SHANKER SINGHAM

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EASTERN PROMISE:

ASSESSING THE FUTURE OF UK-INDIA TRADE

Contents

About the author

Shanker Singham is Chief Executive Officer of Competere, Chairman of Global Vision and an academic fellow of the Institute of Economic Affairs. Shanker has recently been appointed to the Trade and Agriculture Commission. He sits on the Wilton Park Advisory Committee and is a life member of the Council on Foreign Relations and the Bretton Woods Committee. Shanker was an advisor to the US Trade Representative and to the UK Trade Secretary on international trade issues and is a non-government adviser to the International Competition Network. He is one of the world's leading international trade and competition experts and a regular commentator on TV, radio and in newspapers. Shanker has chaired the market access/WTO practices of two global law firms. He has advised parliamentarians and government ministers on the overall approach to UK trade policy including the Brexit negotiations. He is also the Policy Lead of the Trader Support Service Consortium, which is delivering on behalf of the government the implementation of the NI Protocol. He has authored over 100 articles and book chapters, as well as the leading textbook on the interface between trade, competition and regulatory issues.

Summary

- India is at a crossroads. As the UK's Prime Minister prepares to meet Indian leaders virtually, he promises an Enhanced Trade Partnership, possibly leading to a full Free Trade Agreement (FTA). There are important commercial reasons for this agreement, but perhaps more importantly, there are powerful geopolitical reasons. India could be brought into an alignment of nations including the CPTPP members as a bulwark against the negative impact of China's market distortions and security policies.
- The UK may just have the right combination of offensive and defensive flexibility to be able to do a deal with India. The contours of that deal are emerging and involve key UK asks such as financial services and legal services access, as well as Scotch whisky tariff reduction, and key Indian asks such as movement of natural persons supplying services (so-called Mode 4) and the UK committing not to impose bans on Indian agriculture in violation of the WTO SPS agreement, as the EU has done in the past.
- There is a developing alignment of nations, the US and the CPTPP-11, as well as the UK, which collectively promote pro-competitive regulation where countries interact with each other through equivalence and mutual recognition as opposed to regulatory harmonisation, or worse the export of one's regulatory standards in exchange for market access. India has to choose whether to align with these nations or others such as China which have a very different model.
- There are strong geopolitical reasons for India to join this grouping - which could be started with an FTA with the UK – relating to its difficult relationship with China and its need to secure support in the Indian Ocean.
- However, a number of key obstacles remain for this future to be reached. India has recently taken actions against the property rights of foreign investors, including ignoring the results of arbitration. Property rights form the bedrock of economic systems that leverage the forces of competition to generate economic growth. But India's market signals on property rights are negative and risk undermining its global reputation and potential.
- When the Prime Minister meets the Indian PM, be it virtually this month or in person later in the year, he could make it clear that while the UK welcomes a deeper relationship with India, this will depend on whether India endorses, in both word and deed, property rights protection, market competition and open trade.

India at a crossroads

> India has moved on from its non-aligned past. India is today an aligned state—but based on issues…
>
> Foreign Secretary Vijay Gokhale, 2019 Raisina Dialogue, New Delhi.

India is at a crossroads – great opportunities are possible, but it may now need to make good on commitments to open trade, property rights protection and competitive markets, if it is to play the global role it is capable of playing.

While the UK Prime Minister’s visit to India has been postponed, there are still major opportunities available for both countries. A trade deal between the UK and India, which has proved elusive for most countries, is very much a possibility. Such a deal could have significant positive effects for the UK’s financial services, legal services, and food and drink industries. The potential for the UK to use the Enhanced Trade Partnership (‘ETP’)[1] and even the launch of FTA negotiations to lock the Indian government into a broader coalition of willing partners could be a game-changer for the Indo-Pacific region as it tries to reconcile with China as a major market but also a geopolitical competitor and rival.

From an economic and trade perspective, China’s threat is in large measure based on its network of anti-competitive market distortions, its state-owned enterprises and the projection of its market distorting practices on the rest of the world. The India-UK relationship could play a significant role in the containment of these practices. India will have to show that it is moving in the right direction, and there is a new India, one that does not drag its feet in the WTO or display hostility to foreign companies, but instead one that enthusiastically embraces FTAs and prioritises economic growth over legalism.

