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Global Developments: A Plurilateral Services Agreement?

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It is time to stop talking about the Doha Round and to turn to developments in the aftermath of the apparent demise of the multilateral trade talks. There is little doubt that the suspension (or some might say the definitive termination) of the multilateral trade negotiations has released the energies of trade policy officials of important trading nations for invigorating expansion and deepening of regional agreements. Big ideas like the Free Trade Area of the Asia- Pacific and the Trans-Pacific Partnership, which have captured the imagination of the Heads of States and Governments, now have a chance to be translated into reality. Smaller formations of regional agreements, including bilateral ones, are also forging ahead across the globe.

However, there is another show in town. Exploratory talks for realising a plurilateral agreement on services have been launched informally by a group of 16 WTO members, who have styled themselves as the real good friends (RGF) of services trade liberalisation. The coalition that has taken the initiative comprises the US, the EU, Japan, Canada, Norway, Switzerland, Australia, New Zealand among developed economies and South Korea, Pakistan, Mexico, Colombia, Chile, Singapore, Hong Kong, China and Taipei among developing countries and territories. The initiative has been led strongly by the private sector in the major economies and has the backing of the US Coalition of Service Industries and the European Services Forum. The RGF group has begun meeting informally at Geneva to work out the elements of a possible pact.

Obviously, the stasis in Doha talks has led to this development. The rationale given by the RGF group for holding talks in a small group is that while in the WTO, there is great difficulty in achieving consensus among 153 Members except on the lowest common denominator, in a small group of countries, which have already undertaken a significant liberalisation of trade in services, it might be possible to agree on a package based on the highest common denominator. Some of the supporters of the initiative even argue that a plurilateral agreement could eventually be a stepping-stone for a multilateral accord in the area.

The leading emerging economies, however, have come out strongly against the RGF initiative. They argue that the move does not comply with the requirements of transparency and inclusiveness, which provide the foundation of any multilateral process. It would make the resumption of multilateral negotiations more difficult. They see in it a conflict with the notion of a single undertaking agreed to in the Doha Round. They, therefore, have not responded favourably to the call for participating in the talks. There is a standoff on the issue between the two sides.

While there is opposition to the initiative because it is against the spirit of multilateralism, no one is saying that a plurilateral accord would be inconsistent with the WTO agreement. Just as Article XXIV of GATT 1994 provides for an exception from the MFN obligation for WTO Members to form free trade areas (and customs unions), Article V of GATS allows agreements liberalising trade in services between or among the parties to such an agreement. GATT 1994 requires that in a free trade area, the duties and other restrictive regulations of commerce be eliminated on substantially all the trade between the parties. GATS sets the bar lower, and requires that there should be substantial sectoral coverage and that, in respect of the sectors covered the agreement, should provide for the absence or elimination of substantially all discrimination. Thus, the sectoral coverage is not 'substantially all' but only 'substantial'. What GATS envisages is virtually a selective, preferential agreement on services rather than a free trade area embracing 'substantially all' the transactions in trade in services. Another big flexibility provided is that in respect of the sectors covered, not all discrimination but 'substantially all' discrimination should be eliminated.

A plurilateral agreement on services among a subset of WTO Members, as envisaged by the RGF group cannot be opposed on the ground of inconsistency with the WTO agreement. However, the move is still vulnerable to criticism on systemic grounds. The multilateral trading system is already under threat from the large numbers of economic integration arrangements entered into by the WTO Members, regionally, bilaterally and inter-regionally. The plurilateral initiative on services opens another front to weaken multilateralism. If successful, it could foreclose the possibility of resurrecting the Doha Round. Can the proposed plurilateral agreement be turned around and made a stepping stone towards an eventual multilateral pact? Two points need to be made here. First, the traditional method of achieving consensus eventually in the GATT/WTO framework has been negotiations in concentric circles. To start with, an attempt is made in a small group of countries to have a meeting of minds, and if the effort succeeds, the matter is taken to a larger group, and so on, until the whole membership is able to agree. The RGF group could be regarded as the innermost concentric circle and if agreement is reached within the group, larger groups could be consulted. The group already has all the industrialised countries and in a way resembles the core groups of the past. However, in order to ensure that the step-by-step process of enlarging the consensus is carried through successfully, emerging economies would have to be brought into the fold pretty soon. If getting agreement from all Members proves difficult, securing agreement among a critical mass of Members could be the way forward. Even if the sectoral coverage were limited, from India's perspective, it would be important to ensure that all modes of supply, particularly the movement of natural persons, are included substantially in the package. It would be equally important to guarantee that the Members who go ahead with liberalisation, without waiting for all to sign up, extend the benefit of liberalisation to all on an MFN basis. This is what was done in the Information Technology Agreement, and this alone can serve to preserve the spirit of multilateralism, even if it not a perfect outcome. The alternative of sliding into a purely plurilateral agreement, with benefits extended only to the signatories, would be a retrograde outcome, even if it would still be consistent with the letter of Article V of GATS. The idea that a critical mass of WTO members should sign before the agreement becomes operational is, however, acceptable, as it is necessary to preclude a free rider benefit to countries having significant participation in international trade in the covered services.

European Union, Regional and Interregional Economic Integration and India

Anwarul Hoda

A European Union-India Broad-based Trade and Investment Agreement (BTIA) has been in the works since 2007. Because of the lack of transparency in the talks, no evaluation is possible of the possible contents of the eventual agreement, nor a definitive assessment feasible on whether these negotiations are moving towards successful conclusion or are headed for failure. The EU is not only a strongly integrated group of nations by itself but it has also entered into several other regional and interregional economic integration agreements. For many years, it has also been in the process of seeking more of such agreements with countries around the globe, some of which appear to be mired in disagreements. This paper surveys the arrangements entered into by the EU (and the EC), before analysing the available information on the reasons for which some of the ongoing FTA talks, including those between the EU and India, are delayed.

