Trade and Investment Flows Between India and the European Union

Issues and Challenges

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Dipti Ranjan Mohapatra

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PREFACE

The historical linkage between India and erstwhile European Community started in 1962 when there were only six members in European Community. This historical linkage has increased manifold with expansion of EU size and its increasing importance in the global trade market. Meanwhile, European Union has become a strong economic integration of twenty eight mighty nations and India has gained economic importance in south Asia due to its strong market force. One fourth of India's total trade and foreign direct investments originates from EU. Thus, both India and EU are strategic trade partners. India offers a liberalized and free market economy with huge potential to test any new product or innovation for EU member nations. EU also requires strengthening its trade and investment prowess at a time when it is facing a dilemma of trade loss World –wide. India's reform process is still incomplete. India needs to learn many process and policies of liberalization. Starting from historical linkages to a dependable trade tie –up, there are many ups and down. There still exist many trade irritants in the business process between the two partners. The free trade dialogue between India and EU is still incomplete. In order further strengthen the business link between both trade partners, it is important to understand the genesis of their trade relation, its transition, composition, diversification and the future direction. The expectation are many more. However, the book; *Trade and Investment Flows between India and European Union* is a simple attempt to understand this process in a lucid platform and to further up the trade tie. This book will be very much interest to serious researcher and students of European studies.

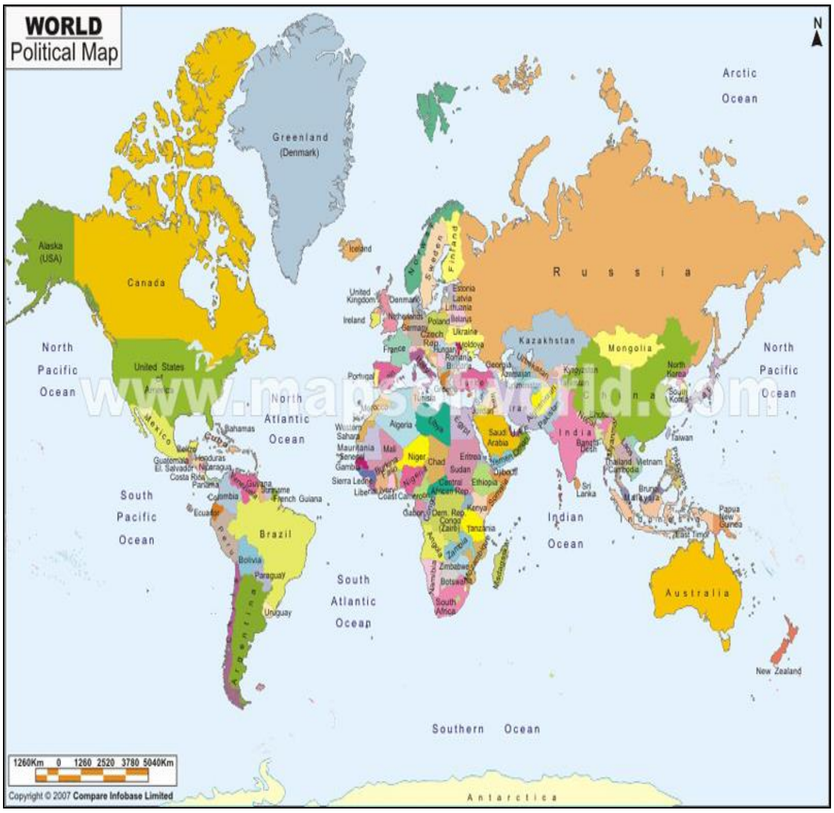

Fig. 1.1: World Map (Political)

Source: mapsworld.com

Chapter-1

India-EU: Economic Profile

1.0 Introduction:

This book presents an in-depth study of India-European Union (EU) economic relations, mutual trade and investment potential. It identifies the most promising sectors where trade and investment linkages could be further strengthened.

The economic relations of India and European Community (EC) started in 1962 when EC was only a group of six countries and was at the nascent stage of its economic development. However, the contemporary India-EC economic tie up have increased manifold; when the EC has come up as a potential trading group of twenty-eight nations and India is experiencing a liberalized market economy. India and EU hold historical economic linkages and their future path of joint economic progress needs further study. EU and India stand to gain from strengthening mutual economic relations for a number of reasons. India aims to complete its economic reform process, diversify its trade basket, and broaden the direction of its foreign trade. Similarly, the EU's shares of world trade and in worldwide investment have reduced in the past two decades and continue to decline. The shrinking of EU share in Indian trade is consistent with EU's losses in trade shares to the rest of the world as a feature of the long-term trend. According to WTO's World Trade Statistics (2001), the EU-15 lost on average, about 1 per cent share in world merchandise trade every year in the period 1990-2000. The loss would be greater with the inclusion of services trade. This situation is fraught with political consequences for EU member countries. These developments point to the need to view India-EU relations in a way, which termed "relatedness" rather than relationship. The EU is India's single largest trading partner in both exports and imports and this trend has been growing over the years. The European Economic Community, which started with six countries, has now become an enlarged Union of 28 states. An enlarged European Union appears with plenty of opportunities for India. It means more demand for Indian goods in the European market. Recent years have witnessed a shift in regional economic cooperation strategy from multilateral to regional and bilateral cooperation agreements (Asian Development Outlook, 2007 and World Trade Development Report, 2007). Here, the study of Indo-EU economic relation particularly the trade and investment is a reflection of the above-mentioned.

The structure of this book is as follows: First Chapter discusses Economic Profile of India and EU. Second Chapter reviews the Historical Trend of the India-EU Trade. Third Chapter discusses the Performance and Composition of India-EU Trade. Fourth Chapter analyses the Trade Barriers in India-EU Trade. There is analysis on the Foreign Direct Investment Flows between India-EU in Fifth Chapter. Chapter Six draws conclusions.

Before analyzing the trade between India- EU, it is necessary to highlight certain facts on the economy of both India and EU.

1.1 Economic Profile: India

India followed socialist-inspired policies from the 1950s until the 1980s. The economy was shackled by extensive regulation, protectionism, and public ownership, leading to slow growth. Since 1991, India moved towards a market-based system (Economic Survey, 2007). With average growth rate of 7% from 1997 to 2011, the economy is among the fastest growing in the World (CIA World Fact Book, 2014). However, the real GDP growth rate dipped down to 5.1% in 2012 and 3.1% in 2013. It has the world's second largest labour force, with 487.3 million people in 2013 (est.) (CIA World Fact Book, 2014). India - an emerging economy is one of the largest in terms with GDP Purchasing Power Parity of US$ 4.99 trillion in 2013 (est.) (CIA World Fact Book, 2014).

1.1.1 Agriculture, Industry and Services:

India has a self-sufficient agricultural sector except the oilseeds sector. In 2013 (est.) 17.4% of GDP comes from agriculture, 25.8% from Industry and 56.9% from services. (CIA World Fact Book, 2014). Agriculture sector produces 25 percent of national output and 15 percent of exports. The industrial base of India is self-reliant in all the core industries and in wide ranging engineering products. In spite of all this, the electronics and hardware sector in India is backward. Major agricultural products include rice, wheat, oilseed, cotton, jute, tea, sugarcane, lentils, onions, potatoes; dairy products, sheep, goats, poultry; fish. Major industries include textiles, chemicals, food processing, steel, transportation equipment, cement, mining, petroleum, machinery, software, pharmaceuticals. Major services include transport, storage & communication, trade, hotels and restaurants, banking & insurance, real estate, ownership of dwellings, legal and business services, public administration, and other services. Major exports of India include textile, gems and jewelry, software, engineering goods, chemicals, leather manufactures and petroleum products. Major imports include crude oil, machinery, gems, fertilizer, and chemicals. India's GDP (purchasing power parity) is USD 4.99 trillion in 2013 (est.) (CIA World Fact Book, 2014), which makes it the one of the largest economy in the World. India's GDP per capita (PPP) is 4000 USD (CIA World Fact Book, 2014). In the late 2000s, India's economic growth averaged 7.0 percent from 1997 to 2011 (CIA World Fact Book, 2014). 29.8% of people are living below the poverty line and unemployment rate is 8.8% in 2013 (est.) (CIA World Fact Book, 2014). Ongoing reforms are watched closely as India could become potentially important for the global economy. A Goldman Sachs report predicts that "from 2007 to 2020, India’s GDP per capita will quadruple," and that the Indian economy will surpass the United States by 2043. If it can fulfill its growth potential, it can become a leader for the world economy, and a key contributor to generating growth." Although the Indian economy has grown steadily over the last two decades; its growth has been uneven when comparing different economic and social groups, geographic regions, and rural and urban areas. (Inclusive Growth, World Bank, 2006) World Bank suggests that the most important priorities are public sector reform, infrastructure, agricultural and rural development, removal of labor regulations, reforms in lagging states. (India Undernourished Children, World Bank 2006).

Fig. 1.2: India Map (Political)

Source: Survey of India, 2014 (www.surveyofindia.gov.in) downloaded on 05.10.2014.

Table 1.1: GDP Growth Rates of India During 1988 to 2013 (in %)

Year	*1988*	*1989*	*1990*	*1991 (BOP Crisis)*	*1992*	*1993*	*1994*	*1995*	*1996*	*1997 (Asian Crisis)*
GDP Growth (%)	9.6	5.9	5.5	1.1	5.5	4.8	6.7	7.6	7.5	4.0

Year	*1998*	*1999*	*2000 (Dotcom burst)*	*2001 (9/11 Incident)*	*2002 (Agriculture Shock)*	*2003*	*2004*	*2005*
GDP Growth (%)	6.2	8.8	3.8	4.8	3.8	7.9	7.9	9.3

Year	*2006*	*2007*	*2008*	*2009*	*2010*	*2011*	*2012*	*2013*	
GDP Growth (%)	9.3	9.8	3.9	8.5	10.3	6.6	4.7	5.0	

Source: Meta Data of India, World Bank, Retrieved on 05.10.2014

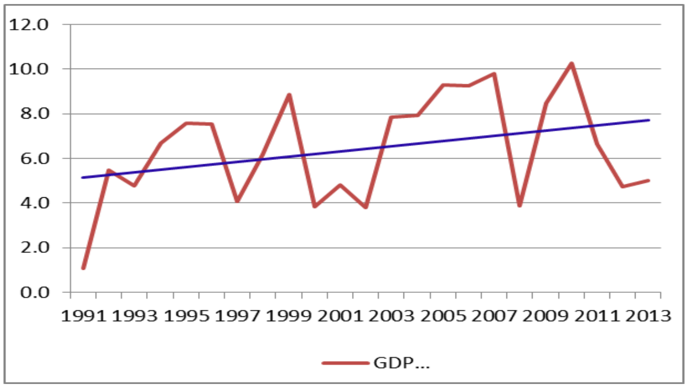

Fig 1.3: GDP Growth Trend of India (1991-2013)

The GDP growth trend of India during 1991 to 2013 is presented in Table 1.1.

1.1.2 Financial Sector and Market Structure:

The financial sector of India is developed and there exist a solid capital market with 5000 listed companies with Bombay Stock Exchange and with a market capitalization to USD 1.51 trillion as on May 2014. (Business Standard, India, 2014). India's external deficit varies in between 1.5 percent to 2 percent but is stable. India's import dependency on petroleum goods and fertilizer sector is very high. It follows a western model of legal and accounting system and business policy environment with periodic changes in liberalization of investment and trade regulation that helps the foreign investors and business enterprises. The diverse portfolio of foreign exchange resources including foreign equity capital, demand/time deposits and institutional investments helps to realize profit by Indian companies. India began its economic reform in 1991 with a policy that allows participation by the foreigner in consumer goods (Ahluwalia, 2002). This raised the expectation on India in the International Business World as the market here is represented by billions of people with a World-sized market of consumer durables that ultimately helps the industrial / manufacturing investment in India. The huge population size with 350 million Indian in the middle income group with diversified market segmentation creates wide platform for all the foreign companies to plan, launch, test and experiment their products such as white goods, other durables here as the market size is bigger than the population of the world's most advanced economies (World Bank, 2005). A more realistic estimate of the market potential is obtained through corrections and classification based on consumption level and penetration trends of consumer goods in Indian homes. The above-mentioned is derived through 35 million homes that comprises effective consumer base for durable like automobiles, white goods and consumer electronics. Indian consumers are again classified through socio-economic classification (SEC) which groups the households by the education levels and occupation of chief earning members. India lives in its village as three fourth of India's population lives in 0.6 million villages. The earning of these rural mass contributes one third to the national income. The rural consumers represent more than 50 percent of consuming classes and are prime targets of FMCG companies. Several brands of product of these companies are aimed at this burgeoning segment. Indian rural villages are typical types and are identified with unique characteristics such as seasonal demand, language barriers, gender dominance in decision-making, absence of organized distribution structure and perception barriers to several life style products. Human resource is one of the valuable economic assets of India. With a literacy level of 74 percent (Census 2011, India), India is considered World's third largest population of trained industrial workers with a population of 14 million and 4 millions of scientific and professionally trained person. The numbers of entrepreneurial class and private sector employee are fairly well spread and well distributed in Indian market. Recently India's achievement in software development, info-tech industry implies its technical prowess in the World. India is considered as leading suppliers of high-end software skills and attracts a lot of investment in IT sectors.

The Research and Development (R & D) sector in India is at developing stage. Most of the R & D works take place under Government funding. The R & D expenditure of India is less than one percent. The Government of India has provided a tax deductibility of 150 percent on annual R & D expenditure by Indian companies to promote R & D to increase the national intellectual property. The cost of labour is low in India. Industrial activity, taxes, foreign exchange competition, intellectual property, social security covers all aspects of trade for regulatory business environment in India. The business policy regulations are maintained through notification. Thus person interested in keeping track of all the above is required to continually keep a track of all these information and latest amendment in their business interest.

1.1.3 The Business Regulatory Environment:

Foreign Currency Regulation: It is otherwise known as Foreign Exchange Management Act (FEMA). The equity, sale/transfer of shares to residents, repartition of profit/dividend, royalties and technology fee, repatriation to share capital following disinvestment or winding up, capital gain and saving, overseas borrowings, placement of equity, acquiring/ or investing in overseas ventures are allowed only for approved categories of trade and capital transactions (Ministry of Finance, Government of India, 2014).

Industrial Regulations: In order to establish a industrial unit in India certain provisions of industrial licensing (only in specified lists of sector), local permission for pollution control, power and water connections, employment regulations, industrial safety, and working conditions of workmen statutory registration, use of contract labour and other industrial regulations are required (Ministry of Finance, Government of India, 2014).

Regulation for Managing Business Enterprises: For this, conduct of company affairs, accounting practices, and other compliances (comprises act, accounting standards, corporate governance reporting, transfer pricing rules etc.) are required to be followed (Ministry of Finance, Government of India, 2014).

Regulation Concerning Taxation: For this income tax act, custom act, excise and salts dune acts are required to be followed (Ministry of Finance, Government of India, 2014).

Regulation Covering Capital Markets: For initial public offering, rights, and preferential issues of capital, share buyback, and delisting, listing guidelines issued by the Security and Exchange Board of India (SEBI) are followed (Ministry of Finance, Government of India, 2014).

Other Act or Regulation: Consumer protection act, corporate governance rules, substantial acquisition and competition policy are required for regulation concerning business and practices. Certain conditions of regulation for export and imports of goods and services policy, GATT/WTO agreements are requisite policy for trade regulations. Patent acts, trademark acts, industrial design acts, copyright acts, geographical indication acts are required for intellectual property regulations (Ministry of Finance, Government of India, 2014).

In India the interest of industrial workers, employees in government enterprises, and government-controlled sector like banking and infrastructure are generally protected as a policy of employment regulation. However, the interest of the administrative and management staff, employees in non–manufacturing enterprise, casual workers, domestic helps etc. depends upon the individual contracts of the employment conditions. Labour contracts and civil courts are there to solve the disputes on employment related issues on industrial employees and for other categories respectively.

1.1.4 The Industrial Labour Regulations:

The Industrial Dispute Acts: It generally maintain the conduct of industrial relations and provides a framework for fair and just settlement of disputes by negotiations, arbitrations, conciliation, compromise or adjudication (Ministry of Labour, Government of India, 2014).

The Trade union Act: The management of industrial relations on behalf of the workers is maintained through Trade Unions Act that provides registration of trade unions. The wages in the organized sectors are negotiated through collective bargaining, conciliation, and adjudication. Most of the trade unions have link with political parties and the leading parties sponsor the trade union wings (Ministry of Labour, Government of India, 2014).

The Minimum Wage Act: The employees working in specified employment categories especially in industry are protected through the minimum wage act floated by government. The payments are subjected to periodic review and revision. The stipulated levels of wages are generally higher than normal but can also be lower where collective bargaining is not taking place (e.g. contract labour) (Ministry of Labour, Government of India, 2014).

The Payment Bonus: A minimum bonus of 8.33% of salary and maximum of 20% of the annual income can be paid as payment bonus. The establishment employing twenty or more persons even for one day during a year pays the bonuses. Newly established units are exempted until they start making profit in five years of operation (Ministry of Labour, Government of India, 2014).

The payment of Gratuity Act: This act provides payment of gratuity to employees those who have completed five years of services at the rate of 15 days salary for each completed year of service. These are paid at the time of retirement and are tax free up to Rs. 350,000/-. All the establishments are required to register under these acts after five year of establishment. If there are more than ten workers working in any establishment, it has to pay the gratuity (Ministry of Labour, Government of India, 2014).

1.1.5 Social Security Regulations:

Employee Provident Fund: It provides retirement benefits in the forms of provident fund, family pension, and deposit linked insurance for employees (EPF, Government of India, 2014).

The Employees State Insurance Acts: It provides medical benefit in case of sickness, employment injury and pension for dependent in case of accidents death at the work place (ESIC, Government of India, 2014).

The Maternity Benefit Act: It provides maternity and other benefits to women employees period before and after the childbirth (Ministry of Labour, Government of India, 2014).

The Women Compensation Act: It provides payment of compensation to working - women and their dependent in case of accident and injury arising in the case of accident in the course of employment resulting in disablement or death (Ministry of Labour, Government of India, 2014).

Factories Act: The factories act regulates safety, health, welfare of workers employed in factories. There are several acts about the working conditions: the equal remuneration act, the child labour act, the contract labour act (Ministry of Labour, Government of India, 2014).

Employment Regulations for Foreign Nationals: There is a time limit up to three years for foreign national to take up an employment either in short-duration or regular employment on non-permanent basis. The following basic requirements are necessary for foreign nationals to take up an employment in India (Ministry of External Affairs, Government of India, 2014).

A valid business visa and working permits,

- Permissions from Ministry of Home Affairs for extended stay in India (exceeding three months),
- Permission from the Department of Company Affairs for the appointment of an expatriate as a whole time director if he was not resident in India during past twelve months,
- Clearance from the Department of Company Affairs for managerial remuneration to the managing or the whole time director in excess of specified terms,
- Prior approval of Reserve Bank of India for repatriation facilities.

1.1.6 Macroeconomic situation and main challenges:

The economic growth is satisfactory with wide fluctuations and accompanied by moderate changes in external benefits. The external deficit in India is because of large savings in oil prices during the past years. However, the full growth of India's potential and the possible development on export markets is not yet realized. India's economy has grown very rapidly in recent years. Since 1991 it has been among the top 10% of the world's countries in terms of economic growth. The primary challenge for India is to sustain this growth while spreading its benefits more widely. This requires continuous effort as international experience shows that growth slows down unless reforms are pushed through when growth is high (World Bank 2014).

Major obstacles to India's growth are:

- Infrastructure Shortages
- Large Fiscal Deficit
- Restrictive Labor Regulations
- Unreformed Financial Sector

Infrastructure: Crippling infrastructure shortages are the leading constraint to rapid growth as well as in spreading this growth more widely. These shortages have resulted in a skewed pattern of growth that is not sustainable. While the high skill services sector that employs the better educated among India's work force has flourished, the growth of more labor- intensive manufacturing that generates jobs for low and semi-skilled workers has remained constrained. Infrastructure shortages have particularly hindered the growth of export oriented manufacturing and value-added agriculture that integrate into global supply chains, and need good roads, ports, airports, and railways as well as reliable power and water to prosper. The major challenges of infrastructure development are:

- India needs to invest 3-4% more of its GDP on infrastructure to sustain 8%growth.
- The private sector can play an important role in investing in infrastructure, including through public private partnerships.
- Improving the country's capacity to implement infrastructure projects will be as important as increasing the amount of investment available.
- Investments should improve the delivery of services, and service providers need to be made more accountable to consumers. Emphasis should be placed on maintaining existing assets.
- Reforms need to be accelerated in all sectors. Difficult issues such as rationalizing user fees for services need to be faced.

Fiscal Deficit: The country's consolidated fiscal deficit has been persistently large for many years. While recent efforts to tackle the deficit have paid off in substantial progress, it remains a continuing concern. The major challenges of fiscal deficit are:

- The existing deficit leaves no fiscal space for new government spending on areas of high social priority. Initiatives in rural and urban infrastructure, employment, education, and rural health will have to be financed with some combination of higher taxes or user charges, or by cutting existing expenditures.
- Large deficits and an unreformed banking sector reduce the private sector's ability to obtain bank financing.

Labor Regulations: India's existing labor regulations - among the most restrictive and complex in the world - protect only the insiders, the small number of workers who are already working in the organized sector, while hobbling the creation of manufacturing jobs for the tens of millions unemployed or working in poor quality jobs. There are at least four times more unemployed people (around 35 million) than are employed in the organized private sector. Firms with more than 100 workers consider labor regulations to be as constraining to their operation and growth as power shortages. The major challenges are:

- Design labor regulations that attract more labor- intensive investment, especially in the formal manufacturing sector.
- Reforms should protect the interests of *all* workers by ensuring that workers' legitimate interests are met. The World Bank does not advocate a regime of "automatic hire and fire" - though that is what the vast majority of workers in the unorganized sector actually face.

Financial Sector: Financial sector reforms have led to a booming stock market that has helped large firms finance their expansion easily. However, small and medium enterprises - which are an important engine of growth and productivity - have not been able to access finance as they are too small to be of interest to equity markets or FDI. Growth in lending to this sector has been slow due to the closely regulated publicly owned banking sector which has few incentives for innovation, and a large deficit with the attendant fears of making new loans.