China is a threat not only to the UK but India as well. India is surrounded by a significant Chinese military presence in Sri Lanka and Pakistan (naval bases), and Indian troops have even been killed on the disputed border with China.

There are also major opportunities for the Indian tech sector, which wants to be able to move its workers to help manage and run UK subsidiaries of Indian facilities. Indian agriculture has also suffered from EU sanitary and phytosanitary (SPS) bans, as well as a high EU Common External Tariff on agricultural products, which India had to pay after it graduated out of the GSP preference programme. If the UK lowers its tariff

1 Announced by Secretary of State, Liz Truss, and Indian Trade Minister Piyush Goyal, in February 2021.

schedule even further below the EU's Common External Tariff and diverges from EU SPS bans on products such as basmati rice and mangoes, then Indian agriculture could substantially benefit. And India certainly wants its students to have the opportunity to study in the UK. This is not just an Indian ask, but also a UK offensive interest, as Indian students studying at UK universities constitute an export of UK educational services.

There are major challenges, including India's undermining of investor protections, its rule of law violations and its historic protectionism. A question for the Modi administration is whether the Indian government is market friendly or business friendly (i.e. favouring Indian incumbent companies at the expense of new entrants, foreign or domestic).

Meanwhile, there are signs that India is making progress through agricultural and labour reforms at the state level. But serious problems remain, and indeed are growing, in the protection of property rights and in particular India's recent track record protecting the property rights of foreign investors (see below).

Potential for a UK-India trade deal

A trade deal could significantly increase bilateral trade flows, which have not grown as much as the parties would have wished in recent years. Bilateral trade flows are worth US$15.7 billion in goods and US$18.9 billion in services at the moment, but goods trade flows have been stagnant for a long time, with overall UK goods exports to India actually declining between 2012 and 2016. This suggest there is significant scope for a substantial increase in bilateral trade flows. But the trade deal has an even more significant role to play in terms of the geo-strategic dimension. Major UK industries such as tech, food and drink, legal, educational and financial services could all benefit from a trade agreement where India opens up these sectors, or in the case of educational services, the UK taps into the vast market of Indian students eager to study in the UK. India could benefit significantly if the UK were more accommodating on business visas and adopted better rules for its tech sector, as well as improved access for its agricultural exports.

Indian trade experts have pushed the Indian government to accelerate its discussions with both the UK and the EU, acknowledging there is likely to be a bigger gain with the UK.[2] Reporting in India has also started to focus on the trade benefits of an improved UK-India relationship, as well as the geopolitical benefits to India and the UK.[3] India is already the UK's sixth biggest trading partner (non-EU). India's services sector in particular stands to gain significantly from a UK-India FTA. Ajay Sahai of the Federation of Indian Export Organisations has pointed out that India could gain substantially in sectors such as IT, R&D, architecture and financial services, and some of these areas could be win-wins for both countries.[4]

A trade agreement with India could further bolster the UK's credentials as a free trading nation. Many countries have sought to do a trade deal with India, but these have proved notoriously difficult to close. The EU-India negotiations have been going on since 2007 without success. The US discussed a potential phase one deal with India without much success during the Trump administration. It is possible that the UK has the key to unlock the Indian puzzle when it comes to closing out trade agreements.

2 See: 'India should now aggressively pursue FTAs with EU, UK: Trade experts', The Times of India, 25 December 2020 (https://timesofindia.indiatimes.com/business/india-business/india-should-now-aggressively-pursue-ftas-with-eu-uk-trade-experts/articleshow/79955951.cms).

3 See: 'India, UK to forge 10-year roadmap for ties, push talks on trade deal', Hindustan Times, 15 December 2020 (https://www.hindustantimes.com/india-news/india-uk-to-forge-10-year-roadmap-for-ties-push-talks-on-trade-deal/story-c9Jb9Bwtkrv7VYJk1xEyYI.html).

4 See: 'India's services sector set to gain from Brexit agreement', Livemint, 25 December 2020 (https://www.livemint.com/news/world/india-s-services-sector-set-to-gain-from-brexit-agreement-11608914566397.html).

