



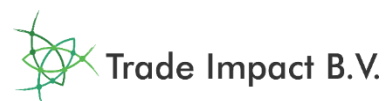
Trade Sustainability Impact Assessment (SIA) in support of Free Trade Agreement and Investment Protection Agreement negotiations between the European Union and the Republic of India

Draft Final Report

Draft Executive Summary

October 2023

Prepared by consortium led by Trade Impact B.V.
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The views expressed in the report are those of the consultant,
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INTRODUCTION

In 2022, the EU and India launched negotiations on a Free Trade Agreement (FTA) and an Investment Protection Agreement (IPA). In line with a well-established EU practice, the European Commission requested an independent expert team to conduct a Sustainability Impact Assessment (SIA) study to analyse potential economic, investment-related, social, environmental, and human rights-related impacts of both agreements for the EU and its Member States on one hand, and India, on the other. Desk research has been accompanied by stakeholder engagement. The general part of the analysis has been complemented by three case studies, and conclusions and recommendations.

1 ECONOMIC ANALYSIS

A reduction in tariffs and non-tariff barriers as a result of a future FTA is expected to lead to overall increases in welfare, GDP, and trade in the EU and India. By 2030, compared to the situation without the agreement in place, both EU GDP and welfare are expected to rise by 0.1% and 0.2% in the conservative and ambitious scenarios,¹ respectively. The corresponding GDP (and welfare) effects for India are much larger in percentage terms at 0.6% (0.5%) and 1.0% (0.8%).² The ultimate impact is likely to be significantly influenced by the extent to which non-tariff barriers are eliminated, making provisions pertaining to, inter alia, Technical Barriers to Trade (TBTs), Sanitary and Phytosanitary Measures (SPS), Good Regulatory Practices, customs and trade facilitation, rules of origin, and investment of notable significance to the eventual outcomes that arise from the agreement.

Bilateral EU merchandise exports to India are estimated to grow by 107.6% (€112.5 billion) up to 2032 in the ambitious scenario while India's merchandise exports to the EU are expected to rise by 86.6% (€110.7 billion). Most EU sectors are projected to more than double in value³ of their bilateral exports to India. This includes the EU's largest merchandise sectors (chemicals, electronics, and machinery), agricultural sectors (dairy, sugar, and tobacco and beverages), as well as the textiles, pharma, minerals, metals, and transport equipment sectors. On the Indian side, several key sectors for the Indian economy are projected to gain in excess of 100% in exports to the EU. This includes wearing and apparel and chemicals, as well as dairy, grains, sugar, meat, textiles, motor vehicles and transport equipment. The expected increase of India's exports to the EU in textiles and wearing and apparel sectors could negatively affect exports from Türkiye and Asian Least Developed Countries to the EU in these sectors.

In services, results from the economic model suggest that the EU-India FTA is likely to increase EU's bilateral exports to India by 4.7% (€1.6 billion) in the ambitious scenario, and India's bilateral services exports to the EU by 0.1% (€124 million).

Results from the economic modelling also show that the EU is expected to gain significantly from the EU-India FTA in bilateral exports in some of its largest MSME-intensive merchandise sectors, like electronics, machinery, rubber, and plastics. Similarly, on the Indian side, sectors like leather, rubber and plastics, ferrous metals, metal products, electrical equipment, machinery, textiles, and apparel may substantially increase bilateral exports.

Regarding public procurement, estimates from a structural gravity model suggest that EU-India procurement would have been larger by €550,000 per year on average over 2000-

¹ The ambitious scenario entails a 95% tariff reduction (EU agricultural sectors excluded; the majority of Indian agricultural sectors excluded; some TRQs excluded); reduction of NTMs by 10% for EU and India symmetrically for NAMA sectors; reduction of NTMs in agriculture; reduction of services barriers by 3% of existing barriers (excl. transport and other services). In the conservative scenario, tariffs are reduced by 90% and NTMs by 5%.

² In the ambitious scenario, EU GDP is estimated to grow by €47.9 billion and India's GDP by €69.6 billion. The EU is likely to record tariff revenue loss of €3.6 billion and India of €10.4 billion. Welfare gains for the EU are estimated at €41 billion and India's at €33.8 billion.

³ However, the estimated value of increase in sectoral exports in the ambitious scenario varies significantly, from €21.7 billion in the EU exports to India in the chemicals sector to €105 million in the dairy sector.

