

The EU-India FTA: initial observations from a development perspective



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TRAIDCRAFT
Fighting poverty through trade

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About Traidcraft

Traidcraft Exchange is the UK’s only development charity specialising in making trade work for the poor. In collaboration with local partners we work to create opportunities for poor people to harness the benefits of trade, helping them to develop sustainable livelihoods. Traidcraft also aims to use the experience of its sister fair trade company, Traidcraft plc, to improve wider trade practices. Traidcraft’s Policy Unit conducts research and advocacy work to improve trade rules and the practice of companies.

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Executive summary

In June 2007, the European Commission (EC) and the Government of India embarked on negotiations towards a comprehensive and far-reaching Free Trade Agreement (FTA), which could have significant consequences for the Indian economy and poverty reduction efforts.

Although both parties were initially enthusiastic in their pursuit of an FTA, key fault-lines are now emerging. India is seeking lower levels of liberalisation than initially proposed, in order to protect its sensitive sectors, and wants to exclude key areas – for example government procurement - from the negotiations altogether. Thus far, the EC has rejected these proposals and has insisted that India and the European Union (EU) are ‘equal players in this negotiation and should have a high level of ambition’.

In European media India is regularly portrayed in terms of its impressive levels of growth, its high-technology services sectors and the bullish attitude of its major conglomerates in European markets. However, such a characterisation masks the bigger picture.

- India’s GDP is 6% of the size of the EU’s. Its per capita income ranks it alongside Nicaragua, Angola and Vietnam.
- India has the largest numbers of poor people of any country in the world. According to new Asian Development Bank (ADB) measures 792 million (nearly three quarters of the population) live on less than a dollar a day. This is equivalent to the entire population of Africa, the Caribbean and Pacific countries combined.
- For the EU trade with India makes up 2% of its total trade, while for India the EU is its largest trading partner, making up 20% of its total trade.

A growing body of literature shows that developing countries entering into trade agreements with richer country partners which lock down far-reaching liberalisation and de-regulation commitments have faced serious risks to their vulnerable sectors - such as small farmers, small and medium enterprises (SMEs) and workers - as well as reduced flexibility to implement national policies. India has taken a leading role at the World Trade Organisation (WTO) to mitigate these risks: notably the WTO mini-ministerial meeting in July 2008 ended without conclusion, in part because of the stance taken by India – on behalf of many developing countries – that they should retain tools and flexibilities to defend farmers, vulnerable industries and future economic development needs. Yet many of India’s concerns in the WTO are equally, if not more, warranted in the context of the proposals for the EU-India FTA.

This report examines key aspects of the EU-India FTA, with a focus on the likely impacts on sectors that are important to poverty reduction and development. It considers in particular the consequences for India of liberalising its trade in goods, retail, financial services and government procurement. A number of fundamental issues are assessed, concerning both the increased presence of EU goods and businesses in India and the reduced scope for regulation that the FTA would entail.

Drawing on the evidence and research base currently available, this report finds that the FTA could have a number of early-felt impacts in India, for example:

- immediate risks from liberalisation to EU products for a very wide range of vulnerable sectors – from agricultural products, including dairy, to light manufactured products such as paper. In the auto-parts sector the EU's own impact assessment predicts that the FTA will have a 'notably negative' short-run impact and cause a significant fall in employment. Not all of the sectors of critical importance to livelihoods will be able to be protected and difficult choices will have to be made
- inadequate safeguards to protect vulnerable sectors in case of import surges, even though India has fought hard for these in the WTO
- diminished government revenue with an increased pressure on the Indian government to either cut public spending or increase domestic taxes to off-set the shortfall
- an acceleration of the entry of major European retail chains, which will drive concentration within the sector. This is likely to exacerbate the already negative impacts for the informal sector, which includes millions of India's poorest people, whilst also tying farmers into greater dependency and vulnerability
- the FTA may restrict India's options for South-South partnerships or other strategic alliances.

In addition, the FTA is likely to restrict the scope for India to regulate in the interests of development in a number of ways. For example:

- export taxes that can promote domestic value addition, as they have in the Indian leather sector, could be restricted
- the scope for the Indian government – at federal or at state levels – to regulate the operations of large retail chains in the interests of small retailers and farmers could be challenged
- the potential for India to use its vast government procurement market to address inequalities by directing spending towards marginalised sectors could be curbed
- the potential to oblige banks to extend loans to SMEs and rural customers – as was successfully undertaken by India in the past – could become more difficult.

There are growing concerns, including from the UN and others, that North-South FTAs may be intrinsically problematic for the less developed partner – because they reduce the national policy space that can play such an important role in the medium and long-term growth of domestic industries. Unless India is able to negotiate an agreement that looks very different from current EU proposals, it is highly questionable whether the EU-India FTA is the best way forward for development.

Introduction

The context of negotiations

In June 2007, the European Commission (EC), on behalf of the EU member states, and the Government of India embarked on negotiations towards a comprehensive and far-reaching free trade agreement (FTA)¹. This is one of a series of FTAs that India is involved in, although most of the others are with developing country partners². In comparison to India's other FTAs, the proposed EU-India trade deal has more significant implications because of the magnitude of the imbalance between the two parties and the extent of its proposed coverage.

A growing body of literature shows that developing countries entering into trade agreements with richer country partners which lock down far-reaching liberalisation and de-regulation commitments have faced serious risks to their vulnerable sectors - such as small farmers, SMEs and workers - as well as reduced flexibility to implement national policies³.

In the multilateral context, India has taken a leading role amongst developing countries to mitigate these risks, insisting that any new World Trade Organisation (WTO) deal must be driven by development objectives. The WTO mini-ministerial meeting in July 2008 ended without conclusion, in part because of the stance taken by India – on behalf of many developing countries – that they should retain tools and flexibilities to defend farmers, vulnerable industries and future economic development needs.

Yet as this report will show, many of the concerns about the development impacts of the WTO proposals rejected by India are equally, if not more, warranted in the FTA context. Indeed, the Indian government itself has recently expressed concerns about a number of the EU's proposals for the FTA.

Europe's global strategy

The EU's decision to negotiate an FTA with India dovetailed with the launching in 2006 of its new trade strategy, 'Global Europe: Competing in the World'. The Global Europe strategy has arisen in a context of Europe's decreasing share of world markets, the rise of new global competitors such as China, and a failure to secure sufficient levels of increased market access into developing countries through the WTO. The strategy is aimed at 'keep[ing] the EU at the forefront of international competitiveness' through seeking to make progress in the WTO, but also through pursuing increased and preferential levels of access to new and growing markets through the FTA route. The EU is particularly targeting countries or regions with large but still relatively protected markets, including India, ASEAN, South Korea, Central America and the Andean countries, where the gains to EU companies are likely to be greatest. A further factor is that 'several of [the EU's] main trading partners and priority targets have been negotiating FTAs with [the EU's] competitors'⁴, which makes it particularly important for the EU to secure preferential agreements with these countries in order not to be left behind.

Footnotes

- 1 FTAs are bilateral or regional trade agreements requiring extensive liberalisation of goods and services between trading partners. FTAs typically go beyond multilateral commitments, by binding partners to more far-reaching liberalisation and by introducing new rules on investment and other trade-related areas.
- 2 During the past 10 years India has concluded FTAs with Sri Lanka, Singapore, Thailand, MERCOSUR, Chile, Nepal and BIMSTEC. India recently concluded an FTA with ASEAN, is part of an ongoing process leading towards an FTA with South Asian countries (SAFTA) and it is also negotiating with Japan, Korea, Malaysia, the South Africa Customs Union, Brazil, South Africa and the Gulf Cooperation Council.
- 3 For specific country cases see, for example, A. Nadal (2000), The Environmental and Social Impacts of Economic Liberalisation under NAFTA; African Trade Policy Centre, UN Economic Commission for Africa (March 2005) Karingi et al. 'Economic and Welfare Impacts of the EU-Africa Economic Partnership Agreements'. For more generic concerns see UNCTAD (2007); Joseph Stiglitz, cited in La Jornada, 19 May 2006; Oxfam 2006, Signing Away the Future; H.J. Chang
- 4 European Commission (October 2006) 'Global Europe: Competing in the World'

2005

an EU-India summit generates 'political commitment to increase bilateral trade and economic cooperation and to tackle barriers to trade and investment' between the two trading partners. A High Level Trade Group (HLTG), comprised government representatives and business leaders is mandated to take this forward.

2006

a decision is taken to launch an FTA on the basis of broad parameters defined by the HLTG.

2007

negotiations begin with a shared commitment to aim for conclusion by the end of 2008.

2008

by August four rounds of negotiations have taken place and a range of differences are emerging between the two parties. The likelihood of a 2008 conclusion looks increasingly slim.

In the EU's current raft of FTAs it aims to go far beyond not just existing WTO commitments but also proposals being discussed in the ongoing Doha Round. Objectives set out in the Global Europe strategy as well as in the EC's mandates for individual FTAs include:

- faster and deeper tariff liberalisation
- the removal of restrictions on exports in order to facilitate EU industries' access to raw materials
- new rules on investment as well as competition policy, both of which were rejected by India and other developing countries in the WTO
- increased commitments to further open up services
- new rules on government procurement, also rejected by developing countries in the WTO, but which the EU sees as 'an area of significant untapped potential for EU exporters in advanced and emerging economies'⁵
- stricter enforcement of intellectual property rules
- extended rights for third-party stakeholders, including companies, to be consulted in advance of partner countries' introduction of new regulations⁶

In addition, the EU has started to insist that FTA partners commit to extending to the EU any terms that they grant in the future to other major trading partners. The inclusion of a 'most-favoured nation' (MFN) clause in the EU's FTAs and Economic Partnership Agreements (EPAs) has been widely criticised by the African, Caribbean and Pacific (ACP) countries involved and other developing countries for being an infringement upon national sovereignty and an obstacle to building preferential South-South trading arrangements.

The EU's FTA negotiations with ACP countries (EPAs) demonstrates its willingness to negotiate aggressively for its interests, even with very poor countries. Throughout the EPA negotiations, the EC consistently stressed the primacy of development objectives and the EU's lack of offensive interests in ACP markets⁷. Yet even in this context, the EU has pushed extremely hard to secure the same kinds of extensive WTO plus commitments outlined in its Global Europe strategy⁸.

In its dealing with India the EU will expect even more extensive coverage, as it sees the two parties as 'equal players in this negotiation'⁹ and expects the agreement to be "comprehensive and ambitious in coverage, aiming at the highest possible degree of trade liberalisation including far-reaching liberalisation of services and investment" in line with the Global Europe strategy¹⁰.

Unlike the EU's stated lack of offensive interests in ACP markets, the EU and its companies have clear ambitions to extend their reach into India's rapidly expanding market. The EU appears particularly concerned to gain access to India's government procurement market, to improve access for its foreign investors in manufacturing sectors as well as in key services including banking and retail. European companies also have interests in exports to India across a range of sectors from automobiles to dairy products.

Footnotes

- 5 European Commission (2006) op cit
- 6 European Commission (2007) Recommendation from the Commission to the Council – Authorising the Commission to negotiate a free trade agreement with India on behalf of the European Community and its Member States (henceforth referred to as EC mandate for EU-India FTA), paragraph 37
- 7 See, for example, speeches by Trade Commissioner Peter Mandelson, available at http://ec.europa.eu/commission_barroso/mandelson/sp_dev_en.htm
- 8 See Griffiths, M. et al (2007) 'Partnership Under Pressure'; and Oxfam International (2008) 'Partnership or Powerplay' for examples of coverage of interim EPAs
- 9 European Commission (2008) EU-India FTA Negotiations: EC Key Messages', January-February 2008
- 10 EC mandate for EU-India FTA (2007) op cit

India's stance

The Indian government and industry representatives have approached the FTA with Europe with initial enthusiasm. The report of the High Level Trade Group (HLTG) - in which the Indian government and selected industry representatives played an active role - set out far-reaching parameters for the FTA very similar in scope to those outlined in the EU's own global strategy.

