India's Comprehensive Trade Agreements
Implications for Development Trajectory

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India's recent overlapping comprehensive trade agreements, which combine accelerated goods trade liberalisation with deeper and wider liberalisation in agriculture, "investment" and services, have wide ramifications on her development despite the extent of liberalisation that the country has undertaken over the last two decades. It is argued that the growing trade deficit and the changed nature of recent foreign direct investment inflows already throw up industrial policy and financial regulatory challenges before India for developing dynamic competitiveness and reducing financial fragility in the economy. The investment provisions in the recent comprehensive trade agreements compound the dissonance between India's development needs and industrial and macroeconomic policies by putting World Trade Organisation-plus constraints on the country's regulatory ability.

Smitha Francis is thankful to the Indian Council for Social Science Research for a research grant that supported a research survey of India's preferential trade agreements, the original inspiration for this work, and gratefully acknowledges the comments received from Jayati Ghosh, Prabhat Patnaik and Amiya Bagchi, and the participants at the ICSSR Research Surveys Workshop, 4-7 May 2011, at ICSSR, New Delhi. An earlier version of this paper was presented at the ARTNeT Symposium "Competitiveness and Economic Diversification in Asia and the Pacific – Towards a Return of Industrial Policy", 25 July 2011, UNESCAP, Bangkok. The usual caveat applies.

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1 Introduction

As India's industrial production figures have declined once again[1] and the mainstream discourse focuses on "policy paralysis" as the cause of India's growth decline, the implications of the dynamics arising from trade and financial liberalisation carried out in the economy over the last two decades have been largely ignored. As before, a major thrust of the latest round of reforms to spur growth is further liberalisation. As a major component of this, "comprehensive" free trade agreements (FTAs) as the springboard for industrial growth – through greater access to export markets and increased foreign investments into the country – are likely to witness a renewed momentum. Given that India has already pursued some "comprehensive" FTAs recently, this paper attempts to throw light upon some of the problems associated with such a strategy.

As Table 1 (p 110) reveals, unlike in the past when we mostly undertook trade liberalisation at the most favoured nation (MFN) level with only a few exceptions,[2] there are currently 18 preferential trade agreements (PTAs)[3] in force involving India, with the spurt in agreements occurring since 2000.

What is significant is that the majority of India's PTAs involving both developed and developing countries since the mid-2000s (Singapore, South Korea, South Asian Association for Regional Cooperation (SAARC), Asia-Pacific Trade Agreement, Japan and Malaysia) are comprehensive in nature, which go beyond trade liberalisation in manufactured goods to cover liberalisation in agriculture, trade, services, "investment", intellectual property, etc, (see Table 1). Apart from the Association of Southeast Asian Nations (ASEAN) and Sri Lanka with which there are ongoing negotiations on investment and services, the India-European Commission (EC) FTA under negotiation since 2007 and the India-European Free Trade Association (EFTA) FTA under negotiation since 2008 also include services and investment. While ongoing negotiations for creating an FTA in the cases of the India-Southern African Customs Union (SACU)[4] PTA and the INDIA-Gulf Cooperation Council (GCC) Framework Agreement on Economic Cooperation between the Republic of India and the Member States of the Cooperation Council for the Arab States of the Gulf involve only goods so far, given the emerging trend, these agreements are also likely to eventually cover services and investment.

While there are some papers that discuss the expanding coverage of India's recent PTAs beyond goods market access to include liberalisation in agricultural and services trade,

investment, intellectual property protection, etc (for example, Banga and Sahu 2010; Francis 2011a; IDEAS 2009b; Kumar 2007a, 2007b; Sengupta 2011), there have been few efforts to understand the inter-sectoral linkages and economy-wide implications of the commitments made by India under its recent PTAs. This paper is an attempt in that direction. It is argued that accelerated goods trade liberalisation through overlapping comprehensive PTAs that combine deeper and wider liberalisation commitments in agriculture, "investment" and services have wide ramifications for India's development trajectory, despite the extent of liberalisation that the country has undertaken over the last two decades.

2 Comprehending India's Recent Trade Agreements

The seeming impasse in World Trade Organisation (WTO) multilateral negotiations since the late 1990s has been the common catalyst driving the rising engagement of countries in PTAs globally. But the heightened competition brought about by south-east Asia and China's export success, followed by the proliferation of PTAs initiated by ASEAN (beginning with the ASEAN-China FTA) became additional factors driving the rise of PTAs in the Asian region in the 2000s, including for India.

India's increased involvement in PTAs is also apparently rationalised by the fast-track export promotion strategy adopted by successive Indian governments since the 1991 economic reforms.[5] As more and more countries have become members of multiple regional trade agreements (RTAs), competitive regionalism has played an important role, as there is an assumption of net gains in becoming a PTA member.[6]

For a country joining a PTA in goods, the most important advantage is expected to arise from the difference between the MFN rate and the preferential tariff rate (that is, the margin of preference) offered by the member/s under that agreement. This margin of preference is believed to give comparative cost advantage to RTA member producers over both non-member producers and producers in the partner countries, and thus lead to an increase in its exports. But given that tariffs are only one among several factors determining the export

Table 1: India's Preferential Trade Agreements in Force (as of June 2012)

S No	Agreement	Partners	Coverage
1	India-Nepal Treaty of Trade since 1950; last renewed in 2009 for seven years.	Nepal	Goods, unilateral preferences for the landlocked partner
2	The Agreement on Trade and Commerce between India and Bhutan since 1972; last renewed in 2006 for 10 years.	Bhutan	Goods, unilateral preferences for the landlocked partner
3	The Bangkok Agreement since 1976; the Asia-Pacific Preferential Trade Agreement (APTA) since 2005.	Bangladesh, Sri Lanka, South Korea and Laos. China joined in 2001.	Goods (framework agreements on investment and services in 2009 and 2011 respectively)
4	Global System of Trade Preferences among Developing Countries (GSTP) (1989).	Several countries in Africa, South America. West Asia, Caribbean, Europe, East Asia, Middle East, North America, Central America.	Goods
5	SAARC Preferential Trading Arrangement (SAPTA) (1995).	Bangladesh, Bhutan, Maldives, Nepal, Pakistan and Sri Lanka.	Goods
6	India-Sri Lanka FTA (2001).	Sri Lanka	Goods (services and investment negotiations began in 2005)
7	India-Afghanistan PTA (2003).	Afghanistan	Goods, unilateral preferences for the landlocked partner
8	India-MERCOSUR PTA (2003).	Argentina, Brazil, Paraguay and Uruguay.	Goods
9	Bangladesh-India-Sri Lanka-Thailand Economic Cooperation (BIST-EC) since 1994; the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC) since 2004.	Bangladesh, Sri Lanka and Thailand. (1994); Myanmar joined (1997); Bhutan and Nepal (2004).	Goods, accords on services and investment in 2007
10	India-Thailand Framework Agreement for establishing a FTA (2004).	Thailand	Goods
11	Comprehensive Economic Cooperation Agreement between the Republic of India and the Republic of Singapore (2005).	Singapore	Goods, services and investment
12.	South Asian Free Trade Area (SAFTA) (2006).	Bangladesh, Sri Lanka, Pakistan and Maldives (1997); Bhutan and Nepal (2004).	Goods
13	PTA between the Republic of India and the Republic of Chile (2009).	Chile	Goods
14	ASEAN-India FTA (2010).	Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Thailand, Singapore and Vietnam.	Goods (services and investment negotiations began in 2009)
15	India-South Korea Comprehensive Economic Partnership Agreement (2010).	South Korea	Goods, services, investment, competition, intellectual property rights
16	SAARC Agreement on Trade in Services (2010).	SAARC countries	Services
17	India-Japan Comprehensive Economic Partnership Agreement (2011).	Japan	Goods, services, investment, intellectual property, government procurement, competition
18	Comprehensive Economic Cooperation Agreement between India and Malaysia (2011).	Malaysia	Goods, services, investment

This list of covered areas is not exhaustive. Areas such as trade facilitation and customs cooperation, Mutual Recognition Agreements (MRAs), safeguard measures and compensation mechanisms are common to some of the earlier agreements.

