

EXTRAORDINARY AND PLENIPOTENTIARY **diplomatist**^{PLUS}

www.diplomatist.com • Vol. II • Issue No. 4 • May 2010 • Rs. 55

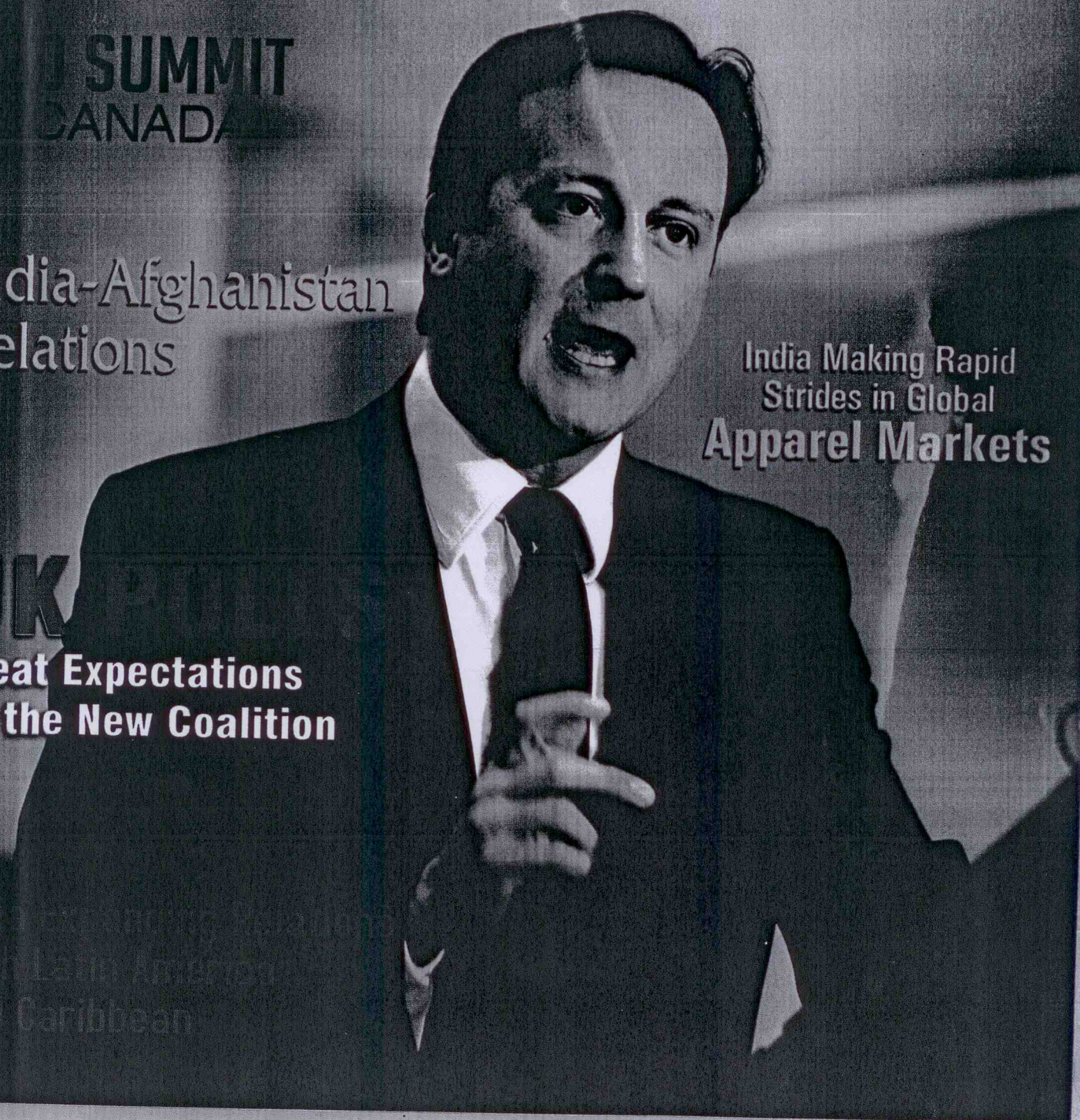
G20 SUMMIT
CANADA

**India-Afghanistan
Relations**

**India Making Rapid
Strides in Global
Apparel Markets**

UK
**Great Expectations
on the New Coalition**

**UK Foreign Secretary
Announces New
Strategy for Latin America
and Caribbean**



INDIA-EU ECONOMIC RELATIONS

Upcoming BTIA—Prospects and Challenges

By Arpita Mukherjee and Ramneet Goswami *

India and the European Union (EU) are negotiating a Broadbased Trade and Investment Agreement (BTIA), which is likely to be signed this year. The negotiations began in June 2007 after the High Level Trade Group set up by both economies recommended that a comprehensive agreement will be beneficial for India and EU. The BTIA will cover goods, services, investment, government procurement, sustainable development and labour standards, among others.