In the context of the FTA, India is keen to secure better access for Indian service providers in EU markets, to improve its market access in key product sectors, notably textile and clothing exports (in a context of increased competition from China, Bangladesh and Vietnam) and to remove some of the non-tariff barriers to its exports of agricultural products to the EU. The Indian government also sees opportunities for attracting inward foreign direct investment (FDI) in a number of strategic sectors, as well as having interests in outward FDI to Europe.

However, as the negotiations have progressed, India has identified a number of sensitivities which the EU does not appear ready to accommodate.

Fault-lines emerging

Key fault-lines are beginning to emerge in the negotiations. The Indian government has sought lower levels of liberalisation than initially proposed by the High Level Trade Group, in order to retain sufficient scope to protect its sensitive sectors, in particular in agriculture. The Indian government also has stated it wants to exclude government procurement from the negotiations. However, the EU sees inclusion of government procurement as a non-negotiable and has also so far objected to asymmetry in tariff liberalisation commitments.

Whilst the EU is treating India as an equal partner in the negotiations, a number of realities about India need to be borne in mind when assessing the scope for an FTA to deliver development outcomes.

India's impressive growth

In European media India is increasingly characterised by its impressive levels of growth, its high-technology services sectors and the bullish attitude of its major conglomerates in European markets.

There is ongoing debate about the role of trade liberalisation to date in driving India's growth¹¹. Whatever the driving factors, India is certainly recognised for its economic growth levels that have accelerated during the past few decades, from annual GDP growth of around 3% in the 1960s and 1970s to 5% in the 1980s to the current levels of more than 8%¹². Its economy is well known globally for its expanding output in high-technology services sectors, in particular IT and other business services as well as banking and communication services. In addition, major investments from Indian corporations in high-profile European companies and brands - notably Tata's purchases of Corus steel, Tetley tea and most audaciously Jaguar and Land Rover - have contributed to a popular perception of India as an emerging global superpower. However, such a characterisation masks a more complex picture.

Footnotes

- 11 Harvard economists Rodrik and Subramanian (2004) have presented evidence to challenge prevailing orthodoxy from the World Bank and others that trade liberalisation has been the key catalyst of India's growth. See Rodrik and Subramanian (2004) 'From "Hindu Growth" to Productivity Surge: The Mystery of the Indian Growth Transition', IMF Working Paper
- 12 Based on data from Central Statistical Organisation of India

- India's GDP is only 6% of the size of the EU's¹³
- for the EU, trade with India makes up only about 2% of its total trade; for India, trade with the EU makes up about 20% of its overall trade¹⁴.

... and its persistent poverty and inequality

Whilst certain groups in India are amassing huge wealth and the middle classes have certainly been expanding, poverty levels remain extreme and inequality appears to be growing.

- Using the PPP conversion measure India's GDP per capita stands at about \$3,800, similar to the levels of Nicaragua, Angola and Vietnam¹⁵.
- Using new poverty estimates from the Asian Development Bank (ADB), GDP per capita is even lower – at about \$2,100¹⁶.
- India has the largest numbers of poor people of any country in the world. According to new ADB measures, the actual numbers of poor people living on less than \$1 per day (at PPP measure) are as many as 792 million or 73% of the population; those living on less than \$2 per day as over one billion people or 94% of the population¹⁷. This is more than the entire population of the ACP countries combined.
- While poverty levels appear to have reduced overall, the rate of poverty reduction appears to have slowed and inequality to have risen, according to a number of recent studies¹⁸.
- A 2008 report from UNICEF finds that “unless India achieves major improvements in health, nutrition, water and sanitation, education, gender equality and child protection, global efforts to reach the millennium development goals (MDGs) will fail.”

Much of India's growth has been services-driven (services grew by an average of 7.5% per annum during the 1990s, as compared to 5.8% for industry and 3.1% for agriculture). Unfortunately this services sector growth has not led the way in job creation. The modern services sector (excluding informal services such as small-scale retail) accounts for only a small proportion of overall employment and household incomes. In 2003 the International Monetary Fund (IMF) joined a host of voices to talk about the ‘the relatively jobless nature of growth in the Indian services sector’¹⁹. Today India's high-technology services sector still employs less than 1% of the workforce²⁰.

Meanwhile, more than half the population works in agriculture, yet agricultural incomes are stagnating and farmers work in a context of underinvestment combined with an erosion of institutions and service provision.

Few new jobs are being created in manufacturing sectors. Indeed, according to one study there has been no rise in employment in manufacturing from pre-1990s reforms to the post-liberalisation period²¹.

Footnotes

13 Based on figures from CEPII – CIREM (2007) ‘Economic Impact of a Potential Free Trade Agreement between the European Union and India’

14 <http://www.eubusiness.com/Trade/India%20EU%20trade/>

15 Polaski, S. et al (2008) ‘India's Trade Policy Challenges’, Carnegie Endowment for International Peace p.,3 based on IMF World Economic Outlook Database 2007

16 Based on Asian Development Bank (2007) Purchasing Power Parity Preliminary Report

17 Calculations by Polaski et al (2008) op cit, based on ADB measures (2007)

18 ADB Key Indicators 2007; ADB (October 2007), ‘The Millennium Development Goals: Progress in Asia and the Pacific 2007’; National Commission for Enterprises in the Unorganised Sector (NCEUS) (2007), ‘Report on the Conditions of Work and Promotion of Livelihoods in the Unorganised Sector’, UN Millennium Project (2005), ‘Investing in Development: A Practical Plan to Achieve the MDGs’

19 Gordon J. and Gupta P. (2003) ‘Understanding India's Services Revolution, IMF Working Paper

20 Polaski et al’, op cit

21 Ghosh J. Sengupta A. and Roychoudhury A. (2008) ‘The Impact of Macroeconomic Change on Employment in the Retail Sector in India: Policy implications for growth, sectoral change and employment’, Economic Research Foundation, New Delhi, for the International Labour Organisation (ILO)

And overall employment levels have been getting worse. National Sample Surveys on Employment and Unemployment revealed a sharp decrease in the rate of employment generation across both rural and urban areas during the 1990s. For permanent or secure jobs the rate of increase was close to zero. In both rural and urban areas the absolute number of unemployed increased substantially, and the rate of unemployment went up as well²².

In sum, whether or not trade liberalisation has been the key catalyst for India's growth, it does not appear to have catalysed sufficient levels of poverty reduction, nor provided sufficient jobs in sectors of relevance for poor people – and it has coincided with growing levels of inequality. The question is whether the EU-India FTA can help to reverse this trend.

Initial assessments - based on economic modelling - do not bode well for India. For example, one study by Carnegie anticipates ‘the overall impact on India would be slightly negative, with overall real income and private household consumption showing small declines’. The study anticipates only very modest gains in employment generation and conclude that while ‘the potential gains are modest ... the risks are not insignificant’²³.

About this report

The following chapters explore these risks in greater depth and ask whether the EU-India FTA will exacerbate or alleviate the immense poverty and inequality highlighted above. In particular the report focuses on the impacts upon small and medium enterprises (SMEs) and small farmers. According to official figures India has 13 million SMEs employing around 41 million people and accounting for 6% of GDP²⁴. Meanwhile, over half of India's population still live on the land, of whom 80% are small farmers owning less than two hectares of land. Given the high unemployment and level of inequality in India, these sectors are likely to be critical both for employment generation and for a more equitable distribution of economic growth. As a development NGO working to ‘fight poverty through trade’, Traidcraft is concerned to ensure that these groups are strengthened and not undermined as they have an important role to play in catalysing sustainable and equitable economic development.

This report does not attempt to be comprehensive in its review of the proposed FTA but rather focuses on the potential implications for several sectors of the Indian economy as illustrations of the risks involved. The sectors chosen are goods, retail services, financial services and government procurement, each of which have specific relevance for poor people and the achievement of development goals. Subsequent chapters explore these sectors in turn.

The report is based on a review of existing, available studies and impact assessments on the EU-India FTA and specific sectors of the Indian economy. It also draws on the experience of other FTAs - notably the EU-Chile agreement and on Traidcraft's existing expertise on EPAs.

Footnotes

22 Cited by Ghosh J. Sengupta A. and Roychoudhury A. (2008) op cit

23 Polaski et al, op cit

24 All figures for 2007, Government of India, MSME website

Tariffs as development tools

- When the US had the same levels of per capita income as Brazil and China have today, its applied tariffs were four times higher³⁰.
- Many of today's developed countries had average tariff rates in the region of 30-40% until the 1950s³¹.
- Tariffs were an important part of the growth strategies of successful East Asian economies such as Korea.³²

This chapter looks at the likely implications for India of liberalising its goods trade as part of an EU-India FTA. It assesses whether the proposed liberalisation could limit India's scope for protecting existing sensitive sectors – with consequent impacts on marginalised producers - and whether government policy space to develop new industries in the future could be restricted.

Far-reaching liberalisation between unequal partners

A central element of any WTO-compatible FTA is that both parties should eliminate tariffs on 'substantially all trade' in goods, covering both agricultural and manufactured products, 'within a reasonable length of time'²⁵. The EU has generally interpreted this to mean approximately 90% of trade over a maximum of ten years, although it has allowed a minimal degree of flexibility on this for its trade agreements with ACP countries on development grounds.

Prior to the start of negotiations, the EU and India preparatory group (the High Level Task Force) agreed to go even further than the EU's already quite narrow interpretation of WTO requirements, by aiming to liberalise 90% of tariff lines and trade volume over 7 years²⁶. While India has since asked for a reconsideration of the extent of liberalisation it should be expected to undertake, the EU has refused, insisting that 'the EU and India are equal players in this negotiation ... the level of duty elimination on both sides should be comparable'²⁷.

India takes on significant commitments, with more to lose

Although India did undertake considerable reductions in its applied tariffs during the 1990s and beyond, dropping from an average of 79% tariff (unweighted) in 1990 to 17% in 2005²⁸ it is still considered a relatively protected economy and its tariff levels remain significantly higher than the EU's 2% average. This should not be surprising. Most now-developed countries maintained higher tariffs than their more advanced competitors at their earlier stages of development as part of an industrialisation strategy. For example, during the 19th century and until the end of the Second World War, the US – in an effort to catch up and then overtake the UK - maintained average tariffs of between 35-50%, only liberalising after it had established industrial dominance²⁹.

In the WTO context India has long maintained that it requires the flexibility to use tariffs to support a range of sectors. The Indian government and major industry bodies strongly objected to non agricultural market access (NAMA) proposals that would commit developing countries to drastically reduce their use of tariffs and cap them at low levels³³. India has also objected to the uneven nature of proposals in which developing countries – because they now largely have higher tariff levels than developed countries – would be expected to undertake much higher reductions than their developed country counterparts.

Footnotes

25 Article 24 GATT

26 EU-India High Level Trade Group (October 2006), Report of the EU-India High Level Trade Group to the EU-India Summit

27 EC EU-India FTA Negotiations: Key Messages (Jan-Feb 2008)

28 CARIS-CUTS International (2006) 'Qualitative Analysis of a Potential Free Trade Agreement between the European Union and India'

29 Chang H.J. (2007) 'Bad Samaritans: Rich Nations, Poor Policies and the Threat to the Developing World'

30 Ibid

31 South Centre (2005) 'Why Developing Countries Need Tariffs'

32 Ibid

33 Letter from Chairman of the Confederation of Indian Industry's WTO and Trade Agreements Committee, Mr R. Gopalakrishnan, to WTO Director-General Pascal Lamy, 24 June 2008

Despite India's firm stance in the multilateral context, the government is faced with much more far-reaching commitments in the EU FTA than even the most extreme proposals on the table in the WTO. Given the difference in existing tariff structures between the two partners, it is India that will have to take on the far greater burden of commitments, as it has to drop from an average of 17% to 0%, in contrast to the EU's obligations to drop from 2% to 0%, for the vast majority of respective product lines. In addition, as India is far more dependent upon trade with the EU than vice versa, the effects will be felt more deeply and widely across a range of sectors.

The extent to which India will be able to successfully 'adjust' and reap benefits from such far-reaching elimination of tariffs in a trade deal with a much richer economy remains to be seen. The predicted increases in exports are extremely asymmetrical, with one study predicting EU exports to India rising by \$17-18bn, while exports from India to the EU only increasing by \$5bn (of which the vast majority is in textiles and leather)³⁵.

