Delhi Policy Group

Advancing India's Rise as a Leading Power

DPG POLICY BRIEF

Moving Trade Agreements Forward with Select Partners

Author

V.S. Seshadri

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President Donald Trump and Prime Minister Narendra Modi at their summit meeting in New Delhi, February 25, 2020. Source: Flickr/MEAIndia

PM Narendra Modi and PM Boris Johnson meeting on the sidelines of the G7 Summit in France, August 25, 2019. Source: Flickr/MEAIndia

PM Narendra Modi with PM Scott Morrison at the India-Australia virtual Summit on June 4, 2020. Source: PMIndia.

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Concluding trade and investment agreements is in the news again. This time the United States, the United Kingdom, the European Union and Australia are all in favour among India's newly shortlisted partners. At the India-Australia summit meeting in early June, both sides decided to reengage on CECA negotiations[1] to find a mutually agreed way forward after suitably taking into consideration earlier bilateral discussions. The summit meeting with the EU in mid-July saw the two sides reaffirming commitment[2] to work towards balanced, ambitious and mutually beneficial trade and investment agreements. A few days later, at the IDEAS summit organised by the US-India Business Council, Commerce and Industry Minister Piyush Goyal not only conveyed that US and India 'were almost there' in respect of the limited deal that has been under discussion for a while, but he also called[3] for the two sides to aim for a quick intermediate deal of "50 may be 100 products and services" of an eventual FTA that itself may take a few years to conclude. Finally, with the post-Brexit UK, there is now an affirmation of a shared commitment, at the recent Joint Trade and Economic Committee meeting[4] (JTEC), to negotiate an FTA and towards that end, early harvest deals in a phased manner.

A veteran trade columnist[5] has quipped that India's 'Act East policy' was now giving way to a 'Welcome West plan'. He also observed that on trade relations, it may be more symbolic than substantial.

Will it turn out to be just that? Or can we expect a more well focussed and implemented strategy this time? News reports[6] suggest that a recalibration of

[1] See https://www.mea.gov.in/bilateral-documents.htm?dtl/32729/Joint_Statement_on_a_Comprehensive_Strategic_Partnership_between_Republic_of_India_and_Australia

[2] See https://www.mea.gov.in/bilateral-documents.htm?dtl/32827/Joint_Statement_of_the_15th_IndiaEU_Summit_July_15_2020

[3] See the news item https://www.thehindu.com/news/national/almost-there-piyush-goyal-on-limited-trade-deal-with-us/article32153317.ece

[4] See the Press Release https://pib.gov.in/PressReleaseIframePage.aspx?PRID=1641126

[5] See the column 'Act East policy giving way to Welcome West' by T.N.C. Rajagopalan, Business Standard, 27 July 2020

[6] See the news item by Siddhartha on 'Govt. to revamp FTA strategy to ensure economic benefits, Times of India, 22 July 2020

India's FTA strategy is underway, with high level discussions being held within the government to focus on alliances with 'peaceful countries'.

Is this new momentum driven largely by an underlying assumption that with most of the identified prospective partners sharing serious concerns about China, we can expect more political accommodation being shown by them in clinching the deals?

Or does it arise from a recognition that if such FTAs, or other smaller deals as precursors, could be quickly realised they could greatly spur investment inflows into the country at this critical time? It may well also enable India getting into more supply chain arrangements. Further, there may be an expectation that the new policy thrust will also help in a reversal of the international business sentiment after India's withdrawal from the RCEP negotiations in November 2019.

Need for greater realism and strategy

Whatever may be the driving elements, a degree of realism needs factoring in. FTAs are deep economic integration arrangements. Neither the US nor the EU would depart from their templates for such agreements that have evolved over time. In both their systems of governance, FTAs go through multi-layered scrutiny. The EU's FTAs are negotiated by third parties with the European Commission (EC), but behind it are 27 governments, each of which have their own interests. The deal also needs passage through the European Parliament. The EU's recent agreements with Vietnam, Japan and Canada, one developing and two others developed, could well serve as its templates.

Similarly, any FTA with the US will need Congressional approval and the deal will have to conform to the principles set out in the updated version of the Trade Promotion Authority adopted in 2015. The US's revised NAFTA deal with Canada and Mexico (called USMCA), which is the first FTA to receive US Congressional approval last December since 2011, with bipartisan support, will most likely serve as the guiding basis for the crafting of further US FTAs in the near term.