The opportunity for a deal is far more significant than narrow commercial objectives. Such a deal would have a strong geopolitical dimension. The UK government has recognised this in its Integrated Review,[5] in which it endorsed an Indo-Pacific tilt, not unlike the approach taken by the two most recent US administrations. The Integrated Review specifically highlights the importance of the Comprehensive and Progressive Trans Pacific Partnership (CPTPP). In the US, Senator John Cornyn has already highlighted the potential for India to be included in CPTPP accession talks.[6] The CPTPP members would be generally interested in Indian accession provided that the Indian government agreed to make the changes that CPTPP requires. It is worth pointing out that the UK + US + India + existing CPTPP-11 countries constitute around half of the global economy. If you add in the countries seeking accession such as Korea, Indonesia and Thailand, it is even bigger- and Japan as the G-3 economy is very focused on increasing the strength and influence of CPTPP as a platform. Since the UK is also acceding to the CPTPP (it filed its own accession papers in February), and also negotiating an Enhanced Trade Partnership agreement with India, it is in the ideal situation to play a role in securing India through an FTA that others have not achieved.

The contours of such an FTA are beginning to emerge, and they rely on the UK having very specific and focused offensive interests, and quite limited defensive interests. Defensively, the UK is able to be more open than the EU, for example in areas such as agriculture and the SPS rules that often keep agricultural products out of the EU market. In recent years for example, the EU has banned basmati rice and mangoes (India has been targeted by very low Maximum Residue Levels allowed in agricultural products – far lower than sound science would suggest). The offensive interests and defensive interests of the Parties are set out below and indicate where further deal contours can take shape. These deal contours also suggest a few quick wins, or an early downpayment on an ultimate FTA could be possible, and would send powerful signals around the world. Matching offensive interests (of both parties) to areas where there is little defensive baggage would be the key areas where gains could be made, and both parties would be not withholding these to secure a final FTA. While some of this requires a level of trust between negotiators, the geo-strategic dimensions of this negotiation could merit its consideration.

The UK's offensive interests are also sharply defined. The UK is a major services exporter – especially financial and professional services. The army of lawyers, accountants and ancillary service providers that help to grease the wheels of the City of London would benefit from access to a growing Indian market that is in increasing need of complex and sophisticated financial services. The UK's interests are not just in services. Scotch whisky, for example, has suffered for decades from unjustifiably high tariffs imposed by successive Indian governments. While these have been lowered from the stratospheric heights of a 750 per cent effective rate of taxation in the 1990s

5 See: 'Global Britain in a competitive age: The Integrated Review of Security, Defence, Development and Foreign Policy', HM Government, March 2021 (https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/975077/Global_Britain_in_a_Competitive_Age-_the_Integrated_Review_of_Security__Defence__Development_and_Foreign_Policy.pdf).

6 'Hearing to Consider the Nomination of Katherine C. Tai, of the District of Columbia, to be United States Trade Representative, with the rank of Ambassador Extraordinary and Plenipotentiary', United States Senate Committee on Finance, 25 February 2021 (https://www.finance.senate.gov/hearings/hearing-to-consider-the-nomination-of-katherine-c-tai-of-the-district-of-columbia-to-be-united-states-trade-representative-with-the-rank-of-ambassador-extraordinary-and-plenipotentiary).

to about 150 per cent today, it is still a formidable trade barrier.

If the UK can make progress with India in these areas, that will generate a powerful group of supporters for an India FTA. Indian government officials could take note of this and use it to ensure that their interests in the UK can be swiftly achieved. The principal Indian asks, beyond the elimination of agricultural barriers, are in the area of movement of natural persons, specifically for visas for business travel. What India wants here is the ability for its IT executives in particular to be able to easily travel to the UK to staff their developing UK subsidiaries, and to ensure its students are able to study at UK universities. Given India's geostrategic importance, and the shared history and culture, it is ludicrous that the number of Chinese students studying in British universities far exceeds the number of Indians (Chinese students make up the largest cohort with 120,385 studying in the UK in 2018/19- compared with 26,685 students from India and 20,120 from the USA. Italian and French students are the two largest cohorts from the EU with almost 14,000 students each studying in the UK in 2018/19).

