India’s Proposed FTAs with EFTA and the EU: Complicating a myopic policy regime

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While noting the high levels of foreign investment that are being sought, India’s Commerce and Industry Minister announced at the Economic Forum in Davos that the country is seeking to raise the share of the manufacturing sector in GDP from the current 15-16 per cent to 25 per cent over the next decade. He was reiterating a policy already stated in the Ministry’s National Manufacturing Policy announced in 2011. The Report highlighted the fact that the share of manufacturing in India’s GDP has stagnated at 15-16% since 1980, while the share in comparable economies in Asia is much higher at 25 to 34%.

While the official acknowledgement of the fact that the country has been dangerously lagging behind in manufacturing sector growth and employment has been significant, there is one huge problem. That is the glaring inconsistency between what the government envisages the manufacturing sector to be in ten years, and what it has sought and continues to seek to do with its trade policy.

Since bringing down the average MFN tariff levels under the WTO commitments, India’s trade policy has been reduced to signing bilateral or regional free trade agreements (FTAs), either in a competitive spree or as misplaced foreign policy instruments. India’s MFN tariffs on as much as 91% of non-agricultural products were already down to the 5-10% range or below by 2009. In general, the margins of preference under India’s PTAs have thus become less significant. However, there are several tariff lines where elimination of even an already low tariff can make a difference to foreign firms’ competitiveness and cause an adverse impact on domestic firms. This is also relevant for products with non-advalorem tariffs. India has committed to reducing or eliminating tariffs in most consumer goods, capital goods and intermediate goods in its FTAs with ASEAN, Japan and South Korea. These include products belonging to industries such as organic and inorganic chemicals, metal and metal products, electrical and non-electrical machinery industries, etc**.**

With no strategic industrial policy in place, one of the central problems in the goods chapters of India’s FTAs in force is that there has been no consistent policy regarding the products kept in the negative lists of such trade agreements. Important sectors such as textiles and clothing; plastic and plastic products; rubber and rubber products; etc. have been included in the negative lists of India’s FTAs with South Korea and Japan, after they have been already liberalised under the FTA with the ASEAN grouping, which are highly integrated through production and marketing networks with many developed countries within and outside Asia. As a result, India’s bilateral trade deficits with the ASEAN-10 group as well as with South Korea and Japan have been growing, clearly showing that the preferential access these trade partners obtained in the Indian market has led to greater effective market access for them compared to what India has gained in their markets. It was against the backdrop of growing awareness of the messiness of our trade policy that the Parliamentary Standing Committee on Commerce began an exercise last year of reviewing India's experience with the FTAs already in force.

But currently, pressure on concluding two more FTAs is building up yet again, this time with developed country partners in the European Free Trade Association (EFTA) and the European Union (EU).

As before, all the negotiations are taking place in secret. Most of the publicly available information relates to IPR issues, thanks to the awareness generated by the NGOs working in the health sector. Under IPR, EFTA is asking for mutual recognition for Geographical Indicators as well as for data exclusivity, both of which India is opposed to. Data exclusivity refers to the protection provided to the technical data generated by companies for establishing the usefulness and safety of newly innovated products. This is especially contentious in the pharmaceutical sector, which conducts expensive global clinical trials on new medicines. As has been pointed out, by gaining exclusive rights over this data, pharmaceutical companies can prevent their competitors from obtaining marketing licence for low-cost generic versions during the tenure granted under data exclusivity. Switzerland reportedly has huge interest in this sector. Earlier, the EU was also pressing India to agree to an intellectual property rights regime over and above what the country has agreed multilaterally in the WTO. After facing tremendous pressure from health NGOs and others working on access to medicines for millions of people in India and elsewhere, the EU said that they were not expecting India to change its IPR regime.

However, there is absolutely no publicly available information on the tariff reduction schedule or on provisions in the services or investment chapters or on other behind-the-border policy measures that have become part of the recent comprehensive trade agreements. While the only information on these negotiations comes from occasional newspaper reports, there are many issues that can be flagged based on the templates or other agreements recently signed by these developed countries.

