procurement market in India is estimated to be in the order of \$100 billion, or 20% of GDP, which gives the government considerable scope to use this spending to facilitate domestic recovery, by purchasing goods and services from domestic firms that tend to have greater multiplier effects within the wider economy and to create more jobs. The US attempt to use government procurement to benefit domestic firms, under its Buy America scheme, is one of the strategies it is adopting to support its economy through a downturn. However, even though India is not a signatory to the WTO government procurement agreement, the EU is demanding that any FTA with India must include a commitment to fully open up government procurement, so that EU companies can bid on an equal footing to domestic ones for government contracts.

**Measures to stimulate domestic content.** While the use of local content requirements is already precluded by the WTO's Trade Related Investment Measures (TRIMS) agreement, WTO members still have scope to place other conditions and entry requirements on foreign investors to ensure their activities benefit the domestic economy. These range from joint venture, R&D/training requirements, technology transfer and import balancing requirements. For example, when Ford India set up as a joint venture in 1996, it was also required to balance its imports and exports. Its solution was to source components locally, launching a joint programme with the Automotive Component Manufacturers Association. The same requirement led General Motors and Daimler Chrysler to develop more linkages with local firms.

These are just some of the policy instruments currently available to India which could be closed off by the proposed EU-India FTA, leaving little scope for implementing the economic strategies that are generally important for developing countries, even more so in the current exceptional times.

## For what gain?

Given the serious problems that an FTA with the EU would pose for India, the question is what would India gain? When it entered into the FTA, India was keen to secure better access for Indian service providers in EU markets; to improve its market access in key product sectors, notably textiles; to remove some of the non-tariff barriers facing its exports of agricultural and chemical products to the EU; and to attract additional FDI. The current proposals – especially in light of the economic downturn – look unlikely to deliver on these ambitions.

It is difficult to judge how much the FTA would help India secure greater access to the EU for its skilled professionals as providers of business and IT services. The European Commission, which is negotiating the FTA on behalf of the European governments, does not have full powers to conclude a deal in this area, as it enters into the sensitive territory of Member States' powers to grant temporary visas and work permits to non-EU nationals. The extent of the EU's likely offers to India in this areas have never been guaranteed – and are even more uncertain the current employment situation in Europe. Unemployment is rising across the EU and in key countries there is a notable decline in vacancies for jobs in the very IT and business service sectors in which India is seeking to gain greater entry<sup>61</sup>. Meanwhile, the UK government, for example, has been recently tightening its criteria against which highly skilled workers seeking entry are judged.

In the areas of goods, calculations made prior to the economic downturn forecast a fairly narrow set of gains to India from market access to the EU, largely concentrated in the textiles and apparel sector and to a much lesser extent in leather and footwear, chemicals, metals and plastic products<sup>62</sup>. Even then the expected job creation was characterised by one of these studies as 'representing only a very modest contribution to India's employment needs'<sup>63</sup>. Since these studies were conducted, exports from India to the EU have reduced.

Setting aside the fact that the EU market is contracting, India will not be able to secure significantly increased market access for its goods into Europe, through an FTA, until the EU addresses some of its non-tariff barriers, such as standards attached to food products and to chemicals, which Indian exporters have difficulty in meeting. Yet, the EU's FTAs so far have largely focused on facilitating the application of existing standards (e.g. WTO Sanitary and Phyto-sanitary Standards), rather than making EU standards less stringent. Between the EU and India there is potential to overcome the obstacles faced by Indian exporters by establishing more mutual recognition of testing labs or by the EU increasing support for upgrading India's labs and storage facilities. The FTA is unlikely to help, partly because it will not contain binding commitments on additional development assistance to support such initiatives. Moreover, exporters are increasingly affected by private standards such as GLOBALGAP, which fall outside of the purview of trade agreements.

Whilst it is possible that such trends will turn around, entering into an FTA riddled with risks on the basis of a gamble on expected gains would seem to be a highly dangerous strategy for India.

## Conclusion and Recommendations

This paper has argued that, far from being part of the solution for India, accelerated trade, investment and financial liberalisation of the kinds being proposed through an EU-India FTA would increase India's economic exposure to the effects of the credit crunch and to what looks to be a protracted economic downturn. Such an FTA would also drastically limit the Indian government's scope to put in place domestic policies that counter the impacts of these global economic trends. An EU-India FTA would tie the hands of the Indian government – at a moment when more than ever it needs to keep its options wide open.

There is a groundswell of concern about the proposed FTA among Indian civil society organisations, including trade unions, farmers' organisations, social movements and academia, leading to calls upon the government of India to immediately halt the negotiations. Indian organisations are also calling for the government of India to:

- Address the lack of transparency in the negotiations, making public all existing negotiating positions, draft proposals and government commissioned studies, and allowing for proposals to be fully debated and discussed in parliament;
- Undertake extensive consultations with key constituents such as trade unions, farmers, women, dalit, adivasi and other peoples' organizations, SMEs, cooperatives and hawkers<sup>64</sup>.

Traidcraft calls upon the UK and other EU member state governments to:

- Desist from using the current economic crisis to push through free trade agreements with developing countries, such as the EU-India FTA. Instead, there should be an immediate halt to the EU-India FTA negotiations;
- Champion the rights of developing countries to intervene in their markets to support national development plans and the livelihoods of vulnerable farmers, workers and SMEs, just as European governments are seeking to do now in response to the economic downturn;
- Guarantee that any trade negotiating process between the EU and India will be made fully transparent, with negotiating documents made publicly available, to enable much better scrutiny from civil society including non-governmental organisations, trade unions, parliamentarians, SME bodies and all those effected by such an agreement;
- Commit to undertake a review of the EU's current trade strategy, as laid out in its Global Europe document<sup>65</sup>, which should be replaced with an approach that addresses the real challenges for developing countries in realising sustainable development, food security, access to credit, decent jobs and poverty reduction for their people.

## Endnotes

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- <sup>1</sup> Mandelson, P (19 January 2009), UK Secretary of State for Business, Enterprise & Regulatory Reform, Speech to CII Partnership Summit, Delhi
- <sup>2</sup> European Commission (October 2006), 'Global Europe: Competing in the World'
- <sup>3</sup> Business Europe (24 February 2009), letter to European Trade Commissioner Catherine Ashton
- <sup>4</sup> Peter Mandelson (19 January 2009), *ibid*
- <sup>5</sup> International Labour Organisation (3 February 2009), Global Employment Trends 2009
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- <sup>7</sup> Import statistics from Eurostat show a marked decline in imports from India, from Nov-Dec 2007 to Nov-Dec 2008. See also Federation of Indian Export Organisations, February Newsletter.
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- <sup>17</sup> See WTO GATS, Article VI.4(b) and EU-CARIFORUM EPA (2008), Article 100.2
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- <sup>46</sup> Government of India (2007), Economic Survey 2006-07, tables 2.3 (customs revenue) and 2.12 (tax revenue)
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- <sup>59</sup> Currently domestic banks are obliged to direct 40% of their lending to so called priority sectors' including SMEs; foreign banks are obliged to direct 32% of their lending to these sectors.
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- <sup>63</sup> Polaski et al (2008) *ibid*
- <sup>64</sup> See statements of the Indian FTA Forum representing nearly one hundred trade unions, farmers' organisations, social movements, civil society organisations and academics, who have called for the FTA to be halted. For example, FTA Forum (21 September 2008), 'Statement of Concern from India'; FTA Forum (21 November 2008) 'EU-India Free Trade Agreement: for Whom?'
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