2014 at the current USD-EUR exchange rate if they had a preferential procurement agreement in effect with the procurement ambition level similar to the EU's existing FTAs.

Recommendations: To maximise the positive economic impacts of a future FTA, the negotiators should seek to conclude an agreement that results in the greatest degree of liberalisation possible. It could consider phasing in tariff reductions and allowing for lengthier transitions for full liberalisation of products where economic impacts and adjustment costs are expected to be greater. For the EU, this would relate to textiles, apparel and sensitive agricultural products esp. rice, whereas for India, this would include electronics, machinery, and sensitive agricultural products esp. meat. EU sugar sector representatives requested its full exclusion from liberalisation. To facilitate trade in agri-food products, multiplicity, and differences in standards across importing jurisdictions should be reduced. Moreover, SPS measures should be based on international standards and their imposition justified by providing scientific evidence. The future FTA should strengthen conformity to the principles of the WTO TBT Agreement. It should also strive for the maximum harmonisation of domestic standards with relevant international standards and simplification and reduction in NTBs as these are amongst the main issues discouraging MSME-participation in trade and GVC-integration. The FTA should also consider meaningful liberalisation of the public procurement markets on either side, including at the sub-national levels, by removing existing 'buy local' regulations and also implement non-discrimination in the award of government contracts. The services chapter should emphasize liberalisation of market access and behind-the-border barriers to Mode 3 and facilitation of Mode 4 trade in services. The agreement should also include a comprehensive Digital Trade chapter with strong rules on data protection and security and ensuring that cross-border data flows are not limited by data localisation requirements.

2 FOREIGN DIRECT INVESTMENT (FDI)

Recent studies have shown that the conclusion of International Investment Agreements (IIAs) can increase FDI flows. Indeed, the estimates from the gravity model suggest that - everything else being constant - and on average, the EU-India IPA is likely to enhance the stock of bilateral investments from the EU into India by 1.2%. Accordingly, a future EU-India FTA and IPA could increase bilateral FDI flows, leading to increases in national economic growth, competition, and product quality, and thereby benefiting investors and consumers in the EU and India. A state-of-the-art IPA, which would reduce or even remove existing obstacles to FDI, coupled with appropriate investment protection standards and access to an Investment Court System (ICS) is likely to further increase the potential beneficial impacts on FDI flows as investor confidence would be improved

As regards, FDI restrictions – both in India and the EU – several areas of concern for European and Indian investors have been identified. Regarding India, the current lack of access to the public procurement market has been highlighted as a very important area of concern. Also, the existing FDI approval mechanisms and FDI caps for many sectors constitute obstacles for European investors. Also, the lack of fair and equal treatment regarding investments in the automotive industry and the slow procedures for trademark applications in India, slow court proceedings and enforcement procedures of intellectual property rights (IPR) are perceived as areas of concern. Moreover, following the termination by India of all its IIAs with EU Member States, the lack of any investment protection and lack of access to an effective dispute resolution mechanism for European investors have been universally highlighted as an area of concern.

Regarding the EU, the recently adopted EU legislation, such as the EU FDI Screening Regulation, EU Foreign Subsidies Regulation, and Carbon Border Adjustment Mechanism (CBAM) may - to the extent they fall within their scope - have a restrictive impact on Indian FDI flows into the EU.

Reflecting recent developments in international investment protection best practices, the EU has developed new procedural and substantive protection standards regarding fair and equitable treatment, expropriation, and dispute resolution mechanisms. This new approach is also reflected in the EU's IPA textual proposals. Accordingly, the proposals contain the

broad-based definition of investment and investor, a closed list of fair and equitable treatment breaches, most-favoured nation, and national treatment obligations, as well as provisions against (indirect) expropriation. Procedurally, the creation of a two-tiered ICS is envisaged, and mediation is also mentioned as a dispute resolution mechanism. Also, India's 2015 model IIA text reflects a policy shift of rebalancing the rights and obligations of host States and foreign investors.

Recommendations: Given the existing identified FDI policies that can have a restrictive effect in both the EU and India, a modern and robust EU-India IPA should be negotiated which addresses the highlighted areas of concerns. Hence, state-of-the-art investment / investor protection clauses, combined with a state-of-the-art dispute resolution mechanism such as the ICS is needed. In addition, mediation, and other dispute resolution mechanisms suitable in particular for SMEs, which would assist in resolving problems of foreign investors, should be considered. These elements will contribute to achieving a high level of investment and investor protection, transparency, and fair treatment, which in turn will provide confidence to foreign investors and thus stimulate bilateral FDI flows.