Source: Compiled by the authors based on information from the website of the Department of Commerce, India (http://commerce.nic.in/trade/international_ta.asp).

performance of a particular product (more on this shortly), the "actual" market access gained by India can be analysed by looking at whether India has *consistently* gained market shares in the countries with which it has signed PTAs. The distribution of India's exports reveals that with the exception of China (which joined APTA in 2001) India's top markets (those with at least a 5% share in the total) are all countries with which we have been trading on an MFN basis until very recently (Table 2).

Table 2: Change in Geographical Distribution of India's Top Export Markets
(percentage share in total)

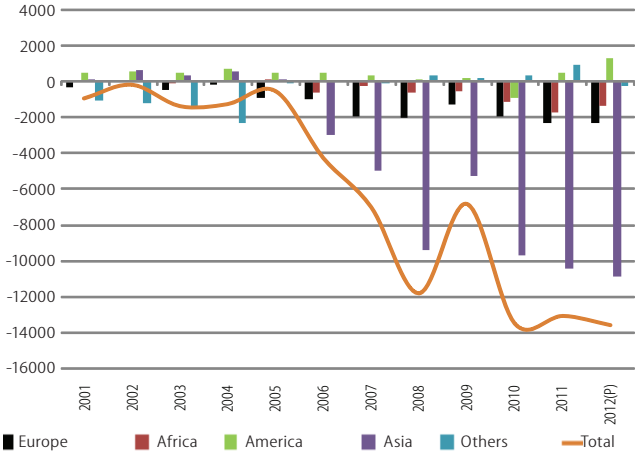
Partner	1995	2002	2005	2009	2010
United Arab Emirates	4.5	6.2	8.4	14.4	12.4
USA	17.4	20.7	16.5	10.8	10.7
China	1.0	3.1	7.2	5.9	7.9
China, Hong Kong SAR	5.7	4.7	4.4	4.0	4.3
Singapore	2.8	2.8	5.4	3.9	4.1
Netherlands	2.4	1.9	2.4	3.7	3.0
United Kingdom	6.3	4.8	4.9	3.7	2.9
Germany	6.2	4.1	3.5	3.3	2.7
Belgium	0.0	3.2	2.8	2.0	2.3
France	2.3	2.1	2.0	1.9	2.2
Japan	7.0	3.6	2.4	1.8	2.2
Indonesia	2.1	1.5	1.4	1.7	2.1
Saudi Arabia	1.5	1.8	1.7	2.2	2.0
Italy	3.2	2.5	2.5	1.9	1.9
South Africa	0.0	0.9	1.4	1.1	1.7
Brazil	0.3	0.7	1.0	1.0	1.7
Rep of Korea	1.4	1.2	1.5	2.1	1.6
Malaysia	1.2	1.5	1.1	2.0	1.6
Sri Lanka	1.3	1.7	1.9	1.0	1.5
Bangladesh	3.3	2.0	1.7	1.0	1.4
Areas, nes	1.4	1.8	0.2	3.9	1.3
Iran	0.5	1.0	1.1	1.1	1.1
Vietnam	0.4	0.6	0.6	1.0	1.1
Spain	1.3	1.5	1.6	1.1	1.0
Thailand	1.5	1.5	1.1	1.0	1.0

The table includes only countries with at least a 1% share in India's total exports. In 2010, three more countries joined this list: Israel (1.3%), Pakistan (1%) and Turkey (1%).
Source: Based on UNCOMTRADE Database.

However, it cannot be ignored that the share of India's exports going to Asia in general has seen a substantial rise. Along with significantly increased trade with China (followed by the United Arab Emirates, Saudi Arabia and South Korea), some of the south-east Asian countries with which India has signed trade agreements (beginning with the Early Harvest Programme with Thailand in 2004) have played a role in this changing pattern. However, among India's PTA partners, the shares of these east and south-east Asian countries in Indian imports have been higher than their shares in Indian exports, reflecting net market access gains for them in India (Figure 1).

It should be noted that because India has been undertaking voluntary tariff liberalisation at the MFN level over the last decade, the potential margin of preference for PTA partner countries has been reducing in significance. As Indian tariff profile data given by the WTO shows, by 2009, when some of the recent PTAs were being negotiated, India's MFN tariffs on as much as 91% of non-agricultural products were already down to the 5%-10% range or below (including zero duty on some).[7] At the same time, even in 2009, close to 70% of India's agricultural

Figure 1: Region-wise Trends in India's Trade Balance (2001-12, $ million)



Source: Export Import Data Bank, Trade Statistics, Ministry of Commerce & Industry, Department of Commerce, Government of India.

tariff lines were still in the tariff range of 25%-50%. This is why recent PTAs such as the ASEAN-India FTA have included agricultural products in order to obtain preferential access to India's agricultural markets.

Given the lack of progress in the WTO negotiations, it was to be expected that developed countries would use the RTA route to push for deeper liberalisation than that under the WTO. Thus in goods and non-goods areas, North-South trade agreements have typically involved stricter and wider commitments than those under the WTO and several critical implications of such agreements have been analysed for other countries.[8] But how is it that India's PTAs involving developing countries have also come to include WTO-plus commitments?

At least since the mid-2000s, it has been argued that while subregional or bilateral regional cooperation initiatives under the framework of SAARC are desirable, the diversities in the levels of economic development, economic structure and capabilities are quite wide at the broader Asian level (see, for example, Batra 2006; Das 2009; Francois et al 2009; Kumar 2004, 2007a, 2007b). Thus increasing India's participation in PTAs especially involving the east and south-east Asian economies has been argued to offer more extensive and mutually beneficial linkages through dynamic industrial restructuring within the region through (i) greater competition and hence an improvement in efficiency; (ii) gains from greater inter- and intra-industry specialisation, economies of scale and learning-by-doing; (iii) reduction of intra-regional transactions costs; and (iv) some protection from adverse developments in the world markets; etc (Park et al 2008).

Some of these purported benefits from industrial restructuring can be linked to the segment of regional integration theory focusing on the potential dynamic effects of capital mobility. This argument based on the neoclassical production function is that the freeing of cross-border investments under a PTA leads to increased investment in member countries, and increased investment leads to higher levels of growth (Ali and Perez 2006). These dynamic considerations with an implicit assumption of complementarity in production structures offer the logic behind the argument that PTAs enable rapid and

"efficient industrial restructuring" by enabling member countries to participate in production networks. The latter would of course require the liberalisation of cross-border investments, apart from trade liberalisation.

The introduction of free capital mobility into trade agreements is thus justified[9] in order to enable industrial restructuring in the member countries led by foreign direct investment (FDI). Thus since 2005, starting with the Comprehensive Economic Cooperation Agreement (CECA) with Singapore followed by the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC) accord, India's recent PTAs with South Korea, Japan and Malaysia include liberalisation in "investments".

The increased interest to include investment, services and other non-goods areas under recent PTAs is also partly explained by the increased external integration of the Indian manufacturing and services sectors that has occurred as a consequence of the trade and FDI liberalisation carried out, especially since 1991. There has been a continuous liberalisation of the regulations relating to FDI inflows and terms of operation of FDI companies since the 1991 Industrial Policy Act and further liberalisation that accelerated from the mid-2000s. FDI outflows have also been liberalised more recently. Thus, apart from a significant increase in FDI inflows since 2004-05, there has been an increase in the number of Indian outward investors in particular sectors (for instance, in iron and steel, automobiles, chemicals, resources; or services like hospitality, healthcare, education, information technology (IT) and IT-driven services, and recently agriculture too). This means that Indian firms are seeking not only to stimulate inward FDI, but also to enable and protect their own outward FDI in other countries.

Subsequently, the alignment of the interests of Indian firms seeking more external markets and outward investment opportunities in goods and services, and the interests of firms already associated with multinational corporations (MNCs) domestically have come to dominate India's negotiating positions. This has been pushing India towards making WTO-plus binding liberalisation commitments in investment and services in her trade agreements. Together with the political economy of financial liberalisation, which has led to financialisation and increased foreign capital dependence of the economy (not necessarily involving only the biggest firms), this confluence of interests has also meant that recent FTAs involve extensive and detailed provisions to liberalise and protect all kinds of "investments" and not just FDI (more on this later).