It should not be a surprise if for Australia as well, CPTPP could shape its approach. While the UK's negotiating stance remains to be tested, its Government has already announced it will be a champion for free trade and hopes to secure free trade agreements with countries covering 80% of UK trade within the next three years[7]. While the UK is formally out of EU since January 31, 2020 it is still in transition mode and its future trading arrangements vis-a-vis the European Union have to be finalised before this year end. The terms of such an agreement will make clear the degree of harmonistion, if at all, the UK would agree to aligning post-Brexit Britain with EU standards and regulations on a variety of products, services and other aspects.

Within India itself, a whole host of concerns were aired when RCEP negotiations were drawing to a close. While some related to opening up further to China that already had a large presence in the Indian market, there were also others. Deep concerns were at display from the dairy and farming sectors[8] but were also voiced by other industries like steel[9]. An FTA deal with any of the present shortlisted partners will most likely involve deeper access than envisaged in RCEP, even as these partner countries may not be as price competitive on industrial products as several RCEP members. It will also carry commitments beyond market access on a range of regulatory aspects, most likely on a significant "WTO plus" basis. Non-trade issues will also get featured and most disciplines will be subject to dispute settlement.

If the expectation of the Indian government is that we will somehow muddle through and deal with the thornier issues when they arise in the negotiations, this may become problematic. It is better that an understanding is evolved domestically as to how these widely different positions can be dealt with and bridged satisfactorily, even though this process can take some time. Where necessary, certain sectoral adjustment assistance may also be necessary to be able to navigate the transition successfully.

An agreed roadmap with these partner countries for the FTA would also be important that stretches out the commitments and their implementation over a reasonable length of time[10]. Certain commitments could also be made

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[7] The strategic approach that UK will adopt towards negotiating FTAs with Australia and the United States have for example been outlined in the policy papers https://www.gov.uk/government/publications/uks-approach-to-negotiating-a-free-trade-agreement-with-australia/uk-australia-free-trade-agreement-the-uks-strategic-approach and https://www.gov.uk/government/publications/the-uks-approach-to-trade-negotiations-with-the-us

[8] See for example https://www.financialexpress.com/economy/rcep-india-asean-fta-what-is-rcep-farmers-strike-experts-warn-of-adverse-impact-on-agriculture-daiy-sector/1752079/

[9] See for example the news item at https://www.thehindubusinessline.com/markets/commodities/steel-industry-fret-as-govt-inches-close-to-signing-rcep/article29575655.ece

[10] In an earlier policy brief in March this year this writer had proposed a comprehensive joint study with the US that can evaluate the feasibility of such an agreement and provide a scoping framework.Such a study could also be tasked to examine about getting the FTA

contingent upon India crossing specific development thresholds during implementation so that there is an in built win-win approach[11]. This would clearly convey India's willingness to abide by those commitments provided its development parameters have risen sufficiently by that time, enabling India to do so. But most important, certain clear red lines need to be drawn for the FTA disciplines regarding affordable access to medicines including generics, limits of agriculture access and autonomy of our regulatory policies which remain key to our continued development and democratic framework. Even the UK is making it clear that its National Health Service would not be subject to negotiations[12] (and should not lead to increased prices of medicines for the NHS).

The idea here is not make these concerns non-starters to any deal, but to provide ringfencing assuring the economic security and policy autonomy of the country, its public health and economic well-being, in a balanced and reasonable manner. Fortunately, this has become a somewhat better understood concept in the context of the overwhelming inroads by China in several strategic sectors worldwide and also the excessive dependence on medicines or other strategic materials on certain sources. The need for policy autonomy is also becoming evident from recent debates worldwide about the ownership of data as a resource, including the need for a balanced regulatory framework governing its privacy and security.