Evolution of the European Union

West European countries have been the mainspring of regional economic integration agreements in the post-World War II world. The Benelux Economic Union had already taken shape in the late 1940s but it was the formation of the European Coal and Steel Community (ECSC) in 1951, integrating the coal and steel industries of France and West Germany, which provided the first major impetus to economic integration in Europe. Italy and the Benelux Economic Union joined the ECSC soon thereafter. In 1957, these six European nations signed two treaties at Rome, creating the European Atomic Energy Community (EURATOM) and the European Economic Community (EEC). The latter envisaged not only the creation of a customs union among the parties but also the establishment of a common market, envisaging the abolition between member states of all obstacles to freedom of movement for persons, services and capital. In 1967, the ECSC, EURATOM and the EEC, were merged to form the European Community (EC).
In subsequent years, Denmark, Ireland, the UK, Greece, Portugal and Spain acceded to the EC, and by the end of the 1980s, there were 12 member states (EC12)

Following the ratification of the Maastricht treaty by the member states in 1993 the European Union was born. The European Union had three pillars, the European Community, which handled economic, social and environmental policies, the Common Foreign and Security Policy and Police and Judicial Co-operation in Criminal Matters. Only the first pillar, the European Community, had legal personality and the other two pillars were handled intergovernmentally. The Maastricht treaty also called for a strengthened European Parliament, the creation of a central European bank and a common currency.

In 1994, the European Community was enlarged (EC15) with the accession of Austria, Finland and Sweden and, in 2003, it expanded eastward to welcome 10 more countries, Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia (EC25). In 2005, with the accession of Bulgaria and Romania, the EC became an entity with 27 member states.

The next and final step in the economic integration was the Treaty of Lisbon, which entered into force on December 1, 2009, completing the process of institutional reform, abolishing the three pillars and making the EU a single consolidated organisation. The European Council has been established, composed of the heads of state and government of the member states, to provide political leadership to the activities of the Union. The European Parliament has been given the power to co-legislate with the Council of Ministers in a majority of cases. The EU foreign policy has been given a higher profile and has been bolstered with new institutions. The protection of human rights in EU law has been strengthened by being subjected to the EU

Charter of Fundamental Rights and the European Convention on Human Rights. Further the Treaty establishes a new voting system for decision making and a double majority system has been introduced, calculated on the basis of two criteria viz., 55% of EU States (i.e. 15 out of 27) and 65 % of EU's population.

Regional economic integration outside the European Union

Within Europe, the EU has entered into a customs union with three states, Andorra, Turkey and San Marino and a free trade area with a number of states, namely, Faroe Islands, Norway, Iceland, Switzerland, FYR Macedonia, Croatia, Albania, Montenegro, Bosnia and Herzegovina and Serbia.

An important group of developing countries with which the EU entered into a free trade area agreement are the countries in the Southern Mediterranean. These countries had benefited from a co-operation agreement with non-reciprocal trade benefits since the 1970s but following a Ministerial Conference at Barcelona held on November 27-28, 1995, Algeria, Egypt, Israel, Jordan, Lebanon, Morocco, Syria and Tunisia entered into a new generation of Association Agreements, which replace the earlier co-operation agreements and envisage, inter alia, the establishment of a free trade area after a transition period of 12 years.
Arrangements with African, Caribbean and Pacific (ACP) countries

For many decades, non-reciprocal preferential arrangements with African-Caribbean-Pacific (ACP) countries were a key feature of the European Community's trade policy. These preferences were a legacy of the preferences of colonial times, which were initially embodied in the first Yaounde Convention (1963) and the second Yaounde Convention (1969) between the EC(6) and 18 African states. Subsequent years saw the perpetuation of the non-reciprocal preference through a succession of Conventions, the last of which Lome IV bis was signed in 1995 between the EC (15) and 70 ACP states.

In 2000, the EC (15) signed the ACP-EC Partnership Agreement or the Cotonou Convention, bringing the curtain down on non-reciprocal preferences. The Cotonou Convention envisages that the non-reciprocal approach in preferences for the ACP countries would be abandoned and the parties would sign Economic Partnership Agreements (EPAs), which are essentially free trade area agreements with certain agreed flexibilities for the ACP countries in question to take into account their asymmetric economic relationship. For negotiating EPAs, the 77 ACP countries have been grouped into six negotiation regions (West Africa, Central Africa, Eastern and Southern Africa, the Southern African Development Community, the Caribbean and the Pacific), based on existing regional integration institutions. So far, the EU has signed definitive EPAs only with the 17 countries of the Caribbean region and with Papua New Guinea among the ACP countries; negotiations with the remaining countries are still on. Interim EPAs have been signed with Ivory Coast and Cameroon.

Other interregional FTA agreements

The EU entered into a Trade, Development and Co-operation Agreement with South Africa in 1999, an Economic Partnership, Political Co-ordination and Co-operation Agreement with Mexico in 2000 and an Association Agreement with Chile in 2003, all embodying free trade area agreements. More recently, the EU-Korea Free Trade Agreement has entered into effect on July 1, 2011.
Interregional FTA agreement under negotiations
The EU entered into FTA negotiations with the Gulf Co-operation Council in 1991, and with the MERCOSUR in 1999. Both these negotiations had been suspended earlier but are reported to have been resumed. In 2007, the EU undertook a new initiative for interregional economic integration arrangements and entered into negotiations with the ASEAN, Canada, India, Ukraine, South Korea, Central America and the Andean Community. As noted earlier, out of these, the negotiations with Korea were concluded and the FTA agreement

has also entered into force. More recently on March 30, 2012, an agreement has been initialled with Ukraine. When little concrete progress was made with the ASEAN as a group, the EU decided in 2010 to enter into FTA negotiations with two member states of the ASEAN, namely, Malaysia and Singapore.
Negotiations have been concluded in 2011 with Central America for an Association Agreement with a trade pillar, which is expected to enter into force later in 2012.

Negotiations between the Andean Community and the EU were suspended in 2008. However, the EU and three Andean countries, Colombia, Peru and Ecuador, resumed negotiations in 2009 but agreement could be reached only with Colombia and Peru in 2010. The agreement is likely to enter into force in 2012.

Main difficulties in ongoing negotiations

ACP countries

The negotiations for the EPAs have not been making progress among African countries, which are finding it hard to reconcile to reciprocal preferential agreements after many decades of non-reciprocal arrangements. The hesitation is due to the assessment of revenue loss as a result of elimination of import duty and is also linked to the realisation that African countries are at a very early stage of industrial development. There are concerns that the EPAs would make economic integration within Africa difficult. The assessment is that the EPAs can move forward only if they are tied to substantial aid flows.