However, preference erosion due to low MFN tariffs has been interpreted to mean that trade agreements might have lesser and lesser impact on trade flows, especially given the high cost of complying with the complex rules of origin requirements to apply for preferential treatment under these agreements.[10] However, this argument misses the point that recent trade agreements also include investment and service sector liberalisation.

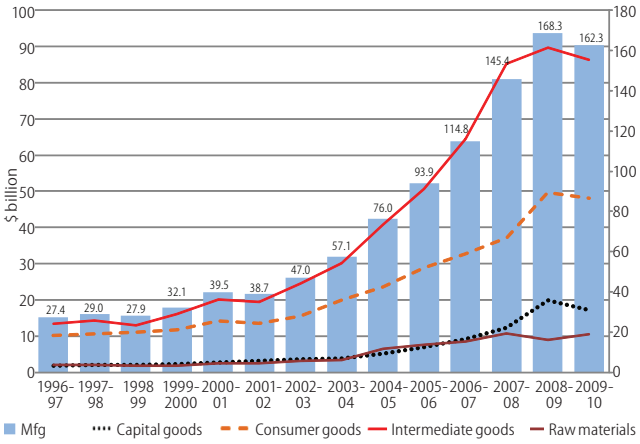
We argue that the nature of production restructuring entailed through increased trade-investment linkages enabled under such comprehensive trade agreements lead to different trends in trade flows than currently acknowledged and adverse implications for a country's industrial development and development trajectory as a whole.

3 Emerging Trends and Linkages

It is not much recognised in the current discourse on the changing composition of India's trade patterns that there is a significant increase in two-way trade in India's global trade involving several sectors. It is known that there is a significant fall in the traditional labour-intensive and natural resource-based exports in sectors such as apparels, cotton, cereals, fish and crustaceans, coffee, tea and spices, etc, which dominated India's exports even during 1995-2002. The dramatic rise in India's exports of petroleum and petroleum products after 2002, which pushed the other traditional export sector gems and jewellery to second rank is also known.

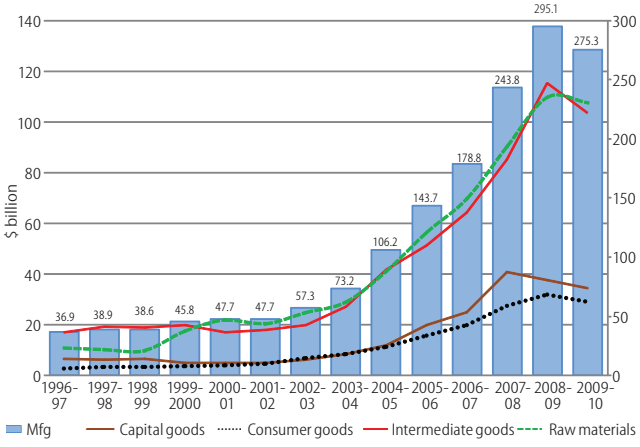
But what is less analysed is that apart from these two sectors, which dominate both exports and imports, sectors such as organic chemicals; electrical machinery; ores, slag and ash; and articles of iron and steel have shown significant increases in two-way trade, with rapid increases in exports and imports.

Figure 2: Composition of India's Manufacturing Sector Exports to the World (1996-2010)



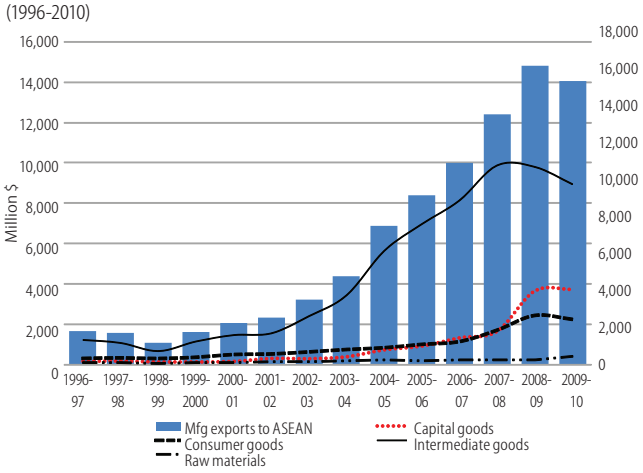
Source: DGCIS HS data based on COMESA classification modified by Ratna and Kallummal (2011).

Figure 3: Composition of India's Manufacturing Sector Imports from the World (1996-2010)



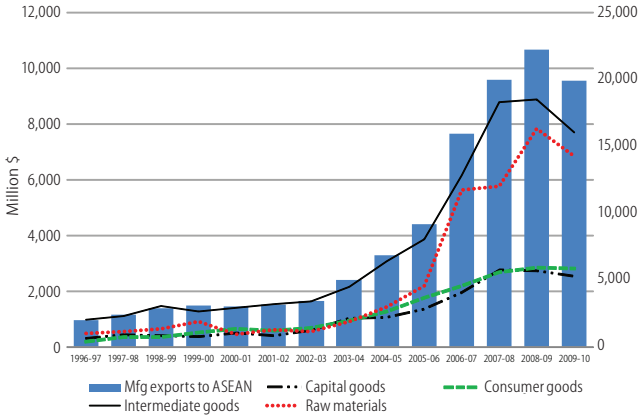
Source: Same as Figure 2.

Figure 4: Composition of India's Manufacturing Sector Exports to ASEAN (1996-2010)



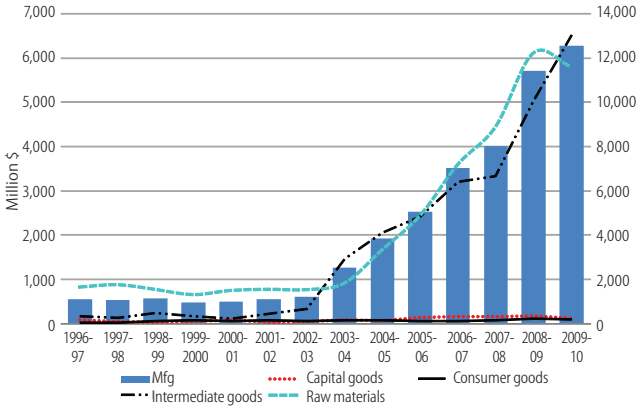
Source: Same as Figure 2.

Figure 5: Composition of India's Manufacturing Sector Imports from ASEAN (1996-2010)



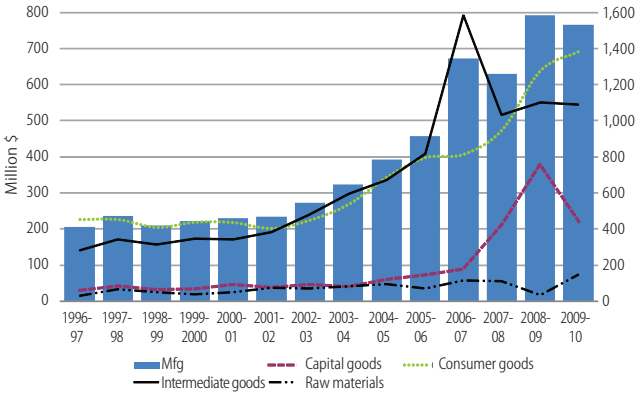
Source: Same as Figure 2.

Figure 6: Composition of India's Manufacturing Sector Imports from East Asia (1996-2010)



Source: Same as Figure 2.

Figure 7: Composition of India's Manufacturing Sector Exports to East Asia (1996-2010)



Source: Same as Figure 2.

Two-way trade also remains significant in non-electrical machinery, iron and steel, automobiles, as well as plastics and plastic products. Among these, the two-way trade in petroleum and petroleum products has been explained by the changes in the volume and structure of India's oil refining capacity, while the increased exports in ores, slag and ash has also been explained at least partly by the enhanced demand for commodities like iron ore from countries such as China (Chandrasekhar 2007; IDEAS 2009a). In this section, we examine the increased two-way trade flows in greater detail to understand the implications of India's dramatically increased trade flows in recent years.