Tough choices about sensitive sectors

If India has to eliminate tariffs on at least 90% of its trade, there is limited scope for sheltering sensitive sectors.

The number of existing sectors that could potentially suffer from direct competition with the EU is considerable. A number of studies have so far identified as 'sensitive' an extensive range of agricultural and meat products, animal and vegetable oils, processed food, fish and fish products, wines and spirits, tobacco, paper, furniture and bedding, plastic products, chemicals, low-end machinery and equipment, various types of vehicles and vehicle-parts, and certain textile products³⁶.

In addition, the Indian government still reserves a number of products for exclusive manufacture by SMEs. The list has reduced over the years, but still includes products ranging from ground nut oil to various electrical parts, which might also be sensitive to EU imports.

The first sustainability impact assessment study estimates that production will diminish across a range of sectors – as a result of the EU-India FTA – with these effects being most pronounced in paper production, publishing, transport equipment, processed food and beverages and tobacco products. The study estimates "large expected negative changes in employment" across these sectors in particular³⁷.

Indian industry sources have suggested that products in the manufacturing sector may be most likely to be hit, as a significant proportion of the sensitive list will go towards shielding sensitive agricultural products. In the end, decisions about which products make it onto the limited 'sensitive list' (the list of products that will not be subject to liberalisation) will require difficult trade-offs between and within agricultural and manufacturing sectors, and will also be subject to negotiation with the EU and its own companies' interests.

Footnotes

34 CARIS-CUTS, op cit

35 CEPII-CIREM (2007) op cit

36 CARIS-CUTS, op cit; Ecorys, CUTS International and Centad (May 2008) 'Global Analysis Report for the EU-India Trade Sustainability Impact Assessment (TSIA)', draft TRADE07/C1/C01 (commissioned by the European Commission) and transcript of conference on 'Exploring New Regionalism – the EU, India and Beyond', organised by Centad, New Delhi, 30 October-1 November 2007

37 Ecorys et al, op cit

'the signing of an FTA between the EU and India ... implies a more substantial change in tariffs for India than for the EU, and consequently more structural adjustment. The greater degree of structural adjustment will occur not simply because of the higher average tariff levels in India but also because of the far greater importance of the EU in Indian trade in comparison to the importance of India in the trade of the EU'.³⁴

Examples of products at risk

Auto and auto-parts

The Indian auto and auto-parts industry is of great importance for employment (it provides an estimated 10 million jobs), contribution to GDP (currently 5% of India's economic output) and its multiplier effects on the wider economy (it is estimated that for every job created directly by the automotive industry, a further seven are created indirectly in the economy at large)³⁸. The sector has major growth potential - in 2007 the Indian government launched an automobile plan that aims to quadruple turnover and provide an additional 25 million jobs by 2016³⁹.

In the context of WTO negotiations, Indian industry representatives have pointed to the sensitivities of the auto and auto-part sector, and fought hard to retain the flexibility to exclude these sectors from liberalisation commitments, which they note would hit SMEs the hardest⁴⁰.

Within the Indian auto-component sector SMEs play a central role, with a high number of companies that are classified as 'small' and part of the unorganised sector. A 2006 study 'SMEs and the Auto-component Industry' recognised SMEs as already key contributors to the total production of auto-components and with considerable potential for increasing participation in the sector. The nature of the production process enables operations that can be divided and tiered in a way that is conducive for SME production⁴¹.

However, the aspirations for increased employment and SME participation could be undermined through the EU-India FTA (despite India's defence of these sectors in the WTO). An EC-commissioned impact assessment study predicts an expansion of EU imports of between 30-50% in motor vehicles and parts, with a 'notably negative' short-run impact and a significant fall in employment in the sector⁴². Another EC-commissioned study predicts 'a significant production decrease' in the sector⁴³.

Whilst the Indian government has reassured the sector that it will aim to exclude some auto and auto-part product lines from liberalisation by adding them to its sensitive list, the EU is likely to negotiate hard against such a move, since the European Automobile Manufacturers Association has already stressed that such a scenario would cause 'concern' to European automobile manufacturers⁴⁴.

Footnotes

- 38 BBC report, 30 April 2007, 'India eyes 25 million automotive jobs', <http://news.bbc.co.uk/1/hi/business/6583203.stm>
39 As cited by Automobile Component Manufacturers Association of India (2008) http://acmainfo.com/docmgr/Status_of_Auto_Industry/Status_Indian_Auto_Industry.pdf
40 Mr Banerjee of Confederation of Indian Industry (CII) speaking at WTO Mini-Ministerial in Geneva on 24 July 2004, cited in 'Trade: Indian SMEs will be hit by NAMA proposals, say industry leaders', in SUNS #6524 dated 24 July 2008
41 Dun & Bradstreet India (2006), 'SMEs and the Auto-component Industry', <http://www.dnb.co.in/SMEs/executive%20summary.asp>
42 Ecorys et al, op cit
43 CEPII-CIREM, op cit
44 European Automobile Manufacturers Association representative, 5 June 2008, Brussels, minutes of public meeting on Trade Sustainability Impact Assessment

Paper

The paper industry in India provides employment to nearly 1.5 million people and contributes Rs 25 billion in government revenue. The country is almost self-sufficient in manufacture of most varieties of paper and paper-board. There are about 650 industrial units engaged in manufacture of pulp, paper and paper-board. Because of the low costs involved in setting up industrial paper plants and relatively low technology requirements, a large number of paper companies are small-scale units. In addition a number of paper products remain on the government's reservation list for exclusive SME production.

But the Indian paper industry has long been a target of EU exporters for further liberalisation. Between 2001 and 2003 the European pulp and paper industry had complained that India retained high tariffs in various paper products and that 'the total cumulative duty applied by India in the sector is one of the highest in the world'. The Confederation of European Paper Industry (CEPI) has recently complained that the lack of progress in the current WTO round "will limit opportunities for the European pulp and paper industry" such that the European paper industry "will not improve access to the growth markets in emerging economies such as China, India and Mercosur countries". CEPI goes on to urge that "it is only fair to expect that these countries meet the challenges of free trade and eliminate their tariffs as soon as possible"⁴⁵. Given the latest WTO failure, European paper industry lobbies are now more likely to press for their interests to be secured through the EU-India FTA.

However, early indications suggest that liberalisation of this sector will undermine jobs and the survival of SMEs. The first set of analysis from the EC's Trade Sustainability Impact Assessment have predicted that jobs will be 'shed' in the Indian paper sector.

Processed dairy products

India's dairy industry is the largest in the world. The sector has assumed a key importance in providing employment and income generation opportunities for millions of rural families. Most dairy farmers are landless and marginal farmers who are able to produce at a very low cost, thereby making their product highly competitive in the market. The sector contributes up to a third of the gross income of rural households and nearly half for the landless and is seen as one of the most pro-poor sectors in India⁴⁶. There are over 100,000 village dairy cooperatives, the largest of which is the highly successful AMUL cooperative, jointly owned by 2.6 million milk producers in Gujarat and providing wide-ranging extension services to its members.

In addition to raw milk production, the Indian dairy sector encompasses the processing and marketing of a wide range of value-added products, from butter, to cheeses and flavoured milk and yoghurt drinks. With increasing income levels in cities, the demand for processed dairy products has been expanding - providing good opportunities for India's dairy farmers and processors. However, this market is also being targeted by the EU dairy sector.

Footnotes

- 45 See www.cepi.org
46 National Dairy Development Board Statistics; and Goswami B. 'Can Indian Dairy Cooperatives Survive in the New Economic Order?'

With the growth of the India middle classes the EU dairy sector now regards India as 'a target for EU value-added products'⁴⁷, especially in products such as cheese, whey and milk powder, as well as butter fat⁴⁸. European dairy companies perceive India as one of the most difficult markets to get into, as it is characterised by 'unrealistically high import tariffs' which 'prevent any substantial imports'⁴⁹. Therefore 'improved market access through FTAs' is considered essential with 'equal or better access than the EU's competitors' being the objective so that 'the EU [is not] left behind'⁵⁰. India's tariff and non-tariff barriers to dairy imports have been a factor contributing to EU companies seeking to enter the Indian market through other means – i.e. by establishing a presence within the country: 'local collaboration for now [is] the only option to do business'⁵¹. For example, Nestlé has an Indian subsidiary and Danone has been trying to establish one. However, EU companies are also interested in accessing India's market through exporting to it, as they already do to a number of other Asian countries⁵². The EU-India FTA is the key route through which they will wish to secure this offensive interest.

Meanwhile, despite ongoing reform of the EU's Common Agricultural Policy such that subsidies will no longer be linked to the production of specific agricultural commodities, European dairy producers will continue to receive general EU aid payments under the Single Payment Scheme.

During 1999-2000, when the tariff for skimmed milk powder was zero, India imported 130,000 tonnes of subsidised skimmed milk powder from the EU - a quantity that would have attracted subsidies worth €5 million according to calculations by Oxfam⁵³. The Indian dairy industry complained that domestic milk producers were unable to compete with these imports of heavily subsidised EU butter and milk powder – and the government subsequently increased tariffs on skimmed milk powder. Yet this kind of flexibility to raise tariffs would be removed if India had to liberalise its dairy sector through the EU-India FTA. In the context of the European dairy sectors' offensive interests in India, this could provide a direct threat to millions of India's most marginal farmers and landless people.

As already noted, of all of these products, some will make it onto the sensitive list and not be subject to EU competition. But difficult choices will have to be made and some sectors (and the livelihoods of those who depend on them) will have to be sacrificed.

Inadequate safeguards

Given the extent of predicted EU imports, safeguard instruments are likely to be particularly important for India to secure in these negotiations. However, the experience of the WTO and other FTAs suggests that the safeguards in this FTA are likely to be inadequate.

Existing WTO safeguards are notoriously difficult for developing countries to use, because they require complex and lengthy procedures in order to establish cause of damage as well as proof that the concerned domestic industry has been injured. The

Footnotes

- 47 'Dairy Trade Offensive Interests', presentation by Jack Baines, president of Eucolait, 25 June 2007
48 *ibid*
49 Presentation to Consultation on EU Agri-Food Export Interests, by European Dairy Association, Rik Lodders, Commercial Director of Nutrifeed, Brussels, 25 June 2007, available at http://ec.europa.eu/agriculture/events/foodexport2007/campina_en.pdf
50 Baines j., Ecolait, *op cit*
51 Lodders, Nutrifeed, *op cit*
52 For whey, six of the top seven export markets are in Asia, while Japan is the third largest market for cheese.
53 Oxfam, 'Milking the CAP'

Indian government has pointed out that such procedures are particularly difficult to put into practice when the affected parties are large and fragmented groups of SMEs – because WTO rules also require a proportion of the affected industry to raise the issue with their government before any measures can be taken⁵⁴.

Existing safeguards are also notoriously inadequate for developing countries seeking to defend agricultural sectors from import surges. In an effort to address these deficiencies in the sphere of agriculture, India – as part of the G33 group of developing countries – has made the establishment of a special safeguard mechanism (SSM) a key plank of its WTO position. The SSM would be a much simpler mechanism, allowing developing countries to automatically raise tariffs in cases where agricultural products were threatened by imports in ways that undermine rural livelihoods, food security and sustainable rural development. The failure of some WTO members, notably the US, to sufficiently accommodate these proposals on agriculture, was a significant factor contributing to the failure to make progress in the Geneva mini-ministerial meeting in July 2008 – as Kamal Nath had made clear that the SSM was a non-negotiable "make or break" issue essential to defending the livelihoods of subsistence farmers⁵⁵.

However, judging by its practice in past FTAs, the EU is unlikely to introduce bilateral safeguards that overcome the problems of existing weak multilateral safeguards, *vis a vis* bilateral trade. Moreover, if developing countries do eventually secure an improved safeguard in the WTO, an EU FTA may undermine India's ability to use it in relation to imports from the EU, its largest trading partner. In the recently concluded FTA with the Caribbean only the right to use existing multilateral safeguards is acknowledged, making it unlikely that new safeguards introduced in the multilateral context in the future would be available to India against EU import surges⁵⁶. In addition, the EU has challenged a number of India's attempts to invoke existing anti-dumping measures to protect its industries against the below cost importation of EU products – and they are likely to seek to limit the use of such measures in the context of the FTA⁵⁷.