3 SOCIAL ANALYSIS

The reduction of tariffs and non-tariff measures in EU-India trade relations is estimated to lead to increase in production and employment in the EU in sectors, such as minerals, paper and publishing, machinery, chemicals and electronics and electrical equipment in the ambitious scenario, while in India, the major increases are expected in the textile, garment, and leather sectors. Increased imports from India in these three sectors, as well as in rice and sugar, may create negative effects for EU businesses in these sectors that are already under pressure. This in turn may bring about negative impacts for working conditions, while in agriculture, it may also lead to withdrawal of smaller producers, which is particularly relevant for small size economies dependent on a few sectors, such as the EU Outermost Regions. This will also represent a lack of incentives for the young generation to engage. It may also mean negative impacts for women employed in the EU textile, garment, and leather sectors who in 2022 represented 53%, 81.3% and 58.5% of workers in these three sectors. On the other hand, women accounted for 19.4% of workers in the machinery sector and around one third in other EU sectors projected to grow thanks to the EU-India FTA which suggests that men will be more likely to benefit from the growth.

In India, while increased exports to the EU may stimulate production, initially they may also lead to increased pressure on workers to deliver to higher production targets through working overtime and with reduced breaks. Moreover, only part of additional jobs that may be created are likely to be formal and permanent. If the recent trends in the Indian labour market are maintained, the majority of new jobs are likely to be allocated to workers on temporary contracts or hired informally and not enjoying any legal protections. Also, while in this process more women and persons from religious minorities and lower castes may find a job and have a source of income, their working conditions are likely to be poor and wages below the statutory minimum. Poverty among working adults may in turn preserve the practice of engaging children in work thus cementing child labour incidence in families of informal and home-based workers. There is also evidence of child and forced labour in the sugar and rice sectors projected to grow.

Recommendations: While the reduction of tariffs and non-tariff measures should support job creation in both Parties, sectors already being under pressure should be excluded from a further liberalisation (like sugar) or there should be separate conditions, including longer transition agreed for sensitive products and parts of the sectors. India should extend legal protections, including minimum wages and social security coverage on all workers, improve implementation of the domestic legislation and ratified ILO conventions and strengthen the labour inspection system to ensure effective enforcement. It should also create conditions for trade union operation. International brands sourcing in India should start paying prices allowing for payment of decent wages to workers and should avoid applying unfair practices. Moreover, they should increase transparency regarding their suppliers and apply effective monitoring regarding respect for workers' rights along the supply chain, beyond tier one suppliers. The Government of India acting with the private sector should develop

and make widely available and affordable vocational training programmes to give young people and existing workers an opportunity to get upskilled and receive higher income. Building on the EU proposal, the Parties should adopt provisions in the TSD chapter underpinning respect for labour standards. The EU should improve the proposals for Due Diligence Directive and Forced Labour Regulation to ensure their effectiveness in fight against forced labour and child labour. The Parties should also promote CSR practices.

4 ENVIRONMENTAL ANALYSIS

From an environmental perspective, the most substantial expected impacts of the FTA are related to climate change, air quality, land use and biodiversity.

With regard to climate change, CO₂ emissions are expected to increase in case of an ambitious scenario, resulting from increased bilateral trade between the two partners (e.g., in the dairy, apparel, leather and textiles sectors), when compared to the situation without the FTA. The diversion effect for the FTA despite a positive, albeit very limited, impact in the rest of the world will not be sufficient to offset that increase. It is expected that India and the EU will reaffirm their commitments to implement the Paris Agreement, their Nationally Determined Contributions, and other Multilateral Environmental Agreements through dedicated provisions in the TSD chapter. We note though that both NDCs appear so far insufficient to meet the Paris Agreement goal of limiting global warming to 1.5°C.

Both Parties are also expected to commit to promoting mutual supportiveness of trade in environmental goods, and climate policies and measures, which are on itself positive provisions. This has the potential to be particularly impactful for the uptake of Electric Vehicles (EVs), in particular electric two- and three-wheelers, in India.

The FTA is expected to have a negative impact on air quality in India through increased production in impacting sectors (e.g., the meat and dairy sectors in particular). Emissions of non-CO₂ greenhouse gases and air pollutants, such as nitrous oxide, methane or ammonia are expected to increase in India due to the FTA.