It is well established in the literature that production sharing by MNCs between countries involved in regional or global production networks typically leads to an expansion in two-way trade across those countries, in particular, two-way trade in intermediate goods (see, for instance, Athukorala 2003; Fukao et al 2003; Haddad 2007).

An examination of India's global trade after decomposing it into raw materials, intermediate goods, capital goods and consumer goods clearly reveals the huge jump in intermediate goods exports and imports by India, along with a huge increase in raw material imports. This trend becomes evident from 2003-04 onwards (Figures 2 and 3, p 112).

This seems to reflect India's increasing integration into regional/global production networks led by MNCs from India and abroad, following the progressive liberalisation of FDI policies and tariff liberalisation. This is supported by the pattern of FDI inflows into India's manufacturing sector. According to Rao and Dhar (2011), even though the services sector attracted the majority of inflows during the spurt in FDI inflows into India during 2005-08, automobile industry, electrical equipments, metallurgical industries and chemicals (other than fertilisers) received the majority of the FDI equity inflows into the manufacturing sector.[11]

Francis (2011a) had established that in addition to the 10 sectors mentioned in the context of India's global trade, India has witnessed increased two-way trade with Indonesia, Malaysia, Thailand and Singapore in the following sectors: miscellaneous chemical products; rubber and rubber products; optical, photo, technical, medical, apparatus, etc. The decomposition analysis of India's trade with ASEAN and east Asia into raw materials, intermediate goods, capital goods and consumer goods, clearly reveals the huge increase in intermediate goods trade between India and ASEAN as well as between India and east Asia (Figures 4-7).

It can be argued that the rising share of east Asia in India's total trade mentioned earlier and the rapid increase in two-way

trade observed in India's trade with south-east and east Asia, especially in intermediate products, point towards India's increasing integration into the regional and global production networks centred on ASEAN and China.

It has been argued elsewhere that the rapid increase in two-way trade observed in India's trade with south-east and east Asia can be linked to the industrial restructuring being undertaken by MNCs in the region, beginning with the Early Harvest Scheme of the Thai-India FTA and the CECA with Singapore (Francis 2011a; IDEAS 2009b; Kumar 2007b). It has also been argued that the emerging production network-driven industrial restructuring involving India and the east Asian economies is likely to intensify with the entry into force of the recent overlapping PTAs with ASEAN, South Korea, Japan and Malaysia (Francis, forthcoming). Apart from foreign MNCs, this also involves the big Indian firms investing abroad. Clearly, just as in the case of FDI inflows, FDI outflows also lead to production restructuring and a change in the pattern of trade flows.

This evidence on FDI-led production restructuring in the region as leading to two-way trade flows in specific two-digit sectors needs to be juxtaposed with existing evidence that so far in the period when FDI inflows into India have been rising rapidly, the export intensity of foreign firms has been more or less stable (Chandrasekhar and Ghosh 2010; Das 2011; Joseph and Reddy 2009). This would suggest that a significant part of the two-way trade has to be attributed to domestic firms (and is not limited to the big Indian firms making outward FDI).

The dynamics of the increased two-way trade is thus likely to be different in different sectors such as petroleum and petroproducts, gems and jewellery, electrical and non-electrical machinery industries, chemicals and pharmaceuticals, iron and steel, automobiles, etc. Disaggregated industry-level analysis is required to establish two aspects here:

- The degree to which what is seen as two-way trade at the two-digit level is inter-industry trade and intra-industry trade (IIT).
- The extent to which domestic and foreign invested firms contribute to either kind of flows.

To the extent that India is involved in production sharing in an industry, it will be reflected in high shares of IIT.[12] However, the traditional G-L index does not adequately capture the nature of specialisation reflected in IIT. IIT itself can be divided into two parts: IIT in horizontally differentiated products and IIT in vertically differentiated products, accounting for specialisation along ranges of quality within industries and product lines.[13] These distinctions are important to understand the nature of production specialisation between countries and the level of technological capability. Only such an analysis will reveal whether the country's production is occurring in dynamic sectors with significant increasing returns, which offer sustained productivity growth, rising real wages and externalities through forward and backward linkages. This has to be explored using data at least at the five-digit Standard International Trade Classifications (SITC) or six-digit Harmonised Commodity Prescription and Coding System (HS) level of disaggregation.[14]

Further, whether India obtains broad-based benefits from the opportunities for dynamic industrial restructuring at the broader Asian level depends on India's position along the production value chain for particular products. The division of labour (through MNCs and otherwise) is the fundamental determinant of how the value added and profits are distributed among different countries. The former gets determined by relative labour costs, availability of natural resources or other inputs at competitive prices, as well as other domestic factors such as the level of domestic investments, presence of agglomeration economies, the state of infrastructure, macroeconomic stability and transparency of the regulatory environment. It is also crucially dependent on whether the existing industrial and technological capabilities in the country offer higher productivity levels than other competing countries for the specific segment of the production process involved.

In the case of liberalised trade, investment and cumulative rules of origin under overlapping comprehensive FTAs, the net impact of the division of labour under production networks on India's productivity and output growth as well as job creation will depend on the following:

- Whether India is chosen for the production of a particular product line which offers scope for sustained productivity gains and externalities.
- The extent of foreign facility closures in India in conjunction with new investments in other host countries.
- The extent of closures by domestic companies due to the increased foreign competition in the domestic market.
- The nature and pattern of outward FDI by Indian firms.

The interaction between these factors will shape the nature and outcome of industrial restructuring.

Thus, the crucial point often left out even in the economic analysis on the benefits from RTAs is that tariffs are only one among several factors determining export performance – whether network-driven or otherwise. There are several other factors that interplay and determine sustained export competitiveness of a country. These include, among others, the following:

- The size of the economy and its stage of development.
- The level and nature of investments, both domestic and FDI.
- The extent of domestic production diversification and the level of technological capabilities, which enable the country to respond to changing patterns of external demand, faster product cycles, etc.
- The nature of proliferating non-tariff measures with technological implications.
- The degree of trade and financial liberalisation that has moulded its development trajectory and keeps influencing macroeconomic and other policy decisions (which in turn affect industrial growth).

Both export performance as well as productivity gains and externalities that Indian firms seek to garner from being involved in production sharing through comprehensive trade agreements ultimately depend on dynamic industrial competitiveness. The latter has been historically proven to be linked to strategic industrial policies.[15]

It should be remembered that since the 1991 economic reforms there has been a reduction or dismantling of a plethora of industrial policy instruments in India, which had been used to help improve domestic manufacturing capabilities and create the conditions for the development of technologies in the post-Independence decades.[16] These were successful in a broad range of industries, and particularly in textiles and garments, pharmaceuticals, automobiles, iron and steel, and other metal-based industries, light and heavy electrical machineries, etc. Apart from import protection, coordination of plans/strategies, public sector manufacturing, directed credit, etc, these include a regulated FDI policy, small-scale industrial policy, patent protection, strong indigenisation policies, etc.

A pertinent question is whether India's broad and diversified production base and capabilities originating in past industrial policies have been enriched by the subsequent liberalisation policies as predicted. It is common even among economists to relate the faster growth rates in Indian exports (and the export success of a few sectors) and imports to tariff liberalisation and accelerated export promotion policies post-1991. But misunderstanding the crucial interactions between industrial policy and indigenous capability development can lead to misinterpretations and result in inappropriate policy conclusions. If liberalisation of imports and other restrictions has led to greater productivity growth and improved the competitiveness of the domestic industry, then we need to address the reasons behind the increasing trade deficit of India in recent years.