Flexibility to build up new industries will be limited

Whilst the EU-India FTA would limit the scope to protect existing sensitive sectors and minimise the tools to prevent damage, it would also restrict the potential to develop new sectors in the future as part of an evolving economic strategy.

Not only would tariffs and other trade barriers have to be eliminated on at least 90% of all trade - across both agricultural and industrial sectors – but the scope to raise them in the future would be removed. Currently India has considerable 'water' between its applied tariff levels and its much higher bound levels – allowing tariffs to be raised strategically and selectively as part of an evolving economic strategy. At least until a WTO agreement is concluded such flexibility remains – and even with a WTO deal, the most far-reaching proposals allow more flexibility than is included in the proposed FTA. In addition to binding tariffs at 0% on most products, the EU's past FTAs have included a 'standstill clause' that prohibit countries from raising tariffs even for products on the sensitive list.

Liberalisation of certain products may directly benefit key sectors, for example where imported inputs enable industries to produce more cheaply. This can be of particular benefit to SMEs for whom high input costs can be prohibitive. However, there is

Footnotes

- 54 India's WTO submission, TN/RL/W/26, October 2002
55 Quoted in ICTSD's "Bridges", Issue 1 of Mini-Ministerial coverage, 21 July 2008
56 Aprovev (2008) 'Solutions for Dealing with Import Surges and Dumping', Technical Discussion Paper, June 2008
57 CARIS-CUTS, *op cit*

a loss of 0.6% of India's GDP would mean approximately US \$6 billion less in the government's kitty⁶⁴, which – if retained – could pay for bringing health care to 1.2 million villages⁶⁵.

nothing to prevent India from reducing tariffs on inputs to benefit domestic industries on a unilateral basis – whilst retaining the scope to alter such tariffs in the future. In contrast to the unilateral approach, FTAs require countries to make a one-off assessment about their existing needs and sensitivities and live with that decision into the future, regardless of changing circumstances.

Scope to restrict exports undermined

Export taxes can be an important means for promoting value-addition by ensuring the availability and affordability of raw materials for domestic processing. India currently maintains export taxes on raw hides, which has helped to promote value-addition in the leather sector, although this is not to the liking of the European leather industry as it restricts their access to raw materials⁵⁸.

Although controversial, export restrictions have also been used to promote food security in a context of food inflation. For example, India has recently restricted exports of some rice varieties to ensure security of supply during the food price crisis. Although export taxes are still allowed in the WTO, they are increasingly restricted in the EU's FTAs. The EU-Chile agreement requires immediate elimination of all export prohibitions or restrictions and prohibits the future introduction of such measures⁵⁹. Even in agreements with much poorer negotiating partners, such as Papua New Guinea, the EU has insisted upon immediate elimination of export taxes⁶⁰.

Reduction in government revenue

Estimates vary as to India's level of dependence on income from tariffs. According to the OECD India is reliant on income from trade taxes for 24.1% of total tax revenue⁶¹, while the Carnegie Foundation estimates a figure of 11.4% for 2004-05⁶². Whichever estimate is used, since the EU is India's principal trading partner, a significant proportion of this revenue will be lost through eliminating tariffs on substantially all trade to the EU. The Carnegie study estimates that the EU-India FTA would reduce the Indian government's tariff revenue by nearly one-third, or 0.6% of GDP (based on 2004-05 figures), which is more than would be lost under a simulated WTO scenario or under FTAs with the US or China⁶³.

Given India's significant development challenges and its difficulties in meeting the MDGs, such a reduction in government revenue could have devastating consequences for its potential investments in social programmes as well as reduced income for poor people if taxes are raised.

In the 1990s significant reductions in applied tariffs had welfare-reducing effects on Indian households, as the government made up for the lost revenue by both increasing taxes and reducing spending⁶⁶. During the period from 1990-91 to 2001-02 customs revenue fell from 3.6% to 1.8% of GDP. During this same period

- direct taxes of the central government increased from 1.9% to 3.0% of GDP

Footnotes

58 See Euro Leather statement at <http://www.euroleather.com/> (last checked July 2008)
59 EU-Chile agreement, Article 76
60 Interim EPA between PNG and the EU, initialled in 2007
61 See Kowalski (2005) 'Impact of Changes in Tariffs on Developing Country Government Revenue', OECD Trade Policy Working Paper No 18, OECD Paris.
62 Polaski et al, op cit
63 Polaski – based upon her figure of 11.4 %
64 Based on assumption of India's GDP standing at roughly US\$ 1 trillion
65 Author's calculation, based on government's plans to spend \$1.5bn on providing health care to 300,000 villages, through its National Rural Health Mission
66 Economic Survey of the Government of India, 2006-2007. See Table 2.3 (customs revenue) and Table 2.12 (combined tax revenue of the centre and states)

- total expenditure fell from 17.2% to 15.8% of GDP⁶⁷

The reduced revenue arising from the EU-India FTA is likely to be most acutely felt by the poorest, who depend disproportionately upon publicly provided services and infrastructure, and for whom tax increases have the strongest impact. For SMEs it may also result in reduced spending on the services they most need, such as subsidised credit or skills and technology enhancement.

Narrow gains for India's exports

Whilst the preceding analysis suggests that India looks likely to suffer some important losses from locking down further liberalisation of trade in goods, in the context of an FTA with the EU it also hopes to see improvements to its own access to the EU market. However, initial assessments seem to indicate that the net benefits to India in the area of goods are likely to be small.

Existing studies suggest that India will see some gains through increased exports to the EU in selected sectors – the predicted gains being very largely concentrated in the textiles and apparel sector and to a much lesser extent leather and footwear, chemicals, metals and plastic products⁶⁸. Jobs may be created in some of these sectors, though it is doubtful whether the extent of employment creation – 'representing a very modest contribution to India's employment needs'⁶⁹ – will outweigh the predicted losses. It is also of concern that the benefits seem likely to accrue in such a narrow segment of the economy, with one study predicting that 'all the benefits of the agreement in terms of production will concentrate in the textile industry'⁷⁰.

The textiles industry contributes about 14% to industrial production, 4% to the GDP, and 17% to the country's export earnings – and it provides direct employment to over 35 million people, a large proportion of whom are women and/or from marginalised groups⁷¹. The sector has major strategic importance for India – as it is forecast to provide expanded employment opportunities alongside very high growth. A study conducted in 2006 projected year on year growth of 16%, with the value of the sector reaching US\$ 115 billion by 2012⁷².

Expansion of the textile industry, driven by increased exports to the EU and other destinations, is a key interest of the Indian government – and one in which it seeks to achieve significant gains through the EU-India FTA. If the EU liberalises its textile market to India, as it may well do in order to secure a deal, this will undoubtedly enhance employment within the sector.

Limited progress on standards

Another area of aspiration on the part of India is in the area of standards. A key concern for Indian exporters is the way in which EU standards make it difficult to export to the EU. Standards such as Sanitary and Phyto-sanitary Standards (SPS), while explicitly aimed at protecting health and safety, have sometimes been overly stringent and used for protectionist reasons. In addition, costs of meeting standards can sometimes be prohibitive, especially for SMEs.

Footnotes

67 Ibid
68 See Polaski et al, op cit; CEPII-CIREM (2007), op cit; ECORYS et al, op cit
69 Polaski at al, op cit
70 CEPII-CIREM (2007), op cit p21
71 From Government of India, Ministry of Textiles, 2007 Annual Report <http://texmin.nic.in/annualrep/AR07-08-01.pdf>
72 Government of India, Ministry of Textiles (2006) 'Report of the Working Group on the Textile and Jute Industry for the Eleventh Five-Year Plan'

However, the EU-India FTA is unlikely to address this issue in a fundamental manner. The EU's FTAs so far have largely focused on facilitating the application of the WTO SPS provisions, rather than including individual provisions that depart from existing WTO commitments⁷³ or which make EU standards less stringent.

Harmonisation of standards between the EU and India or the setting up of more accessible testing labs may be ways of addressing the cost issue. Also there could be a focus on the exchange of information, simplifying procedures for testing and certifying or improving India's testing facilities or storage facilities and packaging systems⁷⁴. Yet an FTA is not likely to be the best channel for addressing these issues of capacity building, development assistance and information exchange. FTAs do not come with binding commitments on development assistance, and cooperation on simplifying and harmonising procedures can take place outside of an FTA where trade-offs in other areas are not expected.

Moreover, increasingly exporters are affected by private standards such as EurepGAP (now GLOBALGAP) which fall outside of the purview of trade agreements.

Regionalism may suffer

The European Union has long advocated the potential economic development benefits to be gained from regional integration among developing countries, including South Asia. In its own words, 'the EU values cooperation and regional integration efforts in South Asia' and has been supportive of SAARC as a regional organisation⁷⁵. The EU has also been in favour of the adoption of the South Asia Free Trade Agreement (SAFTA) framework treaty in 2006, as a means to 'stimulate intra-regional trade and integration'⁷⁶.

However, it is far from clear how a bilateral trade deal between the EU and India will support regional integration and intra-regional trade within South Asia. A growing body of literature has begun to question the compatibility of North-South FTAs and regional integration between developing country neighbours. UNCTAD has recently concluded that 'the trend towards North-South bilateral or regional trade agreements [...] threatens the viability of existing regional cooperation arrangements among developing countries'⁷⁷ and a series of studies by the UN Economic Commission for Africa have demonstrated how the EU's trade deals with African countries are going to severely undermine intra-regional trade⁷⁸.

An FTA between the EU and India may have negative impacts on India's neighbours if the EU captures markets in India that displace exports from India's poorer neighbouring countries [trade diversion]. Although existing intra-regional trade within SAARC appears very low, it is important to some of the smaller members of the bloc. In 2005-06 SAARC members accounted for 57% of Nepal's exports, 10% for Sri Lanka, 15% for the Maldives, and 2% for Bangladesh⁷⁹. To the extent that their SAARC exports are going to India, these countries are likely to lose out through trade diversion from EU imports.

Footnotes

73 CARIS-CUTS, op cit

74 Ibid

75 http://ec.europa.eu/external_relations/saarc/intro/index.htm

76 http://ec.europa.eu/europeaid/where/asia/regional-cooperation/support-regional-integration/saarc_en.htm

77 UNCTAD (2007), Trade & Development Report 2007

78 Karingi S. (2005) 'Economic and Welfare Impacts of the EU-Africa Economic Partnership Agreements', UN Economic Commission for Africa (UNECA), African Trade Policy Centre, March 2005

79 UNCTAD (2007), presentation to Centad conference on new regionalism

In addition, EU imports into India could enter the markets of regional neighbours, through trans-shipment, especially as SAFTA members begin to reduce their tariffs to one another. This could have impacts on sensitive sectors in these countries and may discourage the development of new industries in these countries, if they perceive a threat from competing EU products [see box on Swaziland].

When Swaziland's neighbour South Africa entered into an FTA with the EU, South Africa reduced its tariffs on sugar and sugar-containing products. As Swaziland was part of a customs union with South Africa, the threat of EU sugar products entering into the Swazi market was a key factor undermining Swaziland's development of a sweets industry for the regional market⁸⁰. Swaziland's subsequent efforts to negotiate an adjustment to South Africa's reduction commitments to the EU have met with very limited success.

Such effects may appear allusive at this stage – but the EU-India FTA will undoubtedly have as yet unpredictable effects on India's neighbours and on the scope for building regional cooperation in the future.

... and South-South trade could be undermined

In addition, the inclusion of a most-favoured nation (MFN) clause would have implications for India's trade relations with future strategic partners.

The EU insisted upon introducing clauses in EPAs, obliging ACP countries to grant the EU equivalent terms to those granted to other major trading partners with whom ACP countries enter into a future trading arrangement. The inclusion of the MFN clause in the EU's FTAs and EPAs has been widely criticised by the ACP and other developing countries for being an infringement upon national sovereignty and an obstacle to building preferential South-South trading arrangements.