Figure 1.4: Map of European Union in 2014

(This map is not to the scale)

Source: Map downloaded from www.bbcnews.com on 26.10.2014

1.2 European Union: An Introduction:

The EU traces its origins to the European Coal and Steel Community formed among six countries in 1951 and the Treaty of Rome in 1957. Since then the Union has grown in size through the accession of new countries, and new policy areas have been added to the remit of the EU's institutions Contents. Presently the European Union (EU) is an economic and political union of 28 member states, located primarily in Europe. With almost 500 million citizens, the EU generates an estimated

30 percent share (USD 16.073 trillion in 2012) of the nominal Gross World Product. The EU has developed a single market through a standardized system of laws, which apply in all member states, guaranteeing the freedom of movement of people, goods, services and capital. It maintains a common trade, agricultural and fisheries, and a regional development policy. Eighteen member states of EU have adopted a common currency, the Euro (€). The EU has developed a role in justice and home affairs, including the abolition of passport controls between many member states under the Schengen Agreement, which also incorporates non-EU member states. The EU operates through a hybrid system of inter-Governmentalism and supra-nationalism. (Europa, 2009). However, it also has supranational bodies, able to make decisions without unanimity between all national governments. Important institutions and bodies of the EU include the European Commission, the European Parliament, the Council of the European Union, the European Council, the European Court of Justice and the European Central Bank. EU citizens elect the Parliament every five years.

1.2.1 European Union:

After the end of the Second World War, a move towards European integration was seen by many as an escape from the extreme forms of nationalism, which had devastated the continent. One such attempt to unite Europe was the European Coal and Steel Community, which, while having the modest aim of centralized control of the previously national coal and steel industries of its member states, was declared" a first step in the federation of Europe" European Commission, 1950). The founding members of the Community were Belgium, France, Italy, Luxembourg, the Netherlands and West Germany (European Commission: *A Peaceful Europe - the Beginnings of Cooperation*). Two additional communities were created in 1957 i.e. the European Economic Community (EEC) establishing a Customs Union and the European Atomic Energy Community (EURATOM) for cooperation in developing nuclear energy. In 1967, the Merger Treaty created a single set of institutions for the three communities, which were collectively referred as the European Communities, although more commonly just as the European Community (EC) (*Merging the Executive,* European Commission*)*. The 1957 Rome Treaty created the European Economic Community. In 1973, the Communities enlarged to include Denmark, Ireland and the United Kingdom. Norway had negotiated to join at the same time but a referendum rejected membership and so it remained outside. In 1979, the first direct, democratic election to the European Parliament was conducted. Greece, Spain and Portugal joined in the 1980s. In 1985, the Schengen Agreement created largely open borders without passport controls between most member states. In 1986, the European flag began to be used by the Community and the Single European Act was signed. In 1990, after the fall of the Iron Curtain, the former East Germany became part of the Community as part of a newly united Germany. With enlargement toward East-Central Europe on the agenda, the Copenhagen criteria for candidate members to join the European Union were agreed. The European Union was formally established when the Maastricht Treaty came into force on 1st November 1993. Austria, Sweden and Finland joined the newly established EU in 1995. In 2002, Euro notes and coins replaced national currencies in 12 of the member states. In 2004, the EU saw its biggest enlargement to date when Malta, Cyprus, Slovenia, Estonia, Latvia, Lithuania, Poland, the Czech Republic, Slovakia, and Hungary joined the Union. On 1st January 2007, Romania and Bulgaria became the EU's newest members and Slovenia adopted the Euro (*A Decade of Further Expansion*: Europa). Croatia the latest member of EU entered on 1st July 2013. Now the European Union is composed of 28 independent sovereign countries, which are known as member states: Austria, Belgium, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, and the United Kingdom. There are six official candidate countries, Albania, Iceland, Macedonia, the Republic of Macedonia, Montenegro, Serbia and Turkey (Europa: *Candidate and Potential Candidate Countries*). To join the EU, a country must meet the Copenhagen criteria, defined at the 1993 Copenhagen European Council. These require a stable democracy, which respects human rights and the rule of law; a functioning market economy capable of competition within the EU; and the acceptance of the obligations of membership, including EU law. Evaluation of a country's fulfillment of the criteria is the responsibility of the European Council. The current framework does not specify how a country could exit the Union (although Greenland, a Territory of Denmark, withdrew in 1985), but the proposed Treaty of Lisbon contains a formal procedure for withdrawing. Four Western European countries that have chosen not to join the EU have partly committed to the EU's economy and regulations: Iceland, Liechtenstein, and Norway are a part of the single market through the European Economic Area, and Switzerland has similar ties through bilateral treaties. The relationships of the European microstates Andorra, Monaco, San Marino, and Vatican City include the use of the Euro and other areas of co-operation *(Use of the Euro in the World*: *The Euro Outside the Euro Area*, Europa).

In December 2007, European leaders signed the Lisbon Treaty, which was intended to replace the earlier, failed European Constitution, which never came into force after being rejected by French and Dutch voters. Some basic information about EU is given in Table 1.2.

Table 1.2: Facts on EU

Member States	28	
Government	Commission	
	Parliament	
	Council	
Formation		
	Paris Treaty	18th April, 1951
	Rome Treaty	25th March, 1957
	Maastricht Treaty	7th February 1992
Area	Total	4,423,147 km^2 (1,707,787 sq mi)
	Water (%)	3.08
Population		
	1st January 2012	503,679,730 (excl. Croatia)
GDP (PPP)	IMF October 2013	
	Total	USD 16.073 Trillion (2012)
	Per capita	USD 15,700 to USD97, 000
	Total	US $19195 Billion
	Per capita	US $38,732
Currency	Euro (€)	
European official languages	German, English, Italian, French, Spanish, Polish, Romanian, Dutch, Greek, Czech, Swedish, Hungarian, Portuguese, Slovak, Danish, Finnish, Lithuanian, Slovenian, Bulgarian, Estonian, Irish, Latvian, Maltese and Croatian	

Source: European Commission Services, 2014.

Table: 1.3 –Information on EU member countries

Country	***Capital***	***Population (Million)***	***Area (Sq. Km.)***	***Currency***	***Language***	***Year of Entry in EU***
Austria	Vienna	8.3	88,885	Austria Schilling	German	1995
Belgium	Brussels	10.5	30,158	Belgian Franc	Flemish*	Founder Member
Denmark	Copenhagen	5.4	43,094	Danish Krone	Danish	1973
Finland	Helsinki	5.3	338,000	Markka	Finish, Swedish	1995
France	Paris	60.9	550,000	French Franc	French**	Founder Member
Germany	Berlin	82.5	356,854	Deutschemark	German	Founder Member
Greece	Athens	11.1	131,957	Drachma	Greek	1981
Ireland	Dublin	4.2	70,000	Punt	English, Irish	1973
Italy	Rome	58.8	301,263	Lira	Italian, French	Founder Member

Country	*Capital*	*Population (Million)*	*Area (Sq. Km.)*	*Currency*	*Language*	*Year of Entry in EU*
Luxembourg	Luxembourg	0.5	2,856	Luxem. Franc	French***	Founder Member
Netherlands	Amsterdam	16.3	41,864	Guilder	Dutch	Founder Member
Portugal	Lisbon	10.6	92,072	Portug. escudo	Portuguese	1986
Spain	Madrid	48.3	504,782	Peseta	Spanish****	1986
Sweden	Stockholm	9.0	450,000	Swedish Krona	Swedish	1995
UK	London	60.4	242,500	Pound Sterling	English, Welsh	1973
EU -15	Brussels-HQ	392.1	3,244,285	Euro	All the above	-

Country	Capital	Population (Million)	Area (Sq. Km.)	Currency	Language	Year of Entry in EU
Bulgaria	Sofia	7.97	111,000	Lev	Bulgarian	2007
Cyprus	Nicosia	0.8	9,000	Euro	Greek, English	2004
Czech. Rep.	Prague	10.3	79,000	Czech. Koruna	Czech.	2004
Estonia	Tallinn	1.3	45,000	Estonia Kroon	Estonia	2004
Hungary	Budapest	10.1	93,000	Forint	Hungarian	2004
Latvia	Riga	2.3	65,000	Lats	Latvian	2004
Lithuania	Vilnius	3.4	65,300	Litas	Lithuanian	2004
Malta	Valletta	0.4	316	Euro	Maltese, English	2004
Poland	Warsaw	38.1	313,000	Zloty	Polish	2004
Romania	Bucharest	21.6	238,000	Leu	Romanian	2007
Slovakia	Bratislava	5.4	49,000	Slovak Koruna	Slovak	2004
Slovenia	Ljubljana	20.0	20,000	Euro	Slovenia	2004

Croatia	Zagreb	4.2	56,594	Croatian Kuna	Croatian	2013
New EU -12	-	121.67	1,087,616	-	All the above	-
EU -15	Brussels-HQ	392.1	3,244,285	Euro	All the above	-
EU -28	Brussels-HQ	503.7	4,423,147	Euro	All the above	-

Source: European Commission Services (2014)

*NB: * French, German and Italian also.*

***Breton, Alsatian German also.*

****German, Luxembourgish*

*****Catalan, Galidan Basque*

Luxem. Franc is Luxembourg Franc.

Portug. escudo is Portuguese escudo.

1.3 An Economic Profile of EU:

Since its origin, the EU has established a single economic market across the territory of all its members. Currently, a single currency is in use between the 18 members of the Euro zone. Considered as a single economy, the EU generated a combined Gross Domestic Product (GDP) of USD16.073 trillion in 2012, which makes it the largest economy in the world by nominal GDP and the second largest trade bloc economy in the world by PPP valuation of GDP. It is also the largest exporter of goods, the second largest importer, and the biggest trading partner to several large countries such as India, and China. 161 of the top five hundred largest corporations measured by revenue (Fortune Global 500) have their headquarters in the EU. In August 2012, unemployment in the EU stood at 11.4 percent while investment was at 21.4 percent of GDP, inflation at 2.2 percent and public deficit at -0.9 percent of GDP. The GDP growth rate of EU during 2003-2013 averaged 1.1 percent per annum. The GDP growth rate of EU from 1974 to 2013 is shown in the Table 1.5.

Table: 1.5 – GDP Growth of EU-15

Year	***GDP Growth Rate (in %)***
1974-85	2.0
1986-90	3.3
1991-95	1.5
1993	-0.4
1994	2.8
1995	2.4
1996	1.7
1997	2.5

1998	2.7
1999	2.5
2000	3.4
2001	3.1
2002	3.0
2003	1.5
2004	2.6
2005	2.2
2006	3.4
2007	3.2
2008	0.4
2009	-4.5
2010	2.0
2011	1.6
2012	-0.4
2013	0.1
Average of 2003 to 2013	1.1

Source: Eurostat, European Commission, June 2014

The GDP growth trend of EU for the period 1994 to 2013 is shown in the Fig 1.5.

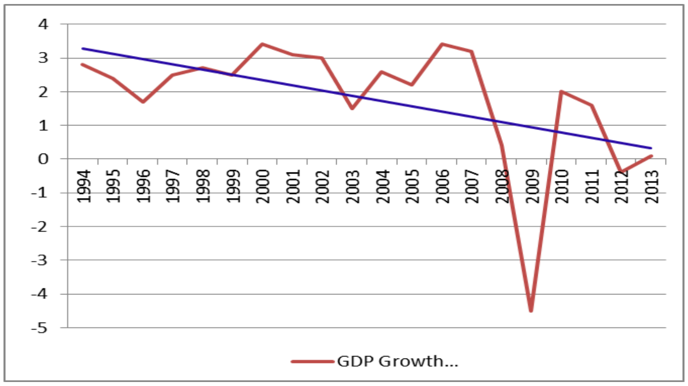

Fig. 1.5 GDP Growth Trend of EU 1994-2013

1.3.1 Single market:

EU member states have a standardized passport design with the words "European Union" given in the national language(s) at the top. Two of the original core objectives of the European Economic Community were the development of a common market, subsequently renamed the single market, and a Customs Union between its member states. The single market involves the free circulation of goods, capital, people and services within the EU, and the customs union involves the application of a common external tariff on all goods entering the market. Once goods have been admitted into the market they cannot be subjected to customs duties, discriminatory taxes or import quotas, as they travel internally. The non-EU member states of Iceland, Norway, Liechtenstein and Switzerland participate in the single market but not in the customs union. Half the trade in the EU is covered by legislation harmonized by the EU. Free movement of capital is intended to permit movement of investments such as property purchases and buying of shares between countries. Until the drive towards Economic and Monetary Union the development of the capital provisions had been slow. The free movement of capital is unique insofar as that it is granted equally to non-member states. The free movement of person's means citizens can move freely between member states to live, work, study or retire in another country. This required the lowering of administrative formalities and recognition of professional qualifications of other states. The free movement of services and of establishment allows self-employed persons to move between member states in order to provide services on a temporary or permanent basis. While services account for between sixty and seventy percent of GDP, legislation in the area is not as developed as in other areas. This lacuna has been addressed by the recently passed Directive on Services in the internal market, which aims to liberalize the cross border provision of services. According to the Treaty, the provision of services is a residual freedom that only applies if no other freedom is being exercised.

1.3.2 Monetary Union:

The creation of a European single currency became an official objective of the EU in 1969. However, it was only with the advent of the Maastricht Treaty in 1993 that member states were legally bound to start the Monetary Union no later than 1st January 1999. On this date, eleven of the then fifteen member states of the EU duly launched the Euro. It remained an accounting currency until 1st January 2002, when Euro notes and coins were issued and national currencies began to phase out in the euro zone, which by then consisted of twelve member states. The euro zone has since grown to 18 countries. The European Central Bank in Frankfurt governs the euro zone's monetary policy. All other EU member states, except Denmark and the United Kingdom, are legally bound to join the Euro when the economic conditions are met, however only a few countries have set target dates for accession. Sweden has circumvented the requirement to join the Euro area by not meeting the membership criteria. The Euro is designed to help build a single market, for example: easing travel of citizens and goods, eliminating exchange rate problems, providing price transparency, creating a single financial market, price stability and low interest rates, and providing a currency used internationally and protected against shocks by the large amount of internal trade within the euro zone. It is also intended as a political symbol of integration and stimulus for more. The Euro, and the monetary policies of those who have adopted it in agreement with the EU, are under the control of the European Central Bank (ECB). There are eleven other currencies used in the EU. A number of other countries outside the EU, such as Montenegro, use the Euro without formal agreement with the ECB. The EU operates a competition policy intended to ensure undistorted competition within the single market. The Commission as the competition regulator for the single market is responsible for anti-trust issues, approving mergers, breaking up cartels, working for economic liberalization and preventing state aid.

1.3.3 Economic Governance:

The Competition Commissioner is one of the most powerful positions in the Commission, notable for the ability to affect the commercial interests of trans-national corporations. For example, in 2001 the Commission for the first time prevented a merger between two companies based in the United States, which had already been approved by their national authority. Another high profile case against Microsoft resulted in the Commission fining Microsoft over €777 million following nine years of legal action. In negotiations on the Treaty of Lisbon, French President succeeded in removing the words "free and undistorted competition" from the treaties. However, the requirement is maintained in an annex and it is unclear whether this will have any practical effect on EU policy.

1.3.4 Budget:

The EU had an agreed budget of €120.7 billion for the year 2007 and €864.3 billion for the period 2007–2013, representing 1.10% and 1.05% of the EU-27's GNI forecast for the respective periods. By comparison, the United Kingdom's expenditure for 2004 was estimated to be €759 billion, and France was estimated to have spent €801 billion. In 1960, the budget of the then European Economic Community was 0.03% of GDP. In the 2010 budget of €141.5 billion, the largest single expenditure item is "*cohesion & competitiveness*" with around 45% of the total budget. Next comes "*agriculture*" with approximately 31% of the total. "*Rural development, environment and fisheries*" takes up around 11%. "*Administration*" accounts for around 6%. The "*EU as a global partner*" and "*citizenship, freedom, security and justice*" bring up the rear with approximately 6% and 1% respectively.

Chapter- 2

India-EU Trade: A Historical Perspective

2.0 Indo-EU Trade: A Historical Perspective:

The India-EEC economic cooperation began in 1962, when India established its diplomatic relations with the European Community (EC) in Brussels. The relationship received a boost in 1973, when the UK became a member of the EC along with Denmark and Ireland. These three countries became members of the EC through Instrument of Accession with effect from 1st January 1973 (Official Journal of the European Communities, 1972). The six members Community increased to a nine member-union, thereafter expanding its regional trading bloc. Even though in the late 1960s, the three communities, the European Coal and Steel Community (ECSC) set up in 1951, the EEC and the EURATOM in 1957 managed institutionally. However, in pursuance with the Joint Declaration of Intent (JDI) in 1972, the EC and the UK undertook a special programme for developing trade relations with the developing independent Commonwealth countries in Asia. The participating countries were India, Pakistan, Sri Lanka, Malaysia and Singapore.

According to the Treaty of Accession, UK, Denmark and Ireland gave commitment to get the treaty ratified in their national Parliaments before 1st January, 1973.

From among the developed political collectivities, the EC was the first to have granted (in 1971) the Generalized System of Preference (GSP) facility to India, the first among the Asian countries, aimed at encouraging export of manufactured goods of Asian countries. In addition, the EC also sought to strengthen bilateral economic cooperation with the Commonwealth countries of Asia. Apart from extending GSP facility, the EC also undertook to examine, from the date of Britain's accession, the problems of trade of Asian developing countries (Sri Lanka, India, Malaysia, Pakistan and Singapore). Apart from extension of the GSP facility to manufactured goods, the EC also extended tariff benefits to these countries through the Most Favoured Nation (MFN) scheme (Chopra and Lall, 1984).

However, the GSP aimed at encouraging manufactured exports of developing countries in general and India in particular, was not very successful in achieving its goal simply because of its structural rigidities. GSP separated goods into different categories, according to the degree of their sensitivity in the EC market. This facility excluded most sensitive items from the GSP list. In most cases, the entire gamut of non-sensitive items was included in the GSP list. As a result, most of India's quotas on textiles and apparels remained unutilized over the years. Until recently, agricultural and processed foods were not included into the GSP list. This benefit has also been constrained by enabling and graduation clauses.

2.1 India-EC Commercial Cooperation Agreement (CCA) of 1974, renewed as Commercial and Economic Cooperation Agreement (CECA) in l981:

The Commercial Cooperation Agreement (CCA) was signed by India and the EC on 17th December 1973 and came into force on 1st March 1974 (Commercial Cooperation Agreement, 1973). It was the first ever trade agreement by the EC with any Asian developing country. It gives emphasis on the need "to consolidate, deepen and diversify their commercial and economic relations to the full extent of their growing capacity to meet each other’s requirement on the basis of complementarily". This agreement provided the basis for improving economic cooperation between the two countries on a historical basis, spreading over trade, investment, technology transfer and finally the establishment of joint ventures in both collectivities as well as in the third country markets. CCA was first enforced for five years with the provision for automatic renewal unless disrupted by any contracting party (Ramanathan, 1984). The CCA also extended MFN facility to India in principle in accordance with the provisions of the General Agreement on Tariffs and Trade (GATT) and emphasized the promotion and diversification of both way trade based on comparative advantage and cooperation. This mutual relationship is sine-qua-non for accelerating economic growth of an underdeveloped economy like India where, foreign trade sector is still premature to face international competition. An Indo-EEC Joint Business Commission was setup to provide institutional support for augmenting two ways trade based on complementary and cooperation between the two democratic collectivities. The India-EEC Joint Business Commission took up trade promotion programme and increased the EC's assistance for India's participation in European trade fairs, and visits of Indian delegations to the member countries & vice-versa. Another salient feature of the agreement was the preparation of a report on Joint Project Planning by Smallman Consultant Ltd. to identify the areas of cooperation between these two parties. This agreement also provided for special sectorial agreement between India and the EC on jute, coir and cotton textiles.

The CCA between India and the EC cited a model, which inspired the non-associated developing countries of the sub-continent to strengthen economic cooperation among them through cooperation. These non-associated countries were Bangladesh, Sri Lanka, Pakistan and Nepal. These agreements marked an important beginning of the implementation of the *Joint Declaration of Intent* annexed to the Treaty of Accession of the United Kingdom to EEC (Joint Declaration of the Intent, Official Journal of the European Union, 1972).

India's exports to the EC had been increasing satisfactorily both in values as well as in terms volume since 1973-74, which revealed the satisfactory functioning of the CCA (Ramanathan, 1984). India has been importing mainly capital & engineering goods, machinery (both electrical and mechanical), chemicals and sophisticated instruments etc. since 70s, as a move to strengthen its industrial base. On the other hand, India's export basket has constituted jute, tea, textiles and garments, diamond, raw leather and leather manufactures oil cake, tobacco, carpets, coffee etc. One of the largest import items of India—the raw diamond from Belgium was re-exported again to EC member states and elsewhere after substantial value addition (Ministry of Commerce, Government India, 1973). There had been a strong apprehension that India's exports to the west European countries might get hampered owing to UK's accession to the EC, for it had been the traditional and most important trading partner of India on account of historical trade links. However, this apprehension was plummeted when India's exports to EEC increased from Rs. 609 Crore in 1973-74 to Rs. 1392 Crore in 1976-77. This steady growth of India's exports was uninterrupted except in 1977-78, when this upward movement was arrested temporarily. Since the conclusion of the CCA, India's exports increased reasonably well, and its imports surpassed its exports, which resulted in a chronic balance of trade deficit. EC's imports from India, increased from $806 million in 1973, to US$2501 million in 1980. On the other hand, EC's exports to India increased from US$832 million in 1973, to US$3200 million in 1980, which ultimately increased the trade deficit from US$26 million in 1973 to $699 million in I980.

In 1975, India was plunged into a serious balance of payment crisis due to exorbitant rise in oil prices. The EEC allocated about 40 per cent of the direct aid under the "Cheysson Fund" to India. The aid amounted to US$75 million out of a total available fund of US$187 million (Chopra & Lall, 1984). Besides, India received a substantial allocation of fund from the UN Emergency Fund, to which EC's contribution was US$63 million. Under the technical aid programme of EC to developing countries, India received 20 per cent of the total allocation. These funds were used to combat drought, to construct warehouses for storing food grains and fertilizers and to build shelters for the use of cyclone and flood affected people.

