

Global economies of scale in the EU-India trade agreement: are they the key to a return to economic growth?

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Abstract Economies of scale are an alternative source of growth particularly at a time when countries are suffering from global economic malaise. The proposed EU-India free trade agreement holds substantial promise as this will create a combined market of over one and a half billion and generate economies of scale from intra-industry trade, which are likely to be concentrated in manufactured products such as chemicals, machinery and transport equipment. Bold action is needed on the part of politicians in both the EU and India to successfully negotiate the agreement given that this will enable both countries to reap the efficiency gains of global economies of scale, provide a significant competitive advantage over other major economies and deliver the necessary spur to shake both the EU and India out of their current economic stagnation.

Introduction

Since June 2007, the European Union (EU) and India have been negotiating a preferential free trade agreement (FTA). After being announced with considerable fanfare, talks have been ongoing, but no accord has emerged. A number of deadlines have passed and may well lapse again (Khorana and Perdikis, 2010; Khorana and Garcia, 2013). The pace of EU-India FTA talks has been impacted by ongoing negotiations between countries for Transatlantic Trade and Investment Partnership (TTIP), Trans Pacific Partnership (TPP) and ongoing talks in Asia, including Regional Comprehensive and Economic Partnership (RCEP). In the aftermath of the

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2008 financial crisis, the EU slipped into the worst economic recession since the 1930s (Viju and Kerr, 2011). As in the wake of the stock market crash of 1929, governments have failed to fully understand the degree to which the financial crisis would impact the real economy and have exhausted most of their domestic economic policy options without seeing a return to sustained economic growth (Kerr 2012). Many economists are predicting up to a decade of economic malaise before a return to sustained economic growth (Krugman, 2012; The Conference Board, 2012; Stiglitz 2012). India has not escaped the contagion of the recession (World 2011).

While Indian economic growth remains positive, it is no longer at a rate that can be leveraged to overcome deep resistance to structural change. Without rapid economic growth, there is a potential for economies such as India to slip into suboptimal institutional equilibriums that inhibit future growth and are hard to escape (MacKay and Kerr, 2007). While much has been made of the Indian economic miracle in the first decade of the 21st century, it remains a fragile phenomenon (Bhagwati and Calomiris 2008).

To escape from long-term economic malaise, the EU economy needs sustained economic growth. India too needs high growth rates to keep it on the road to economic reform. At the moment, no conventional economic policy tools appear available in either the EU or India to generate the required growth. Unconventional methods are, hence, suggested. If fiscal and monetary policy cannot be used to generate the economic growth required, then exogenous factors must be harnessed. One such exogenous factor is the opportunities that could arise from restructuring to take advantage of economies of scale. One potential source of such opportunities can arise from removal of barriers to trade (Perdikis and Kerr 1998). A preferential FTA between the EU and India that has a large ambition in terms of liberalisation may well have sufficient economies of scale embedded in it to provide the growth required to both shake the EU out of its economic malaise and secure India's further transition. The proposed agreement is thus politically and economically crucial—not only would it create greater confidence in the EU, strengthen its role as a global actor, and revive market confidence in the ailing eurozone, a successful conclusion will also increase both partners' global competitiveness. Moreover, the combined weight of India and the EU, representing more than a fifth of total world population, would be an FTA representing the largest number of people ever attempted suggesting that the FTA has the potential to set in motion large and extensive economic change (Khandekar and Sengupta 2012). Much of the benefit of globalisation is expected to arise from the specialisation stemming from economies of scale (Greenspan 2007). The possibility of integrating the EU and Indian markets, however, raises the question as to whether their joint market is sufficiently large to reap almost all of the potential benefits available from globalisation.

A host of studies model potential economic outcomes of the proposed EU-India FTA (CARIS-CUTS 2007; Decreux and Mitaritonna 2007), but none examine the potential economies of scale from the proposed agreement. Our paper examines whether the EU-India FTA will lead to economies of scale, and comments on potential sectors that could benefit from such economies. The paper is structured as follows: "Trade liberalisation, disequilibrium, and economies of scale" delves into the economics of trade liberalisation and economies of scale and estimates intra-industry trade flows using the Grubel-Lloyd index for the EU and India. "The EU-India negotiations-

limited ambitions” places the ongoing negotiations into perspective and elaborates on the underlying reasons for slow progress of ongoing talks. “Conclusions” concludes.