Notably, when the MFN clause was introduced into the EPAs, Brazil stated that the retention of this clause would provide a disincentive for Brazil to enter into an FTA with an ACP country – because the benefits of any negotiated preferences for Brazil would be eroded by the automatic granting of equal preferences to the EU – clearly illustrating the way in which this clause may undermine the incentives for developing countries to enter into trade deals with each other in order to enhance South-South trade⁸¹.

However, the EU's insistence upon this clause in trade agreements with much weaker countries, suggests that it will be equally if not more determined to exact these terms in an agreement with India, as it seeks to maintain its edge over competitors such as the US and China.

This would mean India committing up front to granting the EU equivalent terms to those extended to its other strategic partners, with potential implications for South-South trade within and beyond the Asian region.

Footnotes

80 Traidcraft (2007) 'Economic Partnership Agreements: Building or shattering African regional integration?'

81 Dièye C.T. and Hanson V. (2008) 'MFN Provisions in EPAs: A Threat to South-South Trade?', Trade Negotiations Insights, ECDPM, vol 7, no. 2, March 2008

The retail sector in India is the second largest source of employment after agriculture and is currently undergoing a transformation that will have far reaching impacts on small retailers and on suppliers. This section looks at the implications of the rise of supermarkets for small retailers and agricultural suppliers – and the likely impacts of liberalisation under an FTA with the EU.

Transformation of the Indian retail sector underway

Currently retail in India is very largely dominated by the informal sector. It is both run by, and caters to, the poorest in society. Approximately 96-97% of overall retail sales in India are made through the so-called unorganised retail sector, comprised mainly of small shops and hawkers and estimated to employ around 30-40 million people⁸².

The informal retail sector is widely recognised to be a critical source of livelihoods for millions of India’s poorest, who have extremely limited alternative options. Because of the limited up-front capital requirement, the sector has been a relatively easy-entry economic activity for the low-skilled and is a key to survival.

During the last few years capital-intensive, large-scale retail chains – referred to as ‘organised retail’ - have been expanding at a rapid rate and this is expected to accelerate over the next few years: Indian firms such as Tata, Birlas, Reliance, Mittal and RPG have entered the retail market. The organised sector is expected to grow at a rate of 45-50% per year - much faster than the predicted growth of the unorganised sector - and is likely to quadruple its share of total retail trade to16% by 2012⁸³.

While large domestic retailers are rapidly extending their reach, the government currently limits the presence of foreign retail companies. The wholesale sector was liberalised in 1997 and a number of foreign companies have entered through this route – including the German retailer Metro, the South African ShopRite, Wal-Mart through a joint venture with Bharti Enterprises and now Tesco through a joint venture with Tata. However, to date there has been a total ban on foreign direct investment (FDI) in multi-brand retail and a 51% cap on FDI in single-brand retail as of 2006.

A number of foreign retailers are nevertheless impatient to get further access to the Indian market. According to one report ‘the involvement of the world’s largest retailer [in the Indian market] immediately triggered the “Wal-Mart effect” ... the sheer announcement sparked off feverish negotiations of multinationals like Tesco ... Carrefour, Auchan, Lotte from South Korea and Australian retailer Woolworths’⁸⁴.

As a consequence of this interest from European firms amongst others, the EU has been pushing for India to fully liberalise retail and lock-down that liberalisation through the WTO – but India has refused to commit to this in the WTO context. The EU-India FTA provides another potential channel for European retail companies to secure further and more rapid entry into the Indian retail market, as they strive to maintain an edge over competitors from other countries. While the Government of India has so far pledged not to open up the retail sector through the FTA, the EU is likely to press for its inclusion as it is a key offensive interest for its retail companies⁸⁵.

Footnotes

82 Kalhan A. (2007) ‘Impact of Malls on Small Shops and Hawkers’, Economic and Political Weekly, 2 June (2007)
83 Joseph M., Soundararajan N., Gupta M., Sahu S. (2008), ‘Impact of Organized Retailing on the Unorganized Sector’, Indian Council for Research on International Economic Relations (ICRIER)
84 Quoted in Elsevier Food International Vol. 10, Number 2, May 2007
85 European Services Forum (2007), ESF Response to DG Trade Questionnaire on FTAs, 5 June 2007

Entry of foreign players fuels retail consolidation

The experience of numerous other countries shows that the entry of foreign companies with a much larger capital base than domestic rivals has tended to fuel increased concentration in the retail sector, as they either merge with and then buy up domestic firms, or as domestic firms enter into mergers with each other in order to compete with these foreign firms. Consolidation within the retail sector also fuels the spread of big retail companies into new geographical areas⁸⁶. In this way, the entry of European retail giants is likely to accelerate the trend towards consolidation of the sector and in doing so magnify the impacts on smaller retailers and farmers.

- In Brazil the domestic chain CBD entered a joint venture with Casino (France) and was then bought out. The top seven retail chains in Brazil are now all foreign owned⁸⁷.
- In China, domestic chains have remained prominent despite the entry of foreign chains – this was achieved through mergers and acquisitions among local chains in response to the new competition, which is resulting in increased levels of concentration in the sector⁸⁸
- In Russia ‘we are seeing rapid countrywide expansion and numerous mergers by the leading domestic players, taking place not least in anticipation of further Western operators entering the market’⁸⁹.

Impacts on small retailers in India

The effects of the rapid rise of domestic retail chains in India are already being felt by small retailers. One independent study of three different areas in Mumbai found that 71% of the small shops (all of which were within one kilometer of a mall) had seen a decline in sales, in most cases of around 20%⁹². Another study conducted in Delhi by Research Foundation for Science Technology and Ecology/Navdanya found that 88% of the existing retailers in Laxmi Nagar, Paharganj and Nagloi had experienced a fall in their sales, since Reliance stores had appeared in their area. 59% of the respondents said that the impact on sales was of a magnitude that they believed they would soon have to abandon their businesses.

If retail is liberalised to even larger and more established European retail giants, such impacts upon small retailers are likely to be exacerbated.

Footnotes

86 ICRIER, op cit
87 Ibid, op cit
88 Ibid
89 Planet Retail (2006) ‘Global Retail Concentration’
90 ICRIER, op cit
91 Ibid
92 Kalhan (2007), op cit

‘competition from larger chains in turn pushes intermediate-city-based chains to extend into the hinterland towns, seeking refuge from the increasing competition in its base market; this process accelerates the diffusion of supermarkets over space.’⁹⁰

‘FDI combined with financing from either the competitive or leading local investors led to the rapid consolidation and multinationalisation of the supermarket sectors in developing countries over the past decade’⁹¹.

‘at least for Thailand, the experiences that occurred in the retail trade have given rise to serious thoughts on having appropriate and sound regulatory framework set before liberalisation is unleashed in a fast and uncontrolled manner’⁹³.

Undermining the flexibility for pro-poor regulation

The EU-India FTA may also limit India’s ability to introduce regulation at a later date should that become necessary once the impacts of liberalisation are seen.

Experience from countries with already well-established retail chains tends to show the importance of having strong regulation in place before such chains become overly dominant in order to protect the interests of smaller retailers and suppliers including farmers and in order to maintain a more balanced retail environment. It is more difficult to establish such regulatory mechanisms once foreign firms are established and are in a position to lobby against restrictions upon their activities.

There is currently limited regulation in the Indian retail sector - with the rapid rise of organised retail, these retailers have been advocating for greater deregulation and more flexible policies that would facilitate their growth. For example, the retail industry appears to be encouraging states to repeal what remains of certain long-standing laws to restrict urban land holdings (under the Urban Land Ceiling & Regulation Act); to control rents (rent controls have worked against the easy acquisition of real estate for commercial use); and to limit working hours (under the Shops and Establishment Act which is seen as restrictive on retailers opening hours).

However, in contrast to this trend, a number of proposals have been put forward by Indian civil society organisations and some state governments aiming to limit supermarket expansion and defend the interests of smaller retailers. Such proposals would be difficult to introduce in a context where retail had been liberalised to EU companies under an FTA.

- Proposals to reserve set percentages of commercial space in cities for small retailers and to place limitations on the numbers of large retailers operating within a certain zone would be difficult to introduce if the Indian government had already liberalised the sector in its FTA with the EU and if it had not scheduled limitations on EU companies up-front. Limitations on the numbers of foreign suppliers or the numbers of outlets conflict with requirements in the WTO⁹⁴ as well as in existing FTAs such as those with Chile and the Caribbean⁹⁵. In addition the EU has complained in the WTO context about ‘limitations on the purchase or rental of real estate’⁹⁶ as they see such restrictions as potentially preventing them from establishing a market presence.
- Proposals that communities should be empowered to establish their own economic, social, environmental, and planning policies and standards for retail operations through the use of “economic needs tests”. These tests have been used in some countries to assess the likely consequences for employment and other social or economic outcomes prior to granting a retailer a license. These tests have however been under attack in the WTO and are prohibited in the EU’s FTAs with other trading partners, such as Chile and the Caribbean.

Footnotes

93 Communication from Thailand, TN/S/W/4, 22 July 2002
94 GATS Article XVI prohibits the placing of limitations on the numbers of foreign suppliers or the numbers of outlets
95 See EU-Chile FTA, Article 97.2 and Cariforum EPA, Article 67.2
96 Communication from the European Communities and their member states – GATS 2000: Distribution, 22 December 2000, WTO document S/CSS/W/37 para 11

In addition, once commitments have been made to liberalise a service sector under an FTA, subsequent introduction of new regulations could be subject to scrutiny by the EU and its companies. The EU is asking for its stakeholders to have the right to prior consultation on the introduction of new legislation that may be considered to have ‘an impact on trade in goods and services’⁹⁷. In the EU-Chile FTA there are restrictions upon the introduction of new regulations that could be considered ‘more trade-restrictive than necessary’⁹⁸.

Furthermore, the independence of state governments in India to decide how to regulate the retail sector within their state may be curbed by an FTA in which there are obligations for commitments agreed at the centre to be implemented at all levels of government⁹⁹.

The need for pre-existing regulation of retail giants

- In the UK the growth of supermarket dominance has been accompanied and facilitated by an increasingly deregulated policy environment, such as reduced restrictions on opening hours, flexible planning rules, and lax competition laws which have allowed larger retailers to buy up small shops. A UK parliamentary investigation into effects of supermarkets identified poor planning policy as a key reason behind the demise of small shops¹⁰⁰. Weak planning regulations can be exploited by large retailers as, for example, ‘decisions made by local councils to accept new supermarket stores are in many cases not made on the grounds of retail need, but because the weak planning system and the power imbalance on a local level makes it increasingly difficult for them to refuse the strong-arm tactics of the supermarket chains at the local authority level in driving their store expansion.’¹⁰¹
- In Thailand retail services have been gradually liberalised since the 1980s and foreign supermarkets account for a significant percentage of the retail market. Investigations into the impacts of supermarket expansion, fuelled by liberalisation, revealed a number of negative impacts including a fall in the share of traditional retail shops by 14% between 1997 and 2001, an erosion of revenues for traditional wholesalers and middle men, and the development of an oligopolistic structure where a handful of players were beginning to dictate prices¹⁰². As part of efforts to tackle this dominance, new zoning regulations were introduced in 2003 stipulating that they could only establish outlets at least 15km from the commercial centres of provincial towns. While the effect of this should have been to limit hypermarket and superstore expansion in the future, news of the impending regulation spurred a rush from Tesco to secure sites across the country before the draft regulations become reality¹⁰³. This led the Thai government to conclude that, ‘at least for Thailand, the experiences that occurred in the retail trade have given rise to serious thoughts on having appropriate and sound regulatory framework set before liberalisation is unleashed in a fast and uncontrolled manner’.