The Commercial Cooperation Agreement provided a solid basis for Indo-EC Economic Cooperation., The EC set up an Action Defining Committee (ADC), which had its first meeting in New Delhi in 1977. The meeting identified three major areas for intensifying cooperation: new energy sources, environmental research and remote sensing management of scientific and technical information. The CCA did not have adequate room for such cooperation and the initiative was made on personal institutional levels. Indian scientists and policy makers took part in three conferences on solar energy organized by the Commission. A Joint Coal Gasification Study began in 1978, and scientists from both sides visited the facilities both in the EC and in India. The EC had been making a major contribution to India's food need. Through Food Aid Programme, it took part actively in Operation Milk Flood-II, an ambitious project that helped about 10 million families through increased production and marketing of milk. (Chopra & Lall, 1984).

From the Special Action Fund initiated in 1978, India alone was allocated US$50 million of the total US$430 million, out of which a sum of US$45 million was provided for the Agricultural Refinance and Development Cooperation for lending to farmers, training, etc., and US$5 million provided for rural electrification.

Some broad conclusions therefore, emerged from the review of the operations of the CCA: Firstly, both India and the EC have made concerted efforts to gain the fruits of the agreement. As a result, the contracting parties were able to establish a strong link between trade and cooperation. Besides trade, cooperation had also extended for conservation of natural resources, energy related technology, environment protection and its improvement.

Secondly, though in some areas, cooperation was in-depth and results were quite enthusiastic, in general, EC's efforts to make it a success were lackluster simply because of absence of spontaneity and thrust in it. EC's structural and functional limitations were other reasons. However, bilateral relations between India and some member states of EC were quite encouraging in general, but the economic relation of Western Europe with India was not optimum. (Commercial Cooperation Agreement, European Commission, 1973).

Thirdly, since the conclusion of CCA in 1973, India has been trying to intensify its economic relations through increase in trade. However, both exports and imports had gone up significantly between 1973 and 1980, but the import kept on surpassing exports every year. The situation had become so worse that in 1980, India's trade deficit with EC shot up to US$ 699 million from US$26 million in 1973. This adverse balance of trade situation was due to a growing protectionism in EC during 70s. The Commission resorted to several non-tariff barriers for its imports from developing countries. Therefore, in spite of India's constant endeavor to increase its exports, it could not achieve much success because of growing protectionism in the EC (Yeats, 1979).

2.2 EC and Protectionism:

Protectionism in the European Community was evident from the First Oil Shock of 1973. The trend got aggravated during the Second Oil Shock in 1979. The seventies were characterized by growing protectionism in the EC. The first Multi-Fiber Arrangement (MFA) was concluded in 1974 and it was reviewed thereafter for the fourth term ending on 31st December 1994. Apart from quantitative restrictions on exports of textiles and garments, other non-tariff barriers were marketing regulations, health regulations, phyto-sanitary regulations, import levies and other bilateral agreements restraining exports of textiles and garments (UNCTAD, 1983). Two oil shocks in the European economy were followed by demand recession. It was also found that growth in productivity was much less than the growth of wage to the workers, which led demand side recession. This problem of demand management got aggravated because the European capital goods industry became obsolete in the seventies. Therefore, the output of low capital-intensive sector became incompetent and faced less demand. This was the basic reason why EC took recourse to such protectionist measures to protect its ailing domestic industry from foreign competition (World Bank, World Development Report, 1983).

2.3 Commercial and Economic Cooperation Agreement (CECA) 1981:

After the expiry of the CCA, India and the EC decided to start fresh negotiations with a view to arriving at a new agreement in the light of the experience gained until then. After prolonged negotiations, India and the EC agreed to conclude a new agreement, which was concluded on 23rd June 1981, known as Commercial and Economic Cooperation Agreement (CECA) (Commercial Cooperation Agreement, EC, 1973). The main objectives of this new agreement were:

(i) Developing commercial relations and intensified economic cooperation,

(ii) Providing a new dimension to the mutual relationship between India and the EC;

(iii) Strengthening economic relationship based on mutual cooperation and comparative advantage;

(iv) Pursuing economic cooperation in an evolutionary and pragmatic manner;

(v) Reaffirming determination to expand mutual trade for achieving wider economic and social objectives as an important instrument for strengthening international cooperation,

(vi) Augmenting international economic cooperation commensurate with human resources, intellectual and material resources.

The CECA endorsed the MFN (Article 2) treatment as the basis of trade between two countries. Both the contracting parties agreed to honor their commitments given in the GATT. Both parties affirmed their faith on free trade and agreed to extend maximum degree of liberalization to each other products of which, they used to offer to a third country. CECA emphasized the commercial exchange between two countries (Article 4). In order to do this, they decided to rely on frequent interactions between economic operators of both sides, which included sending trade delegations, promoting visits by persons, arranging trade fairs in both collectivities and facilitating free movement of persons for developing industrial technical and commercial contacts. The agreement emphasized the need for bilateral cooperation in identifying the areas of joint ventures in production, trade and marketing.

In areas of industrial cooperation (Article 5), the agreement laid down principles of joint effort in Research and Development (R&D) activities, Joint Research in Areas of Energy and Environment and a smooth process of Technology Transfer between the two parties. All such cooperation policies were in conformity with the laws of both EC and India. As regards investment, the EC agreed to extend direct concessional transfer as well as institutional and other source of finance to India suited to its policy framework in favour of non-associated countries. Protection of investment was a crucial area of cooperation, but Foreign Direct Investment (FDI) flows into India had been severely constrained by intricate rules and regulations which existed in India around that time. After much deliberations and clarifications, it was decided that both sides would take steps to promote mutually beneficial investment, which was consistent with their laws and policies.

Both parties felt the need for a Joint Business Commission (JBC) (Article 10) as an effective mechanism for monitoring the implementation evaluating of its progress. The Joint Commission was given the task of studying the impact of trade barriers, viz. tariffs and non-tariffs, on adoption of the trade pattern and marketing structure to fulfill the objectives of the agreement. A new private mechanism known by the nomenclature "Joint Business Council" (JBC) was set up to act as a catalyst to promote Indo-EC Economic and Commercial cooperation. The JBC was also required to monitor the Community Fund earmarked for the implementation of the agreement. The Commission was also empowered to mandate a specific sub commission or an Expert Group to study all specific issues that came in the way of implementation of the agreement and to suggest suitable measures, which would be binding on the respective governments (Saxena, 1984).

The CECA was concluded on 23rd June 1981. The new agreement extended the horizon and scope of its economic and commercial cooperation. The Commercial Cooperation Agreement of 1973 continued up to 1980. CCA was the first of this kind of cooperation agreement between India and the EC. In spite of adverse international economic scenario due to two successive oil shocks, India's performance on the export front was relatively well. Between 1973 and 1980, India's exports to the EC increased by 210 per cent, on the other hand, imports also grew remarkably by 284 per cent. The compound growth rate of India's exports was relatively better which, was 17.55 per cent against the import growth of 21.22 per cent during the same period.

2.4 Trade Performance of India with EC:

CECA were more diversified than CCA but its performance on the external front was quite lackluster during this period. CECA were concluded in June 1981 and continued up to 1994 and were then replaced by the Cooperation Agreement on Partnership and Development (Cooperation Agreement on Partnership and Development, EC, 1994). During CECA, exports grew only 9.54 per cent at compound rate whereas import growth was 7.97 per cent during 1980 to 1993. One interesting feature about this period was that exports growth was higher than import growth. This was quite contrary to what happened during CCA.

The percentage change in India's exports over the corresponding period of the previous year was 2 per cent in 1980 but rose to a phenomenal level of 20.6 per cent in 1993. Similarly percentage change in India's imports over the previous year, which was 5 per cent in 1980 also rose to 18.8 per cent in 1993. The trade balance was as usual in favour of the EC. India's trade deficit with the EC, which was 499 million ECUs in 1980, rose to the peak level of 3,196 million ECUs in 1986, declining to 2905 million ECUs in 1989, but reducing to an all-time low of 348 million ECUs in 1991. If success is at all measured in terms of growth rates, certainly CECA does not deserve kudos, but India has been much successful in reducing the trade deficit with the EC over the years.

When one reviews the operations of the CECA in terms of trade between India and the EC, one could easily observe that India has not been able to realize its economic potential for exports to the member states of the EC. Though the Commission has been the major trading partner of India, sharing about 30 per cent of its exports and imports, the existing level of Indo-EC Commercial and Economic Exchanges are far below their actual potential. Both ways Indo-EC trades was no more than 1.11 per cent of EC's external trade in 1992.

One possible reason may be the inability of the Indian exporters to conform to the European specifications and fast changing market trends. To satisfy European quality standards and maintain strict delivery scheme had also been difficult for many of the small-scale exporters from India, In order to capture the European market, quality is the most important determinant rather than cost-competitiveness. India, often neglect quality aspect and tend to give greater importance to the price factor (Weston and Cabel, 1979).

The second major reason for failure to utilize the full potential of India's exports to the EC seemed to have been the emergence of neo-protectionism in the form of labyrinthine non-tariff barriers (NTBs). Textile is India's single largest export item, constituting more than one-third of its total exports. However, the irony is that the entire basket of our textiles and apparel exports has been under strict quantitative restrictions in the EC operated through Multi-Fiber Arrangement (MFA). Not only is the NTB coverage ratio higher than in India's exports to the EC, but average weighted tariffs are also exorbitantly higher in the NTB-affected items. Nearly 50 per cent of India's exports to the EC are exposed to EC's NTBs. various quotas have also been binding constraints to India's exports. EC's variable levy is another example of NTBs, which puts an effective barrier to Indian agricultural exports. India is principally an exporter of low value added labour- intensive items, which do not have free access to European market. Textiles, leather, jute, diamonds, precious and semiprecious stones, etc. are some of the examples.

2.5 India-EC Cooperation Agreement on Partnership and Development:

The thought and action to improve the economic and commercial cooperation between India and the EC was initiated on 17th December 1973 through the conclusion of the Commercial Cooperation Agreement followed by Commercial and Economic Cooperation Agreement on 23rd June 1981. In 1994, Cooperation Agreement on Partnership and Development (CAPD) replaced these agreements. This new agreement is a modified version of the two erstwhile agreements and is in response to India's economic reforms, which were initiated in July 1991. The new cooperation agreement has maintained the objectives, as enshrined in the CECA, and emphasized upon the need for environmental protection and sustainable management of natural resources. In the new agreement, the EC has extended MFN facility to India in continuation of the earlier agreement. The new agreement has emphasized the highest degree of liberalization in conducting trade between the two contracting parties by eliminating trade barriers.

Trade in goods has been the central issue for discussion in all bilateral negotiations, but this is for the first time that, both the parties have agreed to promote trade in services in a mutually exclusive way[1]. Regarding customs duty, both the contracting parties have agreed (in accordance with law) to exempt goods admitted temporarily to their territories for subsequent re-export unaltered from duty, tax and other charges. This may also be for goods, which re-enter their territories after processing in the other member states, which may not be sufficient for the goods to be treated as originating from the territory of that contracting party.

Recently there has been a spate of anti-dumping cases in the EU. A host of India's export of textiles has been subject to EU's anti-dumping duty. In the new agreement, the EU becomes more flexible in dealing with anti-dumping cases arising from India. As regards anti-dumping and anti-subsidy investigations, every party has agreed to examine in detail the submission of the other and will inform the interested parties concerned of the essential facts based on which decision is to be taken. Before imposing any antidumping duty, the contracting parties would do their best to evolve a mutually acceptable constructive solution to the problem.

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[1] This was the outcome of the Uruguay Round of Multilateral Trade Negotiation, where, for the first time, trade in services was given the status of a separate negotiating group.

The new cooperation agreement primarily works in three broad areas indicated below:

i) Improving the economic environment in India by facilitating better access to EU's know-how and technology;
ii) Facilitating contacts between economic cooperation and other measures designed to promote commercial exchanges and investments; and
iii) Reinforcing mutual understanding of their respective economic, social and cultural environment as the basis for effective cooperation.

Besides other conventional areas of economic cooperation, this agreement has given much emphasis on the importance and up gradation of the protection of intellectual properties in India[2]. Ineffective protection of IPR is the main deterrent factor for inadequate flow of FDI into India. European companies are highly skeptical about transferring their state-of-the-art technologies to India in anticipation of getting it pirated. Presently India is having the process patent system in areas of drugs and pharmaceuticals and agro-chemicals. In order to upgrade our patent regime, the EU has agreed to provide training to Indian personnel and help Indian technical institutions to introduce courses on IPR study.

The new agreement has also extended its area of operation to

[2] IPR is a major issue between India and the EC. FDI flow from EC to India has not grown satisfactorily due to lack of effective protection on IPR. To know in details about this, see

(a) "Final Act of the Uruguay Round of Negotiations: The Proposed sui genres system for India", in B. Bhattacharya and A. K. Sengupta (eds.) "Trade in Agriculture: The Uruguay Round and After", Indian Institute of Foreign Trade, 1994, pp. 211-242.

(b) "Patenting Biotechnology and Micro-organism: Indian Position in the Post Uruguay Round in K, R, Gupta (ed;) World Trade Organization and India, Atlantic Publisher, (New Delhi), 1996, pp. 83-111.

some new horizons. These are: Conservation of Depletable Energy, doing Extensive Research on Development of Non-Conventional Energy and finding out suitable methods for saving and efficient use of Energy. This agreement also stresses the need of Protecting the Environment. In order to Protect Natural Resources, both the countries have pledged to work together on water, soil and air pollution, community afforestation and sustainable management of natural resources etc. Apart from these areas, the CAPD pledges to extend cooperation in all conventional areas of socio-economic activities of the two countries.

The new agreement (CAPD) has been formulated in the light of India's move towards liberalization. Since 1991, India has entered into a new era of economic development through liberalization of policies and procedures in almost all spheres of economic activities. Taking advantage of a liberalized regime, economic transactions both ways have increased substantially. Such an increase in economic cooperation is not only evident in augmenting trade but also, Europe's response to Indian economic reforms has been encouraging which is revealed from the fact that it has shown an increasing flow of FDI from Europe coupled with the increasing number of joint ventures and technology transfer agreements.

Another important provision of this agreement is the dismantling of all barriers on trade. As a part of the New Economic Policy, India has already liberalized its trade sector through drastic reductions of tariffs from its imports (WTO, 1994).

2.6 Structure and Operation of the EC's GSP Scheme and India:

The EC's GSP scheme in India has been working in three major areas, *viz.* agriculture, textiles and industrial goods. In the industrial sector, hosts of manufactured and semi-manufactured items are included in the GSP scheme of the EC. Most of the GSP-covered items have been enjoying either duty free treatment or minimum duty. The rationale behind such preferential treatment is to let India develop its industrial base as well as manufactured exports. This system is non-discriminatory and non-reciprocal and is in addition to MFN facilities.

In textiles, total exemption from duty is granted to India because the entire gamut of trade is guided by the MFA system, settled bilaterally between India and the EC. Ceiling and quota arrangements are applicable for preferential imports by individual countries. According to quota system, higher duty is applicable automatically when value of exports exceeds the quota. However, in case of ceiling, duty is enforced after negotiations. The EC has never charged higher duty in case of exceeding ceiling limit.

In agriculture, a list of products is drawn up and the items included in the list are determined from time to time. EC is quite flexible in reduction of duty and even in some cases, complete exemption is also permissible subject to the exigency of the situation. No quantitative ceiling has been fixed except for five products in which case overall quotas are expressed in tonnes (two types of canned pineapple, instant coffee and two types of tobacco). The preferential treatment is granted according to the nature of products, i.e. sensitive and semi-sensitive items.

Since the adaptation of the EC's GSP scheme in 1971, India has increasingly been enjoying this benefit in all of its manufacturing exports either in the form of zero-duty or in the form of quota/ceiling. Initially, agricultural products were not included in the scheme but afterwards food products were included in the preferential list. The GSP treatment is not the same for all goods. It depends on the nature of goods, i.e. sensitive, semi-sensitive and in general category.[3] Trade in textiles is controlled by the MFA, a bilateral system outside of the GATT

[3] This list is prepared as per the classification done in the Indo-EC textile accord in December 31, 1994, Cf. Commission of the European Communities, Official Journal of the European Communities, Brussels, December 1994, p. 9-22.

framework. GSP facilities have also extended to the items covered by MFA. The Preferential (GSP) treatments are given mainly to three types of products, *viz.* (a) agricultural goods, (b) textile items, and (c) industrial goods. India is amongst the few developing countries in Asia, which are given extensive GSP coverage to its exportable to the EC.

In 1981, 73.08 per cent of India's total exports to the EC were eligible for the latter's preferential (GSP) treatment, it declined to 57.38 per cent in 1982 and 70.54 per cent in 1990 but slightly increased to 74.76 per cent in 1992. This showed that EC's GSP scheme was not successful in promoting Indian exports, which, on the other hand, implied that EC's GSP scheme had not been popular in India over the years, whatsoever the reasons may be, the picture of actual utilization is even more dismaying[4]. In 1981, 42.39 per cent of the items covered by GSP beneficial actually, i.e. actual utilization ratio (i.e. ratio of total value of items actually to the total value of items eligible for GSP treatment) was 42.39 per cent in 1981, which increased to 61.55 per cent in 1992. This trend implied that, over the years India had been trying its best to improve its GSP utilization. The worst year in respect to GSP utilization was 1984 when the ratio dropped to 24.77 per cent from 45.76 per cent in the preceding year. However, this disappointing performance in GSP utilization has improved significantly in the latter years. Notwithstanding several concerted efforts to improve actual utilization of the EC's GSP facility, actual utilisation has been low because until now (i.e. 1992) it covered barely half of India's total exports to the EC. In 1981, approximately 31 per cent of India's total exports to the EC received GSP benefits, reduced to the lowest level in the next year when this ratio plummeted to 24 per cent. However, it again improved in the successive years and finally reached 46.02 per

[4] For reasons for failure of the GSP utilization, see Vincent Cable and Anne Weston, South Asia Exports to the EEC: Obstacles and opportunities, (London: Overseas Development Institute, 1979), pp. 159-162.

cent in 1992. During the same period, compound growth rate of GSP utilization was 14.76 per cent, whereas in case of coverage ratio it was 9.87 per cent, which meant less and less items were covered by GSP.

2.7 The ECs New GSP Scheme:

The EC's GSP scheme has been a 10-year phenomenon. On completion of the first 10 years, revision took place on 1st January, 1981 which was followed by a mid-term revision on 1st January, 1986. The next revision was delayed because of a stalemate in finalizing the Uruguay Round of Multilateral Trade Negotiations. Finally the EC Council at a meeting held on 19th December, 1994 approved the new GSP Scheme which entered into force on 1st January, 1995 (Official Journal of the European Community, 1994 and Mission of India to European Union, 1995). The scheme, only covers industrial products and was valid for 4 years (1995-98). It is clear from the new scheme that the existing GSP scheme for agricultural products was rolled over for 1995. The list of beneficiary countries also remained unchanged with the addition of South Africa only. Presently as many as 147 developing countries have been enjoying GSP benefits extended by the EC. The entire basket of imports covered by GSP has been segregated into four groups, e.g. very sensitive, sensitive, semi-sensitive and non-sensitive. In the new scheme, GSP quotas and ceilings have been abolished and all items have been categorized under four major groups depending on the sensitivity mentioned above. Very sensitive items attract the highest rate of duty 85 per cent of the common external tariffs (CET) of the EC under MFN and thus getting a waiver of 15 per cent only. The "sensitive" category attracts a duty rate of 70 per cent and is thus eligible to get 30 per cent waiver of the MFN tariffs. "Semi-sensitive" items are subject to 35 per cent tariff, obtaining 65 per cent waiver of the MFN rate. Non-sensitive items are excluded from the duty list.

In the revised GSP scheme, the EC has introduced "Graduation

Clause" which means more advanced developing countries are excluded from the GSP facilities with a view to imparting more and more facilities to the poor countries. The graduation clause is both "product specific" and "country specific". The main features of the graduation clause are:

i) The graduation clause is supplemented by "solidarity mechanism" which applies to beneficiary countries whose total exports of item exceed 25 percent of the value of total imports of that product into EC from all beneficiaries of GSP, they would be excluded from GSP in that particular item w.e.f. 1st January, 1995

ii) Current GSP beneficiaries with per capita GNP in excess of US $600 would be entitled 50 per cent of the GSP benefit from April 1995 to 31st December 1995. With effect from 1st January 1996, GSP benefits are totally withdrawn from these countries. The targeted countries were: Hong Kong, Singapore, South Korea, Saudi Arabia, Oman, Brunei, Qatar, United Arab Emirates, Kuwait, Bahrain, Libya and Nauru.

iii) Those countries with less than $6000 per capita GNP, would continue to enjoy GSP benefits in sectors in which they have attained a high degree of trade specialization and would be entitled to only 50 per cent of the GSP benefits in these sectors with effect from 1st January 1997.

iv) The EC has decided that preferential access for individual beneficiary countries would be stopped with immediate effect if it is proved that operation of the graduation mechanism has resulted in providing certain beneficiary countries with greater access for specific products than available to them under the existing GSP scheme.

v) The GSP benefit would be completely withdrawn from 1st January 1999.

vi) Instead of GSP scheme, the EC introduced "Special Incentive Scheme" with effect from 1 January 1999. Under this scheme EC extended additional preferences to these GSP beneficiaries that make a written request and provide evidence to the effect that they have adopted and effectively implemented the provision of ILO Convention No. 87 and 98 concerning freedom of association and protection of the right to organize and bargain effectively and of the ILO Convention No. 138, concerning minimum age for admission for employment; furthermore, tariff preferences was given to those countries that strictly adhere to social and environmental clauses.