Trade liberalisation, disequilibrium, and economies of scale

It has long been recognised that with trade restricting barriers in place, the limited size of national markets can prevent firms—and their customers—from benefiting from technically available economies of scale. One of the central observations made by Adam Smith (1776) in his *Wealth of Nations* was that the division of labor is limited by the extent of the market. Over time, Smith’s observation was formalised and incorporated into economic theory (Stigler 1951; Buchanan 1993). The potential for international trade to provide sufficient markets to garner the benefits of economies of scale followed their incorporation into international trade theory (Ethier 1993; Perdikis and Kerr 1998). While early theories such as Adam Smith’s concentrated on the benefits from labour specialisation, economies of scale is primarily a technological phenomenon. Technical efficiency improves with the increasing size of the production enterprise meaning that average total cost declines as the quantity of output produced increases—up to some limit where increasing the size of the production unit no longer provides technical efficiencies or the scale of the enterprise becomes too large to be effectively managed. The latter is managerial diseconomies of scale. Hence, the long run average cost curve is expected to be U-shaped. If there is no constraint on output—such as the size of the market—then the firm(s) in the industry will evolve until a size that can utilise the available scale-based technical efficiencies is reached. If the market is too small to profitably support the output of such a firm, then smaller scale production facilities will be built—meaning that technical efficiency will be less/cost will be higher. If the size of the market, however, can be extended through the removal of trade barriers; over time, the efficiencies associated with additional economies of scale can be reaped.

The benefits of trade liberalisation without the existence of unrealised economies of scale are expected to arise from the movement of resources from relatively inefficient, previously protected industries to relatively efficient industries. Except in the very short run, increased trade—imports and exports—is the result of these changes in the allocation of productive factors. The removal of trade barriers initiates a state of disequilibrium whereby forces tend to move the economy towards a new equilibrium. If untapped economies of scale are available as a result of trade liberalisation, then the degree of disequilibrium will be greater but the size and direction of changes will be less transparent. This is because the nature of technical efficiencies underlying economies of scale will vary from industry to industry. There may also be synergies between the different scale economies that lead to even larger efficiency gains and, as costs/prices fall other industries which do not have any further economies of scale to exploit may have their relative competitiveness improved. The increased degree of disequilibrium that will exist if unexploited economies of scale are available in the wake of trade liberalisation could provide the necessary spur to shake both the EU and India out of their economic stagnation. This follows from trade theory that usually assumed scale economies are external and, therefore, available to all firms in the economy (Perdikis and Kerr 1998). In light of the sheer asymmetry of the proposed EU-India FTA, Balogh’s (1963) argument that a country loses dynamism following slowdown in

innovations might not hold good. On the contrary, Gremmen and Vallabergh (1986) proposition might apply if the Indian firms developed research and innovation under the proposed FTA scenario. An important implication of the economies of scale argument is that an FTA with the EU will allow India to produce standardised as well as differentiated products. This draws on a similar experience of European firms which were limited by small size of home markets prior to the single market, experienced economies of scale. Dreze (1960) argued that goods produced under economies of scale are differentiated by national regulatory standards, which lends support to the argument that India continues to export non-differentiated intermediate products to the EU under the current patterns of trade. In general, trade theories incorporating economies of scale, whether in a static configuration or forms that incorporate a dynamic element, tend to confirm the significance of economies of scale in explaining trade patterns (Perdikis and Kerr 1998).

Within the context of the proposed EU-India FTA, an important source of gains from trade liberalisation through integration is a larger market which will support achieving economies of scale in production since the market created by the single economic space is likely to facilitate higher production such that as production increases, the per unit costs decrease leading to higher profits. Studies show that increased profitability impacts on economies in the host country through a positive multiplier and circular flow effects (Simms and Simms 2006). Further, enlarging the market is likely to lead to larger firms and increased competition between firms in India and the EU following an internationalisation of production systems. Internationalisation, which involves vertical trading chains in a particular stage of production, is an increasingly important feature in the literature on inter- and intra-industry trade (OECD 2002a). Earlier studies on internationalisation by Posner (1961) explicitly introduced the concept of imitation lag, and Vernon (1966) and Hirsch (1967) used the product life cycle approach to explain the basis for trade, and it is Finger (1975) who attempted to incorporate price factors as determinants of price patterns. More recent theories of intra-industry trade, however, particularly focus on regional agreements among developed countries following changes in trade patterns after the formation of the European Economic Community (OECD 1994).