A trade deal with the United States

If trade numbers are any guide, an FTA with the US could offer the largest benefit to India. Firstly, the US is still not so heavily enmeshed with FTA deals, with only fifteen so far, as against the EU which is already party to 42 FTA agreements. Any deal with the EU can at best bring India on a level playing field

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done in a phased manner. It was further stated that it may even be advisable to dodge the question of a big trade deal until a few mini deals on trade are done and there is greater confidence and comfort level to move further under the new Comprehensive Global Strategic Partnership. See https://www.delhipolicygroup.org/publication/policy-briefs/india-us-trade-prospects-for-an-elusive-limited-trade-deal-and-a-looming-big-deal.html

[11] As far as this writer is aware this kind of of commitment that is contingent upon a party to the FTA reaching/crossing a development threshold has not been attempted in an FTA. But precedent exists in WTO rules. For example, Article 27.2 (a) of the Agreement on Subsidies and Countervailing duties of WTO did not prohibit developing countries including India from giving export subsidies until their GNP per capita was less than US$1000 per annum.

[12] Protecting the right to regulate public services, including the NHS and public service broadcasters is a key element outlined in the UK government strategy paper for its FTA with US . See the link at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/869592/UK_US_FTA_negotiations.pdf

with so many of the EU's existing FTA partners, quite a few of whom are also developing countries. But in a deal with the US, India could reap some early mover advantage as well.

Secondly, apart from the complementarity of the two economies, India's bilateral trade with the US has shown considerable dynamism even as India's overall exports worldwide have stagnated at around US$ 300 billion since 2011-12. The US share in India's export basket has climbed from 11.35 % in 2011-12 to almost 17% now, rising even in 2019-20, a year in which India's exports to most other countries saw a decline. That there could be some more of trade and investment disengagement between the US and China, giving rise to further opportunities, buttresses this factor.

Finally, India has a surplus on services trade with the US, making an FTA which could lend greater stability and depth to this sector yet another key element. Even in respect of the level of engagement between businesses on the two sides, these are fairly intensive in a number of areas, not just in IT or IT enabled services. Substantial investments span in both directions.

That said, in terms of FTA standards, trying to match US expectations will be the most difficult for India among all the prospective FTA partners. The market access demand, particularly on the agriculture side, will be quite challenging. The US also has a penchant for exporting its domestic laws through the FTA mode, which is what constituted much of TPP.

It is perhaps keeping this in view that the Minister for Commerce and Industry, Piyush Goyal, has suggested going in for an intermediate deal covering 50 to 100 products and services at this stage, even as a full-fledged FTA may take some years to come about. He was perhaps taking the cue from the limited Phase-1 deal arrived at between the US and Japan early this year, as precursor to a comprehensive bilateral FTA. But Japan has also retained certain leverages as also a dose of scepticism about going in for a full-fledged FTA at this stage[13]. This too may be important for Indian negotiators to keep in view.

[13] See for example the reply given by Japanese Foreign Minister Motegi to a reporter's question about the time schedule for further negotiations with US beyond the Phase-1 deal. He says 'first Japan and the United States intend to conclude consultations over the agenda of discussion within four months after the date of entry into force of the Japan-U.S. Trade Agreement (Phase-1 deal). Thereafter, we intend to enter into negotiations in the areas of customs duties and other trade restrictions, barriers to trade in services and investment, and other issues in order to promote mutually beneficial, fair, and reciprocal trade. It does not mean negotiations in all of these areas.' See the link at https://www.mofa.go.jp/press/kaiken/kaiken4e_000699.html

The Phase-I deal between the US and Japan[14] involved each side agreeing to eliminate or reduce tariffs on approximately US$ 7.2 bn. each of their bilateral exports and imports, accounting together for 5% of bilateral trade. Japan's concessions extended to around 600 tariff lines in agriculture, which will enable 90% of the US farm exports to Japan to enter duty free or with reduced tariffs. In return, the US committed to reduce or eliminate tariffs on 241 tariff lines, 42 of them in agriculture, but more on certain industrial products of export interest to Japan like machine tools, fasteners, steam turbines, bicycles, bicycle parts, and musical instruments. Additionally, the Phase-1 deal also included a digital trade agreement that was more or less on the lines of the USMCA that is now being viewed by the US as a "gold standard".

The deal between Japan and the US became relatively easy and quick since the limited objective of the US was not to lose the market access gains it had secured, particularly in the agriculture sector under TPP. (Of course, Japan did not agree to including rice in the deal. The US on its part did not agree to any specific commitment on not imposing auto tariffs). With CPTPP coming into force minus the US, it was important for the US to fast track this element. For Japan, it was not too difficult a concession to make since it had already conceded to these demands under TPP. The latter also included a chapter on e-commerce that carried most of the commitments in the now signed bilateral digital trade agreement.