It is likely to further strengthen the economic and strategic relationship between India and the EU and enhance trade, investment and cooperation by removing the existing barriers. Since both India and EU are members of the World Trade Organization (WTO) and are negotiating in the Doha Round of WTO



Indian Prime Minister, Dr. Manmohan Singh speaking at India-EU Business Summit

There is a strong economic reason for India and EU to enter into a BTIA. At present, the EU is India's largest trading partner in goods, second largest trading partner in services (after the US), second largest investor (after Mauritius) and the largest in terms of foreign technology transfer.

negotiations, this agreement aims to be WTO plus. In fact, this will be India's first agreement which will cover issues like government procurement and labour standards.

Strong Reason

There is a strong economic reason for India and EU to enter into a BTIA. At present, the EU is India's largest trading partner in goods, second largest trading partner in services (after the US), second largest investor (after Mauritius) and the largest in terms of foreign technology transfer. Overtime, India-EU trade has increased. Between 1998 and 2008, the bilateral trade in goods has increased by four times, whereas trade in services has

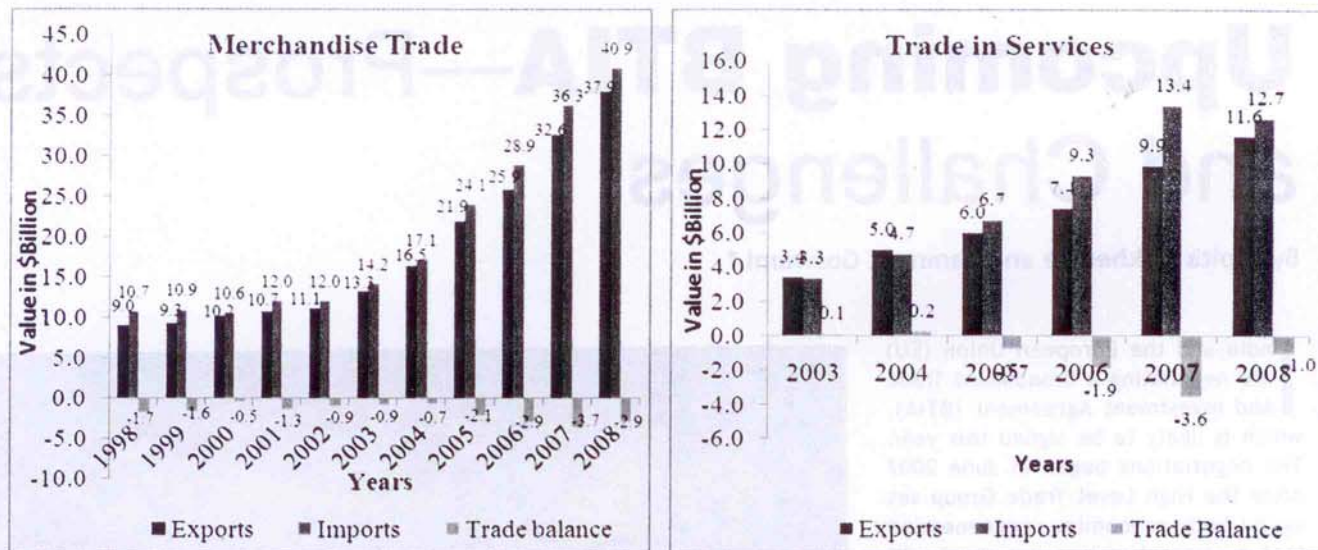
increased over 3.6 times between 2003 and 2008 (see Figure 1). Even with the global slowdown, the merchandise trade is expected to double by 2012.