Studies analysing intra-industry trade capture different types of trade in the measurements of intra-industry trade, i.e. horizontal trade in similar products with differentiated varieties; trade in vertically differentiated products distinguished by quality and price; and vertical specialisation of production that results in trade in similar goods at different stages of production (OECD 2002b; Fontagne and Frueudenberg 2002). Under the pattern of current EU-India trade, studies show that the proposed FTA is likely to be driven by vertical specialisation of production across countries through the exploitation of comparative advantage; an example is using cheap unskilled labour for assembly purposes or specialised personnel for research and development (Gasiorek et al. 2002). Evidence, after the implementation of NAFTA between Mexico and the USA, suggests a rapid increase in intra-industry trade in manufactured goods which resulted in economies of scale for trading partners (Globerman 1992). Other studies suggest that intra-industry trade can increase between developed and developing countries following an agreement (OECD 2002a, b; Globerman 1992).

Intra-industry trade flows, commonly measured by Grubel and Lloyd (1975), are based on commodity group transactions conventionally defined as the two-way exchange of goods within standard industrial classifications. This index takes the minimum value of zero when there are no products in the same class that are both imported and exported, and the maximum value of 100 when trade is intra-industry (in this case X_i is equal to M_i). Thus, for any particular product class i , an index of the extent of intra-industry trade (IIT) in the product class i between countries A and B is given by the following ratio:

$$IIT_{i, AB} = [(X_i + M_i) - |X_i - M_i|] 100 / (X_i + M_i) \quad (1)$$

Table 1 reports the Grubel-Lloyd index for each two-digit SITC (revision 3) product class between the EU and India. Results show high intra-industry trade between EU and India in selected sectors, which is indicative of EU's importance as a trading partner for India (first in order of importance).

The extent of intra-industry trade between the EU and India is higher across categories of manufactured goods (0.91) than it is across trade in non-manufactured goods (0.65). Intra-industry trade is particularly concentrated and is highest in more sophisticated manufactured products such as chemicals, machinery and transport equipment. In contrast, it is low for unskilled labour intensive sectors such as agricultural products, textiles and clothing. As India develops and integrates into the world economy, the composition of trade flows are likely to tend to move away from primary

Table 1 Grubel-Lloyd index for trade between the EU and India

Product groups (SITC Rev 3)	Years		
	2007	2009	2011
1000—Primary products	0.65	0.70	0.75
1100—Agricultural products (food incl. fish and raw materials)	0.42	0.40	0.44
1200—Fuels and mining products	0.81	0.89	0.88
2000—Manufactures	0.91	0.92	0.94
2100—Iron and steel	0.89	0.73	0.96
2200—Chemicals	0.91	1.00	0.91
2300—Other semi-manufactures	0.69	0.69	0.69
2400—Machinery and transport equipment	0.45	0.59	0.62
2410—Office and telecomm equipment	0.41	0.73	0.81
2420—Transport equipment	0.59	0.97	1.00
2430—Other machinery	0.39	0.37	0.42
2500—Textiles	0.14	0.15	0.16
2600—Clothing	0.02	0.01	0.02
2700—Other manufactures	0.75	0.84	0.87
3000—Other products	0.55	0.52	0.66
Total (all products)	0.95	0.96	0.99

Source: Authors' calculations

products, initially towards unskilled labour intensive products and subsequently towards human-capital intensive products in manufacturing, which are more likely to benefit from economies of scale in production. This indicates that over the longer term, complex manufactured goods, which rely on components and processes, may eventually benefit from splitting production across countries under the FTA setting. It follows that elimination of tariff barriers under the proposed FTA complemented by India's low labour costs is likely to attract manufacturing firms to set up production based in India and also to use the facilities as an assembly base for re-exports. While the intra-industry trade index suggests that a fair degree of complementarity exists between partners in the manufacturing industry, competition is likely to be fierce in this sector as illustrated by a high and rising intra-industry trade between the EU and India with each partner specialising in specific products (transport equipment in the EU and its parts in India). These are primarily parts and accessories of motor vehicles, transport equipment, iron and steel products, and chemicals.