As argued by Chaudhuri (2010), while the moderate import growth witnessed by India post liberalisation and her export success in industries such as pharmaceuticals, iron and steel, automobiles and parts, etc, during 1985-2001 reflect the success of past industrial policy, the sharp increase in Indian imports and the slowdown in the export growth of advanced technology products since 2001 would point to a lack of dynamic industrial competitiveness and a failure to develop new industries. In the study by Chaudhuri, the advanced technology category includes pharmaceuticals, office machines and automatic data processing equipment, telecommunication equipment, aircraft/associated equipment, optical instruments and apparatus, measuring and checking instruments. Note that barring pharmaceuticals, the others fall in the electronics and electrical machinery and the non-electrical machinery groups in the HS classification, which have seen greater market share gains in India, particularly by the east and south-east Asian countries.[17] On the other hand, based on an analysis of India's pharmaceutical sector import trends, Kallummal and Bugalya (2012) found that there was growing import dependence of the sector during 2001-10 over the period 1996-2000, which was particularly true in the case of pharmaceutical imports from China that shifted towards products that have a high share in India's imports. It was also found that China was taking advantage of India's lack of strategy and used a discriminatory pricing policy during 1996-2010 to gain market share.[18]

Detailed industry-level analysis is necessary to confirm how much of India's exports in the sectors that are considered as medium or high technology is due to data aggregation, while the actual specialisation is in the low or medium value-added activities within the advanced sectors at the two-digit level. Available evidence on India's technological lag and absence of broad-based industrial growth (Alessandrini et al 2009; Chandrasekhar and Ghosh 2008a, 2011; Joseph and Reddy 2009 among others) clearly points to the interplay between continuing market failures and the trade and investment liberalisation that has been carried out in the last two decades in the absence of coordinated industrial and trade policy support. However, while the challenging task before India is to implement coherent policies that would address the market failures across a diverse range of sectors for developing dynamic competitiveness in a broader range of manufacturing and services industries, we argue that the investment provisions in the recent comprehensive trade agreements compound the dissonance between India's development needs and industrial and macroeconomic policies by putting legally binding constraints on the country's ability to implement certain industrial policy instruments and eroding her capability to have regulated capital account convertibility.

4 Compounding Policy Dissonance

As already mentioned, India's recent comprehensive trade agreements include WTO-plus commitments in the areas of services, agriculture, investment, etc. In this paper we focus on the implications of the commitments made under various investment provisions, their inter-sectoral interactions and economy-wide implications.

Recent trade agreements involve detailed provisions to liberalise and "protect" all kinds of "investments" as well as conditions on the "treatment" of investments. These are revealed in the major features of the investment provisions under the India-Singapore, India-South Korea, India-Japan and India-Malaysia comprehensive trade agreements, which include:

- Definitions of investment, investors and policy measures affected by the agreement.
- General and specific "standards of treatment" of investments such as national treatment, fair and equitable treatment, MFN treatment, performance requirements, etc.
- "Protection of investments" through protection against nationalisation and expropriation, compensation for expropriated investments, availability of investor-state dispute settlement system, guarantee of free capital transfer, etc.

The overall implications of investment provisions under a PTA have to take into account the interactions of the definition provisions with the operative (treatment and protection) provisions as well as the interaction between investment provisions and other liberalisation commitments across different agreements (Francis 2011b).

4.1 Broad Investment Definitions and Financial Stability

Most of India's comprehensive FTAs with investment provisions or chapters (Singapore, South Korea, Japan and Malaysia) include "broad" definitions of investment wherein besides FDI other forms of capital flows are included in investment. These

asset-based definitions of "investment" typically cover equities, securities, loans, derivatives, sovereign debt, as well as a broad range of intangible assets such as traditional intellectual property rights, business concessions, etc.

Given that national treatment clauses grant equality of treatment between foreign and domestic enterprises, such investment definitions will affect the government's ability not only to attract ownership-based FDI and regulate multinationals so as to maximise the benefits of FDI,[19] but also to regulate other types of foreign investments that are allowed through broad definitions.

It is true that India's Consolidated FDI Framework that came into effect in April 2010 includes all kinds of foreign capital in the definition of FDI and removes the distinction between long-term productive FDI and volatile portfolio investments, since all foreign investments in equity capital and equity-related instruments (other than those purchased by foreign institutional investors on the stock market) are being treated as FDI independent of any controlling stake.[20] Rao and Dhar (2011) showed that within the increased FDI inflows during 2004-09, non-acquisition type "development-oriented" FDI[21] accounted for only 36% of the total inflows of $81 billion covered by the 2,748 cases studied. The majority of the equity inflows were found to be brought in by private equity (PE) investors and portfolio investors as well as by firms controlled by Indians (round-tripping).

However, by bringing non-FDI foreign investment categories under the investment disciplines in trade agreements, India has bound itself to extending "preferential" conditions of entry and operations that are offered for FDI to classes of investors like PE funds and venture capital (VC) funds, who do not either bring in FDI-type ownership advantages to the host companies or contribute to national investments even in the medium term, as they are known to sell and move out. The majority of India's 72 bilateral investment treaties (BITs) in force also contain broad investment definitions (Francis 2012).

Under broad investment definitions, India has also bound herself to offer preferential treatment to other classes of investors whose actual identity is often unknown (for example, hedge funds) and some of whom may not be regulated in their own home countries. Further, broad definitions of investment could lead to situations where host country governments can be sued even by such investors in financial assets and instruments, by deeming legitimate financial sector regulatory policies as expropriation.

The agreements contain "denial of benefits" clauses, which stipulate that the investment provisions are not applicable to enterprises that have no substantial business operations in the other party's territory; or if host country investors are found to own or control the enterprise making the investment. While the latter is expected to take care of round-tripping investments by Indian firms, it is not clear how the former will help in the case of PE and other kinds of funds (of non-parties) that establish offices in a party to the agreements.[22] Only Malaysia CECA's investment chapter contains a definition of ownership that requires a 50% equity ownership together with control. In any case, the onus of proving the origin of these investments will lie with Indian authorities. The complexity of the overlapping and different legal provisions across these chapters in the different agreements will exacerbate the policy maze surrounding capital flows into India.

It needs to be noted that despite the liberalisation of FDI policy, by 2009 the share of manufacturing in total FDI equity inflows had declined to just about 21% (or to almost half of what it was in 2005).[23] It was the share of services that increased the maximum in FDI inflows. Within the latter, non-tradable sectors like construction and real estate sector, followed by the financial services sector, attracted the largest shares, while IT and the information technology-enabled service (ITES) sector declined in share. This explosion of service sector FDI into the finance, insurance and real estate (FIRE) sector that liberalisation of FDI norms has resulted in has implications for industrial development not only because this involves a diversion of capital away from the productive sectors (as seen in south-east Asia before the 1997 financial crisis (Dhar and Kallummal 2007) and in several other countries and regions subsequently), but also because it plays a major role in generating speculative bubbles in the economy that could lead to subsequent crashes. As has been seen time and again in the aftermath of financial crises in different countries since the 1990s, the latter in turn has a severe adverse impact on the productive sectors.

Further, there is already evidence that FDI is adding to the current account deficit (rather than helping to reduce it) given that most of the foreign invested companies are domestic market-oriented. Not only are they not contributing to India's export revenues, they are also increasingly causing net outflow of foreign exchange. Based on Reserve Bank of India data, Chandrasekhar and Ghosh (2010) have shown that between 2002-03 and 2006-07, there was a sharp increase in the net outflow of foreign exchange on account of the operation of FDI companies in the country. At the same time, the large inflows of other types of foreign capital being allowed through the FDI route has not only been causing currency appreciation and leaving an impact on the competitiveness of domestic players, but they have also been debt-creating (as in the case of FDI allowed through fully convertible debentures). All the above trends will be accentuated by the broad investment definitions in the recent trade agreements.

The government should be able to regulate capital account convertibility in order to avoid explosive external debt-accumulation and speculative capital flows, both of which could become a trigger for macroeconomic instability. As experiences in other countries have shown, short-run macroeconomic adjustment problems triggered by a balance of payment (BOP) or financial crisis often severely limit the policy options available for pursuing industrial growth and diversification needs and thus truncate an indigenously-driven industrial development trajectory. As the recent crisis showed, all countries with open financial sectors will be affected by the volatile functioning of unregulated financial markets elsewhere. All these mean that governments should have the

ability to frame regulations as and when required depending on changing financial sector dynamics.