FDI from EU

The cumulative foreign direct investment (FDI) inflows from the EU (between January 2000 and December 2009) have been around US\$21 billion, which accounted for around 19.8 percent of India's total FDI inflows. The top five sectors of FDI inflows were services, automobiles, chemicals, computer software, housing and real estate. Indian investment in the EU has also increased. In 2008, Indian FDI outflows to EU were US\$5.4 billion compared to US\$97 million

¹ Source: Eurostat. Values are converted from Euro to US Dollar. Exchange rate for 2001 is €1 = \$0.89658 and for 2008 is €1 = \$1.47134 (source : <http://www.oanda.com/currency/historical-rates>)

Figure 1: Trends of India's Trade in Goods and Services with EU



Source: Compiled by the authors from IMF DOT Database and Eurostat

Note: (a) Due to expansion of the EU, for 1998 to 2003 – EU15; for 2004 and 2005 – EU25; and for 2006 onwards EU27.

(b) Exchange rate: For 2003, €1 = \$1.13208; for 2004, €1 = \$1.24386; for 2005, €1 = \$1.24539; for 2006, €1 = \$1.25622; for 2007, €1 = \$1.40; for 2008, €1 = \$1.47134

(source: <http://www.oanda.com/currency/historical-rates>)

in 2001. The UK, Belgium and Germany are some of the preferred investment destinations and information technology, automobile and pharmaceuticals are some of the key sectors of India's investment interest.

India and the EU have trade complementarities in both goods and services. India offers labour intensive products while EU products are capital intensive. A large number of EU companies are now sourcing products like apparels, leather shoes and handbags, auto components and home furnishing from India.

Advantage India

While India has an abundant supply of young-educated, English-speaking manpower at lower costs, the population in many EU member states is ageing and there is likely to be a labour shortage in the future. The EU companies are technologically advanced and they are willing to invest in infrastructure like energy, telecommunication and transport which India needs for its economic growth and development. Therefore, there are opportunities for investment and India-European collaborations whether through outsourcing or joint ventures. For India, this is likely to lead to inflow of finance, technical know-how and global best practices.

India, with a high GDP growth rate despite the global slowdown, has attracted the EU member states whose domestic markets are getting saturated and have low GDP growth rates. This is probably the reason why in 2006 the EU launched a new trade strategy – “Global Europe: Competing in the World” which emphasised on enhancing trade ties with countries like India and South Korea and region like ASEAN. There are other reasons why EU wants to have a BTIA with India.

China Factor

Although, the total India-EU trade has increased, the share of the EU in India's merchandise trade has declined from 26 percent in 1998 to around 17 percent in 2008. The growing share of China in India's merchandise trade from 2.1 percent in 1998 to 8.7 percent in 2008 has raised alarms among EU exporters. The European companies are losing their market share to companies from China and other Asian countries. Therefore, the EU was first to express an interest to enter into a trade agreement with India.

Although, Indian policy makers are aware of the complexities of entering into an agreement with a developed country/block, there are some positive

gains for India. The share of India in EU's merchandise trade is very small but increasing. It increased from 1.3 percent to 2.1 percent between 2000 and 2008 which is larger than India's share in world merchandise trade (around one percent).

EU as Donor

The EU is also one of the largest donors in India's development programmes. These include Operation Flood, which helped India to become the world's leading milk producer; Indian government's District Primary Education Programme (DPEP); Sarva Shiksha Abhiyan (SSA) Programme; among others. Since 1984, research and innovation activities of the EU are grouped under one programme called the Framework Programme (FP).

In the Sixth Framework Programme (FP6) (2002-2006) about 80 projects (out of 5300) involved Indian researchers. The Seventh Framework Programme (FP7) (2007-2013) has a budget of €53.3 billion. It covers sectors like health, information and communication technology, energy, environment, food and agriculture among others and has a strong Indian focus. There is a significant scope for enhancing R&D collaborations between India and the EU if the BTIA is operational.

² For instance see “The EU-India FTA – Critical Considerations in a Time of Crisis”, Working Paper 11, March 2009, CENTAD, http://www.centad.org/cwp_13.asp



The Prime Minister, Dr. Manmohan Singh with the President of the European Commission, Mr. Jose Manuel Barroso and the Prime Minister of the Republic of Portugal, Mr. Jose Socrates, at a delegation level talks during the India-EU Summit in New Delhi.