As economies of scale are enabled by intra-industry trade, production efficiency is also likely to be improved. In static terms, tariff reduction and liberalisation through the FTA can be employed as a means to expand manufacturing by Indian firms through a reallocation of productive resources, i.e. capital and labour, encouraging Indian firms to invest in capital saving technique, which will increase the labour-capital output with positive employment effects. Among explicit arguments for pushing FTA talks between the EU and India is the potential to gain from external and internal economies of scale, and that it is likely to impact on production patterns in both India and the EU, through specialisation. Gains from internal economies of scale are likely to be determined by firms' interaction and their linkages within an industry. External economies of scale manifesting in intra-industry trade, however, are likely to emanate from inter-industry externalities at the national level, although these will again depend on differences among industry groups across the trading partners.

Recent studies, which analyse the economies of scale in European manufacturing industries at the level of industrial clusters, find that there are significant differences between the magnitude and gains from economies of scale across industries and industrial clusters and that external economies of scale, arising from inter-industry external effects and cross-country effects, are less prevalent than increasing returns at the industry and firm levels (Henriksen et al. 2001). Studies by Hay (2001), Ferreira and Rossi (2001), Jonsson and Subramanian (1999) on South Africa, and Lee (1996) on Korea show that reductions in trade barriers are followed by significant increases in productivity, generally because of increased import competition. Kim and Han (2000) find that most of the apparent total factor productivity advance is attributed to compression of profit margins and economies of scale.

Schiff and Winters (2003) find a trade-off between scale economies and competition in a market of a given size such that if firms are larger, there are fewer of them and the market is less competitive. Literature bears testimony that deep integration policy measures (i.e. regulation and standards harmonisation), stimulate economic growth through the channels of productivity growth, and lead to specialisation and economies

of scale (Srinivasan 1996; Birdsall and Lawrence 1999; Gavin and Sindzingre, 2009). In particular, a move by India and EU towards a more open competitive market for trade and investment will require harmonisation of regulatory standards and institutions for both partner countries to benefit from the economies of scale. The power of the economic forces set in motion by technological change with a bias to scale should not be underestimated. The EU-Indian trade agreement may have the potential to create a similar degree of disequilibrium. This may provide the key to the economic growth that is currently needed by both the EU and India—but it will require an agreement that has considerable ambition in terms of the liberalisation it encompasses.

The EU-India negotiations-limited ambitions

As part of Global Europe strategy, the EU began to explore improving trade relationships with large and rapidly growing markets around the world prior to the post-2008 economic recession. This strategy explicitly clarified the economic rationale behind present generation of FTAs:

The key economic criteria for new FTA partners should be market potential (economic size and growth) and the level of protection against EU export interests (tariffs and non-tariff barriers) (European Commission 2006).

De Gucht's 2010 'Trade, Jobs and Growth' follow on strategy further prioritised FTAs and reiterated, "we are not available to do shallow FTAs"(European Commission 2010).

Within the overall construct of the EU, FTAs are an integral part in its trade policy architecture. The EU perceives trading agreements with groupings in the Americas such as the Andean Community countries in Central America, South Korea and and more recently Canada as stepping stones to the achievement of a global economy (DG Trade 2007). India as an emerging economy is central to this strategy (Khorana et al. 2010). The ongoing EU-India trade negotiations are economically significant for both India and the EU. The EU is its largest trading partner accounting for approximately 25 % of Indian exports. For India, the EU is the largest trading partner, accounting for around one-fifth of India's total trade (14.8 % in 2010) whereas India contributes around 2.5 % of total EU trade and is its 10th largest partner. Since 2001, bilateral trade has increased annually by over 11 %. Services are an important component of trade, and Indian exports to the EU touched €8.1 billion in 2010, while imports reached €9.8 billion (DG Trade 2011). EU investments in India tripled between 2002 and 2006 (DG Trade 2011) and between 2000 and 2011 the EU, as India's second largest investor, accounted for 21 % of Indian Foreign Direct Investments (FDI) (Government of India 2011), although outflows from the EU have declined since the 2008 financial crisis.