Footnotes

97 See EC mandate for EU-India FTA, Article 37
98 EU-Chile FTA, Article 102
99 Kelsey J. (2008) ‘Comparison of the Legal Text on Investment and Services in CARIFORUM-EC/Pacific-EC EPAs’ (working document)
100 UK Parliament: All-Party Parliamentary Small Shops Group (2006) ‘High Street Britain: 2015’
101 Friends of the Earth (2006) ‘Calling the Shots: how supermarkets get their way in planning decisions’
102 Communication from Thailand, TN/S/W/4, 22 July 2002
103 Vorley, B. (2004) ‘Regoverning markets, phase 1 overview’, draft, 10 November 2004, p.204

Impacts for farmers

Proponents of retail liberalisation argue that being involved in more direct, modern supply chains is beneficial to farmers. Research from the Indian Council for Research on International Economic Relations (ICRIER) has found that farmers selling directly to organised retail outlets receive higher prices than when they sell through the government regulated wholesale markets. These wholesale markets – APMCs – were created to safeguard the farmers’ interests by regulating the sale of farm produce and aiming to secure them a fair price. APMCs remain the main route through which most farmers currently sell their produce, but they have a reputation for exploiting farmers and for paying low prices.

Meanwhile the Indian Ministry of Agriculture sees modern retail sector growth as a key motor for modernising the agricultural sector – with retail companies regarded as new sources of capital for contract farming and for setting up post-harvest supply chains. The Indian planning commission has also stressed that ‘widespread use of contract farming will be a boon to the farmers and will also improve the efficiency of retail chain operations’¹⁰⁴. A number of Indian retail companies including Reliance and Bharti have already invested in technology and training for some farmers, as well as in infrastructure such as cold stores and warehouses and refrigerated trucks. However, the benefits that accrue to farmers from such a model are typically limited and come with a number of risks attached.

Increased vulnerability

Whilst there do appear to be initial benefits for some farmers, the experience of countries with more mature retail markets suggests that once a level of dependence is established the benefits quickly disappear and suppliers are more – not less - vulnerable. The direct relationship model means that a single company decides what crops a farmer should grow, provides their only market and – crucially – determines price. Such arrangements often come with increased risk for the farmer and higher demands in terms of quality¹⁰⁵. As markets become more concentrated, this increases the buyer power that the supermarket can bring to bear on their suppliers. All of this leads to an increasing squeeze on farmers’ margins. This is exacerbated by the weakened role of traditional marketing boards, which - though not always effective - did boost farmers’ ability to negotiate fair prices as well as providing an alternative reference point to indicate price.

In India, during the course of the 1990s a number of state-led institutions that provided support for farmers and an intermediary function for marketing, were gradually dismantled, exposing farmers to increased vulnerability. However, in some states there remains a degree of regulation of supply, distribution and price setting of key food crops. As retailers enter into the realm of agriculture, institutions such as state run marketing boards and wholesale markets are being further weakened as these companies seek to establish direct relationships with their suppliers. The role of marketing boards is being redefined to focus on quality and technical assistance, with the removal of their remaining functions in regulating production and markets and guaranteeing minimum prices¹⁰⁶.

Footnotes

- 104 Report of the High Level Group on Services Sector, Government of India Planning Commission, March 2008
105 Murphy S. (2006) ‘Concentrated Market Power and Agricultural Trade’
106 See <http://agmarknet.nic.in/amrscheme/markreform3.htm> for reform process

Benefits for the few

Supermarkets tend to buy from a limited range of suppliers, often operating “preferred supplier lists”, which are able to meet their requirements of volume, quality and safety standards with minimal risk to the supermarkets themselves. This means that over time the benefits from selling to supermarkets tend to accrue to few suppliers. In Malaysia for example, the Giant supermarket chain had 200 vegetable suppliers in the early days of its operations in 2001, but by 2003 this was down to just thirty. A similar trend can be seen in Thailand¹⁰⁷. ‘Even in countries where the retail sector is in its early stages, requirements for large volumes and all year round supplies ... can already be a barrier to small farmers’¹⁰⁸.

The trend towards sourcing from larger suppliers in some instances means that supermarkets avoid local sourcing altogether, especially for fresh produce¹⁰⁹. In Asian supermarkets a significant proportion of fruit and vegetable sales is of imported produce, according to the FAO, which notes that supermarket supply chains can be very difficult to develop for produce having limited shelf life and requiring cold chains¹¹⁰. When supermarkets initially entered Poland they depended upon international channels for their supplies, only later building up supply chains within Poland itself¹¹¹. The more food retailing by supermarkets advances the more small farmers will have difficulty in finding other outlets for their produce¹¹². In the cases where small farmers do manage to sell to supermarkets they ‘tend ... to be the asset elite among small farmers’¹¹³.

Lessons from around the world

The UK Competition Commission’s 2008 report on the groceries sector found serious problems in the way that grocery retailers treat their suppliers both in the UK and overseas. Many unfair practices were identified including unwritten contracts, retrospective price changes, forced contribution to promotions and automatic fines. The Commission recommended a new strengthened Code of Practice and the appointment of an Ombudsman to regulate the sector.

In Korea, Wal-mart was found by the government’s fair trade commission to be engaging in a number of practices such as unfair refusals to receive goods, unfair return of products, reduction of prices after products had been delivered and charging suppliers for advertising fees. Carrefour Korea was also taken to court for unreasonably reducing prices for products bought from suppliers¹¹⁶.

In Mexico, the competition authorities have accused the local Wal-mart company, WalMex, of abuse of power by forcing suppliers to sell below costs.

In India, the further opening up to European retail conglomerates risks magnifying the risks for small scale farmers.

Footnotes

- 107 Shepard A. (2005) ‘The Implications of Supermarket Development for Horticultural Farmers and Traditional Marketing Systems in Asia’, FAO, Rome, p.10
108 Vander Stichele M. (2006) ‘Who Reaps the Fruit? Critical Issues in the Fresh Fruit and Vegetable Chain’, SOMO
109 Vorley, op cit
110 Shepard, op cit
111 Vorley, op cit
112 ActionAid (2005) ‘Power Hungry: Six Reasons to Regulate Global Food Companies’
113 ICRIER, op cit
114 Shepard, op cit
115 Reardon T. Timmer P. and Berdegue J. (2004), ‘The Rapid Rise of Supermarkets in Developing Countries’, Journal of Agricultural and Development Economics, Vol 1, No. 2, 2004
116 Vorley, op cit

‘the squeeze on farmer margins is likely to increase further as supermarkets become as concerned with safety and quality as they are now with cost and begin to insist that suppliers comply with standards similar to those of EUREPGAP’¹¹⁴.

‘The supermarket chains, locked in struggle with other chains in a highly competitive industry with low margins, seek constantly to lower product and transaction cost and risk – and all that points toward selecting only the most capable farmers, and in many developing countries that means mainly the medium and large farmers.’¹¹⁵

Improved access to India’s financial services market is a key interest of the EU in the FTA negotiations. This section looks at the likely impacts on lending to disadvantaged sectors if India were to further open its financial services markets to European banks and lock down that liberalisation in an FTA.

European banks already doing well in India

The Indian government has already considerably liberalised the financial services sector and foreign banks have a significant presence in the country.

As of 2004, foreign banks have been allowed to acquire up to 74% equity in Indian private banks¹¹⁷. Existing or new foreign banks are entitled to open up to a combined total of 12 new branches each year. Since 2005 foreign banks have also been permitted to establish as 100% wholly owned subsidiaries.

Moreover, the actual level of openness to foreign banks goes beyond even these formal entitlements. For example, during July 2006-June 2007, India allowed seven already-established foreign banks (including the Netherlands-based ABN-AMRO Bank, Barclays Bank and Deutsche Bank) to open 20 new branches between them, going far beyond the official 12 per year entitlement. Foreign banks are also allowed to significantly further expand their operations through off-site ATMs, with ATMs operated by foreign banks far exceeding the number of their branches. ABN-AMRO Bank operates 110 off-site ATMs with 28 bank branches¹¹⁸.

EU wants India to remove all remaining restrictions

Despite the already far-reaching liberalisation to foreign banks, the Indian government retains the right to limit their further expansion in certain ways. For example, under multilateral commitments India retains the right to deny licenses for new foreign banks when the share of foreign banks’ assets in the domestic banking system exceeds 15%¹¹⁹. Whilst according to some measures the share of foreign bank assets is already considerably higher than this, at 49% in 2007¹²⁰, the Indian government nevertheless retains the flexibility to alter the share of foreign bank assets in the future.

However, the EU is strongly opposed to any restrictions on foreign banks’ further expansion into the lucrative Indian market. The UK is one of the key demandeurs in this sector, with UK industry recommending that ‘the UK government ... strongly urge the complete opening up of the financial services market in India’¹²¹.

In the WTO the EU has called for the elimination of any ceiling on the percentage of banking assets that can be taken up by foreign banks¹²² and also for the removal of India’s restrictions that bank licenses should be ‘conditioned upon existing laws and limited to 12 per year’¹²³. In the FTA context the EU is likely to seek a regime whereby more branch licenses could be allocated and fewer restrictions placed on European banks¹²⁴.

Footnotes

117 Singh K. (2008) ‘Banking Sector Liberalisation in India in the Context of Proposed India-EU Free Trade Agreement’
118 Ibid
119 Ibid
120 Ibid
121 UK Parliament, House of Commons Trade and Industry Committee (2006), ‘Trade and Investment Opportunities with India, Third Report of Session 2005-06’, Vol 1, 3 November 2006
122 GATS 2000 Request from the EC and its Member States to India, submitted in July 2002
123 Ibid
124 CARIS-CUTS, op cit

Foreign banks have fewer social obligations than domestic banks

Whilst foreign banks have an increasing presence in India and are generating higher returns than domestic banks¹²⁵, the obligations upon them to lend to socially disadvantaged sectors are less than those placed upon Indian banks.

- Foreign banks are only obliged to direct 32% of their lending to priority sectors¹²⁶, as opposed to domestic banks that must lend 40% to these sectors. Foreign banks tend to use up the majority of their 32% priority-sector lending requirement on the more lucrative end of this market – i.e. on export sectors¹²⁷.
- Foreign banks have no obligation to lend at all to the agricultural sector.
- Foreign banks are exempted from the Differential Rate of Interest (DRI) scheme under which loans are offered to people below the poverty line, particularly to scheduled caste and tribal people, at a much lower rate of interests with easy repayment rates and no margins¹²⁸.

Post liberalisation trends in lending to marginalised sectors

During the period in which banking has been liberalised and foreign banks have had a presence, lending to socially disadvantaged sectors has declined. In particular, there appears to have been an increase in the number of geographical locations with inadequate banking provision and a particular decrease in lending to rural customers and to SMEs. According to the RBI statistics, out of a total 1,250 bank branches opened between July 2004 and June 2005, only 15 were located in areas with no or insufficient banking provision¹²⁹.

Overall during the 1990s and early 2000s there has been a notable shift away from rural lending, as the urban focus of banking services has intensified. One study calculates that the percentage of credit allocation that went to rural areas fell from 15.4% in 1991 to 9.6% in 2004 – whilst credit allocation towards metropolitan regions increased from 44% to 61% over the same period¹³⁰. According to calculations by the National Bank for Agriculture and Rural Development three quarters of India’s farmers do not have access to banking services¹³¹. Of those farmers who do manage to access banking, it is predominantly the larger farmers, with the small and marginalised farmers almost entirely left out of the formal banking sector. One of the recognised factors behind rising farmer suicides in rural areas has been the lack of affordable credit, as traditional money-lenders face no competition in rural banking markets.

Lending to SMEs has seen a similar trend in the post-liberalisation period, with a decline in SME lending from 15% in 1991 to 11% in 2003¹³². The majority of SMEs continue to depend upon informal sources of lending with higher rates of borrowings. Out of the total financial investments made by SMEs in 2007, only 14% was provided by the formal banking sector¹³³.

