

Trade relations between EU and India

## A business perspective of India's Recent Economic Development

**Prof. Poonam Kumar** was invited to address a mini-hearing of the European Parliament in Brussels on May 3, 2006 as an expert on Indian business. The mini-hearing on "EU-India: Shift in the Centre of Gravity of Trade Policy," was organized by the European Parliament's Committee on International Trade to discuss a report on EU-India Trade relations to be submitted to the EP later this year and to be sealed by the upcoming EU India Summit in Helsinki in October, 2006. *Following is the text of her address.*

Honorable members of the European Parliament, His Excellency Mr. Deepak Chatterjee, Mr. Vandergest, Mr. Stastny, Mr. Sajjad Karim, ladies and gentlemen. It gives me a great pleasure to be amongst you and share my thoughts on "India's recent economic development".

**Economic Overview :** The economy of India is the fourth-largest in the world as measured by purchasing power parity (PPP), with a GDP of € 2.6 trillion. When measured in USD exchange-rate terms, it is the tenth largest in the world, with a GDP of € 543.4 billion. India is the second fastest growing major economy in the world, with a GDP growth rate of 8.1% at the end of the first quarter of 2005-2006.

The country's economy is diverse and encompasses agriculture, handicrafts, industries and a multitude of services. Services are the major source of economic growth in India today, though two-thirds of the Indian workforce earns their livelihood directly or indirectly through agriculture. Economy is showing positive trends in all directions. The stock market has outperformed all expectations and the Foreign Direct Investment (FDI) has multiplied manifold. Projections are now being made that in 20 years, India will be the third largest economy after China and US. Currently there are reforms taking place in several sectors making it an important destination for investments; however Indian economy is facing several challenges:

- Sustaining the growth momentum and achieving an annual average growth of 7-8 % in the next five years is important.
- Simplifying procedures and relaxing entry barriers for business activities.
- Boosting agricultural growth through diversification and development of agro processing.
- Overall industrial growth should be at least 10% per year and integrate not only the surplus labor in agriculture but also the unprecedented number of women and teenagers joining the labor force every year.
- Developing world-class infrastructure for sustaining growth in all the sectors of the economy.
- Opening foreign investment in more areas
- Effecting fiscal consolidation and eliminating the revenue deficit through revenue enhancement and expenditure management.
- Empowering the population through universal education and health care.

To guarantee sustenance of growth, the Indian Government needs to raise the level of investment, which includes investment in infrastructure and also people. It needs to improve productivity and efficiency to face the challenges of global competition. It also needs to focus on capacity building and continue to develop a positive and growth enabling environment for entrepreneurs.

**Population profile :** In India, 36% of its population is below the age of 15 years, and only 4% above 65. A population "bulge" in the working age groups, however large the total population, is an inevitable advantage. In 2020, the average Indian will be only 29 years old, compared with 37 in China and the United States, 45 in Western Europe, and 48 in Japan. This would create a large and growing labor force, which is expected to deliver unexpected spin-offs in terms of growth and prosperity. With 2.4% of the world's land, India supports 17% of global population. Increasingly, this large population base is being viewed as a serious competitive advantage for India, with the potential of leapfrogging the country into the orbit of higher economic growth. A report by Goldman Sachs predicts that India would be the only economy consistently growing in excess of 5% annually till the year 2050. It is estimated that by 2020 the US will be short of 17 million people of working age, China 10 million, Japan 9 million and Russia 6 million. Against this, India will have a surplus of 47 million working age people. Thus India is expected to continue having a competitive advantage in labor costs, which would be sustainable up to 2050.

**Literacy :** The literacy rate jumped from 52 per cent in 1991 to 65 per cent in 2001. The absolute number of non-literates dropped for the first time and gross enrolment in Government-run primary schools increased from over 19 million in the 1950s to 114 million by 2001.

**Outsourcing :** India's transition from being a major business process outsourcing destination to a Knowledge Processing Outsourcing (KPO) destination is imminent. India is set to become the most preferred destination for knowledge process outsourcing as it grows 46 per cent to touch the € 13 billion mark by 2010. Areas with significant potential for Knowledge Processing Outsourcing (KPO) include pharmaceuticals, biotechnology, technology, legal services, intellectual property, research and design, and development of automotive and aerospace industries. India could emerge as a global Knowledge Processing Outsourcing (KPO) hub as the business requires specialized knowledge in respective verticals and the country's engineering and technical institutes are geared to address the manpower demand. Given the large pool of chartered accountants, doctors, MBAs, lawyers and research analysts, India will dominate the Knowledge Process Outsourcing (KPO) sector of the world by 2010. India will garner a whopping 71% of the projected € 13 billion Knowledge Processing Outsourcing (KPO) market by 2010 i.e. € 9 billion.

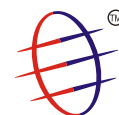
**FDI regime :** Foreign direct investment into India climbed 40% to € 6 billion in the fiscal year ended March, and is expected to rise further as its expanding economy attracts more investors. Three-fourth of this inflow has been in the manufacturing sector. It is expected to easily cross € 8 billion this year. India has displaced US as the second-most favored destination for foreign direct investment (FDI) in the world after China. In a bid to stimulate the sector further, the government is working on a series of



### Speaking at the European Parliament:

Prof. Poonam Kumar seen with Mr. Stastny, Member of European Parliament and Mr. Dipak Chatterjee, Indian Ambassador to the EU to her right and Dr. Willem van der Geest, Director of the Brussels-based think tank European Institute for Asian Studies (EIAS) to her left.

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ambitious economic reforms.