2.7.1 Implications of EU's New GSP Scheme for Indian Exports:

Before the introduction of new scheme, India was one of the largest beneficiaries of the EC GSP scheme. GSP utilization ratio of Indian goods to the EC market has been very low over the years. In 1981, 30.97 per cent of its total exports received GSP benefits in the EU market, of which 3.9 per cent was from exports of agricultural products. In 1990, GSP utilization ratio increased to 44.25 per cent of which 2.95 per cent were from agricultural exports, 18.68 per cent from textile exports and 15.66 per cent from industrial goods exports.

India was concerned about the new GSP scheme, because India graduated from the GSP facility with effect from 1st January 1997 due to its specialization in textiles, garments and leather which are considered as very sensitive in the EC market. Textiles are the only major group whose prospect is uncertain in the EC market after the removal of GSP facility. Not only have textiles been put into the very sensitive category of the GSP list but also all these items have been under stringent MFA quota as well. However, GATT prescribes 6 per cent growth in all quota items (HS category 50-63) but in fact; EC's permissible growth has been only 0.5 to 2 per cent over the years (Sharma, 1984). In spite of stringent quota, the EC has also enforced complicated structure of NTBs. Apart from non-transparent barriers; average (weighted) rate of tariffs of the quotas affected items has been consistently high. Against the average duty of 3-4 per cent (of the rate of customs tariffs), these items will bear levies between 15 and 20 percent. A simple reduction of MFN tariff by 15 per cent (7 per cent after 1st January, 1997) could not help Indian exports in a very significant way.

Another area of concern is that under the Uruguay Round tariff reduction commitments, developed countries pleaded to reduce tariffs on all manufactured goods by 38 per cent. However, under the new GSP scheme, the EC has agreed to reduce only 15 per cent on textile items. Even for highly sensitive items, this reduction was only 12 per cent (*Submission of Tariff Reduction Schedule by the EC* , WTO, 1994).

Under the new provision, the countries with per capita income less than $ 6,000 enjoyed GSP facility in sectors, in highly specialized sector and received only 50 per cent of the GSP benefit. Thus in "very sensitive" and "sensitive" categories India received only preferential benefits of 7.5 per cent and 15 per cent respectively. Even this preferential treatment was withdrawn when India was "graduated" w.e.f. 1st January 1999. Through Council Regulation (EC) No. 2501/2001 on 10th December 2001, a new GSP Scheme came into force from 1st January 2002 to 31st December 2004. The European Community adopted a new Generalized System of Preference (GSP) to foster sustainable development. The new Regulation complements and fully incorporates the recent "Everything but Arm (EBA) initiative in favour of Least Developed Countries (LDCs). The EBA provides for duty and quota-free access to 49 LDCs. The new GSP is for the period 2002-2004. The salient features in the new GSP Scheme were Simplification and attractiveness, better targeting and adoptability. With more than €5 billion of preferential imports to the EU, India ranked second among the users of the EU's GSP. In the years to come, the social and environmental clauses will dominate in the trade policy commitments of the developed countries. These countries have already started thinking to link social clauses with the trade preferences given to developing countries. The EC is vocal about it. In the new GSP scheme, The EC has already linked GSP facilities with improvement of labour standards, human rights treatment and protection of environment. The EC already achieved a considerable amount of success in garnering support from other developed countries. In the new GSP scheme, the EC also declared a special system of incentives in the form of additional tariff preferences to those GSP beneficiaries that would effectively implement the social and environment standards. This is an ominous trend to a developing country like India, where labour and environmental standards are at a sub-optimal stage.

Another area of reservation is that in the new system, preferences will not be given to those items, which are under anti-dumping and anti-subsidy investigation/measures unless it is shown that the said duties are based on a price reflecting the preferential tariff arrangements granted to the countries. This measure poses a real threat to India's textile exporters in the EC market because a host of our textile products is under anti-dumping investigations. Under the pretext of dumping, EC may initiate antidumping investigation on these items in which India has strong competitiveness and can scrap preferential treatment.

Application of "safeguard" is another danger for Indian exports to the EC, On the ground of material injury to the domestic industry, developed countries are given a free hand to enforce "safeguard" or "transitional safeguard" (GATT Article XIX) on any competitive product imported from developing countries. The new scheme will also have a safeguard clause analogous to the provision of GATT to cope with significant unexpected imports of a product, which cause or threaten to cause serious difficulties to a "community producer" of the like or directly competing product. In such cases, common customs tariff duties may be reintroduced on that product at any time at the request of a member State or on the Commission's own initiatives.

In the new GSP scheme, the EC wants effective protection of environmental standards through the enforcement of International Convention on Environment (Agenda 21). For this purpose, the EC intends to apply special incentive arrangements initially for tropical wood products from forests, which are sustainably managed in conformity with International Tropical Timber Organization (ITTO) standards. It is also understood that the margin of additional incentives being considered under these conditions may be 20 per cent of the MFN tariff. Implications of this measure to India are not quite clear. Undoubtedly, this measure will discourage consumption of forest products.

2.8 Bilateral Trade Relation between India and EU:

Present Scenario:

The bilateral trade between India –EU constitutes a quarter of India's total trade. EU is an important trading partner for India, accounting for 16% of Indian exports and 11% of imports in 2014-015 (April-June). India's trade with EU has grown substantially in the last twenty-five years. In 1980s, Indian exports to Europe were less than 2 billion European Currency Units (ECUs). However, in 1990s it increased to 5 billion ECUs. This further increased to 13 billion Euro (€) in 2001. In 2003, the level of EU trade was 28.6 billion €, however, it reached up to 72.7 billion € in 2013. EU's total trade with India was around 13.3% in 2013-2014 with India's export share of 16.4 % and import share of 11.1%; but its impact on India's overall economy was much greater.

However, the trade balance was consistently in EU's favour. The growth in volume of Indo-EU trade encompasses not only products in traditional sectors but almost in all sectors including industrial and service sectors. The importance of India as an important trade partner of EU is evident from the data given in the table 2.1 below. Table 2.1 shows the top 15 trading partners of EU in 2014.

Table 2.1: Top 15 Trade Partners of EU in 2014

Rank	***Trade Partner***	***Trade Value (€ million)***	***Trade Share (%)***
1	USA	484,361	14.2
2	China	428,392	12.5
3	Russia	325,926	9.5
4	Switzerland	263,871	7.7
5	Norway	140,289	4.1
6	Turkey	128,156	3.7
7	Japan	110,641	3.2
8	South Korea	75,808	2.2
9	Brazil	73,140	2.1
10	India	72,683	2.1
11	Saudi Arabia	63,833	1.9
12	Canada	58,912	1.7
13	Algeria	54,340	1.6
14	UAE	53,873	1.6
15	Singapore	46,757	1.4
16	***Total EU Trade***	***3,420,553***	***100%***

Source: Director General for Trade, European Commission, 27th August, 2014

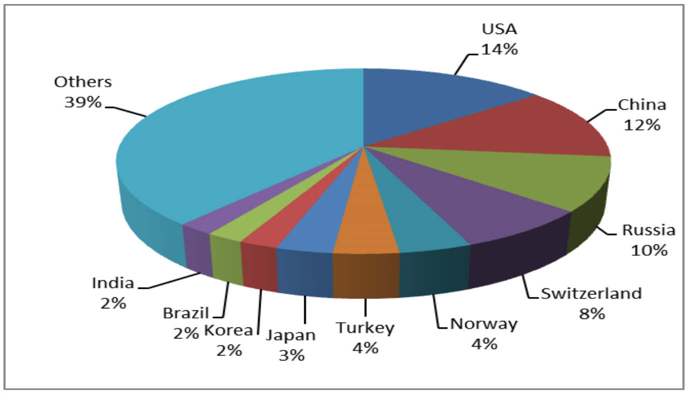

Fig. 2.1: Top 10 Trade Partners of EU (2014)

Table 2.2 shows the top 15 exporting countries to EU in 2014.

Table 2.2: Top 15 Exporting Countries to EU in 2014

Rank	***Trade Partner***	***Trade Value (€ million)***	***Trade Share (%)***
1	China	280,095	16.6
2	Russia	206,146	12.3
3	USA	196,098	11.7
4	Switzerland	94,305	5.6
5	Norway	90.064	5.4
6	Japan	56,565	3.4
7	Turkey	50,401	3.0
8	India	36,809	2.2
9	South Korea	35,840	2.1
10	Brazil	33,096	2.0

11	Algeria	31,920	1.9
12	Saudi Arabia	30,143	1.8
13	Nigeria	28,739	1.7
14	Canada	27,289	1.6
15	Kazakhstan	23,599	1.4
16	***Total EU Export***	***1,682,592***	***100%***

Source: Director General for Trade, European Commission, 27th August, 2014

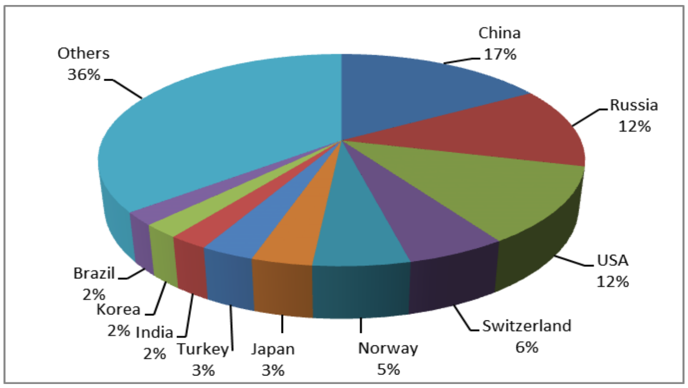

Fig. 2.2: Top 10 Exporting Countries to EU (2014)

Table 2.3 shows the top 15 importing countries from EU in 2014.

Table 2.2: Top 15 Importing Countries from EU in 2014

Rank	***Trade Partner***	***Trade Value (€ million)***	***Trade Share (%)***
1	USA	288,263	16.6

2	Switzerland	169,566	9.8
3	China	148,297	8.5
4	Russia	119,780	6.9
5	Turkey	77,755	4.5
6	Japan	54,076	3.1
7	Norway	50,225	2.9
8	UAE	44,652	2.6
9	Brazil	40,043	2.3
10	South Korea	39,968	2.3
11	India	35,874	2.1
12	Hong Kong	35,749	2.1
13	Saudi Arabia	33,689	1.9
14	Australia	32.092	1.8
15	Canada	31,623	1.8
16	***Total EU Import***	***1,737,961***	***100%***

Source: Director General for Trade, European Commission, 27th August, 2014

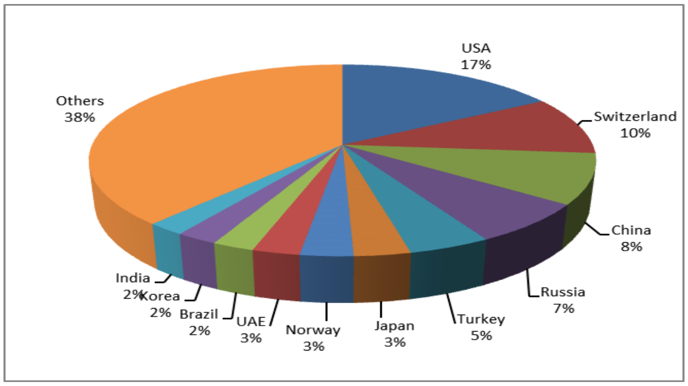

Fig. 2.2: Top 11 Importing Countries from EU (2014)

India's major trading partners in EU are Germany accounting for 2.6% of total trade of India, followed by Belgium with 2.5 %, UK with 1.8%, and Italy with 1.2 % in October 2014 (Ministry of Commerce and Industry, Government of India, Oct., 2014).

Trade in services reached € 22.2 billion in 2011. Indian service exports to the EU grew by 18.68% to €10.8 billion from € 9.1 billion in 2010. Indian service imports which stood at € 11 billion in 2010 remained more or less stable at € 11.4 billion.

The EU is an important source of Foreign Direct Investment for India. India receives only 0.6% of EU's worldwide investments. Similarly, while the EU accounts for 25% of India's Foreign Direct Investment (FDI) during the period January 2000 to December 2012 (*Source: FDI Synopsis on Country European Union, Table No. 6.1. (B), DIPP, Government of India*). FDI inflows from the EU into India increased from €3.5 billion in 2009 to €7.5 billion in 2010 and €14.19 billion in 2011. Indian investment into the EU saw a decline from €0.945 billion in 2009 to €0.48 billion in 2010 but rose again in 2011 to nearly €2 billion. The leading EU member-state investors in India during April 2000 to July 2014 were the UK with total FDI inflow USD 21,587.57 million which was 9.46% of total FDI inflows to India followed by Germany with USD

6,832.62 million (2.99 % of toal FDI inflows to India. Spain had a share of 1,920.12 million USD which was 0.84% of total FDI inflow to India during the above-mentioned period. Total FDI inflows from Italy was 1,452.40 million USD that was 0.64% of total FDI inflows to India followed by Luxembourg with 1,088.65 million USD that was 0.48%) then by Sweden, Belgium and Poland with USD 1,033.41 million (0.45% of total FDI inflows to India), USD 771.26 million (0.34% of total FDI inflows to India) and USD 615.66 million (0.27% of total FDI inflows to India) respectively.

India has signed a *Bilateral Investment Protection Agreements (BIPA)* with 16 members of EU-28 to facilitate the flow of investment and joint ventures between India and the EU member nations. India has also signed a *Double Taxation and Avoidance Agreement (DTAA)* with 18 members of EU – 28. Efforts are still on to sign the above-mentioned with Lithuania, Estonia, Latvia, and Slovenia. India is giving emphasis on signing Mutual Legal Assistance Agreement with EU for Civil and Commercial Matters in the line of Trade Secret Act, IT Act, and the various agreements on TRIPS under WTO for protection of Intellectual Property Rights in order to complete the enhanced cooperation with EU in bilateral trade. There exist several restrictions by EU member states, which repeatedly create problems for the entrepreneurs and investors of developing countries including India. This goes against the spirit of strategic partnership.

2.9 India-EU Proposed Free Trade Agreement in Progress:

India and EU began negotiations for a Free Trade Agreement (FTA) in 2006. Since then there had been six rounds of discussions between the two parties. It is expected that the final negotiations would be completed in 2009.

Potential Benefits of an EU-India FTA:

(i) There appears to be comparatively little sectorial overlap on trade structures or measures of revealed comparative advantage on goods between the EU and India. This would suggest that the two parties have somewhat different offensive and defensive interests which in principal should make negotiation of an agreement easier.

(ii) The share of India in the trade of the EU is low (around 1.5% for both imports and exports), and therefore liberalization with India is unlikely to be perceived as a major threat. The share of the EU in India is higher (share of imports = 25%; share of exports = 21%. However, India's trade is becoming substantially and increasingly diversified by geographical source over time, and the share of the EU has significantly declined since the early 1990s. We therefore also conclude that liberalization with the EU is in general unlikely to be perceived as a major threat, though there may be specific sectors where particular issues arise.

(iii) Services is the fastest growing part of the Indian economy and India has offensive interests in GATS mode 1 (call centers, down the line software engineering) and mode 4 (business visas, software engineers, accountants, lawyers in both directions) liberalization. Both parties are therefore interested in including services in a FTA agreement.

(iv) It would also appear from discussions with relevant officials that agricultural liberalization is unlikely to be a major demand from either party in an FTA and that exclusion of sensitive products on either side is likely to be manageable within the substantially all trade criterion of the WTO.

Potential for 30% increase in each way flows of bilateral FDI as a direct result of signing an FTA

(v) In recent years the attractiveness of India as a destination market for foreign direct investment has substantially increased and this has been reflected in an increase in FDI inflows. However, available evidence also suggests that there are a number of structural impediments in India which result in implemented levels of FDI being much smaller than the approved levels. Those impediments relate to procedural issues, labour laws, levels of corruption and overlapping jurisdictions between states and central government and so on. Improvements with regard to these impediments are likely to significantly increase the attractiveness of India for foreign direct investment.

(vi) Investment caps in a number of sectors suggest potential for national treatment or higher caps for EU firms.

(vii) Our formal gravity modeling suggests a positive relationship between the formation of regional trade agreements and foreign direct investment. Our estimated coefficients suggest that an EU-India FTA is likely to increase FDI flows from the EU by 27%, and FDI stocks by 18%.

Potential for economic gains for both sides from deep integration

(viii) The growth in FDI is closely linked to the potential for gains arising from deeper integration between the EU and India. Increased FDI is, for example, likely to foster faster technical change and total factor productivity growth, exploitation of scale economies arising from increased specialization, and/or may help to generate positive externalities between firms and/or sectors.

(ix) India has a high and fast-growing share of trade in vertically integrated intra-industry trade (IIT) suggesting it is integrating into global supply chains and specializing in a productivity enhancing way. The gains arising from such vertical specialization are also likely to be higher to the extent that an EU-India FTA promotes deep as well as shallow integration.

(x) The growth of FDI and the growth of vertically integrated trade suggest that there is a clear case for discussing regulatory approximation between the partners to further enhance the gains from deeper integration.

(xi) The services sector is extremely important for the two trading partners and from the perspective of this FTA; a substantial coverage of services as in GATS Article V could help deliver improved access to mutual markets and possibly more rapid liberalization of India's services than can be accomplished unilaterally or multilaterally. The challenge for the FTA is not only to accelerate liberalization in India's services sectors, but also to facilitate the implementation of a range of complementary reforms designed to improve the quality of regulation. An important objective for an EU-India FTA would thus be to consolidate the extent of market access in IT and telecom services, to significantly improve market access in the moderately liberalized services, and to open up the sectors that are completely closed at present.

(xii) Trade facilitation is a key issue. There are clear problems in India relating to transparency, different implementation/enforcement policies, complex procedures for calculating customs duties, delays in customs clearance and inter-state variations in internal transit procedures. To the extent that these issues can be successfully resolved or improved upon, the gains from bilateral integration are likely to be that much higher.

(xiii) Government procurement issues are likely to be important for the EU. Public purchase policies in India are often subject to non-transparency, lack of national treatment and the absence of a formal system for redressing grievances in the award of contracts. There is clear potential for gain for both parties by redressing these difficulties.

Potential for Regulatory Convergence

(xiv) Indian standards are not always consistent with international norms. Where they diverge from international norms, it appears that they do not have any obvious efficiency rationale, and therefore they may be set for protectionist reasons. An FTA could eventually help India converge to international norms if backed by mutual recognition of testing and certification. There are issues on both sides here, and while it would be a major challenge, it could be important in areas relevant to market led deep integration and in expanding bilateral intra-industry trade. FTAs rarely offer more than an expression of hope for mutual recognition but it would appear that the economic benefits might well be significant in areas where there is already a developing market.

(xv) An FTA with the EU, particularly including deep integration, could help India to bind domestic regulatory reforms and underpin MFN trade liberalization.

Potential costs of EU-India FTA

Trade diversion:

(i) India has average applied MFN tariffs on goods of 16% with very high tariff peaks (up to 160%) on a relatively small number of goods. This, coupled with the relatively small (25% excluding petroleum products) and declining EU market share (from over 40% in the early 1990s) and the low overlap in production structures between the EU and India, suggests that there is considerable scope for trade diversion for India. This would imply India increasing its imports from the EU but at the expense of more efficient suppliers from third countries.

(ii) For the EU, India's share in imports and exports is around 1.5% with some increase over the last decade. The low share of trade with the EU coupled with the low tariffs applied by the EU on Indian exports (though with a higher incidence of tariff peaks) suggest that there is little scope for trade creation, and again more likelihood of trade diversion.

(iii) Diversion away from more efficient third country suppliers may also apply in services trade and FDI if the FTA gave preferential regulatory regimes to the EU, such as the removal of investment caps in service sectors where other suppliers had begun to enter, but where there is negligible foreign entry to date, EU firms would expand supply to the benefit of consumers while perhaps at the expense of Indian firms i.e. create trade.

Structural and policy impediments in the Indian economy which may limit the gains from deep integration

(iv) In a range of areas such as government procurement, trade facilitation, investment etc. there are important difference between state and central government policies. Hence, even if agreement is achieved with the Central Government, the potential for gain is likely to be diminished by policies and procedures at the state level.

(v) Transparency is a major problem across a range of issues which include investment, trade facilitation and government procurement, as well as SPS and TBT. This applies at both the central and state level, and clearly, a lack of transparency is also likely to limit gains from deep integration.

(vi) Foreign Direct Investment is partially regulated for service by GATS commitments, but these commitments are below those under autonomous liberalization. State level regulations and procedural difficulties appear to inhibit FDI even where investment authorization at the center is automatic.

(vii) There are some concerns about the application and enforcement of Indian Competition law, and dealing with this in the context of a

FTA is unlikely to be straightforward.

(viii) Evidence also suggests that there are significant non-tariff barriers to trade in India, which appear to be approximately of the same order of magnitude as the tariff barriers themselves. The continuation of such barriers will again lessen the potential gains derived from tariff liberalization. It is worth pointing out however, that agreement on deep integration issues as identified earlier (such as trade facilitation or standards) is likely to reduce the height and incidence of the NTBs.

(ix) The divergence of Indian standards from global norms suggests embedded protectionism which may block benefits from an FTA. Large scale harmonization and adoption of international standards across the Indian economy for all domestic producers would be a major challenge, not to mention costly in the medium term for producers and probably consumers. However, Indian exporters able to meet international norms would benefit from cooperation on conformity assessment, as would EU exporters to India.

Chapter 3

India - EU Trade: Performance and Composition

3.0 Introduction:

There have happened several changes in India’s trade with the European Union during pre-liberalization and post- liberalization period. Therefore, it is imperative to know the performance of India’s trade with EU from the point of viewof trade composition and performance. By composition means the items of India’s exports and imports baskets to European Union. Further, what is the prospect of India’s trade with EU?

3.1 India’s Exports, Imports and Balance of Trade with EU:

The European Community (EC) has been India's largest trading partner for more than two decades followed by USA and Japan[5]. The EC's share in India's trade has been growing persistently over the years beginning 1981. In 1980-81, 21.57 per cent of India's total exports were directed towards the EC, while 21.03 per cent of India’s total imports came from the EC. From 21.57 per cent in 1980-81, the share of EC in India's total exports increased to 28.30 per cent in 1992-93, but declined slightly to 26.06 per cent in 1993-94. India's import have also exhibited similar trend. The share of the EC in India's total imports had also gone up from 21.03 per cent in 1980-81 to 30.18 per cent in 1992-93 and marginally declined to 30.04 per cent in 1993-94 (Foreign Trade Statistics, Ministry

[5] EC was the amalgam of 12 countries up to 31 December 1994, and became 15 members’ states thereafter. In the WTO, EC is considered as a single contracting party, because it is a trading bloc and has already completed integration of internal market, we consider EC as a single trade partner.

of Commerce, Government of India).