India offensive interests	**UK offensive interests**	**India defensive interests**	**UK defensive interests**
Mode 4 services, esp. IT	Financial, legal services access	Legal services Indian Bar rules	
Agricultural SPS compliance	Scotch whisky tariff	Insignificant Indian defensive interests	Standards issues in agriculture – but only for goods UK produces, subject to the provisions in the Trade and Agriculture Commission report [1]
Student visas			
Apparel and textile tariffs to be lowered from 16%			Insignificant UK interest (EU textile producers would be much more resistant to change)

1 'Trade and Agriculture Commission Final Report', March 2021, pp. 41-43 (https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/969045/Trade-and-Agriculture-Commission-final-report.pdf).

India's challenges: decline in protection of property and investor rights

There are challenges to such a UK-India arrangement being swiftly closed, including serious questions about whether Modi's India is going to be genuinely market friendly, or is to going to be business friendly in the classic cronyist mould. While India has opened its economy since the initial move away from the import substitution model (market opening began in 1991 under Finance Minister Manmohan Singh), this has proceeded in fits and starts.

As noted in a study for the Legatum Institute,[7] economic activity increases when property rights are protected (including both domestic and foreign parties), markets are based on competition, and trade is open. Property rights and a strong rule of law form the foundation of open trade, foreign investment and competitive markets.

What governments do across these three dimensions of economic activity serve as market signals to potential investors and global capital. The rule of law, independent of political influence, is the guarantor of rights and protections that investors need when taking risks.

It is in this area that there are significant challenges for India, and its market signals have been mixed at best and negative at worst. Recent behaviour shows India moving in a very negative direction on property rights and investor protection. The government is systematically breaking Bilateral Investment Treaties (BITs), ignoring court and arbitration rulings, cancelling contracts, expropriating private property and using state institutions such as the tax authorities and the courts to prosecute the very parties whose rights they should be protecting.

We include three case studies to illustrate the scale of the problem in India.

7 'Anti-Competitive Market Distortions and Their Impact', Legatum Institute, May 2016 (https://img1.wsimg.com/blobby/go/bf4d316c-4c0b-4e87-8edb-350f819ee031/downloads/1cstfqts9_122710.pdf?ver=1611652548073).

Ignoring judgments and expropriating property: the Devas vs. Antrix Case

In 2005, Devas Multimedia Pvt Ltd entered into a deal with Antrix Corporation Ltd, a corporation wholly owned by the Indian government and operating under the administrative control of the Indian Space Research Organisation (ISRO) and the Department of Space (DOS).

Antrix/ISRO signed an agreement to lease 70 MHz of electromagnetic spectrum to Devas through the space segment capacity in the 'S-band' (2500-2690 MHz), and to provide two satellites, to be built, operated and launched by ISRO. These satellites were to form part of a hybrid satellite/terrestrial system through which Devas would provide broadband and multimedia services throughout India.

Over the next five years, Devas paid $14 million in upfront fees to Antrix, secured ISP and IPTV licences, conducted successful field trials and entered into contracts to build the necessary ground infrastructure.

Devas secured over $250 million of combined investment for the project, including $75 million from Deutsche Telekom.

On 25 February 2011, Antrix issued a notice to Devas terminating the Devas-Antrix agreement on grounds of 'force majeure', based on an unexplained 'policy decision' taken by the Indian Cabinet Committee on Security (CCS). As a direct result, Devas's business was destroyed.

In 2015, an International Chamber of Commerce tribunal ruled that the Indian government had 'unlawfully terminated'. Devas was awarded $672 million in compensation.

In 2016, a tribunal seated at the Permanent Court of Arbitration in The Hague under the Arbitration Rules of the UN Commission on International Trade Law (UNCITRAL) ruled that India's conduct constituted an unlawful expropriation of investments by Mauritian shareholders in Devas and failing to provide fair and equitable treatment to their investments, which was in violation of India's Bilateral Investment Treaty with Mauritius. In 2020 the UNCITRAL tribunal ordered India to pay damages of $111 million plus interest.