MERCOSUR

Within the EU, there is unwillingness to grant unrestricted market access for agricultural products as this would necessitate a rapid dismantling of the Common Agricultural Policy. On the other hand, the MERCOSUR countries wish to retain the restrictions on non-agricultural products so as to make it feasible for them to retain their industrial policy.

Gulf Co-operation Council (GCC)

The trade talks were suspended by the GCC in reaction to the insistence by the EU to include in the agreement clauses relating to non-trade issues such as terrorism, nuclear non-proliferation, human rights etc. Subsequently, export duties became the most important issue as Saudi Arabia wanted to retain the right to impose these duties on petrochemical products, while the EU wanted them to commit to eliminate export duties.

ASEAN

The main difficulty in making progress was the inability of ASEAN countries to agree to a common position. Political impediments also stood in the way, as there was unwillingness on the part of the EU to negotiate with Myanmar because of their human rights record. Since the ASEAN countries have separate trade regimes vis-à-vis third countries, the EU found it easier to hold FTA talks with individual countries, Malaysia and Singapore to start with.

Singapore

The negotiations between the EU and Singapore have made rapid progress within two years because of the liberal external trade regime existing in Singapore.

Malaysia

On the goods side, import duties in Malaysia on motor vehicles and alcoholic beverages and the issue of export duties have figured prominently in the talks. In the area of services, the EU request include financial services, telecom, transport and temporary movement of natural persons as well as disciplines in domestic regulations and licensing procedures. On intellectual property rights, the main points of divergence appear to be with regard to data protection and geographical indications. The EU has sought commitments on core labour standards and the level of environmental protection but these have not provoked strong reaction from the Malaysian side.

India

On the goods side, the EU has demanded substantial tariff liberalisation in respect of its major area of export interest, namely, cars, particularly luxury cars, and alcoholic beverages comprising both wines and spirits. In intellectual property rights, its main demands are the request for data exclusivity in respect of pharmaceuticals and agricultural chemicals and the extension of higher levels of protection of geographical indications (GIs) to agricultural products other than wines and spirits. In the area of services, the EU requests for higher foreign equity cover banking, insurance, and multi-brand retail. In addition, the EU has demanded market access by way of commitments in air transport services for airport operations and ground handling, in accountancy and bookkeeping services and in legal services. It has also shown interest in obtaining commitments to participate in environmental services in the country.

Most of the major demands of the EU as listed above are highly sensitive for India and are likely to be obstacles to an FTA agreement. The only exception is the demand in respect of extension of higher levels of protection of GIs to agricultural products, in which India and the EU are on the same side in the WTO negotiations. As regards the import tariffs on cars and alcoholic beverages, there could be some possibility of reduction of tariffs, but the height of the Indian tariffs (60 per cent for cars and 150 per cent for wines and spirits) presents a big problem. Preference against high MFN tariffs is likely to result in unacceptable levels of distortion. In the services sector, there are big political problems in allowing FDI in multi-brand retail in particular, which is an important request from the EU side. The central government appears willing to raise the cap on FDI in insurance but it requires an amendment in legislation, which might be difficult to accomplish for a weak coalition government.

There are some other difficult areas raised by the EU. The first relates to government procurement, in which India has not undertaken any international commitment so far. There is apparent unwillingness on the part of the government to give up the possibility of using government procurement as an instrument of aiding domestic industry. The other area of political difficulty is the apparent insistence of the EU to include provisions relating to labour and environmental issues. Going by the relevant provision in the recent agreement for the EU-Korea FTA, the demand is for India to agree to give effect to the international conventions on core labour standards and to make continued efforts to ratify all ILO conventions that go beyond core labour standards. The EU-Korea FTA agreement binds both sides to uphold and effectively implement all multilateral environment agreements to which they are a party. What would be the most difficult for India is a provision in the EU-Korea FTA agreement, which mandates the two sides to set up advisory groups to monitor the implementation of workers rights and environmental standards.

The EU too is likely to find it difficult to agree to the main demand from India, which is for the liberalisation of the mode of supply pertaining to the movement of natural persons. A monograph recently written by Suman Modwell and Surendra Singh (The EU-India FTA Negotiations: Leading to an Agreement or Disagreement) and published by the Observer Research Foundation (www.orfoline.org), has mentioned that the EU has proposed a ceiling of 40,000 for commercial service suppliers (CSS) and independent professionals (IP). The service sub-sectors to which this facility would apply and the qualifications required for allowing entry are matters still under discussion. In this connection, India has sought additionally that the CSS and IP from India should be granted interstate mobility and a fast track application procedure should be introduced for workers in information and communications technology, enabling a single permit to be issued, combining the work permit, visa and residence permit. Agreeing to this request would not be easy for the EU, as it would inter alia require changes in the Schengen visa rules. The political difficulties should also not be underestimated, as immigration has been an election issue in most of the large EU member states.

Conclusions

The initial impetus for integration within Europe came from the desire to end economic conflicts, which had led to two destructive world wars in the first half of the twentieth century. The subsequent success of the European Union in accomplishing deep economic integration among a rapidly widening group of European countries must be attributed to geo-political dynamics.

Geo-political factors were also important for the other European countries that have agreed to a customs union or free trade area with the EU and the same influences worked also for the free trade areas agreements between the EU and the countries south of the Mediterranean.

Apart from the geo-political factors, the EU experience with economic integration does not reveal any pattern. Concluding an agreement with a comparatively advanced country like Korea has not been a problem. Countries in Latin America, which already have an FTA with the USA, have also not found it too difficult to enter into FTA agreements with the EU. On the other hand, conflict of interest in agriculture because of high levels of domestic support prevalent in the EU has stalled progress in the talks on regional integration with the MERCOSUR countries. With the African countries, dependence on customs duty for revenue and the ongoing programmes of regional integration are important inhibiting factors. With the Gulf countries, export duties on natural resource based products are coming in the way. A more diversified economy like India presents multiple problems as described above. Considering the nature of these problems, it cannot be expected that the European Union-India Broad-based Trade and Investment Agreement (BTIA) would come any time soon. A fractious Parliament in India is likely to make the task doubly difficult.