Most countries of EFTA – Switzerland, Iceland, Norway and Liechtenstein – have a strong advanced industrial base. Switzerland and Liechtenstein are in addition also specialised in financial services, notably banking, wealth management and insurance. Iceland has deeply entrenched interests in fishing and fish processing, while Norway has companies specialised in high-end electronic equipment looking for increased market access through the forthcoming FTAs with India and other BRICS countries. Thus EFTA is possibly looking to include ambitious provisions to secure requirements such as improved market access and/or establishment possibilities, national treatment guarantees, enhanced legal security and the possibility to transfer management personnel.[1]

According to an Indian official quoted in the Economic Times news report, tariff reduction/elimination under the proposed FTA will allow India to import the high-end products manufactured by EFTA members more cost-effectively. It is not clear how these tariff reductions work into the strategic vision for high-tech areas identified in the National Manufacturing Policy. The low margins of preference in the majority of India's product lines and the generally low utilisation rates of the preferential tariffs by firms from trade partners have been the basis of the argument that FTAs do not have major implications for domestic industry beyond being instruments in diplomacy. But the low utilisation rates might typically apply to foreign small and medium firms (SMEs) which find the administrative costs of applying for the preferential route deterrent where the margins of preference are not significant. For larger foreign firms, even margins of preference as low as 6 per cent have been noted to improve competitiveness in the highly competitive global environment and increase their domestic market penetration.

Meanwhile, the possibility of technology transfer by having investment partnerships with these developed country firms is miniscule due to the fact that many firms from Switzerland, Norway etc. are looking at FTAs for facilitating the movement of their employees, e.g. for training, engineering or management functions. This may be negotiated under the services chapter of the proposed agreement, where, as in the India-Japan comprehensive Economic Partnership Agreement (CEPA), there could be provisions that prohibit the Parties from imposing regulatory measures related to services sector investments.

On the export side, apart from textiles, India is expecting greater market access in services sector in those four countries. But there are several reasons why meaningful increase in market access may not materialise for Indian exporters of goods and services.

It is relevant to consider Switzerland's bilateral FTA with China signed in 2013. Once the FTA goes into effect, as much as 99.7 per cent of Chinese exports to Switzerland will be immediately exempted from tariffs, while 84.2 per cent of Swiss exports to China will eventually receive zero tariff. China was able to negotiate transition periods of five to ten years for the reduction of many customs charges. And to the benefit of Swiss agriculture, charges on such products imported from China will remain.

But in 2012, China was already the fourth largest import supplier to Switzerland. With such established market presence and the competitive edge obtained by China under its FTA with Switzerland, it is unlikely that Indian exporters will gain significant additional market access even if a level playing field is created by tariff reduction under the proposed FTA.

[1] This information is based on the perspectives given in the EFTA Bulletin, December 2013.

Further, EFTA free trade agreements explicitly provide for the possibility to take measures necessary to protect human, animal or plant life or health, or relating to the conservation of exhaustible natural resources. In other words, their agreements would clear the usage of non-tariff measures such as SPS or TBT that have been increasingly utilised by developed countries. Indian exporters will likely face considerable discrimination in the EFTA markets as a result of these standards.

The China-EFTA Agreement also provides for the conclusion of an agreement on government procurement between China and Switzerland as soon as China completes negotiations on its accession to the WTO Agreement on Government Procurement (GPA). It should be remembered that India's National Manufacturing Policy talks about considering the use of public procurement in specified sectors with the stipulation of local value addition in areas of critical and strategic technologies such as solar energy equipment, electronic hardware, fuel efficient transport equipment and IT-based security systems. It is crucial that such flexibilities available to strengthen the manufacturing sector are no way diluted through the agreements under negotiation.

A major positive feature of the China-EFTA agreement is that its investment promotion chapter only talks of furthering a legal environment conducive to increasing bilateral cross-border investment and technology flows. There is no definition of investment in this Agreement, which is of critical significance. All recent comprehensive FTAs signed by India have included an investment chapter, which defines investment broadly, with serious adverse implications particularly for industrial policy and financial regulatory autonomy.[2]

The proposed comprehensive India-EU bilateral agreement is even more far-reaching in scope than the proposed EFTA agreement. Besides significant duty cuts in automobiles, wines and spirits and dairy products (areas of major concern for India), the EU is pressing for a hike in the FDI cap in the insurance sector and a strong intellectual property regime. In November 2013, a visiting European Parliament delegation had cautioned that unless India agrees to raise the FDI cap in the insurance sector, the negotiations will not move forward. It is striking that the EU wants the country to raise the FDI cap in the insurance sector even as the Insurance Laws (Amendment) Bill 2008 that seeks to raise FDI cap from 26 per cent to 49 per cent is pending before the national parliament.

On the other hand, according to news reports, India wants liberalised visa norms for its professionals, data secure status[3] and market access in services and pharmaceuticals. The

[2] See the problems with investment chapters in recent comprehensive FTAs in IDEAs (2011), "Investment Provisions in Trade Agreements: Critical issues", IDEAs Policy Brief available at http://www.networkideas.org/briefs/dec2011/PDF/02_2011.pdf .