In 2017, another UNCITRAL tribunal found that India's conduct had breached the India-Germany Bilateral Investment Treaty by expropriating Deutsche Telekom's investments in Devas.

The total compensation owed by the Indian government amounts to $1.6 billion. The Modi government has refused to recognise these judgments, ignored the treaties to which it is a signatory, and has not paid compensation.

The Devas case is particularly egregious because, having lost in the arbitration courts, the Indian authorities are now using the instruments of government – including the legal system – as a weapon to punish Devas and its investors.

The Indian government subjected Devas to intrusive investigations, and ultimately froze the accounts of Devas in India, in a move to financially cripple the company. India's Solicitor General, Tushar Mehta, requested in January this year that the National Company Law Tribunal (NCLT) liquidate Devas and expropriate its property.

The NCLT subsequently appointed a government liquidator to wind up Devas. The liquidator will now have the power – against the wishes of Devas's founders, investors and employees – to dispose of the company's assets, including the ICC arbitration award.

This sort of action is common in less developed or authoritarian countries – where any company opposing the government is immediately accused of criminal conduct to increase the leverage and pressure on them. Officials of these companies are often promptly arrested, questioned, and have their property seized. Compliant judges provide a sheen of legitimacy via the courts.

One should not expect such actions from the Indian government, and yet it is happening.

There have been allegations of systemic corruption at the Central Bureau of Investigation, Comptroller and Auditor General, and the Supreme Court for the last decade. Polls have found that over 45 per cent of Indians believe the judicial system is corrupt. Meanwhile, 89 per cent of Indians have reported paying a bribe in the last year, according to a 2019 poll.

In 2020, a principal director at the Comptroller and Auditor General (CAG), the entity that provided a key audit in the case, stepped down following allegations she had used her previous position to benefit financially.

Prime Minister Modi has the opportunity to set the tone from the top that India will abide by its commitments under international treaties and will respect international courts and arbitrators. That means accepting losses sometimes: all civilised countries do this. Amicable resolutions with foreign investors are a better and more democratic solution compared with threats and expropriations. While the Devas case is an extreme example, there are other examples of problematic actions by the Indian government. Two ongoing arbitration cases concern India's breaching of Bilateral Investment Treaties, including one signed with the UK.

Breaching Bilateral Investment Treaties: Cairn Energy and Vodafone

Cairn Energy

In December 2020, a Permanent Court of Arbitration tribunal in The Hague ruled for British oil and gas company Cairn Energy PLC.[8] The tribunal ruled that India had breached the India-UK Bilateral Investment Treaty (BIT) to which both countries are signatories.

The tribunal ruled that the Indian government seized Cairn Energy's shares in its Indian subsidiary and withheld hundreds of millions of dollars in tax returns, in an effort to seize taxes that had retroactively, and unjustly, been applied to Cairn's activities.

The panel found that a 2012 law passed by the Indian Parliament was a new tax, not a clarification of prior law. Cairn initially brought the case to arbitration in 2015, under the protections it was guaranteed as a foreign investor under the UK-India BIT. [9]

Vodafone Group

In 2007, the Indian tax authority attempted to apply withholding tax to Vodafone's purchase of a Cayman Islands entity with an interest in an Indian cellphone operator earlier that year. After the Indian Supreme Court ruled in 2012 that the transaction was not taxable in India, the country's legislature attempted to apply the 2012 law retroactively to the earlier transaction. In September 2020, Vodafone objected and an arbitration panel ruled in the company's favour.

In all three of these cases, there is a disturbing trend of changes to laws made deliberately to obtain money from investors who would never have invested if they had known that the law could be changed retroactively to frustrate the purpose of the investment. Numerous Indian commentators have also raised the issue as being at odds with India's stated desire to sell itself as an investment destination.[10]