The question then arises what will be the driving elements that will help identify the 50 or 100 products and services in each case for an intermediate deal between India and the US? To some extent this will also depend on what gets included in the 'limited deal' presently at the finalisation stage. But if the US were to insist on a substantial agricultural trade element in the intermediate deal, it could pose a problem for India. Similarly, if the US seeks a digital trade agreement that too may become difficult for India to accept since India's national digital legal framework is still under evolution. Or will the US show more interest on concessions in respect of industrial tariffs, considering that India's average tariff levels are relatively high and also show a preference for greater access on the services side? India may find the latter easier to negotiate.[15]

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[14] https://ustr.gov/about-us/policy-offices/press-office/fact-sheets/2019/september/fact-sheet-us-japan-trade-agreement

[15] It needs to be noted that an intermediate deal or an early harvest deal is not without precedent in India's FTA negotiations. The agreement with Thailand did have an early harvest element that was perceived by the Indian industry as having had a negative impact. The Confederation of Indian Industry (CII) then came up with a paper in November 2006 providing a number of suggestions in respect of future FTAs that inter alia included doing

President Donald Trump and Prime Minister Narendra Modi at their summit meeting in New Delhi, February 25, 2020. Source: Flickr/MEAIndia

As for its own demands, India will need to carefully examine where a concessional tariff for certain products, or an increased access in a specific service sector, will give it an advantage in the US market in the immediate term. This exercise will have to be undertaken carefully, considering also the concessional access already enjoyed by certain third countries in the US. It may further be important to see if there will be certain products with export potential to be manufactured by investors currently (or soon to be) making substantial investments in India. The inclusion of such products in the intermediate deal could brighten their export prospects, which can not only benefit India but also sweeten the deal for investors.

away with early harvests which was then not resorted to in subsequent FTAs that India signed. Now that option is coming back, a consultation with the industry to get them on board would be appropriate. While this paper of CII is no longer available on its website my reference to it is contained in my earlier paper titled 'Evolution in India's Regional Trading Arrangements' which appeared in Volume 43 of Journal of World Trade in their October 2009 issue in page 914.

Even as this identification process continues, it will be advisable for India to get the limited deal signed with the US as quickly as possible and defer bilateral discussions on a possible intermediate deal until after the US Presidential elections.

Possible FTA with the UK

As for a possible FTA with the UK, here again India has been enjoying a surplus both in respect of bilateral merchandise trade and services trade. But the UK which ranked second in India's overall goods trade at the turn of the last century, has been relegated to the 16th place in recent years. While it ranked fourth among India's trade partners in both export and import in 2001-02, it now ranks 6th among India's export destinations and 18th in the list of India's import sources[16].

PM Narendra Modi and PM Boris Johnson meeting on the sidelines of the G7 Summit in France, August 25, 2019. Source: Flickr/MEAIndia

[16] India's goods exports to the UK in 2018-19, as per DGCIS, were US$ 9.3 bn (2.8% of India's overall exports) and imports the same year were US$ 7.6 bn (1.5% of India's total imports).

But the ranking of India and the UK in each other's FDI stock has risen. India stands fourth among all of the UK's FDI sources and the UK figures at the sixth position in India's FDI stock. Coupled with significant trade[17] in services, a wide spectrum of economic engagement does seem to prevail even as, thanks to the familiarity with business practices and common legal frameworks, the potential is far more. Economic complementarities further provide a good basis for an FTA that can help in the rejuvenation of bilateral economic ties. Also, as observed by a Commonwealth study[18], a India-UK FTA may be easier to negotiate than the India-EU FTA, as some of the sticking points in an India-EU FTA may be easier to resolve with the UK.

The UK's priority partners for signing an FTA, post-Brexit, presently include the EU itself, the United States, Australia and New Zealand, with which formal FTA negotiations have already been launched. The UK also believes[19] its deal with Australia will make it easy for it to become a party to CPTPP, which is another of its declared goals. Furthermore, the UK is known to be engaging in discussions with those non-EU countries which have existing trade agreements[20] with the EU.