Sector-wise salient features of FDI

- The FDI cap for aviation has been hiked from 40 to 49 per cent through the automatic route.
- India has set up an Investment Commission that will garner investments in the infrastructure sector among others and plans to increase the limit for investment in the infrastructure sector.
- The Government approved sweeping reforms in FDI with a first step towards partially opening retail markets to foreign investors. It will allow 51 per cent FDI in single brand products in the retail sector.
- Unlike other sectors where FDI is being allowed without bureaucratic approvals on the automatic route, FDI in retail is being considered.
- The Cabinet removed multiple layers of approval while liberalizing existing sectors and opening new ones such as power trading, and warehousing of coffee and rubber to foreign investment.
- This is the first time in 15 years that the whole FDI policy has been reviewed in an integrated manner to remove anomalies and inconsistencies. This is not so much an exercise to revise caps, as to simplify and rationalize the procedures.
- The Cabinet also expanded FDI to 100 percent under automatic route in diamond and coal mining, development of new airports, cash and carry wholesale export trading, and laying of gas pipelines.
- It has raised FDI to 100 percent in petroleum infrastructure and captive mining of coal and lignite for consumption by eligible users.
- Subject to other regulations, it has allowed 100 percent FDI in distillation and brewing of potable alcohol, industrial explosives and hazardous chemicals.
- In line with the Group of Ministers (GoM) recommendations, it has decided to do away with the disinvestment norms in business-to-business e-commerce where a foreign investor had to shed 26 percent equity to an Indian investor within the first five years of operations.
- Indian government has liberalized foreign investment norms in the telecom and the real estate sectors.

**Implications of India's economic growth on Europe :** Growth in Europe has been significantly low in recent years and is of great concern to regulators and businessmen alike. Would a shift in the centre of gravity to EU/India trade be a solution? By 2025 the Indian economy is projected to be about 60 per cent the size of the US economy. The transformation into a tri-polar economy will be complete by 2035, with the Indian economy only a little smaller than the US economy but larger than that of Western Europe. By 2035, India is likely to be a larger growth driver than the six largest countries in the EU. Most forecasts indicate that by 2020 India's gross national product will overtake or be on the threshold of overtaking European economies. Disposable income levels of people in India have multiplied nearly 5 times over the last decade. The increase in income levels has led to a growth in consumption levels.

Scarcely a day passes without media reports on the phenomenal growth of the Indian economy. In Europe, rather than being seen as a welcome development, this is often seen as a threat. Concerns being raised about the off shoring of jobs or the delocalization of industries to low-cost production locations. Also, India is attracting an increasing proportion of foreign direct investment and seen as exploiting its linguistic and human-capital advantages in a world transformed by the Internet. In short, the concern is that competition from India will exert downward pressure on pay and working conditions in the advanced economies.

**Issues of bureaucracy, red-tapism and their solutions :**

Corruption and red-tapism are the two major issues to be dealt with by most of the emerging economies. Bureaucracy and red

tapism have been held responsible for slowing the process of development in emerging economies and India is no exception to this phenomenon. India needs to address these issues and we have seen recent reforms taking place to address the same. Threat also comes from uncertain market conditions, weak economies, deteriorating law and order, and natural calamities. Fortunately, India does not suffer from such issues in a major way. And, even if some threats do surface the benefits far outweigh the perceived risks. Also, India has a strong and robust legal system based on the British laws.

To ensure transparency in decision making, reforms ensuring Corporate Governance are being put in place. It has been an ongoing effort marked by initiatives like:

- Securities Exchange Board of India (SEBI) and stock exchanges have been given the authority to take action against errant companies.
- There is a streamline of the regulatory structure to reduce dilution of surveillance responsibility.

**Potential for enhanced trade & investment between EU and India :**

EU-India trade has grown impressively over the years, from € 4.4 billion in 1980 to €40 billion in 2004. Trade with the EU represents almost a quarter of India's total exports and imports. The EU is also India's largest source of foreign direct investment. However, India accounts for just 1.7% of total EU trade. India attracts only 0.3 % of the EU's world-wide investments.

The EU and India have adopted a Joint Action Plan and agreed to take positive steps to further increase bilateral trade and economic cooperation and to tackle barriers to trade and investment. Specifically, they agreed to set up a High Level Trade Group to study and explore ways and means to deepen and widen their bilateral trade and investment relationship and agreed to cooperate on a number of other trade-related issues.

**Desired areas for reforms in future :** Intellectual Property: In May 2005 India enacted a new Patent Law, bringing its legislation in line with the WTO Agreement on Trade Related aspects of Intellectual Property Rights (TRIPS). The EU is still awaiting implementation of TRIPS rules on data exclusivity.

Tariffs and non-tariff barriers: Indian import tariffs have been substantially reduced, but India's high tariff levels remain a genuine problem for European industry on certain products. There is a growing concern that Indian technical regulations do not adhere to basic WTO rules on transparency, non-discrimination, least trade restrictiveness and science based justification.

Anti-Dumping: The EU recently requested WTO consultations with India on practically all of its anti-dumping measures affecting European exports. This move comes after growing frustration amidst EU exporters not only at the escalation in the number of measures imposed by India, which has now become the world's largest user of anti-dumping practices, but also at the very low standards applied.

**Conclusion :** Has the centre of gravity, for the trade policies between India and EU, really shifted now? Looking at the opportunities the Indian economy has to offer, the human resources that are available and the intention of the government to continue reforms, there is a definite opportunity for growth in the bilateral trade between India and EU.

The real challenge that lies ahead is the management of this potential to ensure it results in general well being and improving living standards along with better security for people and nations at large in both, developed and the emerging economies.

I would like to thank the European Parliament for giving me this opportunity to be here and share my thoughts with you.

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