8 'Cairn Energy PLC', Law360 (https://www.law360.com/companies/cairn-energy-plc).
9 'Cairn Energy's Tax Arbitration Against India On Ice', Law360, 11 March 2019 (https://www.law360.com/articles/1137587).
10 See, for example: 'Is India really an investor-friendly nation?', Financial Express, 6 November 2020 (https://www.financialexpress.com/opinion/is-india-really-an-investor-friendly-nation/2121986/); 'Vodafone, Antrix/ Devas: When government goes back on commitments made, it scares away investors', The Times of India, 24 November 2020 (https://timesofindia.indiatimes.com/blogs/captains-musings/vodafone-antrix-devas-when-government-goes-back-on-commitments-made-it-scares-away-investors/); 'Devas does not deserve such harsh treatment', Livemint, 20 January 2021 (https://www.livemint.com/opinion/online-views/devas-does-not-deserve-such-harsh-treatment-11611158385361.html); 'Spaced-out logic: Trying to wind up Devas to avoid payments is unfortunate', Financial Express, 23 January 2021 (https://www.financialexpress.com/opinion/spaced-out-logic-trying-to-wind-up-devas-to-avoid-payments-is-unfortunate/2176834/); 'Making a mockery of arbitration', Business Standard, 19 November 2020 (https://www.business-standard.com/article/opinion/making-a-mockery-of-arbitration-120111900053_1.html); 'More than a BIT of protectionism', The Hindu, 14 December 2016 (https://www.thehindu.com/opinion/op-ed/More-than-a-BIT-of-protectionism/article16801222.ece).

Future British investors in India will expect the Indian government to abide by the BIT, including arbitration judgments that are awarded as a consequence. If this cannot be certain, then why would any investor feel confident about the provisions of a future FTA, or indeed the Indian government's commitment to the protection of property rights.

Anti-competitive distortions

India's recent Covid-19 vaccine export ban, and its pushing for a TRIPS waiver for Covid vaccines (another attack on property rights protection) are not therefore to be thought of as isolated incidents, but as examples of a deeper trend. India's approach to intellectual property might be expected given its approach to property rights in general as evidenced by the three recent cases cited above.[11]

India's domestic market is still replete with internal distortions, as highlighted by the Legatum report cited above. The study makes the following key findings:

- If India eliminated all its distortions, it would be the fifth largest economy in the world. In GDP per capita terms, it would rise from being ranked 169th to being ranked 67th.
- If India eliminated all its distortions it would generate over 200 million new jobs and reduce absolute poverty to zero.
- If India improved its insolvency rules, opened up to foreign investment in certain areas and better protected intellectual property rules, the number of people living on less than $2 per day would be reduced from 770 million to 627 million.
- Improving its insolvency rules, opening up to foreign investment in certain areas and better protecting intellectual property could lead to a productivity gain of 148 per cent.
- Fully removing its distortions could lead to a productivity gain estimated at 1,875 per cent, of which the Indian economy would capture almost 700 per cent.

A bright spot is that some of the reforms suggested in the Legatum study (the reform of the GST tax, as well as agricultural and labour reforms) have finally been initiated. The market signals are confused, but India is very much on a knife edge, where a few more positive signals in the property rights area, combined with other reforms, might just persuade a sceptical world that there is indeed a new India in town, whether that town is Geneva or Delhi.

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11 'Anti-Competitive Market Distortions and Their Impact', Legatum Institute, May 2016 (https://img1.wsimg.com/blobby/go/bf4d316c-4c0b-4e87-8edb-350f819ee031/downloads/1cstfqts9_122710.pdf?ver=1611652548073).

What can be accomplished in April?

In April 2021, Boris Johnson will enter this world. His conversations this month and beyond could be used to push India into the camp of willing nations, constrain the damaging activities we are seeing from China, and demonstrate that the UK can achieve with its trade openness and soft power what others have not been able to do. He could do this by recognising the following realities:

- Protection of investor rights and respect for the rule of law are inextricably linked to FTA negotiations. Prime Minister Modi should commit to these principles, publicly.
- If these commitments are made, a UK-India FTA (or sectoral deals) would be a positive step and provide a framework for British investors.
- However, FTAs are irrelevant if the rule of law and contracts are flouted, or if anti-competitive market distortions are the order of the day in the market. The Prime Minister should push the Indian government to recognise and respect its existing commitments under BITs and move more quickly to eliminate anti-competitive market distortions of all types.

Institute of Economic Affairs
2 Lord North Street
London SW1P 3LB
Tel: 020 7799 8900
Email: iea@iea.org.uk

Institute of
Economic Affairs