With such a heavy negotiating calendar, early harvest deals with India, as mentioned in the joint press release, following bilateral talks, may be more doable in the short term, but the two sides will also need to come up with a roadmap. It is, therefore, a welcome step that Commerce Minister Piyush Goyal and Trade Secretary Ms. Elizabeth Truss have assigned their deputies, the Minister of State for Commerce and Industry Hardeep Puri and International Trade Minister Ranil Jayawardena, to have monthly meetings to intensify the dialogue.

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[17] As per the Office of National Statistics in UK imports of UK from India on services account were £ 5.013 bn and exports of UK to India were £ 3.951 bn in 2018

[18] See the Trade Competitiveness paper by Rashmi Banga on "BREXIT: Opportunities for India" https://thecommonwealth.org/sites/default/files/inline/TCBP_Paper%2001_Brexit%20Opportunities%20for%20India.pdf

[19] 'The UK sees accession to the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP) as an important way to combat such protectionism and an FTA with Australia as a key step towards that' - an extract from the UK government policy paper on 'UK-Australia free trade agreement-a strategic approach'accessible at https://www.gov.uk/government/publications/uks-approach-to-negotiating-a-free-trade-agreement-with-australia

[20] Just as this brief was being finalised it was learnt that UK and Japan were urgently trying to secure a free trade deal which may involve a few tweaks from the the existing EU-Japan FTA. See the link https://www.ft.com/content/177c3338-5464-4aa1-898b-885f25aeb196

There is some incentive in this for both parties if an early deal(s) can be worked out. For the UK, it could mean getting somewhat ahead of the EU and securing the first mover advantage in sectors where the two are competitors in the Indian market such as autos and alcoholic beverages, where they would be looking for tariff reductions. For India, demands from the UK may be somewhat more easily manageable, particularly if it is done in stages. Should the UK retain sufficient flexibility in terms of introducing its own standards and regulations, this too could provide an opportunity for India to try and see if it can enter into mutual recognition or equivalence arrangements in a number of areas, including agricultural items and agro-processed products where Brexit could open up the UK's market for third countries.

Just as suggested in the case of an intermediate deal with US, identifying products and services for early harvest deals with the UK will require careful study, even as the full scope available for negotiations will become clear only after the UK-EU deal is finalised on their post-Brexit trade arrangements. Fortunately, there is already a considerable body of work undertaken by the various bilateral working groups, the India-UK bilateral trade review and other mechanisms under the JTEC. Specific sectors of particular interest to each side for promoting further bilateral cooperation have also been identified.

Additionally, UK has in the month of May this year published[21] the UK Global Tariff (UKGT) that will replace the EU external tariff list from January 1, 2021. While it has simplified and liberalised tariffs on several items, labour intensive items like apparel and leather goods will still carry high tariffs[22]. Also, while India will receive standard GSP treatment for certain of its export items, countries like Pakistan, Sri Lanka and the Philippines will feature under the Enhanced GSP concession programme, while goods from Bangladesh will secure the benefit of an even more liberal treatment under the 'Everything but arms' initiative. Clearly, securing a level playing field for Indian goods through the early harvest deal must be a key objective for India.

Competitive pressures to work on the EU and Australia

Progress so made with the UK, or if possible, with the US, could induce some competitive pressure on the EU to finalise the long pending Broad Based Trade and Investment Agreement (BTIA) as early as possible. That said, on its own, India will need to internally review the long pending FTA negotiations with both the EU (started in 2007) and Australia (started in 2011) from the perspective

[21] See the link at https://www.gov.uk/guidance/uk-tariffs-from-1-january-2021

[22] Several of garment items for example will attract 12% duty for MFN imports and leather footwear 8%.

of whether some fresh approaches can be brought to the table on some outstanding issues. There are indications that both the EU and Australia[23] [24] could be looking at rebalancing their economic ties with China. Will India receive added focus? As a former Indian envoy to Australia has recently noted[25], "China might just be the catalyst that was needed to infuse new energy into a relationship that has always basked in its potential, but never managed to realise it".

PM Narendra Modi, European Council President Charles Michel and EU Commission President Ursula von der Leyen at the 15th India-EU Summit, July 15, 2020.