Developments in India's Trade and Foreign Investment Policies (Jan-March, 2012)

Shravani Prakash

The first quarter of 2012 saw noteworthy developments in India's trade and foreign investment policies, most of which were introduced under the union budget proposals for 2012-13. Most of the policy changes are in conformity with the trend of ongoing liberalisation, but there have been a few instances of policy reversal as well. Changes in import tariffs were aimed largely at stimulating investment and manufacturing growth in sectors that have been under stress. The basic customs duty has been reduced or fully exempted on imports of machinery and equipment as well as raw materials used by sectors such as textiles, transport, power generation, steel, life-saving drugs, low-cost medical devices etc. However, basic customs duty was also raised in a few cases such as luxury cars (for raising revenue), on primary gold (for dampening imports to alleviate the current account deficit), on bicycles and bicycle parts and on non-alloy steel (for overtly protectionist reasons). Apart from tariff changes, the budget proposals also indicate that the existing policy of canalisation through state trading enterprises of import of aviation turbine fuel would be relaxed in order to allow airlines to effect imports for their own use. Revisions in the foreign trade policy are expected to be announced in April but, in the meantime, ad hoc steps have been announced to restrict exports of cotton and increase the export quota for sugar.

On the investment front, the union government has maintained its resolve to liberalise the foreign direct investment (FDI) regime despite political opposition. The ceiling of 51 per cent FDI in single brand retail trade was raised in January 2012, subject to the requirement of 30 per cent sourcing of goods from locally established, small-scale industries. The finance minister also emphasised in his budget speech that the government is striving to achieve political consensus on permitting FDI in multi-brand retail. Another proposal to allow foreign airlines to invest up to 49 per cent seems to have made some headway as it has received significant support among ministries. The implementation of Advance Pricing Agreement (APA) by introducing it in the Finance Bill, 2012 will facilitate greatly the expansion of cross-border production chains into India. On the flipside, the budget also proposed certain tax related proposals that could discourage global investments into India, including a proposed "retrospective" amendment of the I-T Act to tax offshore acquisition deals and the introduction a statutory General Anti-Avoidance Rule (GAAR). Both these proposals, if implemented, would create uncertainties and erode the confidence of investors, thereby proving injurious to India's image as an attractive investment destination.

Trade Policy Developments

Tariff Reduction - According to the Union Budget 2012-13, no change has been proposed in the peak rate of customs duty of 10 per cent on non-agricultural goods for the current fiscal year. Basic customs duty (BCD) has been reduced for a number of product lines, especially of machinery and equipment and of intermediate goods and raw materials used by different sectors. These changes have been listed below.

Reduction / Exemption in Basic Customs Duty (BCD) on Machinery and Equipment

- *Agriculture:* BCD was reduced for certain agricultural equipment, including a reduction from 7.5 to 2.5 per cent on sugarcane planters, root or tuber crop harvesting machines and rotary tillers and weeders; and from 7.5 to 5 per cent on specified coffee plantation and processing machinery. Imports of equipment for initial setting up or substantial expansion of fertiliser projects has been fully exempted from BCD (5 per cent) for three years.

- *Mining:* BCD on machinery and instruments for surveying and prospecting was reduced from 10 or 7.5 per cent to 2.5 per cent. Coal mining projects have been fully exempted from BCD.

- *Railways:* BCD has been reduced from 10 to 7.5 per cent on equipment required for the implementation of two major projects to be undertaken by the Indian Railways over the next 5 years (installation of train protection and warning system, and up-gradation of track structure for high-speed trains).

- *Roads:* Full exemption from import duty, which has already been provided on specified equipment imported for road construction by contractors of the Ministry of Road Transport and Highways, the National Highways Authority of India (NHAI) and state governments, has now been extended to contracts awarded by metropolitan development authorities. Tunnel boring machines and parts for their assembly, which are covered by this exemption, can now be imported duty free without the end-use condition.

- *Civil Aviation:* Acknowledging India's potential for establishing itself as a hub for third-party maintenance, repair and overhaul (MRO) of civilian aircraft, parts of aircraft and testing equipment imported for this purpose have been fully exempted from BCD. New and retreaded aircraft tyres have been fully exempted from BCD.

- *Iron ore:* BCD on plant and machinery imported for setting up or substantial expansion of iron ore pellet plants or iron ore beneficiation plants has been reduced from 7.5 to 2.5 per cent.

- *Textiles:* As a measure aimed at modernisation of the textile industry, new automatic shuttle-less looms and automatic silk reeling and processing machinery have been fully exempted from BCD. Basic duty on second-hand machinery has been increased from five to 7.5 per cent.

Duty concessions on Intermediate Inputs and Raw materials

- *Power generation:* Full exemption from BCD and a concessional countervailing duty (CVD) of 1 per cent has been provided for import of steam coal for two years, to provide relief to domestic producers of thermal power from rising prices of coal. Full exemption from basic duty has also been provided to other fuels for power generation, including natural gas and liquefied natural gas, uranium concentrate and sintered uranium dioxide.

- *Steel:* BCD has been reduced from 7.5 to 5 per cent on coating material for manufacture of electrical steel and from 2.5 or 7.5 per cent to nil on nickel ore and concentrate and nickel oxide/ hydroxide.

- *Textiles:* BCD on wool waste and wool tops has been reduced from 15 to 5 per cent, and on Titanium dioxide from 10 to 7.5 per cent. Aramid yarn and fabric used for the manufacture of bullet proof helmets has been fully exempted from BCD

- *Medical Equipment:* BCD on specified parts, components and raw materials for the manufacture of some disposables and instruments has been reduced to from 7.5 to 2.5 per cent with concessional CVD of 6 per cent. Full exemption from BCD and CVD has been extended on some raw materials used to manufacture coronary stents and heart valves.

- *Electronics:* Full exemption from BCD (10 per cent) has been extended to LCD and LED TV panels, and parts of memory cards for mobile phones.