The EU-India FTA is expected to have a positive effect on land use with an overall decrease of surface used for agriculture, as well as a decrease in the EU and an increase in India resulting in biodiversity loss through increased crop areas in fragile ecosystems such as humid primary forest.

Agricultural production in specific sectors such as rice and sugar can lead to a concerning overuse of freshwater and chemical inputs for production in India. The EU and India are expected to agree on a dedicated chapter aiming at supporting Sustainable Food Systems with dedicated provisions to support the uptake of sustainable farming methods in India.

Recommendations: The Parties should follow the new EU approach to TSD chapters and agree binding commitments related to climate change and environment, including the Paris Agreement becoming an essential element of the FTA and agreeing roadmaps with concrete commitments, in particular regarding biodiversity. The EU and India should also cooperate under the Sustainable Food System chapter to support the uptake of sustainable farming methods in India and to reverse biodiversity loss related to food production. The Parties should also include into the FTA provisions on conservation of water resources, water use and wastewater treatment. The FTA should also be used to leverage trade in environmental goods and to support, e.g., the uptake of electric vehicles. The EU should consider capacity building activities for Indian stakeholders to inform about recent EU requirements such as in the Deforestation free product Regulation and (once adopted) Corporate Sustainability Due Diligence Directive.

5 HUMAN RIGHTS ANALYSIS

Based on the screening and scoping results, the following human rights are studied in detail: the right to an adequate standard of living, right to water, right to health, right to

just and favourable conditions of work, freedom of association and the right to collective bargaining, prohibition of all forms of forced labour, incl. child labour, and women's rights. The impact of the EU-India trade and investment agreements on human and labour rights is complex and multi-faceted, involving a variety of stakeholders and sectors. Pre-existing situation plays an important role in how economic activities under the FTA/IPA will affect local populations.

Based on the results of the economic modelling, the impact of the proposed EU-India FTA/IPA on human and labour rights in the EU is not expected to be significant overall. Increase in GDP, welfare, and wages is expected to be marginal. However, job losses are expected in such sectors as textile, wearing and apparel (garment), leather, and rice. Due to the pre-existing challenges regarding working conditions faced by some categories of workers (migrants, informal workers) and reported violations in these sectors, labour and human rights of some workers may come under pressure from the proposed agreements (with respect to the right to an adequate standard of living, right to just and favourable conditions of work, and right to form and join trade unions, including the right to collective bargaining). Next to that, based on the reported incidents regarding the quality of certain medicines and food products from India, EU regulatory authorities should continue to apply market surveillance mechanisms and seek to agree with India consumer protection in online purchases to ensure that quality and safety of medicines and products imported from India meet the required standards.

In India, economic modelling predicts a moderate increase in GDP, welfare, and wages, as well as increased employment in such sectors as textile, wearing and apparel (garment), and leather. However, job losses are expected in the paper sector. Moreover, due to a serious pre-existing vulnerability regarding multiple issues related to human and labour rights (low unionisation rate, high informality, poor working conditions, insufficient social protection of workers, discrimination against most vulnerable population groups, restricted civil space, common incidents of forced, bonded, and child labour, and others), the potential of the FTA/IPA is not likely to be used to the full, but only to a limited extent, or not at all. Stakeholders do not expect specific improvements regarding workers' rights or regarding discrimination of religious minorities, persons from low castes, or persons from indigenous communities and women. This views may be affected by poor working conditions both in export-oriented factories and those producing for domestic market. Weak implementation of existing laws, lack of their effective enforcement, and multiple labour rights violations may be the main bottleneck in unfolding the positive effects offered under the Agreements. This situation is complicated by the current restrictions faced by the civil society, whose active participation and feedback are necessary for the effective monitoring and implementation of the FTA/IPA, including TSD chapter.