Footnotes

125 Singh, op cit
126 ‘Priority sector lending’ refers to the provision of (largely concessional) loans to key sectors such as farmers, SMEs, retail traders, students and certain export sectors. Obligations on banks to engage in priority sector lending are a means for the government to encourage credit provision for less financially appealing market segments in order to meet social and development objectives.
127 Singh, op cit
128 Ibid
129 Ibid
130 Associated Chambers of Commerce and Industry of India (ASSOCHAM) (2005) ‘Declining Rural Credit and its Adverse Impact on Future Agriculture Growth’, July 2005
131 Singh, op cit
132 Singh, op cit
133 According to statistics provided by Small and Medium Enterprises Rating Agency – cited by Singh, op cit

World Bank: ‘most foreign banks are large and stick mostly to the banking needs of larger enterprises and high net worth individuals’¹³⁷

IMF: ‘in poor countries, a stronger foreign bank presence is robustly associated with less credit to the private sector’ and ‘in countries with more foreign bank penetration, credit growth is slower and there is less access to credit’¹³⁸

According to the Survey of Small Accounts (2006), the present-day banking system discriminates against all types of small borrowers who seek credit for productive and consumption purposes¹³⁴.

While the spread of micro finance institutions (MFIs) has been a welcome development in India it is questionable whether such institutions can substitute for formal banking provision. With just 15 million clients MFIs have only reached a fraction of those in need of credit¹³⁵.

Lending to disadvantaged sectors declines when foreign banks enter a market

While the causes of reduced lending to disadvantaged sectors are complex, it is notable that the trend in India has coincided with an increased presence of foreign banking as well as reduced obligations on domestic or foreign banks to extend services to marginalised areas. One study of the impacts of entry of foreign banks into India found that foreign banks financed only a small set of very profitable firms upon entry, and that on average, firms were eight percentage points less likely to have a loan after a foreign bank entry because of a systematic drop in domestic bank loans¹³⁶.

The correlation between the entry of foreign banking and diminished lending to poorer customers is not specific to India and has been well documented across developing countries. The World Bank and the IMF have pointed to the poor record of foreign banks in lending to less profitable client bases – and have shown that foreign banks tend to win the accounts of the most profitable customers, lessening the potential returns of domestic banks, which in turn makes it more difficult for them to lend to lower end markets and still turn an overall profit.

In Mexico, the financial-services sector was liberalised in 1993 through domestic legislation that accompanied NAFTA. By 2000, foreign ownership of the banking system had increased to 85%, but lending to Mexican businesses had dropped dramatically – from 10% of GDP in 1994 to a mere 0.3% in 2000¹³⁹.

Given these observations, further liberalisation to European banks in the context of an EU-India FTA risks fuelling the already negative trend of poor lending to socially disadvantaged sectors.

The importance of regulation

As the above figures on banking coverage illustrate, the requirements upon both domestic banks and – to a lesser degree – foreign banks to lend to priority sectors have not translated into anywhere near sufficient access to banking for these groups. In this context, a recent report from the National Commission for Enterprises in the

Footnotes

134 Reserve Bank of India (2008) ‘Survey of Small Borrowers Accounts, 2006’, RBI Monthly Bulletin, June 2008
135 Singh, op cit
136 Gormley, A. (2007) ‘Banking Competition in Developing Countries: Does Foreign Bank Entry Improve Credit Access?’
137 World Bank (2007) ‘Finance for All? Policies and Pitfalls in Expanding Access’, Access Finance, The World Bank Group, Issue No. 20, November 2007
138 Detragiache E. Tressel T. and Gupta P. (2006) ‘Foreign Banks in Poor Countries: Theory and Evidence’, IMF Working Paper
139 Oxfam International (2006) ‘Signing Away the Future: How trade and investment agreements between rich and poor countries undermine development’

Unorganised Sector makes recommendations for the urgent expansion of coverage of institutional credit for small farmers and SMEs in particular¹⁴⁰. While the Indian government is currently exploring market-based approaches to increasing formal banking provision to rural or SME customers, it may also need (now or in the future) to strengthen or expand obligations upon foreign and domestic banks to more effectively extend their coverage to these sectors. Systems involving mandatory lending to poorer sectors can be effective, if well-designed and implemented [see box].

Regulation led to increased pro-poor banking provision

Between 1977 and 1990 the Reserve Bank of India obliged any commercial banks seeking to open a new branch where one already exists, to open four branches in locations with no banking coverage. This regulation – known as the 1:4 rule - was part of a program that sought to expand access to financial services in rural areas. The policy led to a notable and rapid increase in bank branches and in rural credit in less densely banked states. The knock-on impacts of this were significant, with one study concluding that rural branch expansion during the policy period may have accounted for 60% of all rural poverty reduction during the period, largely through an increase in unregistered or informal manufacturing activities which experienced higher returns than in agriculture.¹⁴¹

However, through the liberalisation of banking services in the EU-India FTA, the EU and its banks could make the introduction of such obligations upon European banks very difficult in a number of ways.

- As we saw in Section 2, the EC is seeking prior consultation for its stakeholders on new regulations that it judges to effect trade in goods and services¹⁴². In the Caribbean EPA there are obligations upon parties to consult in advance of the introduction of new measures in the financial services sectors specifically¹⁴³. If such a clause were included in the EU-India FTA, this would allow European banks to have a say in decisions about domestic legislation – allowing them to lobby against obligations upon them to lend to less profitable sectors.
- In the course of negotiations, the EU might even press for the lifting of existing obligations to direct a percentage of lending to priority sectors such as rural sectors or SMEs since it has objected to similar requirements in the WTO context. In other developing countries the EU has called for the repeal of such provisions, for example, in the WTO discussion the EU has requested that Korea remove the existing requirement on foreign banks to lend to SMEs¹⁴⁴ and the EU has also questioned this requirement in its requests to the Philippines¹⁴⁵. In its requests to Malaysia it has questioned existing obligations on banks to provide a certain quota of lending to low-cost housing¹⁴⁶.

If European banks successfully avoid obligations to lend to less affluent sectors, it is likely to also be more difficult for domestic banks to do so while remaining profitable. This could in turn exacerbate the overall decline in bank lending to poor and marginalised groups.

Footnotes

140 National Commission for Enterprises in the Unorganised Sector (NCEUS) (2007), ‘Report on the Conditions of Work and Promotion of Livelihoods in the Unorganised Sector’
141 World Bank (2008) ‘Finance for All?: Policies and Pitfall in Expanding Access’, A World Bank Research Report, 2008; and Burgess R. and Pande R. (2005), HYPERLINK ‘Can Rural Banks Reduce Poverty? Evidence from the Indian Social Banking Experiment’, American Economic Review, 95(3), 2005 <http://www.atypon-link.com/AEAP/doi/pdf/10.1257/0002828054201242>
142 EC mandate for EU-India FTA
143 Article 105.1 Caribbean EPA
144 GATS 2000 Request from the EC and its Member States to Korea, submitted in July 2002
145 See EU GATS 2000 requests to Philippines: Mode 3: MA – Application of specific requirements on lending to SMEs and agro-business
146 EU GATS 2000 request to Malaysia

India's vast government procurement market has the potential to bring economic benefits to marginalised sectors in a context of increasing inequality – as has been achieved successfully elsewhere. This chapter examines the likely consequences of liberalising government procurement to the EU in the context of the FTA.

Government procurement in India

Government procurement refers to the purchase of goods and services by the state or state bodies. The OECD estimates that government procurement constitutes 7% of world GDP and in developing countries it can account for up to 15-20% of GDP. In India its overall value is estimated to be in the order of \$100 billion, representing over 20% of GDP. In 2003 the World Bank noted that in India 'government procurement continues to remain large in volume and all pervasive'¹⁴⁷.

Government procurement in India is carried out across a wide range of ministries, departments, municipal and other local bodies, statutory corporations and public undertakings both at the federal and state levels. It involves the purchase of a vast range of goods and services, from paper products for schools to the supply of small components for various forms of infrastructure (e.g. railways) to the delivery of major infrastructure projects.

EU interests in government procurement

The EU has long been an advocate of the liberalisation of government procurement in the WTO, however developing countries have rejected this and consequently the WTO only covers procurement through a voluntary (plurilateral) agreement to which few developing countries, not including India, are signatories.

Frustrated by the multilateral route the EU has strongly asserted its interest in opening up India's lucrative government procurement market in the context of the FTA – and in successive rounds of negotiations it has clarified 'it cannot envisage a deal that does not include market commitments on procurement'¹⁴⁸. The EU has made clear that it wants provisions similar to the very far-reaching procurement chapter in its FTA with Chile¹⁴⁹.

The EU perceives India's procurement market as too closed to bids from foreigners, whether through explicit rules that favour domestic firms or more through opaque bidding procedures that effectively make it difficult for foreign providers to win government contracts. An EC study notes that while some improvements have been made to transparency to foreign bidders at the level of federal government, state-level procurement policies still largely keep foreign suppliers out¹⁵⁰.

In the context of the EU-India FTA, the EU is therefore seeking the fullest access to the Indian government procurement market through 'progressive liberalisation at all levels of government'. Based on the EU's approach in other FTAs, it will insist that its firms are as free as possible from explicit discrimination, in terms of their eligibility for bidding and securing contracts as compared to domestic firms, by including "national

Footnotes

147 World Bank, India Country Procurement Assessment Report, 2003
148 European Commission (2008), EU-India FTA Negotiations: EC Key Messages, January-February 2008
149 Speech by Thierry Rommel, Head of European Commission Delegation to Malaysia, 'EU-Malaysia partnership', 21 June 2006, Kuala Lumpur, Malaysia
150 CARIS-CUTS, op cit

treatment" requirements in any final agreement. This has been the approach in the EU's provisionally concluded FTA with the Caribbean region, in which the government procurement chapter contains a built-in agenda for liberalisation, with no explicit exemptions to national treatment commitments on development grounds¹⁵¹. The EU will also want to secure measures on transparency that would reduce de facto discrimination against EU firms.

Certain sectors such as construction, the energy sector, port dredging services and other public utilities are of particular interest to EU firms¹⁵². The French conglomerates Bouygues, Vinci and Eiffage, for example, have expressed interest in accessing the Indian market for major public works contracts.

Gains to India from entry of EU firms?

Whilst there are clear arguments put forward by the EC, the World Bank and others that more foreign competition in domestic government procurement markets will lead to efficiency gains for the host country, there are major limitations to such narrow efficiency-based calculations.

Directing government spending towards domestic firms can bring a number of benefits, for example, during periods of recession it can facilitate faster recovery because of the greater multiplier effects of domestic firms to the economy at large. Domestic firms are more likely than foreign firms to source inputs domestically, to employ local staff right up to senior levels and to subcontract to domestic SMEs for services and supplies. In addition, there are a number of ways in which governments can target government procurement spending to marginalised sectors in order to redress inequality and to achieve other social objectives – as the Indian government has tried to do.

A tool to address inequality

The size and reach of government procurement in India means it has potential as a tool to contribute to addressing India's inequalities. For example, government procurement can be used to support marginalised groups or SMEs as part of redressing economic imbalances and achieving social development outcomes. Over many years the Indian government has undertaken a number of measures in this direction, which have included:

- price preferences for SMEs, which are a means of favouring smaller firms when contracts are awarded, even if the price they quote for delivering the good or service is a certain percentage higher than their larger competitor
- a reserve list for certain items that government bodies should only purchase from SME suppliers. This list has reduced in scope over the years, but still retains some 358 items including electrical appliances, small parts, metal objects, rubber goods, cotton products and furniture, to name a few
- directing employment towards marginalised groups, for example in labour-intensive public works contracts
- splitting up – or 'unbundling' – large contracts into smaller packages, in order that domestic firms and particularly SMEs are better able to fulfil them. This has been a common practice in government procurement of construction projects

Footnotes

151 Woolcock S. (April 2008) 'Government Procurement Provisions in CARIFORUM EPA and Lessons for Other ACP states'
152 See, for example, complaints registered on the EU's market access database <http://www.madb.europa.eu/mkacddb2/indexPubli.htm>

These measures have had a mixed record of success in achieving the desired objectives of increasing social equity. According to government procurement expert Simon Evenett, purchases from the small-scale sector made up between 8-10% of total government purchases during the 1990s¹⁵³. The Federation of Indian Small and Medium Enterprises (FISME) estimates that currently only 1% of central government procurement is captured by SMEs, though the state-level picture is somewhat better at around 7-8%.

In this context, SME bodies are encouraging the government to do more to ensure SMEs get a larger proportion of government procurement contracts. Meanwhile, the Indian government is also reportedly considering extending government procurement policies to more actively promote social advancement by members of lower castes¹⁵⁴.