Duty Concessions to serve special needs

- *Agriculture:* Concessional BCD of 5 per cent has been extended to green house and protected cultivation for horticulture and floriculture. BCD on some water soluble fertilisers and liquid fertilisers, other than urea, was reduced from 7.5 to 5 per cent and from 5 to 2.5 per cent

- *Environment:* Plant and equipment required for the initial setting up of solar thermal projects have been fully exempt from special CVD. Lithium ion batteries imported for the manufacture of battery packs for supply to electric or hybrid vehicle manufacturers are now fully exempt from BCD and enjoy a concessional CVD of 6 per cent.

- *Health and Nutrition:* Six specified life-saving drugs/vaccines used for the treatment or prevention of ailments such as HIV-AIDS, renal cancer, etc., have been extended concessional BCD of 5 per cent with full exemption from CVD. BCD on soya protein concentrate and isolated soya protein has been cut from 30 or 15 per cent to 10 per cent to address protein deficiency among women and children, and a concessional BCD of 2.5 per cent (from 5 per cent) has been provided on import of iodine to prevent iodine deficiency. BCD on probiotics has been cut from 10 to 5 per cent. It must be noted that since isolated soya protein, soya protein concentrates, iodine and probiotics are inputs for the food processing industry, any reduction in duty on these would also provide a boost to the food processing industry.

Tariff increases – there was also an increase in tariffs on some products, including the following.

- *Cars:* BCD has been raised from 60 to 75 per cent on completely built units (CBUs) of large cars/MUVs/SUVs having engine capacity above a prescribed threshold and whose value exceeds US$40,000. Given that automobiles are one of the few products in which the BCD is not only higher but much higher than the norm of 10 per cent for non-agricultural products in India, a further increase cannot, in principle, be welcome. However, it must be noted that luxury cars are not produced in India and the increase in duty is mainly an attempt at additional resource mobilisation.

- *Bicycles:* BCD on bicycles has been increased from 10 to 30 per cent and on bicycle parts from 10 to 20 per cent. In justification, the finance minister said in his budget speech that the increase was being proposed as a measure of support to a highly labour intensive industry. It is true that the domestic industry has been in difficulties because of a surge in imports from China in recent years, but it can be justified only if the increase is temporary to enable Indian industry to take steps to become competitive. It would have been ideal if the increase had been introduced as a safeguard measure and then progressively scaled down in future years. Even if the increase is not the result of safeguard action, the duty should still be considered for reduction in steps after two or three years in order to protect the interests of consumers who use this environment friendly mode of transport.

- *Steel:* BCD on non-alloy, flat-rolled steel increased from five to 7.5 per cent. This increase is out of tune with other measures taken to reduce duties on inputs for manufacturing industry. The Indian steel industry is known to be in a healthy state and there is little justification for a measure that would augment their profits, to the detriment of the interests of downstream industries.

- *Gold:* BCD on standard gold bars, gold coins of purity exceeding 99.5 per cent and platinum has been increased from two to four per cent and on non-standard gold from 5 per cent to 10 per cent. Prima facie, the increase is justified as a measure to curb imports of gold, which are exacerbating the worsening current account deficit and that too for an unproductive asset. However, it is necessary also to consider the fact that it is easy to smuggle a low volume commodity like gold and evade customs duty altogether. If the BCD is increased too much, the opportunity cost of compliance could rise and imports could go underground, completely defeating the purpose of raising the duty.

Direct import of aviation turbine fuel permitted - In the light of the high operating costs facing the airline industry, the government has permitted direct import of aviation turbine fuel (ATF) by Indian carriers as actual users and on actual use basis. This is a measure towards reducing the cost of ATF, which is a major contributor to high operating costs. Until now, import of ATF (ITC (HS) Code 27101920) was permitted only by certain state trading enterprises (STEs) of the government. Now, interested Indian carriers can import ATF directly without going through the STE route. While this is a much-needed reform since it would prevent profit making by state trading monopolies, the imposition of actual user condition could be counterproductive. The carriers would have to make investment in storage facilities and for that, a number of them may have to bulk their requirements for imports. After all, aviation turbine fuel can be used only for aircraft and there is no harm in allowing carriers to trade among themselves rather than making the operations rigid by imposing actual user conditions.

Anti-dumping and Safeguard Measures - India continues to be the leading initiator of anti-dumping measures, although the number of new anti-dumping investigations declined significantly to 19 in 2011 compared to 41 in 2010, 31 in 2009 and 55 in 2008. Further, no new anti-dumping investigations have been initiated by India in the 1st quarter of 2012. There have also been no new safeguard investigations initiated as yet in 2012, against 2 in 2011, 0 in 2010 and 10 in 2009.

Imposition of Export duty - For regulating exports, the favourite modality of the Indian government is to impose quantitative controls and export duties are an exception, not the norm. However, for some mineral products, export duties have begun to be used in recent years. Last year, the export duty on iron ore was unified at an enhanced rate of 20 per cent. In the current year, it is the turn of chromium ore. export duty on which has been enhanced from Rs 3000 per tonne to 30 per cent ad valorem.

Export controls on cotton and sugar - A notification issued by DGFT, MoC on March 5, 2012, announced immediate prohibition of cotton exports [ITC (HS) Codes 5201 & 5203] from India, including consignments for which registration certificates had been issued already. Subsequently, the consignments for which export registration certificates had already been issued before March 5 ban were allowed to be exported.
According to a decision of the Empowered Group of Ministers in March 2012, a third tranche of one million tonnes of sugar exports was allowed, bringing the total exports to three million tonnes in the 2011-12 marketing year (October-September). The government had earlier allowed two million tonnes of exports in the marketing year in two equal tranches as the country's sugar output was estimated to exceed domestic consumption by about four million tonnes.

Abrupt decisions to allow or disallow exports of agricultural products and raw materials disrupt international trade and exacerbate the volatility in international prices. In the current situation of high international food prices, there has been a demand from food importing countries to prohibit export restrictions on food products. Even in the case of an agricultural raw material such cotton, there were howls of protest from importing countries when India prohibited exports on March 5, 2012. While for a country like India with a large population and fluctuating levels of domestic production of food products, a demand for a ban on export controls will not be acceptable; there would seem to be case for avoiding ad hoc decisions in order to dampen volatility in prices. A policy replacing quotas with export duty needs to be given consideration.

