IND0026 – Sangeeta Khorana

Sangeeta Khorana

Professor of Economics, Bournemouth University

Question: What are the risks of an interim or early harvest deal?

Response: There is talk about the UK and India aiming to conclude an early harvest trade deal over the next few months. This comes at a time when India is also actively pursuing FTAs with Australia, the UAE (recently concluded), Israel, and Canada.

Early harvest agreements are limited in scope/interim trade agreements, and aim to facilitate bilateral trade on a restricted list of goods and services. Basically, such an agreement is perceived as a frontrunner to a more comprehensive FTA. An early harvest deal between the UK and India is likely to potentially target easy sectors (low-hanging fruits), leaving the more difficult sectors (goods and services) for future negotiations.

However, there are two sides to the argument on the potential to conclude an early harvest deal between the UK and India. While the emphasis on an interim agreement (early harvest deal) may be tactical it could set the roadmap for future talks with a deal that has a minimum level of commitments and pushes contentious issues to be resolved later. The strategy of negotiating 'difficult' sectors at a later date runs the risk of impeding the progress of talks and could potentially affect the conclusion of a broad-based FTA between the UK and India.

Going by precedence, India concluded an early harvest agreement with Thailand in 2004 but this did not progress to a comprehensive FTA. In the early harvest agreement with Thailand, the automobile industry associations complained that relaxations extended by India in the early harvest reduced the incentive for Thailand to work towards a full FTA. It is also worth highlighting that India has a trade agreement with Sri Lanka on goods but the partners did not conclude an agreement on services and investment. To conclude, there are risks but also potential gains from an early harvest deal, which the negotiators will have to weigh carefully.

Question: What could India, and a UK-India FTA, do to encourage greater inward investment by UK companies?

Response: During April-September 2021, the inflow of foreign direct investment (FDI) from the UK into India was recorded at US$ 1.15 billion. The break-up of

FDI by sectors shows that in 2020-21 the main sectors that attracted FDI inflows in India were: computer software and hardware industry attracted the highest FDI inflow (US$ 7.12 billion), followed by the automobile sector (US$ 4.93 billion), services sector (US$ 3.15 billion, trading sector (US$ 2 billion), metallurgical industries (US$ 1.3 billion), and construction activities (US$ 1.22 billion).

Inward investment has long been an important contributor to growth in India and other emerging countries. COVID-19 led to an outflow of investment, and the trade deal is an important opportunity to reset the losses in FDI following the pandemic. Studies show that reducing regulatory risk for investors has striking effects on FDI flows, this are higher than the positive effect of trade openness. Studies also confirm that a one-percentage point reduction in regulatory risk tends to boost the likelihood of an investor entering or expanding in a host country by as much as 2 percentage points.

The Indian government has taken initiatives in recent years which include, for example, relaxing FDI norms across sectors such as defence, PSU oil refineries, telecom, power exchanges, and stock exchanges, among others. To encourage inward FDI from the UK within the FTA context, the Indian government should aim to improve transparency and reduce bureaucracy (e.g. licences). Further, a dispute settlement mechanism which would be negotiated within the FTA would be very useful. Finally, the trade agreement must articulate clear and specific FDIrelated legal provisions and administrative procedures, which will also encourage UK investment in India. To conclude, an enabling environment in India (i.e. the host country) would make the business outlook more predictable and attractive for UK firms to invest in India.