Presently, the EUs contribution to India's trade (both export and imports) is about one-fourth of the total. Not only the EUs share in India's total trade increased over the years, but also the composition of India's exports to the EU has diversified significantly. We have discussed this while examining the commodity composition of Indo-EC trade over the years. Due to several reasons such as India's good economic and political relationship with Germany, France, Italy and UK etc. the regional diversification has occurred. As a result, the India's exports to some member states have increased disproportionately in comparison to others.

India's trade with EU reached the level of €75.8 billion in 2012 but there exist fluctuations in trade balance due to fluctuations in India's exports and imports over the years. In 1980-81, India had a trade deficit with the EU to the volume of USD (-) 1282 million, which increased in the subsequent years and the magnitude of the deficit reached at USD (-) 4259 million in 1987-88. There after it declined and reached to USD (-) 704 million in 1995-96 and USD (-) 591 million in 2001. However, the quantum of both way trade has jumped significantly over the years. In the year 2000, the trade deficit was to the lowest possible level in the last twenty years of trade. The difference between exports and import was only (-) 99 million USD. The above-mentioned implies a favorable trade balance for EU always.

India's export to EU has increased from 1,944 million USD in 1980 to 10,411 million USD in 2000. It further increased to USD 51,581 million 2013 recording an average annual growth rate of 13.1 % during 2000 to 2013. The import increased from 3,226 million USD to 10,510 million USD in between 1980 to 2000. It further increased to 49,950 in 2013 recording an average annual growth rate of 12.7 % during 2000 to 2013. The total trade went up from 5,170 million USD to 20,921 million USD during 1980 to 2000. It further increased to 101,532 million USD in

2013 recording an average annual growth rate of 12.9 per cent.

India’s exports, imports, total trade and trade balance with EU for the period 1980-81 to 2013 is presented in table 3.1.

Table-3.1: India's Exports and Imports with EU During 1980-2013 *(Value in million USD)*

Year	*Exports*	*Annual Growth Rate of Exports (%)*	*Imports*	*Annual Growth Rate of Imports (%)*	*Trade Balance*	*Total Trade*	*Annual Growth Rate of Total Trade (%)*
1980	1,944	-	3,226	-	-1,282	5,170	-
1981	1,290	-33.64	3,191	-1.08	-1,901	4,481	-13.33
1982	2,448	89.77	4,088	28.11	-1,640	6,536	45.86
1983	1,871	-23.57	3,878	-5.14	-2,007	5,749	-12.04
1984	2,139	14.32	4,138	6.70	-1,999	6,277	9.18
1985	2,055	-3.93	4,828	16.67	-2,773	6,883	9.65
1986	2,145	4.38	6,251	29.47	-4,106	8,396	21.98
1987	2,958	37.90	7,217	15.45	-4,259	10,175	21.19
1988	3,417	15.52	6,285	-12.91	-2,868	9,702	-4.65
1989	4,497	31.61	6,304	0.30	-1,807	10,801	11.33
1990	4,703	4.58	7,346	16.53	-2,643	12,049	11.55
1991	4,844	3.00	5,520	-24.86	-676	10,364	-13.98
1992	5,491	13.36	6,839	23.89	-1,348	12,330	18.97
1993	5,524	0.60	6,748	-1.33	-1,224	12,272	-0.47
1994	6,605	19.57	7,357	9.02	-752	13,962	13.77

1995	8,233	24.65	8,937	21.48	-704	17,170	22.98
1996	8,655	5.13	10,382	16.17	-1,727	19,037	10.87
1997	9,089	5.01	10,633	2.42	-1,544	19,722	3.60
1998	8,947	-1.56	10,724	0.86	-1,777	19,671	-0.26
1999	9,382	4.86	10,949	2.10	-1,567	20,331	3.36
2000	10,411	10.97	10,510	-4.01	-99	20,921	2.90
2001	9,846	-5.43	10,437	-0.69	-591	20,283	-3.05
2002	11,886	20.72	12,835	22.98	-949	24,721	21.88
2003	14,517	22.14	15,075	17.45	-558	29,592	19.70
2004	18,249	25.71	19,302	28.04	-1,053	37,551	26.90
2005	23,229	27.29	25,998	34.69	-2,769	49,227	31.09
2006	26,831	21.23	29,856	16.07	-3,025	56,687	15.15
2007	34,535	21.17	38,450	15.28	-3,915	72,985	28.75
2008	39,351	21.24	42,733	14.07	-3,382	82,084	12.47
2009	36,028	20.16	38,433	13.33	-2,405	74,461	-9.29
2010	46,039	18.33	44,540	12.05	1,499	90,579	21.65
2011	52,556	17.18	56,872	11.62	-4,316	109,428	20.81
2012	50,421	16.78	52,275	10.65	-1,854	102,696	-6.15
2013	51,581	16.41	49,951	11.10	1,630	101,532	-1.13

Source: Trade Statistics, Export-Import Data, Ministry of Commerce, Government of India.

Figure 3.1 shows the graph of exports, imports and balance of trade of India with EU during the period 2000 to 2013. The linear increment of total trade during the period 1980 to 1990 and exponential increment of total trade during the period 1991 to 2013 is very clear from the above-mentioned.

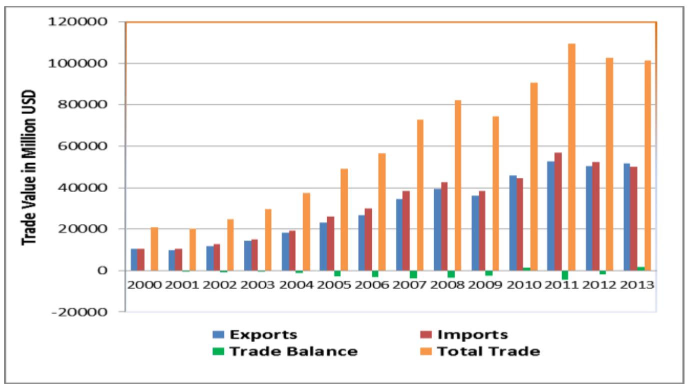

Figure 3.1 - India's Trade with EU (2000-2013)

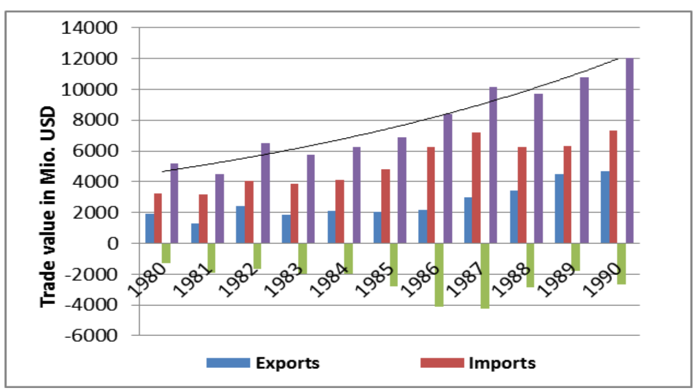

Figure 3.2: Trend of India's Trade with EU (1980-1990)

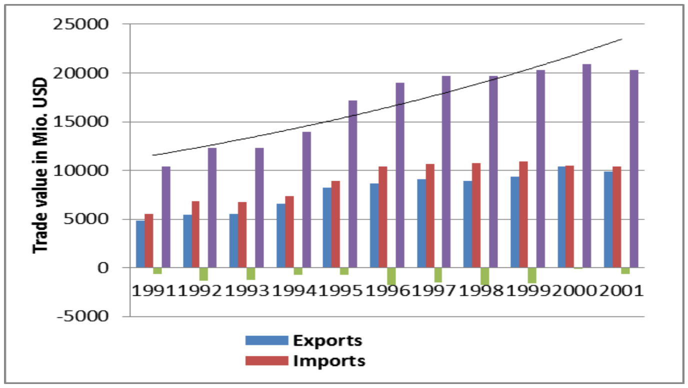

Figure 3.3: Trend of India's Trade with EU (1991-2001)

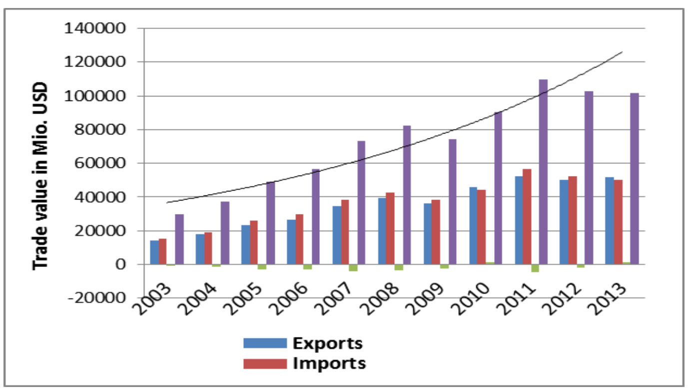

Figure 3.4: Trend of India's Trade with EU (2003-2013)

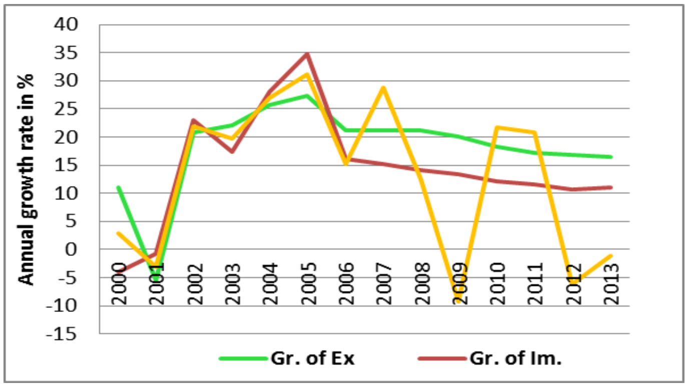

Figure 3.5: Annual Growth of India's Exports, Imports and Total Trade with EU (2000-2013)

The negative growth rate exports in 1981 and 1983 were mainly because of non-diversification of India's export market. In this pre-liberalization period, India's economy was governed by labyrinthine of rules and regulations. The Chinese economy had started their economic liberalization progromme around this time. As a result, their export basket was more diversified in comparison to India's export basket. Thus, Chinese were more successful in exporting traditional items to EU market at a better price than India. The negative growth rate of imports as well as total trade in 1988 and 1991 was because of the severe balance of payment crisis that India faced around this time. However, the negative growth rate of exports, imports and total trade in 2001 was the combined effect of 9/11 incidents and Asian Agriculture Shock around that time. The poor performance of Indian economy resulted in negative growth in 2009, 2012 and 2013. During the period 2001 to 2005 the growth rate of India's import from EU was more than the growth rate of its export to EU except 2003, however this trend got changed from 2006 onward up to 2013. During this period the growth rate of India's export to EU was more than the growth rate of its import from EU. This resulted a favourable balance of payment position for

India with EU during 2010 and 2013.

The future trade between India and EU can be calculated by using a suitable forecasting technique. Here we have adopted the Annual Average Growth Rate method. The result obtain in this method can be checked with Forecasting by Exponential Method.

3.2 Projection of India-EU Trade:

The future trade between India and EU has been projected taking into account the average annual growth rate of trade for the past periods.

Here we have projected the future trade using the following formula[6]:

$T_{pn} = T_{n-1} + (T_{n-1} * X\ \%)$

Where T_{pn} = Trade Projection for n –year

T_{n-1} = Trade in n-1 year

X % = Compound Growth Rate of trade (annual) for a time period.

---

[6] For calculation of India-EU Trade in 2014, We have used the formula:

$T_{pn} = T_{n-1} + (T_{n-1} * X\ \%)$

Where T_{pn} = Trade Projection for n –year =2014

T_{n-1} = Trade in n-1 yea = Actual Trade in 2013 = 101,532 million USD

***X % = Compound Growth Rate of Trade (annual) for a time period*.**

= Average Annual Growth Rate of Trade from 2003-2013 (past ten years growth rate in trade

= 13.12% (Values are taken from Table 3.1)

This is calculated using formula

If $\beta_1 = \beta_0 \{1+(r/100)\}^t$ then $r = \{ (\beta_1 / \beta_0)^{1/t} -1\}*100$

where r = compound rate of growth , β_1 = estimated value of trade at the end of the year, β_0 = estimated value of trade at the beginning of the year, t= No. of Years

T_{2014} =101532+ (101532*13.12%) = 114,854

For the projection of Indo-EU trade in 2014 to 2020, we have taken average annual growth rate of trade for the past ten year between India-EU trade i.e. 2003-2013. The compound average annual growth rate of trade in this was 13.12%. The future trade (approximate) between India-EU has been calculated applying above CAGR for the year rest of the year from 2014 to 2020. The trade projection is shown in Table 3.2. This method of calculation predicts a trade value of 129,924 million USD for the year 2015.

Table-3.2: India-EU Trade Projection from 2014 to 2020

(in Million USD)

Year	*Projected Trade (approx.)*
2014	114,854
2015	129,924
2016	146,971
2017	166,255
2018	188,069
2018	212,745
2020	240,659

NB: Calculated at existing compound average annual growth rate of 13.12%

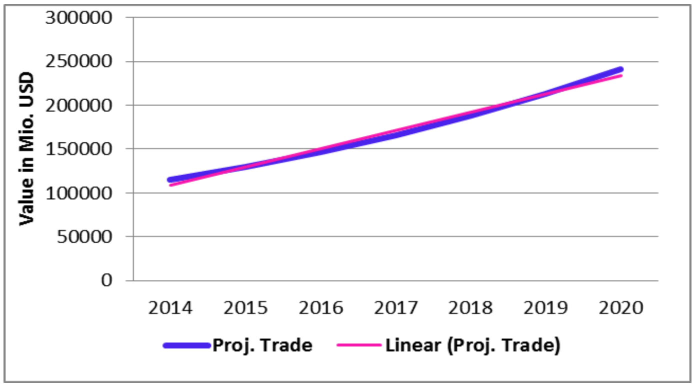

Figure 3.6: Trade Projection from 2014 -2020

3.3 India-EU Trade Forecast using Exponential Smoothing Method*:*

This method, predicts the future Indo-EU trade using exponential smoothing tools. The exponential smoothing analysis predicts a value based on the forecast for prior period, adjusted to the error in that prior forecast. The tool uses smoothing constant α, the magnitude of which determines how strongly forecasts respond to error in the prior forecast. The formula of Trade Forecast in this method is:

$$F_t = F_t + \alpha (A_{t\,-} F_t) = F_t + (1\text{-damp Fact}) (A_t - F_t) \qquad 0 < \alpha < 1$$

For any time period t

F_t *=Smoothed Observation*

A_t *= Original Observation*

α *= Smoothing Constant*

t = the subscripts refer to the time periods; 1, 2 ….n

Values of 0.2 to 0.3 are reasonable *smoothing constants*. These values indicate that the current forecast should be adjusted 20 to 30 for error in the prior forecast. Larger constants yield a faster response but can produce erratic projections. Smaller constants can result in long lags for the forecast values. Here the forecast trade value is calculated based on above formula using the original observation of India-EU trade projection presented above in Table 3.2. Using the Holt model, the results of exponential smoothing for original projected trade are estimated. The result is presented in Table 3.3. The table shows both projected trade (i.e original observation obtained through compound annual average growth rate method calculation) and trade forecast (i.e. estimated with exponential smoothing). The difference in trade in both procedures is shown as Standard Error (SE). Table below shows, India-EU trade is expected to cross 12,190 million USD by 2015.

Table 3.3: India-EU Trade Forecast

(Exponential Smoothing Method)

(Value in million USD)

Year	***Original Observation (A_t)***	***Smoothed Observation (F_t)***	***Standard Error***
2014	114,854	101,532	-13,322
2015	129,924	112,190	-17,734
2016	146,971	126,377	-20,594
2017	166,255	142,852	-23,403
2018	188,069	161,574	-26,495
2019	212,745	182,770	-29,975
2020	240,659	206,750	-33,909

The projected trade in exponential smoothing method is shown in Figure 3.7.

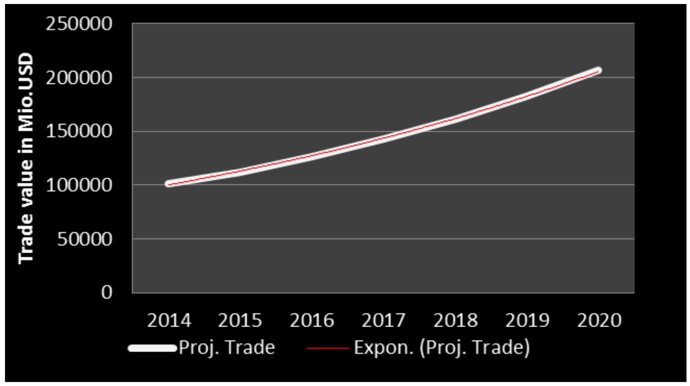

Figure 3.7: Projected Trade (2014-2020)

3.4 Composition of Indian Exports & Imports

Since 1986, all products have been codified in Harmonized System (HS) rather than erstwhile Custom Cooperation Council Nomenclature (CCCN) codes. While showing the market share of India's exports to the European Union[7], we have taken commodity groups at 2 digit level, and secondly considered three years viz. 1991,1996 and 2002 and have shown change in India's shares in the EU market.

For analytical purpose, we have again aggregated all groups (based on HS at 2-digit level) into 14 major groups[8]. Here also we have taken three years as mentioned above. The reason being such selection is to compare the relative changes of India's export shares during these periods. Fourteen major groups' areas follow:

(i) Agriculture and Marine Products, (ii) Minerals, (iii) Chemicals, (iv) Leather and Leather Products, (v) Wood, Paper and Board, (vi)

[7] CCCN coding was pre 1989 version of Harmonizes Commodity description.

[8] This suggestion of groups has been done by European Commission itself as HS-2 digit level. Commission of the European Communities, Ewrastaf (Section on EC's imports from India, Several Issues), Brussels.

Textiles and Clothing, (vii) Carpets, (viii) Umbrellas and Accessories, (ix) Stone, Ceramics and Glass, (x) Gems and Jewellery, (xi) Engineering and Electronics, (xii) Sport Goods, (xiii) Arts and Articrafts and (xiv) Miscellaneous.

3.4.1 EU's Imports from India during 1990 to 2000

In this section, we have focused on the compound growth rate of 97 items at HS 2-digit grouped into 14 major groups as described above.

Table 3.4: EU's Imports from India

(Growth Rates 1990-2000)[9]

HS code	*Commodity*	*India's Share in EU Imports (%)*	*India's Share in EU Imports (%)*	*India's Share in EU's Total Imports (%)*	*Growth Rate of India's Share in EUs Imports*
		1990	*1994*	*2000*	*1994-2000*
	Agricultural & Marine				
1	Live Animals.	0.008	0.0006	0.0023	25.10
2	Meat And Edible Meat Offal.	0.0004	0.001	0	
3	Fish And Crustaceans	1.1	1.88	1.4077	-4.71
4	Dairy Produce	-	0.0018	0.0219	51.66
5	Products of Animal Origin,	0.082	0.91	0.9042	-0.11
6	Live Trees	0.07	1.21	0.2694	-22.15
7	Edible Vegetables	0.06	0.16	0.3014	11.13
8	Edible Fruit And Nuts	0.33	0.94	1.2567	4.96

9 The growth rate is compound growth rate calculated using formula

If $\beta_1 = \beta_0 \{1+(r/100)\}^t$ then $r = \{ (\beta_1 / \beta_0)^{1/t} -1\}*100$ where r = compound rate of growth, β_1 = estimated value of export (or import) at the end of the year, β_0 = estimated value of export (or import) at the beginning of the year, t= No. of Years

HS code	Commodity	India's Share in EU Imports (%)	India's Share in EU Imports (%)	India's Share in EU's Total Imports (%)	Growth Rate of India's Share in EUs Imports
		1990	*1994*	*2000*	*1994-2000*
9	Coffee, Tea, Mate and Spices.	3.21	3.96	4.9867	3.92
10	Cereals.	0.46	0.61	1.3519	14.18
11	Malt; Starches	0.019	0.016	0.0305	11.35
12	Oil Seeds etc.	0.43	0.58	0.893	7.46
13	Lac; Gums etc.	-	4.49	7.8205	9.69
14	Vegetable Plaiting Materials	2.15	2.2	8.1365	24.36
15	Animal or Vegetable Fats	1.26	0.78	1.8963	15.96
16	Preparations of Meat, of Fish etc.	0.03	0.1	0.0789	-3.87
17	Sugars and Sugar Confectionery.	0.73	0.04	0.4457	49.45
18	Cocoa and Cocoa Preparations.	0.002	0.013	0.0001	-55.57
19	Preparations of Cereals, Flour.	0.09	0.1	0.0186	-24.45
20	Vegetables, Fruit	0.13	0.16	0.3933	16.17
21	Misc. Edible Prep.	0.06	0.11	0.1636	6.84
22	Beverages, Spirits and Vinegar.	0.005	0.006	0.0064	1.08
23	Waste from the Food Industry	1.36	1.04	0.1073	-31.52
24	Tobacco and Substitutes.	0.54	0.55	0.7931	6.29
01-24	*Agricultural & Marine*	*0.505*	*0.827*	*1.304*	7.89
			Minerals		
25	Salt; Sulphur etc.	1.28	2.57	2.5721	0.01
26	Ores, Slag And Ash.	0.6	0.67	0.3362	-10.86
27	Mineral Fuels etc.	0.09	0.07	0.0179	-20.33
25-27	*Minerals*	*0.657*	*1.103*	*0.975*	-2.03
			Chemicals		
28	Inorganic Chemicals etc.	0.1	0.18	0.2512	5.71