Changes in Foreign Investment Regulations

Foreign Direct Investment - The permitted FDI limit in single brand retail trading was increased from 51 to 100 per cent under the government approval route, subject to specified conditions (Press note 1 of 2012). The proposals involving FDI beyond 51 per cent, however, would have to meet the condition of mandatory sourcing of at least 30 per cent of the value of products sold from Indian 'small industries (industries with a total investment in plant and machinery not exceeding $1 million)/village and cottage industries, artisans and craftsmen'. Apart from the fact that the consistency of mandatory sourcing requirement with national treatment obligations of the WTO Agreement is questionable, there are practical aspects as well that warrant a reconsideration of the condition by the government. It is understood that major single brand retailers have made the point that they cannot make investments in plant and machinery in locally established industries to produce goods that meet their standards without breaching the ceiling Rs.5 crore stipulated for small-scale industries.

On the issue of moving forward the stalled decision in respect of allowing FDI in multi-brand retail trade up to 51 per cent, the budget noted the ongoing efforts to arrive at a broad based consensus in consultation with the state governments. Further, the crisis confronting Kingfisher Airlines seems to have led the Ministry of Industry to hurry up in considering the proposal for allowing investment by foreign airlines up to 49 per cent.

Advance Pricing Agreement (APA) - Cross-border production networks have had a dominant influence in promoting investment in manufacturing and stimulating trade among entities of the same group globally. This is particularly true in Asia. However, except in the automobile sector, India has not benefited much from cross-border production chains. The provision for an APA has been introduced in the finance bill, 2012, with a view to facilitating the expansion of cross-border production networks into India. APAs are expected to bring down tax litigation and provide tax certainty to foreign investors. According to the Finance Bill, 2012, "APA is an agreement between a taxpayer and a taxing authority on an appropriate transfer pricing methodology for a set of transactions over a fixed period of time in future".

Amendment of Income Tax Act regarding income deemed to accrue or arise in India - Under the Memorandum of the Finance Bill 2012, the government has proposed to amend Sections 9 and 195 of the Income Tax Act. According to the amendment, all persons, whether resident or non-residents, having business connection in India, will be required to deduct tax at source and pay it to the government, 'even if the transaction is executed on a foreign soil'. Further, this amendment will come into effect retrospectively from April 1, 1962, and will apply to all past transactions concerning assets in India.

This amendment is in direct response to a tax dispute case involving the Vodafone Group with the Indian tax authorities, in relation to the acquisition by Vodafone (company resident for tax purposes in the Netherlands) of the entire share capital of CGP Investments (a company resident for tax purposes in the Cayman Islands whose stated aim was acquisition of 67% controlling interest in Hutchison Essar Limited (company resident for tax purposes in India). The Indian tax authorities sought to tax the capital gains arising from the sale of the share capital of CGP on the ground that CGP, whilst not a tax resident in India, holds the underlying Indian assets. Vodafone disputed the decision, saying that neither company is liable to pay the tax as both companies are located outside India and the deal happened outside India. In January 2012, the Supreme Court decided the case in favour of Vodafone. But, if passed, the proposed retrospective amendment of the law to tax deals involving overseas firms with interests in India will circumvent the Supreme Court order and Vodafone will have to pay tax despite winning the case in the Supreme Court.

The retrospective amendment will not only apply to Vodafone but all similar past transactions, thereby creating difficulties for foreign investors. The change with retrospective effect would create a huge amount of uncertainty on India's fiscal and regulatory policies and damage the country's reputation as a destination for foreign direct investment, which India cannot afford. The government must therefore reconsider or revise this move to ensure that only abusive transactions are penalised, and make it a prospective amendment impacting future transactions.

Introduction of General Anti-Avoidance Rule (GAAR) - The budget proposed the introduction of the general anti-avoidance rules (GAAR), with the aim of curbing tax avoidance. GAAR, as envisaged under the Finance Bill 2012, is a broad set of provisions that seeks to tax an 'impermissible avoidance arrangement' whose main purpose is to obtain a tax benefit and which also satisfies at least one of four specified tests. This would mean that in case a tax avoidance arrangement is found to be impermissible, foreign institutional investors (FIIs) will have to pay short-term capital gains tax. Although no one can defend blatant cases of tax avoidance, the wide power imparted to tax officers under GAAR may result in major harassment of taxpayers, even of those who might be genuinely trying to do tax planning. This could lead to large-scale misuse (resulting in large-scale litigation) unless clear rules are framed or a detailed explanatory circular is issued.

GAAR would also have a treaty override provision, implying that in case of a clash, it would take priority over bilateral tax agreements with other governments. For instance, FIIs that until now had been investing in India through countries like Mauritius (which have a tax treaty with India and where FIIs do not have to pay capital gains tax), will now be taxed on capital gains despite coming through Mauritius. This might lead them to pull out of the Indian debt markets.

Has the global food crisis dampened prospects of resuscitating WTO trade talks?

Anwarul Hoda

The WTO trade talks have been have been at death's door for more than a year. There was a ray of hope that after the year-end presidential elections in the USA, the patient might be revived. But the prolonged lull is taking its toll. The emergence of China as an industrial super power has already provoked the USA to make seemingly impossible demands for elimination of industrial tariffs not only from China but from Brazil and India as well. In services, things seem to be going awry because of the US initiative, supported by 15 other WTO members, to go plurilateral. And in agriculture, the global food crisis of 2007-08, followed by another spike in food prices in 2011, have led to a reassessment and fresh thinking in some quarters on the need to strengthen some aspects in the Agreement on Agriculture and the draft modalities. Unless these issues are handled carefully, they too could endanger the talks whenever they are resumed.