But the provision for guarantee of free transfer of funds associated with broad investment definitions erodes national policymaking ability to regulate different forms of capital flows and can contribute to periods of financial sector volatility and macroeconomic instability. Typically, the recent agreements state that a party may adopt or maintain only temporary restrictions on payments or transfers related to investments in the event of serious balance of payments and external financial difficulties, or threat thereof. Thus broad investment definitions including portfolio and other financial assets in preferential trade agreements will erode policy sovereignty over capital control measures that are required to address issues related to financial fragility and macroeconomic stability in the country, which in turn has implications for industrial development.

It should also be noted that even if financial services have been kept out of the list of sectors open for investments, liberalisation of the financial services sector can also occur through Mode 3 commitments within a services chapter. Under the investment chapters with South Korea and Japan, India has kept out the financial services sector. But under the services chapter of the CECA with Singapore, India has already made General Agreement on Trade in Services (GATS)-plus commitments in financial services and included commitments in banking, life insurance and non-life insurance services, as well as asset managers. The denial of benefits clause in the case of financial services mandated an ownership and/or control requirement by persons of India and/or Singapore for a period of four years only. Thus investors from any country can set up an enterprise in Singapore and avail of the preferential treatment under this CECA.

4.2 Implications of National Treatment and Inter-Sectoral Linkages

Given the national treatment clause, if we are to keep policy sovereignty over the FDI regulatory regime to ensure coordination with industrial policy and to meet other national objectives like employment generation, apart from the nature of investment and treaty coverage, other qualifications based on the sector, the scale of investment (for instance, for enabling the domestic small and medium enterprise or SME sector to develop), etc, also should be built into the definition of investment or kept as exemptions to national treatment.

India granted pre-establishment national treatment on a positive list basis in the India-Singapore CECA. National treatment commitments on the pre-establishment stage of investment question the host governments' right to regulate entry of FDI and bind the degree of investment liberalisation. Depending on changing industrial structure and the impact of domestic or external factors on domestic industries and economy, it is necessary for host governments to place limitations on admission and establishment in the context of employment effects, technology transfer, environmental or cultural impacts, defence capabilities, or other development concerns. Given that procedures to screen investments enable the host country to assess its potential impact before granting permission to invest, maintaining the right for prior approval is crucial. Apart from facing the risk of disputes when undertaking FDI policy changes in the committed sectors, given that Singapore acts as the regional/global headquarters for investors from across the world, this has broader implications.

On the other hand, under the agreements with Japan and South Korea, we have bound ourselves at the levels of liberalisation of FDI norms as per the Consolidated Note on FDI 2010. Thus 100% FDI is allowed through the automatic route in most manufacturing and services sectors except in a few areas like retail trading (except multi-brand product retailing); lottery; gambling and betting; chit fund; mutual benefit financial companies; trading in transferable development rights; real estate; manufacturing of cigars, cigarettes, tobacco or tobacco substitutes; atomic energy; and railway transport (other than mass rapid transport systems). Caps on FDI shareholding are now applied to only a few sectors, mainly in the services sector.[24] However, with the binding of the autonomous national FDI liberalisation under the CECA/Comprehensive Economic Partnership Agreements (CEPAs), any changes to its FDI policy can make the government liable to investor-state disputes.

Even if India has made autonomous service sector liberalisation by going beyond its commitments under the WTO's GATS, she should not undertake GATS-plus commitments through FTAs because once they are bound under the investment agreement, it will reduce government flexibility to change policies to suit changing priorities. Further, the agreements with Korea and Malaysia also state that whether or not a service sector is scheduled in a party's schedule of specific commitments in the services chapter (for which national treatment obligations have been exempted), the provisions of the investment chapter relating to free transfers, expropriation and compensation are applicable to "measures affecting service sector investments". Once again, by granting a broad range of rights to investors, the government has kept itself open to the risk of investor-state disputes.

In the context of agriculture, trade and investment liberalisation commitments in agriculture have to recognise all the inter-linkages between agricultural and industrial development[25] as well as the national imperative to support domestic agriculture production for ensuring food security and reducing environmental consequences. While making commitments in services such as retail trade, too, policymakers need to recognise the impact of corporate agriculture and foreign-dominated agricultural services in wholesale and retail trade, logistics and transport, etc, (apart from inputs) on sustainable agricultural production for ensuring food security.

Similarly, allowing FDI into small-scale industries can destroy domestic jobs and livelihoods, with domestic SMEs unable to compete with the large and capital-intensive production by MNCs. None of these considerations related to the agricultural or the small-scale sectors have been taken on board while making the binding investment commitments. For India, with its large agricultural sector and significant SME segment in the agro-processing and food products industries (for example,

frozen fruit and vegetables, milk products, canned fruits and vegetables, bottled and canned soft drinks, prepared fresh and frozen fish industries, etc), it is particularly important to exclude such activities and industries from the coverage of investment so as to protect employment in domestic agricultural processing industries, and also livelihoods in related farming and non-farming agricultural production and services.

While FDI is banned in agriculture, India's Consolidated FDI Framework allows 100% FDI through the automatic route not only in the plantation sector, but also in floriculture, horticulture, development of seeds, animal husbandry, pisciculture, aquaculture and cultivation of vegetables and seeds under "controlled conditions". Hundred per cent FDI under the automatic route is also allowed in services related to agro and allied sectors.

FDI into agribusiness-related activities can also be problematic from the point of view of food security and farm livelihoods. This is because the entry of foreign investment into agribusiness activities sets into motion particular dynamics, which together with trade liberalisation allows them to source their inputs from the most "cost-effective" production countries leads to a further fall in demand for local agricultural produce or/and fall in prices of local crops and other agricultural produce, adversely affecting the income and livelihood prospects of farmers. The various channels of interaction between financial liberalisation and trade liberalisation[26] in the agricultural sector and the current trends in change of ownership patterns in farm input industries and related service sectors through the liberalisation of FDI norms such as logistics and wholesale and retail distribution,[27] combined with the drift towards heightened integration in the agricultural products value chain could lead to significant loss of income for the farmers as well as a decline in their food security.

It should also be noted that in the Japan-India CEPA, specific mention is made that national treatment has to be extended in the case of any new measures that national, regional or local government/authority put in place after the agreement comes into force. Apart from the national-level measures, this could cover a range of policy measures that come under the jurisdiction of states and panchayats in India.[28] In addition, the Korea-India and the Japan-India CEPAs specify that the term "measure adopted or maintained by a Party" means any measure adopted or maintained by central, regional or local governments or authorities, as well as those by non-governmental bodies when delegated by the former. Given that the term "measure" shall include taxation measures to the extent covered by GATS, a broad range of industrial and public policy measures can come under dispute.[29]

4.3 Prohibition of Performance Requirements

Prohibition on performance requirements is a new element related to the treatment of investments in trade agreements. Performance requirements have been part of the FDI regulatory framework in the countries that have effectively utilised FDI for successful industrial restructuring precisely because the contributions of FDI that enable faster catching-up by countries do not occur automatically. An illustrative but not exhaustive list is as follows: (i) Export obligations; (ii) Restriction on sales of goods and services in the host country by relating it to volume of exports; (iii) Restrictions on exports of raw materials; (iv) Local purchase of goods/services; (v) Transfer of technology or other proprietary knowledge or performing a given level of research and development (R&D) in the host party; (vi) Hiring or appointment of employees or officials of the host party nationality; (vii) Location of regional or global headquarters in the host country; (viii) Labour or environmental standards.

The WTO's Trade Related Investment Measures (TRIMs) agreement bans the use of performance requirements such as local content requirements, trade balancing requirements and export restrictions – in general as well as when they are attached to any investment incentives. The Singapore CECA has incorporated the provisions of the TRIMs agreement, but allows performance requirements that are attached to subsidies or grants. Subsidies or grants offered exclusively to domestic investors/investments are also exempt under the Singapore CECA, making it more flexible than TRIMs.

However, both India-South Korea and India-Japan CEPAs prohibit a set of performance requirements, which are TRIMs-plus, such as those relating to technology transfer and senior management board of directors, as well as export obligations for services. In general, any such performance requirements can be maintained only when they are imposed as conditions for receiving some investment incentives.