HS code	Commodity	India's Share in EU Imports (%)	India's Share in EU Imports (%)	India's Share in EU's Total Imports (%)	Growth Rate of India's Share in EUs Imports
		1990	***1994***	***2000***	***1994-2000***
29	Organic Chemicals	0.27	0.08	0.797	46.69
30	Pharmaceutical Products	0.05	0.04	0.991	70.74
31	Fertilizers.	0.0004	0.005	0.0204	26.41
32	Tanning or Dyeing Extracts	0.76	1.21	1.146	-0.90
33	Essential Oils and Resinoids	2.95	0.29	0.3341	2.39
34	Soap etc.	0.014	0.06	0.055	-1.44
35	Albuminoidal Substances	0.03	0.11	0.1886	9.40
36	Explosives	0.004	0.08	0.2127	17.70
37	Photographic Goods.	0.007	0.008	0.0139	9.64
38	Misc. Chemical Products.	0.06	0.25	0.192	-4.30
39	Plastic and Articles Thereof.	0.027	0.07	0.1609	14.88
40	Rubber and Articles Thereof.	0.05	0.13	0.3097	15.57
28-40	*Chemicals*	*0.332*	*0.193*	*0.359*	10.90
Leather & leather products					
41	Raw Hides and Skins	4.25	3.29	2.3813	-5.24
42	Articles of Leather etc.	6.94	10.44	8.1745	-4.00
43	Artificial Fur	0.016	0.24	0.1938	-3.50
41-43	*Leather & leather products*	*3.735*	*4.657*	*3.583*	-4.28
Wood, paper & board					
44	Wood	0.078	0.11	0.1208	1.57
45	Cork	0.0004	0.0007	0.003	27.45
46	Basket ware	0.38	0.9	1.2367	5.44
47	Pulpwood	0	0.00003	0.0028	112.98
48	Paper	0.0007	0.01	0.0349	23.16
49	Printed Books	0.036	0.1	0.1441	6.28
44-49	*Wood, paper &*	*0.083*	*0.187*	*0.257*	5.44

HS code	Commodity	India's Share in EU Imports (%)	India's Share in EU Imports (%)	India's Share in EU's Total Imports (%)	Growth Rate of India's Share in EUs Imports
		1990	*1994*	*2000*	*1994-2000*
	board				
Textile & clothing					
50	Silk	4.95	8.79	12.9476	6.67
51	Wool, Yarn and Woven Fabric.	0.04	5.5	0.7832	-27.74
52	Cotton.	3.45	3.91	4.7996	3.48
53	Vegetable Textile Fibers	5.1	6.37	6.037	-0.89
54	Man-Made Filaments.	0.23	0.5	1.2252	16.11
55	Man-Made Staple Fibers.	1.14	2.46	2.9609	3.14
56	Wadding, Felt And Nonwovens	0.02	0.09	0.2034	14.56
50-56	*Textile & clothing*	*2.133*	*3.946*	*4.137*	0.79
Carpets					
57	Carpets	0.15	8.22	7.5579	-1.39
58	Special Woven Fabrics	0.8	1.31	3.3104	16.71
59	Coated Textile	0.04	0.34	0.3731	1.56
60	Knitted Or Crocheted Fabrics.	0.06	1.24	1.2404	0.01
61	Knitted garments/ACC	1.31	2.08	2.4867	3.02
62	Woven garments/ACC	3	3.56	2.6304	-4.92
63	Made Up Textile	3.11	6.17	7.5778	3.48
64	Footwear	1.94	2.67	2.3815	-1.89
57-64	*Carpets*	*1.301*	*3.199*	*3.445*	1.24
Umbrellas & accessories					
65	Headgear and Parts Thereof.	0.15	0.63	0.3051	-11.38
66	Umbrellas	0.05	0.16	0.0888	-9.35
67	Feathers Articles	0.07	0.17	0.4862	19.14
65-67	*Umbrellas & accessories*	*0.09*	*0.32*	*0.293*	-1.46
Stones, ceramic, glass					

HS code	Commodity	India's Share in EU Imports (%)	India's Share in EU Imports (%)	India's Share in EU's Total Imports (%)	Growth Rate of India's Share in EUs Imports
		1990	*1994*	*2000*	*1994-2000*
68	Stone, Cement	6.3	0.93	1.67	10.25
69	Ceramic Products.	0.3	0.06	0.1509	16.62
70	Glass And Glassware.	0.02	0.08	0.3056	25.03
68-70	*Stones, ceramic, glass*	*2.207*	*0.357*	*0.709*	12.11
			Gems & Jewelry		
71	Pearls Jewelry	26.6	2.6	3.1437	3.22
			Engineering and electronics		
72	Iron And Steel	0.16	0.17	0.4179	16.17
73	Articles of Iron or Steel	0.11	0.28	0.5116	10.57
74	Copper and Articles thereof.	0.14	0.25	0.4179	8.94
75	Nickel and Articles thereof.	0.09	0.05	0.0203	-13.95
76	Aluminum and Articles thereof.	0.2	0.09	0.1099	3.39
77		-	-		
78	Lead and Articles thereof.	0.0003	0.002	0.0089	28.25
79	Zinc and Articles thereof.	0.1	0.016	0.0532	22.17
80	Tin and Articles thereof.	0.006	0.39	0.0846	-22.49
81	Other Base Metals	0.003	0.47	0.108	-21.74
82	Tools & Metal Parts	0.6	0.96	0.7039	-5.04
83	Misc. articles (Base Metal)	1	1.57	1.3372	-2.64
84	Nuclear Reactors	0.06	0.12	0.1234	0.47
85	Electrical Machinery	0.41	0.09	0.1293	6.22
86	Railway or Tramway	0.02	0.007	0.0308	28.01
87	Other Vehicles	0.03	0.09	0.089	-0.19

HS code	Commodity	India's Share in EU Imports (%)	India's Share in EU Imports (%)	India's Share in EU's Total Imports (%)	Growth Rate of India's Share in EUs Imports
		1990	1994	2000	1994-2000
88	Aircraft and parts thereof.	0.03	0.12	0.1046	-2.26
89	Ships, Boats etc.	0.005	0.007	0.1287	62.46
90	Photographic Apparatus	0.13	0.16	0.1451	-1.62
91	Watches and clocks	0.14	0.3	0.1017	-16.50
92	Musical Instruments	0.015	0.24	0.3992	8.85
93	Arms And Ammunition	0.03	0.07	0.0845	3.19
72-93	*Engineering and electronics*	*0.149*	*0.248*	*0.232*	-1.11
	Miscellaneous				
94	Furniture etc.	0.07	0.29	0.477	8.65
95	Toys, Games etc.	0.19	0.31	0.2748	-1.99
96	Misc. Manuf. Articles.	0.16	0.53	0.8528	8.25
97	Artworks	0.58	0.15	0.0884	-8.44
98	Project Goods for Special Uses.	0.09	-	-	
99	Miscellaneous Goods.	0.4	0.05	0.0636	4.09
94-99	*Miscellaneous*	*0.248*	*0.222*	*0.293*	4.73
	Total	-	0.55	0.4892	-1.93

Source: Director-General Trade, European Commission.

Table 3.4 reveals the growth rate in 12 sub-groups in 1994-2000. The growth rate is 7.89 in Agricultural and Marine Products, -2.03 in Mineral, 10.09 in Chemicals, -4.28 in Leather 7 Leather products, 5.44 in wood, paper board, 0.79 in Textile and Clothing, 1.24 in Carpets, -1.46 in Umbrella and accessories, 12.11 in Stones, ceramics and glass, 3.22 in Gems and jewelry, -1.11 in Engineering and electronics, and 4.73 in

Miscellaneous products group. Evaluating export performance in terms of rate of growth, it can be concluded that some agricultural and marine products, export of all mineral items, almost all chemical products, some leather products, almost all items of textiles and clothing and items of stone, ceramics and glasses belonged to high potential areas.

Table 3.5 India's Export Basket to EU (in %)

Products	***1991***	***1992***	***1993***	***1994***	***1995***	***1996***	***1997***	***1998***	***1999***	***2000***	***2001***	***2002***
Marine Products	13.55	13.35	12.57	11.08	11.52	13.44	13.23	11.99	11.88	11.78	10.91	10.01
Minerals	4.18	4.08	4.98	3.53	3.28	3.03	2.26	2.11	2.24	2.36	3.03	2.76
Chemicals	4.92	5.7	5.54	6.46	7.22	7.61	8.47	9.06	8.89	9.64	9.56	10.71
Leather & leather products	15.04	14.7	15.54	15.08	14.33	13.07	12.79	11.73	11.25	11.19	12.55	11.57
Wood, paper & board	0.45	0.48	0.43	0.48	0.49	0.55	0.57	0.56	0.62	0.6	0.62	0.67
Textile & clothing	31.88	33.74	32.24	32.93	34.32	32.02	30.95	30.22	30.3	29.57	29.57	28.25
Carpets	4.53	5.07	5.23	4.13	3.78	3.66	3.64	3.73	3.18	2.65	2.88	2.16
Umbrellas & Acess.	0.02	0.04	0.06	0.75	0.044	0.036	0.052	0.044	0.054	0.058	0.06	0.05
Stones, ceramics & glass	0.43	0.52	0.57	0.69	0.86	0.92	1.02	1.1	1.37	1.4	1.53	1.69
Gems & Jewelry	12.11	10.36	11.07	10.33	10.01	9.98	9.99	11.61	11.68	12.24	10.55	12.26
Engineering & Electronics	10.29	10.72	10.27	11.13	12.59	13.96	15.09	16.1	16.28	16.08	16.05	17.14
Sports goods	0.27	0.32	0.36	0.4	0.43	0.434	0.402	0.45	0.4	0.395	0.384	0.404
Arts	0.08	0.05	0.05	0.03	0.031	0.038	0.068	0.028	0.043	0.022	0.018	0.014
Miscellaneous	0.7	0.87	0.97	1.06	1.08	1.254	1.47	1.63	1.18	2.02	2.3	2.28

Source: *Eurostat,* Commission of the European Communities, Brussels.

Historical trends (*Inventory of EU Tariff and Non-Tariff Barriers,* UNCTAD) of the composition of the India's exports to the European Union show that India had never been a very prominent exporter of hi-tech items during the period 1991-2002.[10] From this table it is clear that India had been exporting primary and labour intensive low value-added manufactured goods. This is the basic feature of India's export pattern to the European Union, in particular to western countries in general. Though aggregate trade data reveal that only 10 per cent of the total exports are agriculture and marine products and around 3 percent are primary products composed of minerals, it should be taken into account that agriculture provides the base of many manufactured goods viz. textiles, tea and coffee. During 1991, agriculture and marine products was the third largest export group having export share of 13.55 per cent next to textiles and clothing, whose share was 31.88 per cent, followed by leather and leather products having a composite share of 15.04 per cent. Other important categories in the export basket were gems and jewelry (12.11 per cent) and engineering and electronic items (10.29 per cent). Chemical products had the share of 4.92 per cent and share of mineral export was 4.18 per cent of the total exports. Carpet was another single largest export item, whose contribution to total export was 4.53 per cent. Shares of other groups were almost non-significant in India's total export basket during 1991. During 1996, trend remained the same but the relative magnitude of different categories had changed. Share of agriculture and marine products had declined to 11.08 per cent during 1994, increased to 13.44 per cent during 1996. Share of minerals had declined between 1991 and 1996, from 4.18 per cent in 1991 to 3.03 percent during 1996. Share of chemicals to total exports had increased significantly during these comparable periods

[10] The exports data have been calculated from the values of exports that are in ECUs. This is because we have taken the values of EU imports from India instead of India's exports to the European Union.

from 4.92 per cent to 7.61 per cent. Share of leather and leather products had declined marginally from 15.04 per cent to 13.07 per cent during these periods. Export of textiles and clothing has been showing an upward trend up to 1996 then has started declining. Its share in 1996 increased to 32.02 per cent from 31.88 per cent from 1991 maintaining the upward trend in-between. Other export categories, which have shown significant increase in growth during these periods, are engineering and electronics, whose share increased from 10.29 per cent to 13.96 per cent and wood, paper and paper boards, whose share increased from 0.45 per cent to 0.55 per cent. At least two product groups whose shares have declined significantly during these periods are carpets, gems, and jewelry. Export share of carpet had declined from 4.53 per cent during 1991 to 3.66 per cent during 1996. The rationale behind such declining trend may be attributed to child labour issue. The EU is the strongest votary of child labour issue. EU has been racking up this issue vigorously in all multilateral negotiations under the auspices of WTO. For quite sometimes, child labour issue in Indian carpet industry was very prominent in Germany. As a result, exporters of carpet had to be accredited with RAGMARK and KALEEN from the Indo-German Export Promotion Council in India. Another reason of such sliding trend maybe the emergence of new competitors from developing countries like Iran and China.[11] The scenario is completely different during 2002. Share of agriculture and marine products have been declining since 1996 and have declined to 10.01 per cent during 2002. This means India is getting less and less market access in the EU as far as agricultural export is concerned. This is simply because of two reasons. One reason is that the EU agricultural sector is heavily protected by subsidies given in "green box" and "blue box". Historically, the EU has been giving heavy subsidies to protect its farm sector from

[11] This classification was done by the European Commission itself for the sake of convenience.

external competition. The EU puts variable levy under Common Agricultural Programme (CAP), the difference between domestic price and international price. Second reason of getting lower market access in agricultural and marine products in the EU has been the increasing use of standards. Germany is emerging as the most environmental conscious country in the world. EU frequently uses stringent sanitary and phyto-sanitary standards (SPS) against its import of agricultural items from India. EU is also the votary of using "Precautionary Principle" in all of its imports of agricultural and chemical items. This will have a disastrous impact on India's export of agricultural and mineral products. Similar to agricultural goods, India's share of minerals has also declined from 4.18 per cent in 1991 to 2.78 per cent during 2002. Share of chemicals has increased tremendously during these comparable periods. Its share was 4.92 per cent during 1991, which skyrocketed to 10.71 per cent during 1996. This shows it is one of the most potential items in Indo-EU trade. Export of engineering and electronic items has shown a significant improvement during this period. Its share was 10.29 per cent in 1991, which phenomenally increased to 17.14 per cent during 2002. Share of leather and leather products has declined from 15.04 per cent to 11.57 per cent during this period. Most significant aspect of India's export to the EU market has been the gradual declining share of textiles and garments. Nearly one-third of India's exports to the EU market are composed of textiles and garments. The quota regime right from the sixties has guided this export pattern. This was the main constraint of getting better market access to the EU. EU has started dismantling quota regime from 1st January 1995 since the onset of WTO and has already phased out 51 per cent of the quota items. India could have taken advantage of this quota liberalization. Instead of this, its share has started declining from 1995 and it became lowest in 2002, when its share reduced to 28.25 per cent from 33.74 per cent in 1992. Declining in share may be due to fierce competition arising from other textiles exporting countries like China, Bangladesh, Hong Kong, Pakistan etc. Secondly, most of the quota-free items are not of any interest to India. The phasing out system is highly back loaded. India is unlikely to get any benefit from the ongoing quota liberalization, which is also reflected in its share to the EU market.

3.4.2 India's Imports and Exports from EU during 2009 to 2013

During 2009 to 2013 the major items that India imported from EU are vegetable products, minerals, chemicals, textiles and textile products, base metals, precious metals, transport equipment and machinery & appliances. The major items of India's export to EU during this period were products of chemical and allied industries, plastics, rubber and articles thereof, pearls, precious metals and articles thereof, machinery and appliances, transport equipment and optical and photography instruments. Major items of India's imports from EU and exports to EU are presented in Table 3.6 and 3.7 respectively.

Table 3.6: India's Import from EU Trade Flows by HS Section 2009-2013

HS Section		***Imports (Mio. €)***				
		2009	***2010***	***2011***	***2012***	***2013***
I	Live animals; animal products	490	550	621	638	627
II	Vegetable products	1,028	1,198	1,454	1,674	1,577
III	Animal or vegetable fats and oils	102	201	277	213	215
IV	Foodstuffs, beverages and tobaccos	393	463	607	669	757
V	Mineral products	2,146	5,002	5,344	5,365	5,210
VI	Products of the chemical or allied industries	2,861	3,708	4,685	4,891	5,055
VII	Plastics, rubber and articles thereof	621	888	1,221	1,147	1,317
VIII	Raw hides, skins and saddlery	966	1,134	1,304	1,292	1,356
IX	Wood, charcoal, cork and articles thereof	45	51	46	53	52
X	Pulp of wood, paper and paperboard	108	121	124	128	127
XI	Textiles and textile articles	6,018	6,692	7,527	6,416	6,492
XII	Footwear, hats and other headgear	990	1,203	1,295	1,147	1,208
XIII	Articles of stones, glass and ceramics	370	475	477	482	468

HS Section		Imports (Mio. €)				
		2009	***2010***	***2011***	***2012***	***2013***
XIV	Pearls, precious metals and articles thereof	1,628	2,322	3,016	2,602	2,399
XV	Base metals and articles thereof	1,734	2,243	3,239	2,914	3,002
XVI	Machinery and appliances	3,127	4,217	4,713	4,529	3,904
XVII	Transport equipment	2,031	2,020	2,426	1,802	1,890
XVIII	Optical and photography instruments, and etc.	225	278	324	363	369
XIX	Arms and ammunition	5	4	4	6	6
XX	Miscellaneous manufactured articles	434	512	511	547	532
XXI	Works of art and antiques	5	8	10	7	7
XXII	Not classified	176	175	704	563	239
Total		***25,503***	***33,464***	***39,927***	***37,447***	***36,809***

Source: Director-General for Trade, Units A4/G2, European Commission, 27.08.2014.

Table 3.7: India's Export to EU Trade Flows by HS Section 2009-2013

HS Section		***Exports (Mio. €)***				
		2009	***2010***	***2011***	***2012***	***2013***
I	Live animals; animal products	26	23	83	27	26
II	Vegetable products	47	55	70	100	70
III	Animal or vegetable fats and oils	17	20	24	52	38
IV	Foodstuffs, beverages and tobaccos	116	193	204	230	247
V	Mineral products	381	275	466	488	370
VI	Products of the chemical or allied industries	2,369	3,099	3,346	3,435	3,362
VII	Plastics, rubber and articles thereof	1,039	1,424	1,635	1,940	1,781
VIII	Raw hides, skins and saddelery	114	133	148	146	136
IX	Wood,charcoal, cork and articles thereof	56	85	101	111	122
X	Pulp of wood, paper and paperboard	723	806	845	772	793
XI	Textiles and textile articles	229	311	361	356	362
XII	Footwear, hats and other headgear	32	36	33	26	31
XIII	Articles of stones, glass and ceramics	242	314	363	333	309
XIV	Pearls, precious metals and articles thereof	4,183	6,875	9,262	8,250	9,157
XV	Base metals and articles thereof	3,494	4,097	4,666	4,452	3,171
XVI	Machinery and appliances	10,001	11,844	13,550	11,614	10,202

HS Section		Exports (Mio. €)				
		2009	**2010**	**2011**	**2012**	**2013**
XVII	Transport equipment	2,212	2,411	2,202	2,966	2,692
XVIII	Optical and photography instruments, and etc.	1,364	1,624	1,884	1,987	1,920
XIX	Arms and ammunition	67	33	32	7	14
XX	Miscellaneous manufactured articles	185	253	280	272	291
XXI	Works of art and antiques	3	30	5	7	14
XXII	Not classified	599	950	1,024	974	766
Total		***27,499***	***34,891***	***40,582***	***38,543***	***35,874***

Source: Director-General for Trade, Units A4/G2, European Commission, 27.08.2014.

Chapter 4

Trade Barriers in India-EU Trade

4.0 Introduction:

The obstacle to trade mainly comes in the form of tariff and non-tariff barriers. In this Chapter, the existing types of trade barriers that prohibit the trade between India and EU have been discussed. After an initial section on definition of types of tariffs and Non-Tariff Barriers (NTBs), a section deals with tariff rate on India's agricultural products, non-agricultural products and specific duties in EU market.

4.1 Trade Barriers:

There may be several reasons as to why Indian share in the EC market has been always at a low level. In spite of having several supply side problems, demand side factors are not less important. Since mid-seventies the EC has become more protectionists towards India (Yeats, 1979). Similarly, we have also pointed out that the entire gamut of the EC's imports of agricultural goods has been protected by the variable levies under Common Agricultural Programme (CAP) (Cline, 1980 & Golden et al, 1994). All imports of textiles and garments have been under stringent quota restrictions since 1961 in ECs market (Laird & Vassenaar, 1991).

Apart from high tariffs, ECs market is well-protected by a plethora of non-tariff barriers. Non-transparent barriers hurt more severely than tariff barriers. Higher tariffs can be absorbed through efficient production but non-tariff barriers are difficult to deal with because in most of the cases they are non-transparent. Trade distortion effects of NTBs are much more prominent than higher tariffs (San Laird, 1995).

India's customs tariff rates have been declining since July 1991, during which the foreign trade regime in India has been considerably liberalized, especially in respect of imports of manufactures. The quantitative restrictions on imports of manufactured products, which were about 90 percent before the economic reforms are mostly done away with. This is accompanied by drastic reductions in industrial tariff rates. The simple average tariff rate has therefore declined from 81.8% in 1990 to 32.4% in 1999 and to 29% in 2002 to about 15 % in 2004. However, the peak rate of import duty, which was 150 per cent in 1991, declined to 40% in 1997, to 35% in 2001 to 30% in 2002, to 20% in 2003 and to 11.5% in 2009. Yet, the current rates of industrial tariff in India are among of the highest in the world. However, different committee has raised the question of reduction of peak rates in India.[12] India is expected to bring its tariff rates in line with the ASEAN levels in the near future.

In the Uruguay Round negotiations, India agreed to reduce tariff on a large number of commodities and remove quantitative restrictions (QRs) on all commodities, except for about 600 commodities at ITC-HS 8-digit or 10-digit level or their sub-groups for security or other reasons (under Article XX and XXI of GATT, 1994).

India has drastically reduced the level of tariff, particularly industrial tariff, in the period since 1991. This reduction should not, however, be attributed to India's commitment under WTO because the tariff rates have in most cases been brought down to a level well below the rates committed. It seems reasonable to argue that the tariff reform undertaken by India in the last 14 years was mostly done at India's own initiative (induced by the benefits expected from such reforms) and had little to do with India's commitment under WTO.