In November 2011, Olivier de Schutter, the United Nations Special Rapporteur on the Right to Food, has submitted a far-reaching briefing note arguing that the design of the WTO Agreement on Agriculture and of the draft modalities for agriculture proposed in the Doha Round needs rethinking. The following excerpt from his report summarises the argument put forward by him:

"… the present food security challenge is taking place during a period of profound structural transformation of the global food economy. The intertwining of food, energy and finance, changing global supply and demand dynamics, and greater consolidation in the agri-food sector, are key drivers of today's high food prices. These conditions differ considerably from the conditions in the 1980s and 1990s when the current international trade regime for agriculture was created. Overproduction and declining prices dominated the agenda when States embarked on establishing a new international trade regime for agriculture during the Uruguay round of negotiations of the General Agreement on Tariffs and Trade (GATT). As a result, much of the existing WTO agricultural trade architecture, ranging from border protection, anti-dumping, and support for producers, are anchored within a framework primarily concerned with managing States' policy response to declining agricultural prices.

Today, the challenge facing the international community is to foster resilient national food systems in food insecure developing countries. There is a global consensus that achieving these goals will require significantly increasing the levels of national and international support for small-scale farmers and sustainable and equitable rural development. This may well include creating new types of food security trade-related measures and revising existing trade rules."

It is difficult to find fault with the basic position taken by the Rapporteur. There is no doubt that subsidised over production of temperate zone agricultural products and the consequent depression of international prices of these products were the main problems that the WTO Agreement on Agriculture sought to address. Although a separate Ministerial Declaration at Marrakesh dealt with the possible problems that might arise for the net food importing countries as a result of scaling down of subsidies, a steep rise in food prices was not considered a real world problem. Today, a convergence of factors has led to high food prices that have affected the poorer developing countries and there is indeed a need to seek ways of moderating the rise in prices, nationally and internationally.

The following are some of the important remedial proposals made by the Special Rapporteur:

1. Exclude defining the establishment and defining of food reserves as trade distorting support
2. Ensure that marketing boards and supply management schemes are not prohibited
3. Guarantee the possibility of developing countries insulating their markets from volatile prices in international markets
4. Ensure that developing countries maintain the possibility to regulate imports in order to make marketing boards and supply management schemes fully functional
5. Allow developing countries to introduce new tariff rate quotas on key tariff lines
6. Limit the developing countries excessive reliance on international trade in the pursuit of food security
7. Ensurestate support, particularly for poor small-scale farmers and the production of staple foods

It would be necessary to consider some of these proposals carefully. In particular, the ambiguities in the existing texts relating to national buffer stocking and domestic food aid would need to be eliminated. Elaboration of Article 6.2 of the Agreement on Agriculture concerning input subsidies for low-income and resource poor farmers and generally available investment subsidies is needed to remove policy constraints in assisting small landholders. It is important however, not to suggest changes that are repugnant to the design of the Agreement, such as reintroducing quantitative restrictions, whether by means of licensing or through the operation of marketing boards. While readjustments in the rules are undoubtedly necessary, it is important to ensure that the proposals in this regard are made cautiously and discreetly, so that they do not provide an excuse for scuttling the negotiations.

India's Special Economic Zones (SEZ) -- Policy Weaknesses Need Attention

Anwarul Hoda

SEZs in decline

IOne of the initiatives taken in the early days of UPA-I was the establishment of a new framework for Special Economic Zones (SEZs), with the enactment of the SEZ Act, 2005, and the SEZ Rules, 2006. In terms of investment attracted, employment created and exports generated, it has been a great success in the first five years. According to a discussion paper circulated by Udyog Bhawan, up to October 31, 2011, 583 proposals for establishing SEZs had been approved, of which 381 had been notified and 143 had started exporting. The SEZs have contributed significantly to the rapid growth in India's exports in recent years and their share in total exports has risen from six per cent in 2006-07 to 28 per cent in 2010-11.

However, over the last year or so, the momentum for expansion of SEZs' activity seems to be on a decline. There has been a sizeable reduction in the number of proposals for setting up SEZs, withdrawal of a significant number of proposals, an increase in the number of requests for denotification of SEZs and a noticeable reduction in interest in setting up units in SEZs. The prospects of increase in economic activity within existing SEZs and for the establishment of new SEZs in the country seem to have shrunk.

The immediate causes for this are the changes in taxation laws in the 2011-12 budget and the build up of public opposition during the 2011 state elections against acquisition of agricultural land for industrial and infrastructural purposes. There are longer-term problems as well. The 143 SEZs are not evenly spread across states and a disproportionate number is concentrated in the five states of Andhra Pradesh, Gujarat, Karnataka, Maharashtra and Tamil Nadu. There is a similar imbalance in the distribution of product groups/services across the SEZs. As many as 80 relate to information technology (IT) services, information technology enabled services (ITeS) and semi-conductors and other information technology hardware. Out of the exports from SEZs, refined petroleum accounts for 34 per cent, IT/ITES including hardware for 27 per cent and gems and jewellery for 15 per cent. Manufactures constitute a small proportion of information technology exports, and here too the domestic value added is very little. Low value addition is also the bane in respect of exports of petroleum products and gems and jewellery. In other words, there is an absence of substantial manufacturing activity in SEZs.

To forestall the impending decline of SEZ activity in the country, it is necessary to identify the main reasons and address them. In this article, we make an attempt to analyse the critical problems and outline ways to deal with them.

Infrastructure support

In the current era of globalisation, manufacturing involves imports and exports of parts and components as manufacturers look for the cheapest sources for intermediate goods. Large volumes of inputs have to flow in and out of industrial units, whether in the SEZs or the domestic tariff area (DTA). Indian units can be internationally competitive only if logistics efficiency in the country is on par with that obtaining in other countries. Not only should our roads, rail, ports and airports be world class, but the processes, applying to freight transport by road or rail within the country and those applying to goods being imported into or exported out of the country, should not be more cumbersome than in other countries. There should be fast movement of traffic on the roads and vehicles carrying goods should not be stuck at inter-state borders or elsewhere for checking by commercial taxes and transport officials. Congestion in the main railway freight corridors should be eliminated to facilitate reliable service. Turnaround time for ships should be minimised at ports by increasing their capacity to handle incoming and outgoing cargo and modernising them. Organised manufacturing is not growing because the infrastructural facilities in the country are not world class, even though some amount of progress has been made in recent years. Investors, whether foreign or domestic, have to see an advantage in setting up a manufacturing establishment in India vis-à-vis other locations in the region. This is the main constraint hindering the establishment of manufacturing units, whether in SEZs or DTA. The SEZs have to be connected with ports and airports with world-class roads and rail and ports and airports too have to be world class, with customs authorities adopting international best practices in trade facilitation.