Lower Tariffs

Some of the initial research on the impact of the BTIA shows that the average tariff rates in the EU are much lower than in India (2 percent and 17 percent respectively). Therefore, India needs to lower its tariffs much more than the EU and hence the goods part of the agreement is clearly in favour of the EU. However, an in-depth analysis shows that this is only partially correct.

Although tariff rates in India are higher, many sectors in which India's trade with the EU is sensitive sector in the EU and faces high tariffs and non-tariff barriers. Indian companies would like to gain greater market access in sectors like textile and auto component. For this, the Indian companies are even aggressively willing to go for zero-for-zero tariff in a sensitive sector like textile with the EU.

A study conducted by the authors on the 'Auto component Sector' shows that labour costs in India are much lower than the EU and therefore EU companies will continue to source from India to maintain their global competitiveness. The automobile market in the EU is also getting saturated and EU companies are targeting the Indian market. If India continues to retain lower duties on auto components and higher duties on luxury vehicle, there is no cause for concern for auto-component manufacturers. Thus, lowering of tariff should not be a problem

as long as India carefully designs the tariff structure and gets greater market access from the EU.

Non-tariff Barriers

Indian companies also face a large number of 'non-tariff barriers' in the EU in the form of standards, directives and regulations. These are implemented for health, safety and environmental reasons, among others and vary across member states.

The Maximum Residue Limits for pesticides in the case of agricultural product exports, the REACH (Registration, Evaluation, Authorization and Restriction of Chemical substance) regulations for chemicals, dyes, etc. affecting exports of not only chemicals but also user industry like textiles, the CE certification for manufacturing of certain products such as construction products, toys, medical devices, etc., are some of the major barriers faced by Indian companies in the EU.

These barriers are more acute for Indian small and medium enterprises (SMEs) which constitute a large proportion of the Indian manufacturing sector in products like textiles and agro-processing where EU regulations are stringent. Some of the EU Directives have restricted trade. For instance in 2004, EU issued a Directive on Traditional Herbal Medicinal Products (Directive 2004/24/EC), under which

companies wanting to export traditional herbal medicines to the EU must submit evidence to prove that the product has been under medicinal use for at least 30 years preceding the date of application, including 15 years in the EU. As Indian traditional medicines were not allowed to be imported in the EU earlier there is no way that these conditions could be met by suppliers of Indian traditional medicines like Ayurveda. To enhance the export potential of the Indian industry, there is a need for identifying the non-tariff barriers to trade in the EU.

During the BTIA negotiations, India can seek clarification about the procedures, push for transparency in regulation and there is a scope for cooperation and mutual recognition of standards. While most studies tend to highlight the unequal level playing field of Indian SMEs versus the EU companies and conclude that lowering of tariffs will lead to further vulnerability, it may not be the case. It is important to note that India is negotiating a series of Free Trade Agreements (FTAs) and tariffs are going to be lower in any case.

India's Options

What India needs to do is to lower the tariffs autonomously. This will enhance its bargaining position in all FTA negotiations including BTIA. In the BTIA, India and the EU should explore the scope for SME collaborations and joint projects. SMEs

³ <http://ec.europa.eu/enterprise/policies/european-standards/documents/harmonised-standards-legislation/list-references/>

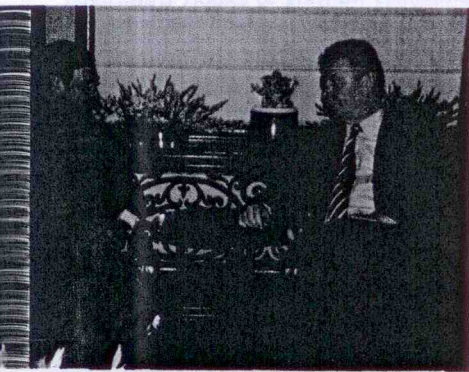
⁴ <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32004L0024:en:NOT>

of both economies together can explore third country markets and can also jointly apply for EU's R&D funding. SMEs collaborations should be explicitly spelt out in the agreement.

Market for Services

At present, unlike goods, the EU does not have a single market for services. The regulations and conditions differ across 27 member states and many decisions like work permit and visas are under the purview of member states. In the EU, around 50 percent of trade in services is among member states and it is increasingly becoming difficult for service providers from third country to access the EU market.