Whatever the balance of success and failure in India's use of government procurement to achieve social objectives to date, successes elsewhere – notably South Africa and Malaysia – demonstrate that there is vast potential. Yet, as we see in this chapter, liberalising government procurement in the context of an FTA with the EU could undermine this potential.

Scope to support marginalised groups

There is scope for India to build on existing policies to use government procurement to help re-balance the social and economic disparities between castes. Malaysia has long used significant preferences in public procurement to promote the advancement of ethnic Malay-owned businesses, which are widely recognised as having achieved its stated objectives. Yet such policies have been under attack from the EU, which complains that it results in a lack of 'level playing field for foreign companies'¹⁵⁵.

Under the EU's FTA proposals it would be prohibited from favouring particular firms on the basis of their origin as opposed to according to objective criteria (such as size or sector)¹⁵⁶. This would make existing policies adopted in some Indian states to favour particular groups illegal and subject to challenge by the EU, and could dampen efforts to build on and improve these existing policies.

Footnotes

153 Evenett S. (2002) 'Multilateral Disciplines and Government Procurement', in B. Hoekman B.M. Matto A. and English P. (Eds.) 'Development, Trade and the WTO', Geneva: World Trade Organization

154 McCrudden, 'Buying Social Justice: Equality, Government Procurement and Legal Change'

155 Roebeling G. DG Trade, European Commission, DG Trade, speaking at National Seminar on Government Procurement, New Delhi, 11-12 May 2006

156 This is the case in the EU-Chile FTA, which requires suppliers, qualification to be judged only on criteria necessary to fulfil the contract in question

Scope to promote SMEs

The South African Government's "targeted procurement" model effectively tilted the balance towards black SMEs in the post-apartheid era by awarding contracts on the basis of a mix of criteria, including price, quality and the achievement of social objectives¹⁵⁷.

The South African approach was based on an understanding that SMEs can benefit from procurement contracts as sub-contractors, supplying the inputs or the services to the larger firm that is the prime contractor. Given the many constraints faced by SMEs, such linkages may often need active encouragement, for example through the government placing conditions upon the larger firms that they do this. South Africa recognised that another way of encouraging SMEs to get direct access to large contracts is by dividing major public projects up into smaller parts so they are within direct reach of smaller firms. Both of these policies were successfully employed by South Africa, with widely recognised positive benefits for the targeted groups, whose market share in the Department of Public Works' spending rose from 2.5% prior to implementation to 32.4% in the third year of operation¹⁵⁸.

Yet, the instruments that South Africa used to successfully promote SMEs could be effectively removed from India's sights under EU proposals. Other policies currently used in India, such as price preferences and reservations for SMEs, could also be more difficult to maintain or build upon, with their preservation subject to negotiation with the EU.

Footnotes

157 Watermeyer, R. (2000), 'The uses of targeted procurement for poverty alleviation and employment creation in infrastructure projects', in Public Sector Procurement Law Review, No 5, 2000

158 Manchidi T.E. and Harmond I. (2002) 'Targeted Procurement in the Republic of South Africa: an Independent Assessment' and Watermeyer R.B., 'Facilitating Sustainable Development Through Public and Donor Procurement Regimes: Tools and Techniques', Public Procurement Law Review 2004 Number 1.

Policy	South Africa example	Potential in India	Impact of EU-India FTA
Splitting up contracts into smaller parts ('un-bundling')	USED South Africa un-bundled government contracts to make them more available for bids from SMEs	USED Unbundling has been common practice in India in particular in construction projects where the vast majority of companies are SMEs	OPEN TO CHALLENGE The EU-Chile agreement prohibits the splitting up of procurement contracts in order to reduce the overall price ¹⁵⁹ . The EU could argue that unbundling was being used to keep contracts under certain threshold values with the intention of excluding European providers. It could therefore mount a challenge and win.
Local content requirements (a type of 'offset')	USED South Africa actively encouraged business linkages between large and small scale enterprises by requiring contractors to either subcontract to, or obtain supplies or services from, targeted enterprises	SCOPE TO USE MORE A dialogue is currently underway in some states and with central government about how SME participation in larger contracts could be boosted. One proposal is that government should ensure that large contractors sub-contract a set percentage to micro and small enterprises.	RESTRICTED The EU-Chile FTA places limitations upon the use of 'offsets', defined in the agreement as 'those conditions imposed or considered ... that encourage local development or improve its Party's balance of payments accounts by means of requirements of local content' ¹⁶⁰ . Such limitations in an EU-India FTA would restrict the scope for India to put in place policies that were effective in South Africa
Price preferences	NOT USED	SCOPE TO USE MORE Price preferences are used by some states. There are proposals from SME bodies for price preferences to be extended and made statutory.	LIKELY TO BE LIMITED Price preferences go against the thrust of the EU's non-discrimination approach. The Caribbean was able to retain the ability to use some price preferences in their EPA but these are likely to be of limited duration. It is also questionable whether the EU would offer a comparable concession to India, given the EU's more aggressive approach towards its FTA with India.
Set-asides (or 'reservations')	NOT USED	USED The government maintains a reserve list for certain items that government bodies should only purchase from SME suppliers. This list has reduced in scope over the years, but still retains some 358 items including electrical appliances, small parts, metal objects, rubber goods, cotton products and furniture	LIKELY TO BE LIMITED India may be allowed to continue to use some of these tools as the EU would allow some exemptions to sectors that are liberalised and also contracts below certain threshold values could be excluded from liberalisation However, the EU will negotiate hard to open up any sector on the reserve list that may be of interest to EU companies.

Footnotes
159 Article 141, EU-Chile FTA
160 Article 138j, EU-Chile FTA

Market access - uneven gains and losses

Research undertaken by UNCTAD India concludes that the potential gains to India from accessing European government procurement markets are likely to be extremely limited. Indian firms would have great difficulty penetrating the European market, because of a combination of supply-side constraints on the Indian side and complex entry requirements on the EU side. Indeed, while India has been accused by the World Bank and the European Commission of being insufficiently open to foreign providers, it would seem that the EU's own government procurement is also inaccessible.

UNCTAD calculates that of European governments' overall purchases of goods and services only 0.36% go to non-European providers. The UK is considered one of the more open of the European member states yet, of the UK's estimated \$20 billion spending on government procurement of goods and its \$90 billion spending on government purchase of services only an estimated 0.2% and 0.1% respectively goes to non-EU providers. This existing 'strong pro-EU bias' leads UNCTAD to conclude that the opportunities for India to access EU markets are likely to be miniscule¹⁶¹.

Whilst the EC has challenged this research, claiming flaws in the methodology, UNCTAD's conclusions seem to be borne out by earlier research from the EC itself, which revealed marked difficulties for even European providers in accessing government procurement markets in other European countries. This EC study found that, on average, 93% of EU public procurement is awarded to domestic companies; and more than half of the EU respondents interviewed in a survey thought they would have no chance bidding in another EU country¹⁶².

Conversely, the gains to the EU of accessing India's government procurement markets are likely to be significant. UNCTAD estimates a rise in EU exports, via government procurement, of at least 12.7%¹⁶³.

Footnotes

161 UNCTAD (2007), presentation to Centad conference on new regionalism

162 Europe Economics (undated), Powerpoint presentation input into 'Evaluation of Public Procurement Directives' (Markt/2004/10/D), final report published 15 September 2006

163 UNCTAD (2007), presentation to Centad conference on new regionalism

‘transparency rules can result in market opening as much as the prohibition of de jure preferences in what is called “liberalisation”’¹⁶⁴

Transparency as a Trojan horse

The concerns outlined above demonstrate that allowing the EU market access in government procurement could limit the scope for India to address key policy objectives.

If the Indian government continues to reject overt liberalisation of government procurement, it is possible that the EU would propose a chapter primarily limited to transparency in government procurement. Limiting the negotiations to transparency would appear on the surface to offer benefits, especially for SMEs for whom complex and un-transparent procedures can be a disproportionate barrier to their being able to win contracts. However, such proposals should be treated with the greatest of caution.

One of the de facto means by which India and the EU states have directed a majority share of government procurement for domestic firms has been through procedures for awarding contracts, such as restrictions on the publication of bids. Addressing transparency issues in a binding trade agreement, could itself be as effective a form of opening up markets as explicit liberalisation commitments. So agreements ostensibly limited to transparency can be a way of foreign providers improving their access to markets.

Furthermore, agreements such as the Caribbean EPA that are said to be limited to transparency have also contained built in liberalisation and national treatment commitments which will in time end de jure preferences for national suppliers as well as including enforcement – or bid challenge – provisions¹⁶⁵. The latter enables parties to issue legal challenges if they believe their suppliers have been unfairly excluded from a contract because of un-transparent contract award procedures. With potential major costs incurred by the losing party, this could make state governments in India more cautious about implementing preferences for domestic suppliers, for fear of costly legal challenges.

There is certainly a great deal of scope to improve government procurement policies within India. Procedures for awarding government procurement contracts are recognised to be complex and insufficiently transparent at some levels of government. This in turn is a barrier for SMEs and can undermine some of the stated pro-SME policies outlined above. These problems also certainly lead to inefficiencies with knock on impacts for welfare. However if the route for addressing these problems is through an FTA with the EU, it is likely that more problems will be created than solved. Transparency measures would be focused upon improving access for EU firms rather than Indian SMEs – and would sooner or later come with restrictions on the scope for the government to actively support SMEs or marginalised castes through government procurement. Improvements to transparency and efficiency can be made domestically, but do not need to be undertaken in the context of a risky binding agreement with another party.

Footnotes

¹⁶⁴ Woolcock, op cit

¹⁶⁵ See Articles 167.1.3 and 167.1.4 of Caribbean EPA; also see Dawar K. and Evenett S. (2008) ‘The CARIFORUM-EC EPA: An Analysis of its Government Procurement and Competition Law Related Provisions’, GTZ

Conclusion and recommendations

Conclusion

It is well recognised that, at a time when India is emerging as a major economic player, the gains from growth have not translated into adequate poverty reduction. This report has examined various central aspects of the proposed EU-India FTA, with a focus on the implications for several sectors of particular relevance for poor people and the achievement of development goals.

A number of fundamental concerns are raised, both in relation to the impacts of EU imports of goods and service suppliers, and from the reduced scope for regulation that comes with the EU’s FTAs. We conclude that the proposed EU-India FTA – based on the EU’s Global Europe Strategy - risks stripping away the very tools that India could use to re-balance the gains from growth and to ensure that the poor are not further marginalised.

The concerns raised in this report echo warnings from the UN and others that North-South FTAs may be intrinsically problematic for the less developed partner – because they reduce the national policy space that can play such an important role in fostering balanced and equitable economic development¹⁶⁶. It also reinforces warnings from earlier research by others such as the Carnegie Foundation, which has argued that the ‘the risks [from the EU-India FTA] are not insignificant’.

Early indications suggest that unless India can successfully negotiate an agreement that looks very different from EU proposals, it is highly questionable whether the EU-India FTA is the best way forward for development.

Recommendations

Recommendations to the EU Member States and the Government of India:

- i) Make development central to any trade regime between the EU and India.
The scope and design of any EU-India trade regime should be determined by development considerations, including the achievement of the Millenium Development Goals. Such concerns should take precedence over the primarily commercial interests of the High Level Trade Group report.
- ii) Allow time for thorough and inclusive impact assessments and consultations.
There is not yet sufficient information and analysis of the scale of the FTA’s potential impacts in India, especially on poverty. In addition, the negotiations themselves lack transparency and there is a critical lack of awareness of the process among key stakeholders. Therefore more time should be allowed for full, participatory impact assessments, as well as for broad consultation with those groups most likely to be affected by the FTA. No FTA should be signed until and unless the development case has been proven.

Recommendation to the EU Member States:

Call for a review of the EU’s new trade strategy as set out in Global Europe. On the basis of mounting concerns about the EU’s current approach to trade policy, the EU should review its FTA / Global Europe strategy, to replace it with an approach that puts development objectives at the core.

Footnotes

¹⁶⁶ UNCTAD (2007), op cit

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