Despite the rhetoric, after 7 years of negotiations, there has been no substantial progress in reaching an agreement. In part, this may be because the analyses that have been undertaken of the potential agreement do not take account of economy of scale effects and that trade negotiators and policy makers are somewhat divorced from the economic travails of both the EU and India—it is trade negotiations as usual. Recent studies, which tend to analyse the effect of FTAs under assumptions of constant returns to scale, suggest relatively modest gains from an agreement. A Government of India (2007) analysis suggests that India will be a net loser in goods, primarily as a result of the loss of revenues from lower or zero tariffs, although gains are expected from

liberalisation of service sector. CARIS-CUTS (2007)) report indicates that liberalisation of trade in goods would yield only ambiguous welfare effects. Agence Europe (2007) concludes that the growth in goods trade will be heavily biased in favour of the EU and its exports will increase by 55 % compared to 20 % for India. Sectors expected to benefit under constant returns to scale scenario are textiles and leather. Achterbosch et al. (2008) employ modelling techniques to examine the effect and find that tariff reductions would involve losses for India but the EU would expand its position in the Indian market. Polaski et al. (2008) also use a CGE model to assess the proposed agreement. Their results indicate relatively modest gains for Indian exports (5.5 %) and imports (3.4 %), and project a negative net effect on India—US\$250 million loss in welfare. The effects are predicted to exhibit considerable differences among sectors with the strongest effects in manufacturing. The proposed agreement is expected to increase employment opportunities for approximately 2.3 million unskilled labourers (0.5 % of total labour force). Using a combination of CGE and gravity model approaches, Ecorys (2009) estimates that the EU will gain €4.4 billion in the short run and €16 billion in the long run, while for India €4.9 billion and €17.7 billion gains in the short and long run, respectively. Declines are predicted in Indian manufacturing including transport equipment, paper production and printing. Indian wages, both skilled and unskilled, are estimated to increase, by 1.5 %. Decreux and Mitaritonna (2007) use CGE model and find considerable gains from tariff reductions for some EU manufacturing sectors such as automobiles and machinery; the Indian service sector is expected to be a major beneficiary. All of these results suggest modest gains from liberalisation and are in keeping with the results expected from the modelling of short run adjustments from the removal of barriers to trade. They do not include dynamic adjustments as a result of shifts in resource use among sectors and do not incorporate changes arising from the ability to exploit economies of scale (Gaisford and Kerr 2001). Given the industry specific and technological nature of economies of scale, incorporating them into formal trade modelling exercises requires assumptions that are simply too historic to yield credible estimates.

The expected gains from liberalisation arising from the formal modelling exercises are modest and fail to grab the attention of policy makers. Given the limited expected gains, there is little that can be used in argument to offset the losses predicted by the protectionists (Kerr and Forgrave 2002). Further, the modelling pertaining to the potential EU-India trade agreement took place prior to the post-financial crisis economic recession that commenced in 2008. The negotiations started during global boom so that there was little urgency in obtaining the gains from trade. Thus, the economic and political environment under which the negotiations were launched was predisposed to an agreement with limited ambition. While the economic prospects in both the EU and India have changed dramatically since 2007, the potential agreement remains on course for a limited ambition—if an agreement can be reached at all. Trade liberalisation is more difficult during recession as protectionist vested interests tend to resonate more credibly if they threaten job losses when unemployment is already high and there are increasing demands for protectionist measures to enhance domestic employment through import substitution (Viju and Kerr 2011).