For instance, the UK visa regime has now become more stringent than before. In the EU, market access barriers are



Anand Sharma, India's Minister of Commerce meeting with Mr Karel De Gucht, the European Trade Commissioner in New Delhi

gradually being replaced by stringent regulations. The WTO negotiations tend to focus on market access issues and, therefore, the regulatory barriers are not adequately addressed.

Service Providers

Third country service providers face several barriers in intra-EU labour mobility. For instance, an Indian software consultant with a work permit in Germany cannot offer services in Spain. Each EU member state has its own rules on investment and the EU market is not harmonized. In the EU, a company is treated as an EU company if it is a wholly-owned subsidiary but it is treated as a foreign company if it has a representative office. Since setting up of a wholly-owned

subsidiary is expensive, this is a major barrier for Indian companies. India wants to address some of these barriers through the BTIA.

In services, the EU has already scheduled the existing market access liberalisation in its revised offer to the WTO (dated 26th June 2005) and there is a limited scope for improvement over it. Both India and the EU have their sensitive areas. For instance, retail is a sensitive area in which India has not allowed FDI in multi-brand retail while EU companies are interested in this segment. Similarly, audio-visual is a sensitive area for the EU in which India is asking for commitments. The negotiations have also changed since the global slowdown. Prior to the slowdown, the EU was a major proponent of financial sector liberalisation but post-slowdown

EU banks like Royal Bank of Scotland (RBS) are getting nationalised. India is a major proponent of liberalising temporary movement of people (Mode 4). While in the early stages of negotiations and even in the WTO, the EU had expressed interest to liberalise movement of people, unemployment and job losses, after the recession has made this a sensitive sector. Also, outsourcing is a sensitive issue for EU companies dependent on state aid.

In the current circumstances, it may not be possible for both India and the EU to go beyond their autonomous liberalisation. In the past, Indian policy makers were of the opinion that the loss that India will incur due to tariff reduction after the BTIA will be more than compensated by greater market access in services. This may not happen. Both economies may not be in a position to go beyond their autonomous liberalisation. Nevertheless, post-global slowdown and increasing protectionism, the BTIA will provide opportunity to India and the EU to secure the autonomous liberalisation in each other's markets.

It will also allow India to enter into mutual recognition agreement with the EU in professional services like architecture which will give better access to Indian professionals in EU member states. Cooperation in sectors like energy, R&D and transport can be beneficial for Indian companies.

Procurement

The core concern of India is how to address issues like government procurement, labour standards, sustainable development and climate change, which are likely to cover in the BTIA. The EU has covered all these areas in its FTAs with other countries, however, their scope varies. India needs to be careful about the scope of the agreement. Also, once India agree to sign an agreement on government procurement, labour standard, etc., with the EU, it will be difficult for the country to deny these to other FTA partners.

The regulatory regime in India is evolving. A study on the EU Preferential Trade Agreements (PTAs) shows that the EU often uses the PTAs to transfer its own regulatory regimes to its trading partners. Therefore, it is important for trading partners to have a sound regulatory framework in place before negotiating such agreements. Also, the EU tends to place its demands on its trading partners across different chapters of the trade agreements. For instance, transport may be covered in services chapter, investment chapter and trade facilitation chapter, among others. Therefore, Indian policymakers have to carefully match their commitments across different chapters of the BTIA so that there are synergies across chapters and in the offers and demands.

These are probably the reasons why India is taking a slow and cautious approach to the negotiations. This is evident from the fact that, although, India-EU negotiations began at the same time as EU-Korea negotiations, the latter has been completed in October 2009. Also, since EU has custom unions with countries like Turkey and blocs like European Free Trade Association (EFTA), India has started the process of entering into FTAs with these countries/blocs.

Otherwise rule of origin can be a problem. Overall, India-EU BTIA is one of the most complex agreements that India is negotiating and its implication depends on the extent of commitments that India can get and what it will offer in return.

(Dr. Arpita Mukherjee is a Professor and Ms Ramneet Goswami is a Researcher at Indian Council for Research on International Economic Relations (ICRIER), New Delhi)

⁵ For example see "The EU-India FTA: Initial Observations from a Development Perspective", September 2008, Traidcraft, UK, <http://www.traidcraft.co.uk/>.

⁶ Horn H, PC. Mavroidis and A Sapir (2009), "Beyond the WTO? An Anatomy of EU and US Preferential Trade Agreements", CEPR Discussion Paper No. DP7317, June 2009, Centre for Economic Policy Research, UK.