[3] Currently, as per the EU's Data Protection Directive, India is not deemed to offer adequate level of protection for personal data involved in outsourcing by EU-based companies. Currently, EU-based outsourcing to India takes place under an alternative lawful means of data transfer (under the approved EC model clauses). But given that these clauses place strict obligations on both parties to ensure privacy

continued willingness on the part of Indian negotiators to trade off increased import penetration in its various manufacturing sectors in exchange for a potential increase in export market access for Indian software and other services companies is another part of the continuing conflict between India's vision for its manufacturing sector and its trade policy. The ramifications of such a trade-off for the economy as a whole should be of major concern, even as it is unlikely that India would be able to secure any significant or lasting improvement in visa norms for its professionals given the rising trend in visa restrictions and protectionist measures in developed countries.[4]

Elsewhere in the world, another provision in trade and investment agreements that has been under severe scrutiny is the inclusion of an investor-state dispute settlement (ISDS) mechanism. ISDS provisions allow foreign investors in India to sue the national government at an international arbitral forum (which remains totally outside national jurisdiction) if they interpret governmental measures or laws as leading to a change in their business profitability or prospects.[5] Given that corporations around the world are using such provisions to force governments to use taxpayers' money to pay compensation for perfectly legitimate regulations to protect public health, the environment and other public interests, ISDS poses serious risks to public policy, including industrial policy, tax policy and financial regulation.

The potential for these FTAs with EFTA, EU or the proposed one with the US to secure long-term market access for Indian exporters is limited also given that the Trans-Atlantic Trade and Investment Partnership between the EU and the US (TTIP) and Trans-Pacific Partnership (TPP) are likely to be concluded soon. Both TPP and TTIP are likely to produce market access restrictions and discrimination for Indian exporters even where India has already signed FTAs with TPP members such as Japan. Further, they will hasten the momentum towards the multilateralisation of regionalism, which is increasingly seen as the only way out of the contradictions between the surge in preferential trade agreements and the WTO. In the case of tariffs, this obviously means the narrowing of the gap between the "best" (that is, lowest) preferential tariff and the MFN levels. On the other policies, it could mean that the least contentious elements in PTAs would be taken to the WTO level. So having ISDS in our

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of data, these are considered by some to act as a disincentive for business. Thus recognition as a data secure country is considered by Indian industry representatives as crucial in gaining effective access to the EU's outsourcing market.

[4] Already there are news reports that visa restrictions and protectionist measures, which limit Indian software exporters' scope of moving some of its workforce to their centres in developed country markets, are forcing companies like the Tata Consultancy Services (TCS) to a substantially increase their hiring locally in their developed country markets (which means greater employment opportunities there) or making more acquisitions abroad to enhance their delivery options (further foreign exchange outflows)

[5] A liberal definition of expropriation prohibits both direct and "indirect" expropriation. Indirect expropriation has been defined in some agreements as "expropriation by measures equivalent (or tantamount) to expropriation or nationalisation". This has been interpreted to mean "change in foreign investors' business profitability or prospects" resulting from any policies or regulations imposed by the host Party. This implies that legitimate regulations at the national, sub-federal and local governments can be brought under litigation for affecting the profits of the investor. See also http://www.networkideas.org/focus/feb2013/Investment_Policy.pdf

agreements with developed and developing countries alike, even as globally there is serious reconsideration on it, may turn out to be an irretrievable mistake on India's part.

The eventual multilateralisation of preferential arrangements at the WTO might take time, but the driving forces behind it are likely to attain a critical mass with the conclusion of the ongoing negotiations between the US and the EU for the Transatlantic Trade and Investment Partnership, or TTIP. At the present juncture, one silver lining seems to be that the European Commission has put the investment component of TTIP trade negotiations with the US temporarily on hold. This has followed pressure from several US and EU civil society groups, which have warned that because of the significant of cross-registered companies in the United States and the EU, the number of ISDS attacks on public interest policies would likely increase dramatically if TTIP includes ISDS. Similarly India should send a strong signal that until there is a consensus on an alternative dispute settlement process to ISDS, protection provisions that give superior rights to foreign corporations will not be included in the new agreements.

Given all these issues, India would do well to put on hold the signing of further agreements at the bilateral/regional level, as the government had declared last year. Leveraging its large domestic market, India needs to carve out a coordinated industrial and trade policy. At the same time, the country should take the lead to strengthen efforts for South-South cooperation to create consensus on the ways to limit loss of policy sovereignty and to regain the lost policy autonomy.