While the negotiations are being conducted in secret, some information can be gleaned on the substantive issues that must be dealt with (Khorana and Perdikis 2010; Khorana and Garcia 2013; Khorana and Asthana 2014). The FTA talks have

largely stalled due to the diverse interests of the EU and India. For example, India perceives the agreement as a mechanism to enhance market access for its textile and clothing exports as well as its services sector. It also hopes to remove some of the non-tariff barriers encumbering access for its agricultural products. In contrast, the EU perceives the agreement as an opportunity to achieve some of its Global Europe objectives through an opening of the heavily protected Indian government procurement, retail and financial sectors. As De Gucht (2011) puts it, the slow pace of negotiations are due to “[...] some thorny issues on the table which require difficult negotiation” and include differences with regards to tariffs on automobiles, wines and spirits, the extent of liberalisation of procurement, investment and services sectors. Contentious issues that pose as major stumbling blocks to FTA talks are continued emphasis by the EU on service sector liberalisation (legal and accounting services, banking, insurance, and retail), intellectual property rights in the health and investment sectors as well as extent of agricultural liberalisation (Khorana and Garcia 2013). This has since changed and discussions with policy makers in India reveal that the planned exchange of offers (on industrial goods, agricultural tariffs and services) has been postponed until the impact assessment on existing FTAs are assessed by India. What also threatens to derail ongoing EU-India FTA negotiations is the EU’s shift to negotiating TTIP with the USA and India’s participation in regional liberalisation talks under RCEP.

The basic contentious issues that block progress of EU-India talks, however, remain unchanged. Among others, these include addressing the question of symmetry in the breadth of tariff cuts by the EU and India. Given that India has high MFN tariffs, the EU wishes symmetry whereby duties would be eliminated on 90 % of both partners’ tariff lines. India is insisting on an asymmetric deal with the EU removing tariffs on 95 % of its tariff lines while India extends the cuts to only 90 % of its lines. The EU has rejected asymmetry on the grounds that this is a negotiation among equals (European Commission 2008) while India’s stance is based on differential treatment as a developing country—consistent with its position at the Doha Round of multilateral negotiations. While 90 % of tariff lines may sound like a major liberalisation, the remaining 10 % of tariff lines in the EU are likely sufficient to provide continuing protection for those sectors where the greatest gains from trade could be secured. So, identifying sensitive sectors are key to the success of the FTA. A reduction to 5 % of tariff lines would mean hard choices having to be made in the EU. What makes tariff cuts very interesting is that the Indian market has been strongly protected and moving to zero tariffs on 90 % of tariff lines would give preferential access to EU firms over a wide range of products.

Liberalisation in services sector is another central element of the EU-India agreement. Evidence suggests that India has a competitive edge in services trade and India’s share in global services trade increased from 0.68 % in 1981 to 2.52 % in 2006 (De and Raychaudhari 2008; Khorana and Perdakis 2010). Trade in services has also grown rapidly, and this is the fastest growth sector in India. The EU is interested in ‘an ambitious, far reaching and comprehensive agreement on services and investment’ (European Commission, 2008). But, India’s ambitions are much more limited, and as evident from FTAs concluded by India, the preference is more for a shallow FTA. India preference for an FTA with EU is similar, and India is keen to reserve Mode 3 services for its own firms and keen on market access into the EU for Mode 1 and Mode 4

services.¹ Of particular interest to India are research and development, health and telephone services in Mode 1 and mutual recognition of professional qualification and less restrictive entry for professionals in Mode 4 (Khorana and Perdakis 2010). A host of services in Mode 3 from banking to legal services, and accountancy, insurance are restricted by a host of regulatory and foreign investment restrictions (Khorana and Perdakis 2010). These sectors are the last refuges of the regulatory raj that dominated much of the Indian economy prior to its move to liberalisation in the 1990s, and these sectors are likely to experience considerable scale benefits. In the current financial sector set-up, consumer retail finance, wealth management services and investment banking remain sheltered. According to Gasiorek et al. (2007), there are a range of horizontal barriers such as dated laws, multiple rules and regulations, inconsistent practices among the Indian state governments, regulatory gaps, public sector bias and limits on foreign investment/ownership that adversely impact EU services—many of which will require aggressive action from the Government of India if there is to be significant liberalisation. Given the plethora of vested interests involved, there is little likelihood of the government being willing to take such a bold step.