Deficiencies in the availability and quality of power are an equally important constraint, particularly for medium and small enterprises, which cannot set up efficient captive power units. The SEZs need other utility services as well, including water and drainage connections.

A substantial programme for building infrastructure has already been taken up by the central government but progress is stymied by the lack of co-ordination among ministries. A number of projects in ports have been bid out but award of tenders is held up for want of security clearance. Similarly, several road projects are delayed while they await environment clearance, shifting of utilities and land acquisition. There has been impressive addition to generating capacity for power during the Eleventh Five Year Plan, but shortfalls in the production of coal have prevented the flow of benefits from this. Both the central and state governments have to redouble their efforts to overcome the many obstacles that are delaying progress in infrastructure projects.

Stable taxation benefits

One of the benefits given in the Income Tax Act through an amendment in 2005 is that a deduction of 100 per cent is allowed in respect of profits derived by a unit located in a SEZ from exports of goods and services for the first five years and of 50 per cent for the next five years. Thereafter, the exemption applies in respect of fifty per cent of the ploughed back export profits. Developers have been allowed the exemption of 100 per cent of profits for 10 years. The Income Tax Act also allowed exemption from minimum alternate tax (MAT) on book profits in respect of any business carried out by an entrepreneur or developer in a unit or SEZ. The SEZ developers were also exempted from payment of the dividend distribution tax (DDT). With effect from 2011-12 the exemption of SEZ units and developers from MAT has been withdrawn. Similarly, the exemption of developers from DDT has been terminated.

Predictability in taxation policies is a sine qua non for making the environment conducive for investment, whether foreign or domestic. The decision to change the policy within five years and withdraw exemption from MAT and DDT is clearly an erroneous decision. The change has dealt a blow to the SEZs and slowed down the momentum of their growth. As it is, the state of our physical infrastructure is an impediment and if unpredictability in taxation policy is added, the situation becomes even worse. What makes the policy change even more unacceptable is that it has been made effective retrospectively and it applies not only to SEZ units that get established henceforward but also to units that have already come on stream.

The above having been said, it must be acknowledged that the introduction of export incentives for SEZ units was a policy reversal after the taxation changes introduced pursuant to 1991-92 economic reforms. The erstwhile benefit of exemption of profits from income tax granted under Sec80HHC of the IT Act had been phased out only in 2004-05. The policy for reintroducing income tax benefits for SEZ units was clearly retrogressive and was inequitable as well because it created a non-level playing field between exporting units in the SEZs vis-à-vis exporting units in the DTA, which did not get the benefit. In the search for solutions for the current mess, we have to bear this in mind.

The criticism made above of policy change made initially in 2006 in favour of SEZ units does not apply to the introduction of incentives in favour of developers. Because of the large risks involved and long gestation of infrastructure projects, the decision to exempt them from income tax, MAT and DDT was fully justified right from the outset. It is the decision to reverse the exemption that is contestable on rational considerations.

Considering all aspects, the best course for government is to restore all benefits to developers at the earliest. As for the benefits to the units within SEZs, the best course would be to restore the benefits to all units, which had already got established or were in the process of getting established at the time of the budget proposals for the year 2011-12.

Rational land related policies

Over the last one year or so, government policy about making agricultural land available for industrial purposes has become restrictive and a number of conditions have been imposed before recourse can be had to compulsory land acquisition procedures. Some of these are retrograde, as they would impede rapid industrialisation of the country, which is imperative if employment is to be provided in new urban centres to people moving out of rural areas. Of course, full compensation must be paid to land-holders and the maximum must be done to provide them with employment, but not to allow the acquisition or conversion of agricultural land for industrial purposes is bad policy, unsuited for our country. An acre of land can provide employment to three persons in agriculture but has the potential to provide industrial employment to three hundred. One of the main reasons for the reduction of interest in setting up SEZs is difficulty in the availability of land for the purpose and its escalating cost. It is crucial that the policy of government for facilitating the acquisition of land for industrial purposes be progressively liberalised.

Because of the difficulty in making land available for industrial purposes, it is necessary to relax the land related policy in respect of SEZs. The minimum area requirement must be reduced and land authorities must grant additional FSI/FAR. Broad banding should be permitted in sector specific SEZs, covering vertical integration and allied service activities. Contiguity norms should be applied flexibly and developers should be freed from the obligation to build costly infrastructure.

The current policy allows SEZ developers to build social infrastructure, housing, schools, hospitals etc. in non-processing zones to serve SEZ needs, but access to clients outside SEZs is not permitted, in view of the fiscal benefits granted. This has resulted in a situation in which there is low capacity utilisation of the facilities and sometimes, the support infrastructure does not get developed at all because of a sub-optimal scale of operation.

The development of utilities such as power/water/effluent treatment facilities and housing and social infrastructure in the non-processing areas of SEZs should be considered important contributions to the social and economic development of the country. It is necessary to facilitate the process of development of urban facilities attached to SEZs by allowing access to them to people outside the SEZs. Where developers are willing to surrender duty concessions fully, they should be given the flexibility of serving the DTA clientele without any limit. In order to facilitate this, simple norms should be laid down to determine applicable duties.

SEZs in backward regions (to be appropriately defined) should be given the freedom to serve non-SEZ clientele without any limit. This would be an incentive for developers to move outside the industrial and urban agglomerations. There should be a reasonable area restriction on the proportion of the overall size of the non-processing zone that can be used for the social infrastructure. Further, the requirement should be imposed that the SEZ needs would be met fully before DTA clients are serviced.

Allowing access to domestic tariff area

An important argument made on behalf of SEZ units is that suppliers from countries that are our free trade area (FTA) partners get duty free access to our DTA but they do not get such access. While the SEZ units have a case, we have also to bear in mind the need to avoid giving an unfair advantage to SEZ units over units in the DTA.

Bearing in mind the interests of all concerned, the balance would seem to lie in giving to the SEZ units unrestricted access to the DTA, not on the payment of the full import duty on the finished product, as is the requirement now, but on the payment of taxes on imported inputs that the DTA units have to pay.

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