The Joint Statement issued following the recent India-EU summit talked generally of the two sides continuing to work towards trade and investment agreements, but did not specifically talk of reviving the BTIA negotiations. Even so, the two sides agreed to have a regular high-level ministerial dialogue to provide guidance to bilateral trade and investment relations. It is hoped that

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[23] See for example the news item "How reliant is Australia on China' dated 17 June 2020 accessible at https://www.bbc.com/news/world-australia-52915879

[24] See also for example the policy brief by Andrew Small on 'The meaning of systemic rivalry between Europe and China' which inter alia notes "on issues ranging from supply chains to ideological competition, European governments have rebalanced their view of what dynamics with China should look like in the aftermath" accessible at https://www.ecfr.eu/publications/summary/the_meaning_of_systemic_rivalry_europe_and_china_beyond_the_pandemic.

[25] See the link at https://theprint.in/opinion/a-belligerent-china-can-be-just-the-catalyst-india-australia-ties-need/434998/

this political level engagement will provide impetus for exploring the outstanding issues afresh. Reference to trade and investment agreements generally in the Joint Statement could perhaps provide the high-level group the flexibility to explore limited agreements to begin with.

The Joint Statement after the India-Australia summit was more specific about reviving the CECA negotiations. The two Prime Ministers in their respective statements indicated that the speed and scope for growth of trade and investment ties between the two countries should be far higher, particularly with the two sides elevating the ties to a comprehensive strategic partnership.

PM Narendra Modi with PM Scott Morrison at the India-Australia virtual Summit on June 4, 2020. Source: PMIndia

Downsides of a phased approach towards FTAs

This brief will not be complete if it does not caution against certain issues that can arise from a more phased approach towards FTAs starting with limited deals. Firstly, FTAs normally involve a package with some market access gains to be made in certain sectors by one party and concessions given on others that can be of greater benefit to the other party, but which taken together are seen as an acceptable compromise for the parties involved. If this process is undertaken in instalments, there will be pressure to ensure that each instalment is balanced, which may not always be easy. Secondly, where Congressional/Parliamentary approval may be necessary, as in the case of the US, doing this in stages may become decidedly problematical. In the case of the

US-Japan Phase-1 deal, the Trump Administration used delegated tariff authorities[26] in the Trade Promotion Authority (TPA) to proclaim that the deal did not require changes to US law, and the deal was treated as an Executive Agreement. This may not always be possible. If India is keen on a totalisation agreement, for example, this will involve changes to US law. Thirdly, it is not abnormal in democratically elected systems of governance for a subsequent administration to dissociate itself with the agreements signed by preceding ones. This has happened with the US on more than one occasion where a subsequent administration has pressured the trade partner to make more concessions. An FTA done in instalments could be even more vulnerable to such pressures and our negotiators will have to build in possible leverages that can deal with such eventualities.

Conclusion

In conclusion, it bears reiteration that FTAs or limited trade and investment agreements as precursors can benefit us economically up to a point, but the principal contribution has to come from domestic reform efforts. It will be futile to rely mainly on foreign investments or to expect that becoming part of supply chains will bail us out, even though these are important avenues for economic growth. Such investments themselves will also realise their full potential only if we work to significantly reduce transaction costs, facilitate trade and enhance ease of doing business. This writer has already dwelt on this aspect at some length in an earlier brief on the Aatmanirbhar policy and trade[27].

That said, there is presently an urgent need for a rapid turnaround in the prevailing business environment. International investors will need to sense a revived business sentiment and government intent to rethink trade and investment on bold lines, even as it is keen to lay down strong foundations for its Aatmanirbhar policy. India should try and generate a perception of trust among its shortlisted FTA partners, not only for accessing the large Indian market but also for using its competitive advantages and secure environment for investments. Concluding trade and investment deals, big or small, will prove beneficial for India's economy if our policymakers strategise and avoid some of the pitfalls outlined in this paper.

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[26] This is indicated in the US Congressional Research Service report on US-Japan trade agreement negotiations at https://crsreports.congress.gov/product/pdf/IF/IF11120

[27] See https://www.delhipolicygroup.org/uploads_dpg/publication_file/aatma-nirbhar-bharat-abhiyan-and-the-trade-factor-1840.pdf

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