Liberalisation of Indian retailing is of particular interest to the EU and foreign investment in the sector is heavily restricted for multi-brand retailing. Indian retailing is heavily weighted towards small family run enterprises that are inefficient, characterised by tax avoidance and low standards for facilities. The entire retail sector could have been easy pickings for EU retailing giants such as Carrefour, Ikea, TESCO, Asda/Walmart and a host of others and they have lobbied hard for retailing to be included. The recent reversal of government policy on retail sector liberalisation is particularly frustrating for EU businesses and this has considerably dampened EU's interest in the FTA. This follows from strong lobbying effort by small and medium sized retailers as well farm groups in India for the sector to retain protection. Non-government organizations and civil society groups have also lobbied against liberalisation, which led the national government to reverse its stand. Thus, multi-brand retailing is now a lost opportunity for EU retailing giants.

Agriculture is another key sector where the negotiations have floundered. It is another sector where both the EU and India have a long history of heavy protection (Kerr 2000; Khorana et al. 2010). India's reticence on opening market access for agriculture is particularly on the structure of safeguard mechanisms. The importance of this sector has been highlighted with India rejecting Trade Facilitation Agreement on grounds of food security. Further, India wants the EU to cut tariff and subsidy support on its agricultural products. As the latter can, realistically, only be undertaken on a multilateral basis, it will be not be possible for the EU to provide concessions. India is also concerned about the inadequate attention to safeguard provisions that allow duties

¹ In the WTO's General Agreement on Trade in Services (GATS) services fall into four modes: (Mode 1) cross border supply whereby services flow across borders (e.g. outsourcing or book editing); (Mode 2) consumption abroad (e.g. tourism); (Mode 3) commercial presence whereby a service supplier establishes itself in the importing country (e.g. a branch of a foreign bank or a subsidiary doing after sales service) and; (Mode 4) presence of natural persons (e.g. doctors or lecturers journeying to a foreign country to deliver their services).

on agricultural products to rise back to the MFN levels—or higher in its WTO proposal—in response to import surges or international price declines. The normal volume triggers are perceived as insufficient to guard Indian agriculture, and India wants price triggers as well. As the combination of volume and price triggers makes investments in international trade activities by potential exporters extremely risky, safeguard provisions are an important potential stumbling block in the negotiations. Further, as India considers agricultural safeguards as the purview of developing countries, it will run contrary to the EU's insistence of symmetry in the status India and the EU in the negotiations. The inclusion of discussions over safeguards is clear evidence of an agreement with limited ambitions.

The EU wants export restrictions on raw agricultural products removed and their future use prohibited. This would undermine recent intervention by the Government of India to avert a food crisis, and this will be unacceptable in light of the national government's insistence on food security as a major concern. There are other potential road blocks to the agreement in the form of the EU's sanitary and phyto-sanitary regulations for food products. The EU food safety regime has been accused of being stricter than that allowed under the WTO rules (Kerr and Hobbs 2005; Isaac 2007) and not strictly based on science (Viju et al. 2011). Food safety is a particularly sensitive political issue in the EU, and any relaxation in these regulation for the products of a developing country is a strictly no go area. It is regulatory barriers, however, that are particularly difficult for exporters from developing countries to deal with. For example, the Rapid Alert System for Food and Feed (RASFF) and Rapid Exchange of Information (REI) in the EU restrict the marketing and use of any product that is found to be posing serious and immediate danger to consumers' safety and health by swiftly exchanging information. Any rapid alert in one EU Member States leads to extensive checks of the subsequent consignments in others which would pose a major threat to Indian exports. Additional barriers include lack of harmonisation of EU microbiological standards and tough norms for horticultural products exported by India. Recent example of the EU's ban on Indian mangoes export on health and safety grounds highlighted existing differences between the negotiating partners and such divergence is a key stumbling block area that makes the proposed agreement truly limited in ambition.

The EU has also been insisting on a competition policy clause, and talks include provisions for rules on agreements between undertakings and on how to prevent the abuse of dominant position by firms in the event of a merger (European Commission 2007). The EU is reportedly asking India to provide effective competition in the local market. This could impact on what India feels is the flexibility it needs to design a competition policy suitable for its economic development. Within the ongoing negotiations, the EU has also raised questions regarding India channelising trade through designated government agencies and state trading enterprises.