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[12] The Virmani Committee [Revenue Department (2001)] recommended the reduction of peak rates to 10% and Virmani (2002) has outlined a schedule of tariff reductions to a uniform rate of 5% by the end of the decade.

4.2 Tariffs in India:

The average tariff rates in the India have declined, but the high rates of tariff in India still found in certain sectors. The three main areas of concern are tariff peaks, specific tariff rate, and tariff escalation.

Tariff Peak: It is referred to the prevalence of relatively high tariffs, usually on sensitive products amidst low level of tariff. Even with a low average tariff rate, it has been found that a substantial number of products have high rate. This means that the market access for certain products is more restrictive than for others. It is calculated by taking a cut of point. In literature, the cut-off point is taken as 12%. All those commodities whose ad-valorem tariff rates are above this cut off points are considered as commodities with peak tariffs. This peak rates tariff is likely to remain in future also.

Specific Tariff Rates: Specific Tariff Rates may come in the form of variable duties, seasonal duties, percentage of specific content of imported commodities etc. The specific duties are not suitable for analytical purposes. Therefore, they have to be converted in to ad - valorem equivalent. This is a complex method. Often, they are expressed as mixed duties. i.e. as a combination of tariff and ad - valorem tariffs. However, not all types of specific duties can be computable in to ad - valorem equivalents.

Tariff Escalation: It implies higher import duties on semi-processed (intermediate) products than on the raw materials, and higher still on finished products. Simply, tariff escalation happens when increasing rates of tariff are applied at different stages of production. This practice protects domestic processing industries and discourages the development of processing activities where raw material originates.

There are seven basic tariff levels in force in India namely as 5%, 15%, 25%, 35%, 40%, 100% and 200%. More than 90% of India's tariff line attracts a maximum basic duty of 35%, which is below the bound levels of 40%. The 100% rates are applied to certain sector. Alcoholic beverage attracts a maximum tariff. Capital goods attracts lowest duty rate followed by raw materials, intermediate, and finished goods. In India four types of import tariffs are generally applied i.e.

(i) basic duty (ii) special basic duty (iii) additional duty and (iv) special additional duty.

The export tariffs in India ranges from 10% to 40%. Ad- valorem or specific duties are example of this type of tariff.

The average tariff rate in India for agricultural products lies within 113.1%, while for other than agricultural products it is 34.6% in 2010. Similarly, the average tariff rate for all the products is around 48.7% in 2011. In India the primary sector is 3- times more protected than the manufacturing sector. The simple average final bound tariff rate in India is presented in Table. 4.1.

Table 4.1: Summary of Tariff Rate in India, 2010

Summary	***Total***	***Agricultural Products***	***Non-Agricultural Products***
Simple average final bound	48.7	113.1	34.6
Simple average MFN applied	12.6	31.4	9.8
Trade weight average	7.2	44.7	5.8

Source: World Tariff Profiles 2012, WTO, ITC, UNCTAD, 2012, P-92 (www.wto.org/statistics).

The average tariff rate (in %) in India for certain selected products in 2010 is presented in Table 4.2.

Table 4.2: Average Tariff Rate for Certain Products in India, 2010

Products Group	*Simple Average Final Bound Tariff (%)*	*Avg. MFN applied duties*
	2010	*2010*
Animal products	105.9	31.6
Diary products	65.0	33.7
Fruits, vegetables and plants	99.4	30.3
Coffee, tea	133.1	56.1
Cereals and preparations	115.7	30.7
Oilseeds, fats and oils	165.2	18.8
Sugars and confectionary	124.7	34.4
Beverages and tobacco	120.9	70.8
Cotton	110.0	12.0
Other agricultural products	105.7	21.5
Fish and fish products	100.7	29.6
Minerals and metals	38.3	7.4
Petroleum	-	8.2
Chemicals	39.6	7.8
Wood, paper etc.	36.6	9.1
Textiles	29.6	13.3

Products Group	***Simple Average Final Bound Tariff (%)***	***Avg. MFN applied duties***
	2010	***2010***
Clothing	38.1	15.1
Leather, footwear, etc.	34.7	10.1
Non-electrical machinery	28.2	7.2
Electrical machinery	27.0	6.9
Transport equipment	35.7	15.5
Manufactures n.e.s.	30.8	8.7

Source: World Tariff Profiles 2012, WTO, ITC, UNCTAD, 2012, P-92 (www.wto.org/statistics).

Table 4.3: Frequency Distribution of Tariff Rate in India, 2010

Frequency distribution	***Duty - free***	***0 < = 5***	***5 < = 10***	***10 < = 15***	***15 < = 25***	***25 < = 50***	***50 < = 100***	***>100***	***NAV in %***
	Tariff lines and import values (in %)								
Agricultural products									
Final bound	0	0	1.2	0.1	2.4	7.2	54.0	35.0	0.3
MFN applied	5.9	4.0	4.0	4.8	4.9	67.9	6.3	2.3	0.3
Imports	21.3	2.9	7.6	2.6	4.7	24.9	34.7	1.2	2.4
Non-agricultural products									
Final bound	3.1	0.5	0	0	14.6	50.8	0.7	0.2	6.0
MFN applied	3.1	14.3	74.8	1.0	1.9	4.1	0.7	0.1	5.7
Imports	19.2	41.0	39.3	0.0	0.2	0.1	0.2	0	0.2

Source: World Tariff Profiles 2012, WTO, ITC, UNCTAD, 2012, P-92 (www.wto.org/statistics).

Table 4.4: India's Export to Major Markets and Tariff Rate in 2010

Major Markets	*Diversification 95% trade in no. of*		*MFN average of trade TL*		*Pref. margin*	*Duty free imports*	
	HS 2-digit	*HS 6-digit*	*Simple*	*Weighted*	*Weighted*	*TL in %*	*Value in %*
Agricultural products							
European Union	25	99	10.8	4.0	1.9	25.8	68.9
China	7	10	15.0	6.0	2.9	7.1	0.0
USA	21	78	5.1	1.6	0.9	75.6	81.8
Saudi Arabia	13	46	11.2	4.0	0.0	25.4	74.9
Pakistan	8	16	9.3	5.5	0.2	30.5	56.5
Non-agricultural products							
European Union	67	1,080	4.5	4.5	2.1	64.1	64.3
USA	60	682	3.7	3.2	0.4	74.1	63.6
China	33	137	9.2	1.8	0.0	9.8	72.2
Hong Kong- Ch.	10	29	0.0	0..0	0.0	100.0	100.0
Singapore	41	177	0.0	0..0	0.0	100.0	100.0

Source: World Tariff Profiles 2012, WTO, ITC, UNCTAD, 2012, P-92 (www.wto.org/statistics).

4.3 Tariffs in EU:

The average tariff rate in EU for agricultural products lies within 13.8%, while for other than agricultural products it is 3.9% in 2011. Similarly, the average tariff rate for all the products is around 5.2% in 2011. In EU the primary sector is 3.5- times more protected than the manufacturing sector. The simple average final bound tariff rate in EU is presented in Table. 4.5.

Table 4.5: Summary of Tariff Rate in EU, 2011

Summary	***Total***	***Agricultural Products***	***Non-Agricultural Products***
Simple average final bound	5.2	13.8	3.9
Simple average MFN applied	5.3	13.9	4.0
Trade weight average (2010)	2.8	9.9	2.4

Source: World Tariff Profiles 2012, WTO, ITC, UNCTAD, 2012, P-76 (www.wto.org/statistics).

The average tariff rate (in %) in EU for certain selected products in 2011 is presented in Table 4.6.

Table 4.6: Average Tariff Rate for certain products in EU, 2011

Products Group	***Simple Average Final Bound Tariff (%)***	***Avg. MFN applied duties***
	2011	***2011***
Animal products	24.3	23.0
Diary products	57.6	55.2
Fruits, vegetables and plants	10.4	11.5
Coffee, tea	6.2	6.2
Cereals and preparations	20.3	16.3
Oilseeds, fats and oils	6.6	7.1
Sugars and confectionary	28.3	29.1
Beverages and tobacco	21.8	19.2
Cotton	0.0	0.0
Other agricultural products	4.4	4.8
Fish and fish products	10.9	10.3
Minerals and metals	2.0	2.0
Petroleum	2.0	2.7
Chemicals	4.6	4.6

Products Group	***Simple Average Final Bound Tariff (%)***	***Avg. MFN applied duties***
	2011	***2011***
Wood, paper etc.	0.9	0.9
Textiles	6.5	6.6
Clothing	11.5	11.5
Leather, footwear, etc.	4.2	4.2
Non-electrical machinery	1.7	1.9
Electrical machinery	2.4	2.8
Transport equipment	4.1	4.3
Manufactures n.e.s.	2.5	2.7

Source: World Tariff Profiles 2012, WTO, ITC, UNCTAD, 2012, P-76 (www.wto.org/statistics).

Table 4.7: Frequency Distribution of Tariff Rate in EU, 2010

Frequency distribution	***Duty - free***	***0 < = 5***	***5 < = 10***	***10 < = 15***	***15 < = 25***	***25 < = 50***	***50 < = 100***	***>100***	***NAV in %***
	Tariff lines and import values (in %)								
Agricultural products									
Final bound	32.3	10.2	15.5	13.0	11.1	9.7	5.2	1.0	32.0
MFN applied	30.1	10.2	16.1	14.2	12.8	7.8	4.6	1.2	32.4
Imports	42.9	12.6	15.5	10.3	10.5	3.5	4.5	0.2	28.0
Non-agricultural products									
Final bound	28.4	37.1	26.6	6.9	0.9	0.0	0	0	0.6
MFN applied	26.7	38.6	27.1	6.7	0.9	0.0	0	0	0.6
Imports	58.8	23.5	10.9	6.0	0.9	0.0	0	0	0.4

Source: World Tariff Profiles 2012, WTO, ITC, UNCTAD, 2012, P-76 (www.wto.org/statistics).

Table 4.8: EU's Export to Major Markets And Tariff Rate in 2010

Major Markets	*Diversification 95% trade in no. of*		*MFN average of trade TL*		*Pref. margin*	*Duty free imports*	
	HS 2-digit	*HS 6-digit*	*Simple*	*Weighted*	*Weighted*	*TL in %*	*Value in %*
Agricultural products							
USA	27	132	6.8	2.1	0.0	24.2	47.7
Switzerland	27	331	37.3	19.6	3.7	30.6	43.6
Japan	27	110	24.6	12.3	0.0	24.7	44.3
China	28	83	15.3	11.3	0.0	6.6	3.2
Norway	25	201	43.7	37.4	5.8	50.2	48.1
Non-agricultural products							
USA	68	1,515	3.5	1.1	0.0	46.2	69.0
China	58	1,215	8.9	7.4	0.0	9.5	22.1
Switzerland	72	1,665	1.9	1.2	1.2	99.4	99.9
Turkey	65	1,492	4.4	4.0	4.0	99.2	100
Japan	68	1,105	3.7	1.6	0.0	48.7	72.8

Source: World Tariff Profiles 2012, WTO, ITC, UNCTAD, 2012, P-76 (www.wto.org/statistics).

4.4 Observation on Tariff in India and EU:

The average tariff rate in India is much higher in comparison to EU for all the products. For agricultural products tariff rates in India is 113.1 in comparison to 13.8% EU, while for non- agricultural products it is 34.6% in India in comparison to 3.9% in EU in 2011. Similarly, the average tariff rate for all the products is 48.7% in India in comparison to around 5.2% in EU. India faced export tariff of 25% for HS-2 digit agricultural products and 99% for HS-6 digit agricultural products in EU markets, which is much higher than India's major agricultural export market in China, USA, Saudi Arabia and Pakistan. Similarly in non-agricultural products Indian products faced a tariff rate of 67% in EU market which is highest in comparison to its other major export markets for non-agricultural products USA, China, Hong-Kong (China) and Singapore.

4.5 Non-Tariff Barriers:

Non-Tariff Barriers (NTBs) refer to any cost escalation measure apart from custom tariff to imported goods. Any restriction imposed on the free flow of trade is a trade barrier. Trade barriers can be either tariff barriers, that is levy of ordinary customs duties within the binding commitments undertaken by the concerned country in accordance with Article II of GATT or non-tariff barriers that is any trade barriers other than the tariff barriers. Non-tariff barriers can take various forms. Broadly, in International Trade these can be categorized as under:

i) Import Policy Barriers
ii) Standards, Testing, Labeling and Certification requirements
iii) Anti-dumping & Countervailing Measures
iv) Export Subsidies and Domestic Support
v) Government procurement

Import Policy Barriers: One of the most commonly known non-tariff barriers is the prohibition or restrictions on imports maintained through the import licensing requirements. Article XI of the GATT Agreement requires Members not to impose any prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export licenses or other measures. Any form of import licensing (other than an automatic license) is, therefore, to be considered as an import restriction. Certain restrictions on imports, however, can be imposed in accordance with various provisions of the GATT. These include restrictions on grounds of safety, security, health, public morals etc. Article XX of the GATT Agreement provides for certain general exceptions on grounds of protection of:

- public morals,
- human, animal or plant life or health,
- national treasures of artistic, historic or archaeological value etc.

These are however subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade. Similarly, Article XXI of the GATT Agreement provides for certain security exceptions. Import restrictions on some items on grounds of safety and security are being maintained generally by all the countries, and perhaps these cannot be considered as non-tariff barriers looking to the purpose for which the restrictions are imposed. Article XVIII (B) of the GATT allows import restrictions to be maintained on grounds of 'Balance of Payment' (BOP) problems. Besides import licensing, import charges other than the customs tariffs and quantitative restrictions there are other forms in which import restrictions can be imposed through import policy. MFA quotas are one such example.

Standards, Testing, Labeling & Certification Requirements:

Prima-facie Standards, Testing, Labeling and Certification requirements are insisted upon for ensuring quality of goods seeking an access into the domestic markets but many countries use them as protectionist measures. The impact of these requirements is felt more by the purpose and the way in which these are used to regulate trade. Two of the covered agreements under the WTO namely the Agreement on the Application of Sanitary & Phyto-sanitary Measures (SPM) and the Agreement on Technical Barriers to Trade (TBT), specifically deal with the trade related measures necessary to protect human, animal or plant life or health, to protect environment and to ensure quality of goods.

The SPM Agreement gives a right to take sanitary and phyto-sanitary measures necessary for the protection of human, animal or plant life or health, provided:

- ✓ such measures are not inconsistent with the provisions of the Agreement;
- ✓ they are applied only to the extent necessary;
- ✓ they are based on scientific principles and are not maintained without sufficient scientific evidence;
- ✓ they do not arbitrarily or unjustifiably discriminate between Members where identical or similar conditions prevail including between their own territory and that of other Members, and
- ✓ they are not applied in a manner which would constitute a restriction on international trade.

Concerning the determination of appropriate level of sanitary or phyto-sanitary protection, the Agreement requires the objective of minimizing negative trade effects to be taken into account. Further, it permits introduction or maintenance of sanitary and phyto-sanitary measures resulting in higher level of sanitary and phyto-sanitary protection that would be achieved by measures based on the relevant international standards, guidelines or recommendations only if there is a scientific justification. However, where no such international standards, guidelines or recommendations exist or the content of a proposed sanitary or phyto-sanitary regulation is not substantially the same as the content of an international standard, guideline or recommendation and if the regulation may have a significant effect on trade of other Members a notice needs to be published at an early stage and a notification is required to be made of the products to be covered with an indication of the objective and rationale of the proposed regulation. The TBT Agreement also contains similar provisions with regard to preparation, adoption and application of technical regulations for human, animal or plant safety, and protection of environment to ensure quality of goods. Both the agreements also envisage special and differential treatment to the developing country members taking into account their special needs. However, the trade of developing country, members has often faced restrictive treatment in the developed countries market and they often raised barriers against them on one pretext or the other. Some of the non-tariff barriers falling in this category are ban on import of goods (textiles and leather) treated with azo-dyes and pentachlorophenol, ban on use of all hormones, natural and synthetic in livestock production for export of meat and meat products, stipulation regarding pesticides and chemicals residues in tea, rice and wheat etc., and requirement of on-board cold treatment for fruits and vegetables export.

Anti-dumping & Countervailing Measures:

Anti-dumping and countervailing measures are permitted to be taken by the WTO Agreements in specified situations to protect the domestic industry from serious injury arising from dumped or subsidized imports. The way these measures are used however, have a great impact on the exports from the targeted countries. If used as protectionist measures, they may act as some of the most effective non-tariff barriers. The numbers of anti-dumping investigations in the recent past have increased manifolds. Not every investigation results in the finding of dumping and/or injury to the domestic industry. However, the period for which the investigations are on, and this period may be up to 18 months, the exports from the country investigated suffer severely. Anti-dumping and countervailing duties being product specific and source specific the importers well prefer switching over to other sources of supply. In some cases, the authorities apply innovative methods to prolong the investigation. A recent practice adopted by the European Commission is a case in example. The European Commission has terminated anti-dumping investigation following withdrawal of the complaint in two cases namely unbleached cotton fabrics from India and others (20th February 1996) and bed-linen from India and others (9th July, 1996), after nearly two years without concluding the investigation, and started fresh investigations immediately after the termination of the two investigations on 21st February, 1996 and 16th September 1996 respectively. It may be a matter of debate whether the European Commission was within their rights to do so but the impact of these decisions is grave on exports of these items from the concerned countries. Another aspect concerns the quantum of duty levied. The WTO Agreements on Anti-dumping and countervailing duties permit the importing countries to impose full margin of dumping and subsidization as anti-dumping duty or countervailing duties but recommends levy of lesser amount as duty if such lesser amount is adequate to remove the injury to the domestic industry. In other words, the agreements recommend that the amount of duty imposed should be such as is adequate to remove the injury to the domestic industry, as any amount in excess of that would only provide an undue protection to the domestic industry.

Export Subsidies & Domestic Support:

Both export subsidies and domestic support has a great bearing on the trade of other countries. While export subsidies tend to displace exports from other countries into the third country markets, the domestic support acts as a direct barrier against access to the domestic market. Generally, the developing countries can hardly find resources to grant subsidies or domestic support. However, developed countries like the members of the European Union and Japan have been heavily subsidizing their agricultural sector through schemes like export refunds, production support system and other intervention measures. [13] Some of these measures include import quotas, licensing, exchange and other financial controls, prohibitions, discriminatory bilateral agreements, variable levies, advance deposit requirements, antidumping duties, subsidies and other aids, government procurement policies, government industrial policy and regional development measures, competition policies, immigration policies, customs procedures and administrative practices, technical barriers to trade, and sanitary and phyto-sanitary measures. In summing up, there is no single internationally agreed list of NTBs. In general, NTBs cover all measures affecting trade, other than tariffs, and hence any list of NTBs will be very long, and is probably continuously growing as governments invent new and new measures. Being non-transparent, NTBs are difficult to identify and analyze.

4.5.1 Identification of EU's NTBs Affecting Indian Exports in 90s:

EU is one of the most active initiator of non-tariff barriers in

[13] Under the Common Agricultural Policy, the EU subsidy European farmers up to $4billion every year, which end up mostly into the pockets of rich land lords who really do not need it. In 1992, Ray MacSharry, EU's agriculture commissioner, calculated that 80% of the subsidies went to the richest 20% of farmers. (Asian Wall Street Journal, 11th December 1996).

international trade. The Indian exporters face substantial hurdles to market access in EU arising from NTBs put up by EU. Different types of NTBs protect the EU market. In EU, the primary sector is five times more protected than the manufacturing sector. In many cases, Indian export products are subjected to multiple NTBs at a time in EU. Even though the UNCTAD inventory lists more than 100 types of NTBs, the number of NTBs being applied to India's exports in EU markets is less than 20. The most important NTB in terms of the volume of exports affected is Multi-Fiber Agreement (MFA) in EU. The EU's protectionism has been growing over the years instead of receding. (Julio, N., et. al. and Doglas, 1994). Since the inception of the General Agreement on Tariffs and Trade (GATT), there is no denying the fact that EC has reduced tariff levels to a considerable extent, but, on the other hand, in the guise of apparent liberalization they have erected an intricate structure of non-tariff barriers to protect domestic industries from external competition (Low & Yeats, 1994). Rate of customs tariffs in the developed countries was 60 per cent during late 1930s, which has now been reduced to around 3-4 percent on an average (Cassing, 1990). This reduction tariffs does not ensure operation of free trade; neither does it reduce protectionism; rather the protectionist tendency has been penetrated into other areas as well in the form of several complicated non-tariff barriers (Deardorff & Stern, 1985). It is estimated that the average rate of tariffs on industrial goods in the developed countries ranges between 10-15 per cent but tariff equivalent of non-tariff barriers in agriculture and some items of textiles is well over 100 per cent (Cline et. at., 1975). This is true in the case of textiles (USITC, 1989). It is very difficult to identify the non-tariff barriers because these measures often lack transparency and are not covered under any trade rules (Papillon, 1994). In most of the cases, enforcing countries like to treat them as "grey areas" because according to them, these measures are consistent with their national objectives. These measures have frequently been used to safeguard their industry from foreign competition. This poses a very common argument to buttress their protectionist measures.

The EU is having the maximum number of NTBs among all developed countries and obviously, it is the most protectionists grouping in the world (Nogues, et. al, 1986). The average rate of tariffs in the EU is around 4 percent but in tariff equivalent of non-tariff barriers in agricultural goods of the EU is well over 100 per cent (Cline et. al., 1980).