Two separate annexes list existing non-conforming measures that are permitted and the sectors and sub-sectors where future non-conforming measures can be adopted. In the Indo-Japan CEPA, all existing non-conforming regulations in all sectors, including services, which were in force on the date of entry of the CEPA, are exempt from obligations related to national treatment, MFN treatment and prohibition of performance requirements.[30] But at the national level, Annex 8 specifies that performance requirement can be imposed only in the case of items reserved for the manufacture of micro, small and medium enterprises (MSMEs).[31] Currently, any industrial undertaking which is not a micro or small scale enterprise, but manufactures items reserved for the MSME sector, would require the government approval route when foreign investment is more than 24% in the equity capital. It also has to abide by the condition to export a minimum 50% of the new or additional annual production of the MSME reserved items, to be achieved within a maximum period of three years. However, the number of items reserved under the Micro, Small and Medium Enterprises Development (MSMED) Act, 2006, has been reduced significantly. Further, the danger is that the government has bound itself not to bring more items under the MSME list, even if changed economic circumstances warrant it.

Further, in Annex 9 of the Japan CEPA,[32] India has reserved the right to adopt or maintain any measure relating to:
(i) Technology transfer and senior management board of directors, in all sectors; (ii) Rights or preferences to economically

backward regions or groups in the interest of balanced development of the economy and maintenance of social equality.

This does give scope to the government to introduce new investment incentives in the form of subsidies, tax exemptions, subsidised bank credit for R&D, balanced regional development, environmental technology application, etc. But because of national treatment, these have to be extended to investors from the bilateral trading partner. This takes away the scope for targeted domestic industrial policy for developing indigenous capabilities.

At the national level, India has given up its right to adopt or maintain any new or more restrictive measure which is non-conforming to the obligations on national treatment, MFN treatment and the prohibition of performance requirements (Annex 9) except in the manufacture of a short list of products.[33] Apart from these, the government cannot introduce new performance requirements at the national level, unless they are applied as conditionalities for receiving investment incentives. At the same time, except in the case of a few sectors/sub-sectors listed in Annex 9, the responsibility for formulating new laws and regulations (unattached to investment incentives) to ensure that maximum long-term benefits can be derived from foreign investments has been passed on to state and other sub-national governments.[34] In a situation of competitive liberalisation across states to attract foreign investments, this is a policy space that is less likely to be utilised.

All these exemptions are circumscribed by the provision in the investment chapters (for example, Japan and Malaysian CEPAs) which specify no existing investment can be diluted/disposed of through the adoption of any new measure after the date of entry into force of these agreements.

4.4 Expropriation Clauses

Given that provisions on investment protection provide for fair and equitable treatment to foreign investors in the event of an expropriation, it is crucial to define the terms of coverage of expropriation to include only direct expropriation. Direct expropriation refers to the nationalisation, transfer of title or seizure of private property by the host government. But expropriation is both direct and indirect in the CEPAs with South Korea and Japan. The determination of what types of government actions/measures are interpreted to constitute an indirect expropriation is based on a case-by-case inquiry (Annex 10-A) which includes "the extent to which the government action interferes with distinct, reasonable investment-backed expectations". The latter in turn is defined in a footnote as follows:

> For greater certainty, whether an investor's investment-backed expectations are reasonable depends in part on the nature and extent of governmental regulation in the relevant sector. For example, an investor's expectations that regulations will not change are less likely to be reasonable in a heavily regulated sector than in a less heavily regulated sector.[35]

Clearly, this means that in a sector that is not regulated at all when the treaty comes into force, introduction of any regulatory policy relating to that sector will be considered as expropriation and the government can be subjected to disputes and compensation claims.

The MFN clauses in bilateral and regional agreements mean that the highest standards in one of them are extended to parties to the other agreements. Francis (2010) argued that since a number of important countries with which India is entering into comprehensive trade agreements are members of various regional agreements, unqualified MFN clauses (for instance, in ongoing negotiations in investment agreement with ASEAN) will facilitate cross-regional harmonisation covering more and more countries and regions, defeating the original purpose of south-south FTAs and establishing a level playing field for foreign investors. This is true of north-south agreements also. It should be noted that the India-Korea CEPA provides for review of MFN commitments whereby if either India or South Korea enters into any agreement with a third party on trade in services, it has to grant treatment no less favourable than that is provided under the new agreement. For example, if India is to cede to the EU demands for deep liberalisation commitments in its ongoing negotiations, this would then set the scene for the application of these MFN provisions.

5 Conclusion

The common argument is that India is seeking to use comprehensive trade agreements as a development strategy to exploit the potential of "efficiency-seeking" industrial restructuring and strengthen export competitiveness. However, the sustainability of inward and outward investments as well as exports depends crucially on developing and maintaining the dynamic competitiveness of domestic entrepreneurs. This policy framework needs to focus on improving conditions for the development of domestic manufacturing capabilities and technologies. It should also be remembered that since industrial and technological capabilities are cumulative in nature, in general, technological trajectories tend to be path-dependent (except when there is a shift in the technological paradigm which could throw up new opportunities for entry for developing economies). The latter calls for strategic industrial and technological development policies by the state, which are incompatible with fully liberalised FDI regimes. Crucially, using FTAs as a strategy to attract investments and improving exports does not ensure an increase in productivity or value addition in the economy, if we are unable to attract the kind of investments that enable these and ensure domestic productive linkages. Without an industrial policy that would help generate high productivity jobs, the path to sustainable industrial development will remain elusive for India.

Although India's FDI policy has been progressively liberalised since the 1991 industrial policy, and several BITs with broad investment definitions have been in force, the fact that we did have the flexibility to change our industrial policy framework to meet changing circumstances or fine-tune it in order to meet industrial policy objectives is recognised at some point. This sovereignty has been surrendered by making BIT-plus

commitments on "disciplining" different investment-related industrial policies and measures in the comprehensive trade agreements with Japan, South Korea, Malaysia, etc. The recent trade agreements, by locking in liberalisation at exiting levels and restricting the use of a range of policies and instruments, preclude the policy space to implement many of the industrial policy tools for building and upgrading such domestic capabilities. The space for sectoral policies and coordinated industrial and technology development policies has become legally constrained. As a result, these comprehensive trade agreements would serve not only to undermine the purported objectives of RTAs, namely, increased investments and greater exports, but could also further undermine India's long-term growth prospects.

Even though trade liberalisation in intermediates may lead to an increase in manufacturing sector productivity, the weak local linkages of the manufacturing sector could imply that this productivity growth occurs in isolated segments. As seen in countries like the Philippines or Mexico, externally-driven industrial growth paths will not lead to the virtuous circles of growth required to transfer the majority in a labour surplus economy into higher productivity jobs. Policy choices that assume similarity or complementarity in production structures and capabilities (across sectors) will erode the national productive capacities in diversified increasing return activities to the detriment of long-term development prospects. Further, trade integration built through production chains will increase India's vulnerability to external shocks thus causing synchronised contraction of trade flows across the Asian countries taking part in production networks.

In the rapidly changing global environment that has had an impact on foreign capital flows into the economy, policymakers might soon push for the pending comprehensive trade agreements with the EU, EFTA and the US under the belief that they will help bring in more foreign investment into debt-ridden enterprises that help them survive. However, signing more and more legally binding trade and investment agreements with inadequate understanding of the interconnectedness of industrial and trade policies to the macroeconomic growth dynamics through employment, value addition and technological development will lead to further adverse impact on India's development prospects.

By compounding the policy dissonance between trade, industrial and macroeconomic policies required for sustainable growth trajectories, India's trade agreements have become an inefficient substitute for coherent trade and industrial policies. While the irreversibility of liberalisation is meant to reduce risks to investors, it reduces policy sovereignty for the country and thus increases the risk of policy failures, compounding market failures.

NOTES

1 Chandrasekhar and Ghosh (2011) warned that there has been a downturn in industrial production since July 2010 and that this can be linked to the nature of the demand drivers behind the spurt in India's industrial growth since 2003-04. See also the more detailed analyses in Chandrasekhar (2011) and Ghosh (2011).