There are also a host of technical barriers to trade (TBT) based on standards and regulations in both the EU and India. These have been discussed at length in Khorana and Perdakis (2010) and Khorana et al. (2011). In part, these arise due to lack of harmonization among member states of the EU and among the individual states in India. Examples include complicated system of taxation made worse with differences in the rate of national and state sales taxes. There is no indication that either the European Commission or the Government of India is willing to engage their Member States/state

governments over such non-tariff barriers, which manifests as major barrier to EU firms in India.

Opening up the Indian government procurement to EU firms is another priority issue for the EU and a bone of contention between the partners (Khorana and Asthana 2014). The EU has complained that the 'Indian government procurement practices are often not transparent, discriminate against foreigners and often give preferences to the locals' (EU Market Access Database 2006). Given that government procurement accounts for nearly 13 % of GDP in India, the Indian government insists that public procurement not be included in the EU-India negotiating agenda. The Indian government perceives that negotiating government procurement will undermine its policy to support the medium and small sector (Khorana and Subramanian 2012). For the EU, the inclusion of procurement is essential for the balance of the agreement (European Commission 2008). Government procurement is, hence, an area where an eventual agreement can only have a limited ambition.

Thus, the analysis suggests that negotiations surrounding the EU-India preferential trade agreement are following a well-worn path leading to a limited ambition. The pace of negotiations lacks a sense of urgency indicating that the focus of partners may well have shifted since negotiations commenced. The positions of all the normal vested interests in protection are represented in discussions so far and will constrain the degree of liberalisation that can be achieved. A limited ambition agreement is unlikely to provide a sufficient degree of disequilibrium to create opportunities where investments in underlying economies of scale appear lucrative. As a result, an opportunity to re-invigorate economic growth in both the EU and Indian may be forgone if the agreement is completed soon.

Conclusions

In the wake of the financial crisis of 2008, the European Union was faced with economic stagnation for a decade. India's economy also lost much of the dynamism that characterised its performance after the decision to move from a largely closed economy to one that is open in outlook and bore the brunt of economic slowdown and growth rates have staggered. The dynamics of ongoing TTIP, TPP and RCEP negotiations have further impacted on the pace of EU-India FTA talks. Both the EU and India require a return to sustained economic growth, but mechanisms to foster that growth continue to elude policy makers. In the EU, the opportunities to use both monetary and fiscal policy to stimulate growth have largely been exhausted while in India, in the absence of growth, it is difficult to overcome the resistance to reform. Alternative approaches, which include demand and supply side policies, are required. Under the FTA scenario, economies of scale are an alternative source of growth for the partner countries that will enable them to reap the benefits of bilateral trade liberalisation. The proposed EU-India FTA may provide the opportunity to garner considerable economies of scale, but only if the negotiations have large ambition. In particular, economies of scale and the degree to which EU and Indian firms can exploit them in a location will also determine firm competitiveness within the context of the FTA (Budd and Hermis 2010). The availability of economies of scale creates conditions of disequilibrium that set in motion forces that yield growth as relative prices change, factors shift among

sectors and investments are made in new production facilities and supporting infrastructure. India is likely to benefit from potential economies of scale and the FTA is an ideal opportunity.

The lack of a momentum in talks from a host of sticky issues could well signal the lack of enthusiasm in partners for the proposed FTA. The FTA is relevant for the EU in light of continuing effects of eurozone crisis as a result of growth in most EU member states continues to be anaemic. Similar is the case for India as its growth is slowing at 5 %, though still greater than the EU. The proposed FTA would create a market of over 1.5 billion people—a market of sufficient size to garner most of the benefits of scale expected from globalisation. This is an opportunity that is too good to miss. Beyond the direct benefits to the EU and India as trading partners, the new combined market may gain a cost advantage over the rest of the world. This change in comparative advantage may well put other economies into disequilibrium, stimulating price adjustments, factor movements and investment that create growth thus contributing to a renewed period of growth in the global economy. Given the current state of EU-India FTA talks, large ambition will require bold action on the part of politicians in both the EU and India. This is particularly relevant in light of ongoing trade negotiations in Asia including Transatlantic, and domestic issues in India which include pro-market focus of the new Indian government. The EU-India FTA is also relevant from the perspective of the EU, as it struggles to conclude a ‘model’ FTA with an Asian economy. Renewed efforts are required by the negotiators to complete the talks before negotiating fatigue sets in and deprives both partners of the opportunity.

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