Recommendations: The Parties should include into the FTA a human rights clause that consists of an 'essential elements' and a 'non-execution' clause to ensure its enforceability. Moreover, the Parties should consider adopting roadmaps with clear commitments and targets in order to address shortcomings and make progress regarding the implementation of human and labour rights. Such roadmaps may also be used to define exact timelines regarding the ratification of the remaining ILO fundamental Conventions unless they are already ratified prior to the FTA signature. The EU and India should negotiate a robust TSD chapter in line with the new EU approach and consider expanding the mandate of Domestic Advisory Groups, to be proposed under the Institutional chapter, to human rights related issues under the FTA. An effective complaint mechanism under the FTA should also be considered to facilitate action in case the Parties fail to respect their obligations under the TSD chapter. Detailed recommendations also include, among others, a need for India to align its existing labour legislation with relevant international standards and effectively implement it; to ensure meaningful participation of independent civil society organisations in the monitoring and implementation of the Agreements; and to put in place effective mechanisms to prevent and mitigate water pollution by industries, notably those whose production is likely to increase as a result of the FTA/IPA.

6 CONTRIBUTION TO ATTAINMENT OF EU STRATEGIC OBJECTIVES

Regarding the first EU strategic objective, the comparison of EU's place in India's trade and investments in 2010, 2022 and projections for 2032 suggests that the EU's share in Indian exports will go up, thanks to the FTA/IPA, from 18.2% to 23.7% and the EU's share in Indian imports will rise from 8.8% to 15.3%. This increase would mean that the relative shares of other trading partners, such as Russia, the US, China, and ASEAN would decrease. Hence, the increase of the relative EU importance as a key trading partner for India (as a destination for Indian exports and as a source for Indian imports), means the FTA/IPA's contribution to achieving the EU first strategic objective.

Regarding the second EU strategic objective, the analysis looked at supply chain security through two dimensions: 1) the share of total EU demand that has to be imported; 2) the market concentration of the EU's import suppliers (i.e., from how many countries the EU sources its imports). The findings suggest that the EU-India Agreements would marginally lower the supplier concentration, but also marginally increase extra-EU imports. If they increase India's reliability as a trading partner, overall EU supply chain security is further enhanced. At the sectoral level, EU supply chain risks are highest for minerals, fossil fuels and wearing & apparel. While the EU-India FTA/IPA is not expected to significantly impact EU mineral supply chain security, they may reduce the risk for wearing & apparel. Therefore, the EU-India FTA/IPA are likely to support the EU strategic objective of increasing supply chain security through diversification (overall and at sector level).

Regarding the third EU strategic objective, EU exports to Russia dropped by €48 billion in 2022 compared to 2021 predominantly because of EU sanctions imposed on Russia (and Belarus) after the 24th of February 2022 invasion of Ukraine. The EU-India Agreements are expected to lead to an increase in exports of €49 billion annually. But these numbers cannot be directly compared, because of a few reasons. First, we do not compare a full year 2022 with an annual effect of the Agreements (the drop in EU exports to Russia only applied to the period 24 February to 31 December 2022). Second, the drop in exports to Russia is partially compensated by increased trade with other partners (trade diversion). This effect is not included. Finally, the drop in exports to Russia for EU companies as a result of sanctions is recorded today, while the benefits of the FTA/IPA will kick in gradually until they fully apply after 2032. Hence, overall, the EU-India FTA/IPA have the potential to offset a significant part of the losses incurred by EU exporters due to the EU sanctions against Russia, by providing alternative outlets for EU exports. However, the effect of these benefits are long term and depend on the level of ambition of the Agreements.

Regarding the fourth EU strategic objective (partnership in Indo-Pacific), a deeper EU-India trade and investment relationship as a result of an ambitious Agreement increases the importance of the EU as a strategic partner for India in the Indo-Pacific and vice versa. For the EU, India could be an alternative market after sanctions closed down the Russian market. The degree to which the partnership could be truly strategic depends on the degree of cooperation on non-trade policy objectives between the EU and India and the level of ambition of the FTA/IPA and the enforceability of their commitments. Hence, the Agreements have the potential to support the achievement of the EU fourth strategic objective while the extent of this support will depend on the provisions to be agreed by the Parties and their implementation and enforcement.

Regarding the fifth EU strategic objective (sustainability), the analysis suggests mixed results regarding the move towards greater respect for international labour standards, tackling climate change, environment protection and upholding human rights. A lot will also depend on the provisions to be agreed and their implementation and enforcement, as well as respect for domestic legislation and international commitments. Historical evidence shows that effective implementation of sustainability measures is even harder than agreeing to include sustainability provisions during negotiations. The EU could try to change parts of its negotiating approach to increase its market access leverage more to encourage trading partners, including India, to up their game in the area of sustainability. This could help to enhance the EU-India FTA/IPA's contribution to achieving the EU strategic objective.

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