2 Until the 1990s, there were just two bilateral and two plurilateral trade agreements (See Table 1), while the only new agreement in the 1990s was the South Asian Preferential Trade Agreement (SAPTA).

3 While regional trade agreements (RTAs) are only one category of PTAs involving member countries belonging to the same geographical region, the World Trade Organisation (WTO) parlance of RTAs is often used in the literature to represent the same broad category as PTAs discussed here, as they denote an important exception to the WTO's MFN principle. But members of an RTA do not necessarily have regional proximity. In this paper, the terms PTAs and RTAs are used interchangeably.

4 SACU stands for the South African Customs Union between South Africa, Lesotho, Swaziland, Botswana and Namibia.

5 Another major export promotion thrust has been attempted through the controversial Special Economic Zone (SEZ) policy.

6 This helps to explain the recent spurt in Indian PTAs, particularly in the east Asian region, even though the official "Look East" policy was launched in 1992. At the same time, given that the developed country markets continue to remain important for India, its decision to go for an FTA with the EFTA and the EU seems to be driven by the fact that these developed country blocs have signed or are negotiating PTAs with several of India's competitors in those developed country markets.

7 But it is important to note that in recent FTAs such as the ASEAN-India FTA, there were still several sectors where the tariff drops from the existing levels were significantly sharp to cause an adverse impact on domestic firms. See, for instance, Francis (2011a) for a detailed analysis of the potential impact of the ASEAN-India FTA on several domestic sectors.

8 See the papers by Rodrigo Pizzaro, Esteban Perez Caldentey, Smitha Francis and Murali Kallummal, and Alicia Puyana at http://www.networkideas. org/ working/papers.htm, http://www.networkideas.org/featart/dec2007/Mexican.pdf and Pal (2008). See also the papers available at http://www. networkideas.org/ideasact/dec09/ia11_IDEAs_FTA_Workshop.htm

9 Ironically, the welfare benefits purported by the models based on comparative advantage underlying free trade theory (and regional integration theory), in its static or dynamic form, follow logically from a set of premises that guarantee from the start full employment and welfare improvement. See Ali and Perez (2006).

10 See Dionisius A Narjoko and Mochamad Pasha in UN (2011).

11 This excludes acquisition of shares together with reinvested earnings. See Rao and Dhar (2011) for a detailed discussion. Including acquisition of shares could change the extent of foreign ownership in certain sectors, given that takeover of existing Indian businesses by foreign companies accounted for a substantial proportion of the reported total FDI inflows in some years. It is also pertinent to note that a sector-wise analysis of FDI inflows from Japan during 2000-07 showed that the automobile sector (41%), together with electrical equipment, trading, services and telecommunications accounted for nearly 72% of the total FDI inflows from Japan (Nataraj 2010).

12 Nag (2011) analysed the two-way trade in auto components using the Grubel-Lloyd (G-L) index and found significant IIT with respect to certain trade partners.

13 For a detailed discussion, see Fontagné et al (2005) and IDEAs (2009b).

14 SITC stands for Standard International Trade Classification and HS stands for Harmonised System.

15 Amsden (1992), Wade (1990), Lall (1996), Jomo et al (1997), Chang (2002), Shafaeddin (2010), etc, all offer extensive discussions on the role played by trade and industrial policies in the technologically advanced early and late industrialisers.

16 While there are crucial differences in the interpretations of India's performance and potential in the manufacturing and services sectors in the post-liberalisation phase, there is now widespread acknowledgement that the capabilities which India had accumulated on the eve of the 1990s reforms is the legacy of her industrial policies. For instance, see Khan (2009) and Felipe et al (2010).

17 According to the government, the actual value addition in the domestically produced electronic product is now very low, ranging between 5% and 10% in most cases. Indeed, the announcement by the government of a hardware development policy is an unambiguous admittance of the policy failure of the last two decades of trade liberalisation which led to the total disappearance of electronics and electrical machinery industry in this country.

18 See the detailed analysis in Kallummal and Bugalya (2012).

19 See the detailed discussion in Francis (2010).

20 See Chandrasekhar and Ghosh (2010), Rao and Dhar (2011) and Francis (2010) for detailed discussions.

21 Rightly, Rao and Dhar (2011) consider only "typical FDI" that would add to existing facilities. The study analysed the largest 2,748 officially reported cases of FDI equity inflows,

each individually accounting for at least $5 million, which together accounted for about 88% of the total for the period September 2004, December 2009.

22 Malaysia's investment chapter also excludes investments by enterprises of the other party owned or controlled by non-parties from preferential treatment, but only if such treatment violates/circumvents any measures that the denying party maintains or might adopt with respect to that non-party.

23 Within the largest 2,748 "development-oriented" cases of equity inflows, the share of the manufacturing sector was a mere 10% of the total (Rao and Dhar 2011).

24 These include air transport services, ground handling services, asset reconstruction companies, private sector banking, broadcasting, commodity exchanges, credit information companies, insurance, print media, telecommunications and satellites and defence production. However, the latest government decision has sought to liberalise the FDI caps in air transport services.

25 Agriculture development provides the basis for industrial development, diversification and growth through backward linkages and demand creation.

26 In fact, the ASEAN-India FTA, which came into force in January 2010, involves substantial tariff reductions across a range of agricultural products. By January 2013, average tariffs in all the agricultural sectors will drop to zero, from as high as an average of 29%. See the detailed discussion in Francis (2011a).

27 See Goswami (2011) for a critique of the argument that the high post-harvest losses in India is the most compelling reason to permit a flood of investment in the new sector of agricultural logistics, to allow the creation of huge food processing zones, and to link all these to retail food structures in urban markets.

28 Dhar and Kallummal (2007) provide a listing of areas under the sub-national level jurisdictions.

29 Ranjan (2010) reports the case of *Occidental Exploration Corporation vs Ecuador,* in which Ecuador was ordered to pay $75 million to a US oil company on account of Ecuador's tax policy violating the US-Ecuador bilateral investment treaty (BIT). In a bizarre interpretation of the national treatment clause that goes to show the unpredictability of tribunal awards, the tribunal in this case held that by distinguishing between foreign oil exporter and domestic flower and seafood exporters, Ecuador had discriminated between exporters (exporters taken as one homogeneous group irrespective of the sector involved) and hence violated the national treatment provision of the US-Ecuador BIT. Ecuador's argument that there was no discrimination since the tax regime was the same for domestic and foreign companies in the oil sector was rejected by the tribunal.

30 See India's schedule in Annex 8 on pp 975-1012 in the India-Japan CEPA.

31 See p 983, Annex 8, Indo-Japan CEPA.

32 See pp 1067 and 1070 of the India-Japan CEPA.

33 Dairy products; canning and preservation of fruits and vegetables; processing, canning and preservation of fish, crustacean and similar foods; bakery products; hydrogenated oils, vanaspati, ghee and vegetable oils; wines, malt liquors, beer; wood and wood products; leather and leather products; industrial explosives, safety fuse, detonators, fireworks; hazardous chemicals; tobacco stemming and manufacturing of products containing tobacco or its substitutes, including bidi; drugs and pharmaceuticals; cement and asbestos and other related products; and air-conditioner, refrigerators and fire fighting equipment. The last two categories are exempted only from the prohibition on performance requirements or, in other words, foreign investments are allowed. See pp 1051-64 of the India-Japan CEPA.

34 This is because apart from exempting existing measures at the sub-national levels, India has reserved the right to adopt or maintain any measure relating to investments as per the laws and regulations framed by the state governments/union territories/local governments. See p 1066, Annex 9, India-Japan CEPA.

35 India-South Korea CEPA, p 233.

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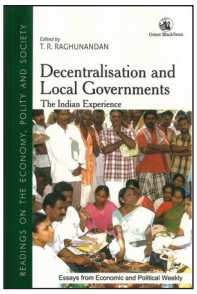
Decentralisation and Local Governments

Edited by

T R Raghunandan



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Pp xii + 432	ISBN 978-81-250-4883-1	2012	Rs 695

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