4.5.2 EU NTBs in 80s and 90s:

Based on UNCTAD 1997 inventory; a list of NTBs enforced on India's exports to EU in 1988, 1992 1993, 1994 and 1997 were analyzed.[14] The analysis revealed that almost all major NTBs in 1988 were also present in 1992. In 1992, we have identified 17 major NTBs applied by EU on its imports from India. Apart from EU specific NTBs some NTBs were also enforced by particular member coun tries. Some of these are described below:

(i) ***Variable Levy:*** EU extensively uses the variable levy on its imports of agricultural goods in order to protect its domestic markets. The extent of variable levy (VL) is the difference between domestic price & international price. These VL are special charges imposed on imports of certain goods with the intention of increasing their price in the domestic market. One form of such protection is the price differential, but other form of protection to agriculture is the higher amount of subsidy given to the farmers for production as well as for exports. The EC variable levy were imposed in 1981 across the countries but to some specific product groups (Larsen, Hansen and Anderson). Indian products subject to the EU's variable levies were fatty livers of geese or ducks, fresh or chilled fatty/livers of geese or duckseese or ducks, fresh or chilled fatty livers (02073100), Pellets

[14] The TRAINS data of UNCTAD covered the NTBs for India's exports for 1997.

of flour and meal manioc, fresh/dried (0714010), manioc, fresh/dried (0714099), crushed or ground and other spices, of a length/width ratio equal to a greater than 3 (10061098, 10062017) ratio greater than 2 less than 3 (10062096) and of similar products (i.e. HS 10062098, 10063027, 10063065, 10063067, 10063096, 10063098, 10064000, 10070090, 10008200, 11041991), rice, sorghum, millet, cereals, sugar cane, sugar, beet sugar cane, molasses, other food preparation etc.

(ii) ***Seasonal Tariffs****:* This was enforced at a particular time on a particular product in order to check the inflow of cheaper imports. Normally it is enforced on agricultural products with the highest import duties applied during the period of the domestic harvest. It has the same impact as the variable levy. The rationale behind such higher tariffs is to protect the domestic farmers from cheaper inflow of food grains and allow them to sell their products in the markets at higher prices[15]. Indian exports subject to the EU's seasonal tariffs are different types of grapes (08061015). The grapes attract a nominal tariff rate of 22 percent. Though Indian share in the EU market was extremely low (0.42 percent) but it was very significant from India's point of view because it exported 746,000 tonnes of grapes in 1992 to the Community. Chile is the largest exporter of grapes to the EC market (50 per cent) followed by South Africa (38.4 percent), and USA (27.3 percent). Developing countries jointly exported 56.37 per cent of total EC's imports (272,145 thousand tonnes).

(iii) ***Anti-Dumping Duties and Anti-Dumping Investigation****:* Anti-dumping duty is applied on a variety of products of labour intensive manufactured goods like textiles etc. (or product groups) if the

[15] Seasonal Tariff is not a regular phenomenon. It is enforced for a particular period of time when supply increases due to seasonal variation. This is applicable to agricultural goods only.

exporting country is selling its products at less than domestic prices. If the investigating authority proves this charge then the authority will calculate the dumping margin of the dumped product through the generally accepted methodology and hereafter the authority will impose final anti-dumping duties equal to the dumping margin, which is the difference between domestic price and the export price of a particular product. There is a provision in the erstwhile anti-dumping code, that during the dependency period (i.e. when the investigations are carried out) the importing country if it wants, can enforce the provisional duties to temporarily check the flow of dumped imports (Tharakan et. al. and Schuknecht et. al., 1994)[16]. Indian exports covered by EU's anti-dumping duties/ investigations in 1992 were some form of acids (2917100) some items of cotton textiles, yarn, polyester yarn, synthetic, staple fibers (only against India and Korea and have been enforced since 1990) of different types, sewing thread of synthetic staple fibers unbleached /bleached single yarn, multiple or cabled yarn, mixed mainly or solely with artificial staple fibers yam, cotton, etc. If we take the items at 8-digit HS level, then about 50 items are covered by EU's anti-dumping duties/ investigations since 1990. All these items were textiles and yarn in which India has comparative advantage in the EC market. In addition to NTBs, these items were also subject to higher tariffs in the EC markets.

(iv) ***Multi-Fiber Arrangement (MFA), MFA Restraint Agreement, MFA Quota, Bilateral Quota, MFA Administrative Cogeneration Agreement and QRs (unspecified):*** The entire gamut of India's

[16] EU's frequently uses anti-dumping duties to restrict cheaper import from the developing countries. Indian Textiles Exports are subject to EC anti-dumping duties as well as investigation is going on to some items, see Swapan K. Bhattacharya's *Mimeo Anti-dumping Measures in the WTO Regime : Indian Scenario and International Practices*, (ASSOCHAM Monograph, Assocham, New Delhi), 1996.

textile exports were under stringent quantitative restrictions of the developed countries. This was a temporary exemption to GATT principle, which had maintained the system for more than last 30 years beginning with Short-Term Arrangement (1962-64) followed by Long-Term Arrangement (1964-72), and MFA's (1973). The MFA started in 1973 and expired in December 1992 after its four terms. But most of our exports of garments and textiles are still under stringent MFA quota, which was phased out from 1st January, 2005, as per the agreement reached by contracting parties to GATT related to trade in textiles and garments at Marrakesh on 15th April, 1994 (World Trade Organization). MFA is a bilateral arrangement outside the GATT framework based on mutually exclusive terms. This bilateral process of negotiations is called MFA Restraint Agreement/Bilateral Quota. In 1992, total 439 items of textiles and garments (at HS 8 digit level) were covered by EC's MFA restraint agreement, the frequency and coverage ratios were almost 100 per cent. This NTB was enforced on 19 developing countries including India since 1981. Tariff rates for these items were exorbitantly high (i.e. three times higher than the average).

(v) ***License:*** Licenses applied by the EU were of two types, viz. (i) automatic licenses, (ii) non-automatic licenses. Both of them are consistent with the GATT licensing codes. According to NTBs requirements, an approval is necessary before any importation, and hence, it is not automatic. Licensing which is to be used to administer a quota is included in the GATT data base under that category (i.e. quota) only. Non-automatic licensing has two distinct categories, viz. (a) this is not subject to specific condition. It is used to restrict the volume of imports when quotas have not been fixed in advance or used for unspecified purposes; and (b) non-automatic licensing is a system, which requires meeting certain specific conditions i.e. minimum export performance, authorized use of imported goods or purchase of domestic products. 24 items (at HS

8-digit level) of Indian exports to EU in 1992 were covered by EU's licensing requirements. These items had spread over HS-0, 1 and 2 at the UNCTAD inventory on NTBs as reported in 1992. The items covered by EU's licensing requirements were palliates of flour, meals/manioc fresh or dried (07141010, 01741099), some types of spices, some forms of rice (broken & flaked), grain sorghum, millet, raw cane sugar, white sugar, (cake), cane molasses, some types of vegetable fruits, (prepared/preserved) champagne and sparking wine, some vegetable materials waste and residual used for animal feed etc.

(vi) ***Community Surveillances:*** There is a good deal of controversy in the GATT/ UNCTAD about the question whether or not these NTMs have trade restrictive effects. Community surveillance is a tool used by EC to control imports through the issuance of automatic licenses. This surveillance procedure has several forms viz., surveillance license, monitoring, retrospective surveillance and Community surveillance. Surprisingly 65 items, which India export to the EU were covered by some of these surveillance schemes introduced by the Community; of which 49 items are in HS-6, and 16 are in HS-7 category. Items covered by Community surveillance scheme are: footwear of different types and different materials for different uses, parts of footwear, assembles of footwear etc. (HS-6); items are in HS-7 of iron & steel, light engineering goods, items of nickel etc. Community surveillance scheme on footwear was introduced in 1978 and on iron & steel items, it has been operational since 1980.

(vii) ***Basic Import Prices and Import Surveillance****:* Import surveillance is a set of measures enforced in different forms for monitoring imports through the issuance of automatic licenses. If at any time it is felt that some imports are injurious to domestic industry, then EC with the help of licenses restricts the imports of these sensitive items. Indian exports put under Community surveillance schemes were also covered by import surveillance scheme and basic import

prices'. Exports of some items of iron & steel, nickel and different types of light engineering goods were covered by this scheme. All these items fall under HS-7. At this level 18 items are covered by basic import prices and 8 are covered by import surveillance scheme.

(viii) ***Reference Prices:*** Reference price is another hard-core NTB. This was a special type of levy imposed on imports. With the help of this tool, EC increases the price of imported goods with reference to its domestic goods. The average tariff rates of these items are higher than the average tariffs on all goods. This NTB was normally applied on agricultural imports and its impact is similar to that of EC's variable levy. In 1992, three items of India's exports to EU were subject to reference prices. Cattle fish and squid (excl. live fresh or chilled) other cattle fish and squid (excl.-live fresh or chilled) and finally fresh grapes were subject to reference prices. India's share is quite significant in the EC market at least in first two items. Indian share was 24.3 per cent for the first item and 34.54 per cent for the second item in 1992. Market share for the last item was very small i.e. 0.42 per cent in the EU during the same year. The average rate of duty was 6 percent for the first two items and 22 percent for the last item.

(ix) ***Miscellaneous Regulations/Non-Commercial Purposes:***

Miscellaneous regulations include many unspecified as well as specified regulations that do not have any price impact at least directly. Almost all regulations are for commercial purposes to save the domestic industry through restraining cheap imports. However, some restrictions were imposed purely on non-commercial grounds. Some of these NTBs are health regulations, sanitary regulations; phyto-sanitary regulations etc.[17] In such

[17] Examples of NTBs practiced on the sanitary and Phyto – Sanitary (SPS) Ground by EU is given below:

cases restrictions are consistent with the national priorities and health objectives. The degree of restrictiveness varies from country to country. The reason behind such restrictiveness is that developed countries are understood to be more health conscious than the developing nations. Food and Drug Administration (FDA) in the USA follows very stringent criteria of issuing certificates. Rather one should call it "grey areas" than purely a barrier because of the objective principles. Miscellaneous regulations pose a serious threat to Indian exporters because exports of 104 items at 8-digit level were covered by these regulations. 15 items were in HS-0, 2 items in HS-1, 39 items in HS-4, 35 items in HS-6, 11 items in HS-9. This means some items from almost every group were covered by miscellaneous regulations.

Table 4.9 and 4.10 shows an array of NTBs that were applicable to all Indian exports in EU market in 90s.

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i. In case of rice, wheat and other foodstuff presence of bacteria or pest residue.

ii. In case of livestock production, presence of all hormones, natural and synthetic, level of harmful substances like cholesterol etc.

iii. In case of cut flower, if paste residues and fertilizer residues exceeds a certain amount.

iv. In case of marine products, presence of certain- diseases, contamination due to improper freezing or packing.

v. In case fruits, presences of flies, insufficient vapor treatment etc.

vi. In case of poultry products, potential outbreak of fowl diseases.

Table 4.9: List of NTBs imposed By European Union in 90s

Sl. No.	***Type of NTBs***
1	Antidumping investigations
2	Antidumping duties
3	Countervailing duties
4	Retrospective Surveillance
5	Prior surveillance
6	Prior surveillance to protect human health
7	Prior surveillance to protect Environment
8	Non-automatic license
9	Authorization to protect environment
10	Authorization to protect wild life(CITES)
11	Authorization to drug abuse
12	Allocated quotas
13	Quota to protect human health
14	Quota to protect environment (Montreal protocol)
15	Prohibition
16	Prohibition on human health protection
17	Prohibition on the basis of origin (Embargo)
18	Technical requirement
19	Product characteristics requirement for human health protection
20	Product characteristics requirements to ensure human safety

Sl. No.	***Type of NTBs***
21	Labeling requirements
22	Labeling requirements to protect human health
23	Testing , inspection and quarantine requirements

Source: UNCTAD's TRAINS database, 1997

Table 4.10: List of NTBs imposed by European Union On Indian Exports in 1999

Sl. No.	***Types of NTBs***	***% of India's exports to EU facing NTBs***
1	Tariff quota	44
2	Non-automatic license	21
3	Import monitoring	12
4	Seasonal tariff	8
5	Import monopoly	7
6	Variable Changes	6
7	Bilateral quota	1
8	Quota for environmental protection	1
Total		***100%***

The increasing use of non-tariff barriers (NTBs) had been one of the major concerns of India as it nullifies effectively the market access supposed to have been given by elimination or reduction of tariff barriers.

4.5.3 NTBs in India-EU trade in 2011 and 2013:

NTBs exercised by India for EU exports:

The *Trade Barrier Investment Report 2011 of European Commission for Trade* opines India's trade regime and regulatory environment as restrictive. In addition to high tariff barriers, India also imposes a number of non-tariff barriers in the form of quantitative restrictions, import licensing, burdensome mandatory testing (such as for tyres for example) and certification for a large number of products as well as complicated and lengthy customs procedures. Although there is, some improvement with regard to intellectual property but the enforcement infrastructure is still significant concerns about India's response to counterfeiting and piracy. Furthermore, in the area of procurement, the Indian legislative framework remains incomplete. It opines for major reforms to ensure compliance with international standards and a predictable environment for bidders. The current trade performance therefore is far short of its potential. The following barriers are significant trade irritants of EU with India

(i) ***Burdensome licensing requirements:*** The licensing requirement related to new security provisions was proposed which affects, the access of European operators to the commercial procurement of telecommunications. The provisions stipulate prior security clearance and technology transfer requirements, as well as an obligation to substitute foreign engineers with Indian ones. In 2009 the EU exported telecommunications equipment worth €1 billion to India.

(ii) ***Restricting exports of cotton:*** From 2004 to 2009 the EU's imports of cotton have increased by 17%. Several cotton products are facing export restrictions in India. Although EU total imports of these

cotton products have experienced a decline of 48% over the five year period, recent measures on these goods are important since 23% of EU imports of these types of cotton products came from India in 2009. Furthermore, as the second largest cotton producer in the world (20% of global production) and the only global net exporter of cotton, India's policy has a significant impact on global cotton supply and hence on prices, aggravating the global upward price spiral. European industry is therefore facing very high prices and a shortage in supply, as India is the EU's main import source for cotton products.

(iii) ***Investment policy*****:** India's investment policy continues to hinder foreign investments. Many important economic sectors such as multi-brand retail remain closed to foreign investment and a series of measures has been adopted to control foreign capital flows and ensure maximum benefit for local companies through technology and know-how transfers.

(iv) ***Sanitary and Phyto-sanitary (SPS) import requirements:*** These requirements going beyond international standards without scientific justification. These hinder various EU exports, mainly poultry, pig meat, vegetables, fruits and timber.

4.6 Progress made in 2013:

India has made certain progress in 2013 in clearing some trade barriers. According to the European Commission's *Trade and Investments Barriers Report*, *2014*, following progress has been made by India to dismantle various trade barriers in 2013

(i) India suspended the implementation of some aspects the preferential procurement policies for domestically manufactured electronic goods and telecom products due to security considerations that would have been be applied in a mandatory manner for both public and most importantly private purchasing

entities (e.g. telecom services operators). For electronics products, India has on 23rd December 2013 adopted a new preference policy which indeed drops security reasons and only addresses public procurement.

(ii) Regarding mandatory compliance of steel products with new national standards and certification by the Bureau of Indian Standards (BIS), the date of entry into force of mandatory certification requirements steel products was shifted to April 2014 and beyond. In addition, in August 2013, some products that are directly supplied for major projects subject to some conditions were exempted from the certification scheme.

(iii) India has also formally extended a grace period for the compulsory registration of 15 categories of IT and consumer electronics goods

(iv) India introduced some changes in investment rules and opened the possibility for 100% foreign ownership in the telecoms sector; in addition, more recently the Government expressed the intention of raising FDI limits in defence manufacturing from the current 26% to 49%, while a similar approach in the field of insurance companies was not adopted by the Parliament.

There was also a positive development in single-brand retail investments. Following the opening of the sector, some European companies have already applied for and received licenses. A European company has also applied for a multi-brand retail license, the first for a foreign company in India.

Observations from India: Indian exporters to complain about growing protectionism applied on Indian exports in EU market. Some observations are:

(i) More than half of India's exports to the EU have been subjected to NTBs, and a majority of them are hardcore. The items that are covered by NTBs are also subjected to higher tariffs. The average (weighted) tariffs of NTB-affected items is almost double than average tariff of all items exported by India to the EU.

(ii) The majority of Indian exports to the EU contain textiles and garments, agricultural goods and low value-added manufactured goods. India's Competitiveness of these items is high. Revealed Comparative Advantage of these items is greater than unity. Tariff equivalents are much higher on those items, which have been covered by non-tariff barriers.

(iii) Quotient of NTB-coverage as well a frequency ratio is well above average in case of textiles and agricultural items. The tariff equivalent in case of agricultural exports it is well above 100 per cent.

(iv) Major NTBs in the EU market is the agricultural subsidy, growing environmental measures, technical barriers to trade, sanitary and phyto-sanitary standards, bio-safety measures, precautionary principle, health related measures, standards related to product and process methods, labeling and packaging standards, eco-labeling standards etc.

(v) The agricultural subsidy virtually closes door to India's agricultural exporters. In spite of distinct price preference over all agricultural items produced in the European Union. India is not in a position to export in the said market due to heavy subsidy provided to European farmers.

(vi) Another major concern of Indian exporters in the European market is the growing environmental standards. Germany has been emerging as one of the environmental conscious countries in the world. Considering the importance of environmental protection in sustainable development EU has been insisting on enforcing on stricter discipline on the environmental management.

4.7 Conclusion:

Relatively EU market is much open than India. If we see degree of openness measured in terms of tariff and non-tariff barriers to trade, we will find that high tariff and non-tariff barriers characterize India's market. However, India and EU have committed to enhance economic cooperation in a mutually exclusive way. Future prospects of trade depend on how much liberalization one will undertake to globalize its economy.

Chapter 5

India-EU Foreign Direct Investment (FDI): An Empirical Analysis

5.0 Introduction:

FDI plays vital role in the economic growth of a nation. The FDI equity inflow from EU to India is around 25% of the total inflow. The literature on FDI gives emphasis on country-specific characteristics responsible for FDI inflow. These characteristics include economic factors, country policies, institutional factors etc. Here there is a brief analysis on the role of certain economic factors on FDI inflow from EU to India in recent years.

5.1 Overview of Foreign Direct Investment (FDI) in India:

International capital movements, especially cross-border direct investment inflows popularly known as foreign direct investment (FDI), were seen increasing rapidly in the years following the end of World War II. FDI plays a major role in globalization, influencing both the growth of an economy as well as the profitability of investing companies. This requires countries to have a better understanding of FDI so that they can take initiatives to attract FDI.

Different government initiatives have resulted in a significant increase in the number of FDI activities around the world, especially in developing countries. According to UNCTAD’s World Investment Reports (2004, 2005, 2006, 2008), FDI inflows from developing and transition economies reached record levels in the year 2007 contributing to their economic growth. Appropriate policy responses in both source and recipient countries could increase the development gains from this trend. UNCTAD’s World Investment Report, describes this rise of developing country transnational corporations as part of a burgeoning shift in the structure of the world economy. India is also a part of this burgeoning shift. While FDI inflows into India are increasing, as recorded by the Reserve Bank of India (RBI), Indian FDI equity inflow increased from 2,347 million USD in January 2000 to 22,789 million USD in December 2012, as recorded by the Reserve Bank of India (RBI). The cumulative FDI inflows from all countries in India during this period from January 2000 to December 2012 were 188.47 billion USD (FDI Synopsis, DIPP). This indicates that foreign companies are investing in India to access key resources of host country and to enter into the bigger South Asian Countries market.

In India, as in most developing countries, inward and outward FDI are not easy to analyze because of their national definition and interpretation. Prior to the year 2003-04, Indian FDI reporting was not in line with international standards. The Reserve Bank of India (RBI) and the Secretariat for Industrial Assistance (SIA), which publish official statistics, reported only the equity component of FDI since 1991. So, re-invested earnings were not considered as part of FDI, whereas IMF guidelines estimate that they are part of FDI inflows. Indian data neither included the proceeds of foreign equity listings nor foreign subordinated loans to domestic subsidiaries. Overseas commercial borrowings were also disregarded, as well as some depository receipts over 10 per cent of the equity coming from foreign institutional investors (Srivastava, 2003). Although there was a difference and scope for improving India's FDI statistics in order to put them in line with international standards, India's share in total volume of FDI inflows in the world is very small. It is also true that the opening of the country is relatively new and the FDI experience rather short.

As in the case of other developing countries, Indian policy makers were initially suspicious about the impact of FDI in India. Political motives and mass movements also took time to realize the importance of FDI in the development of an economy. The year 1991 has acquired a revolutionary status as a time of change in the planning of India's future through liberalization despite the fact that there was unevenness in policy implementation. Suspicion was replaced by a pro-FDI policy in 1995-96 following the debate of 1991-93 and, by 2007; there was a general consciousness across the political spectrum in favor of attracting FDI. By the year 2002, FDI changed completely for India and by the year 2003-04, a committee addressed the non-comparability of Indian FDI statistics by the Department of Industrial Policy & Promotion (DIPP), in order to bring the reporting system of FDI data in India into alignment with international best practices. According to this new definition of FDI, over the years India's total capital inflow increased from 4,089 million USD in the year 1995-96 to 188.47 billion USD in the year 2012.

One important point to be noted here that, over time, actual outward FDI from India also increased significantly along with the increase of FDI inflows into India. Prior to the year 2004-05 both inward and outward FDI were increasing at a slow rate, but both types of FDI started increasing at a higher rate from the year 2004-05. Despite the fact that Indian firms started investing abroad towards the beginning of 2000, the volume of outward FDI is increasing significantly to catch up with inward FDI into India. This proves that India is not only considered as a destination for FDI but also identified as a source of FDI for other countries. India receives FDI from a number of countries. Developed countries with their comparative advantages in technology and possession of huge capital stocks are expected to be a bigger source of FDI, but developing countries are slowly beginning to invest more in India.

The increasing share of FDI sourced from developing countries indicates that emerging multinationals from developing countries are more engaged in cross-border activities, reflecting the impact of globalization. As many developing country governments have eased their policies toward capital outflows, their companies have expanded their operations abroad. This increased inflow from developing countries is partially explained by the well-known investment development path (IDP) theory by Dunning, which says outward FDI is undertaken when the country reaches a certain minimum level of development. As countries move along the IDP from the initial stage of only receiving inward FDI, domestic firms acquire ownership and other advantages to go abroad and the country reaches the final stage and becomes an important outward investor. Indian outward investors are investing in a number of developed and developing countries. While shares of FDI inflows are showing convergence, the share of outward FDI to the developed and developing countries shows that the gap between two is diverging. As predicted by IDP theory, initially Indian Official FDI was concentrated towards other developing countries. However, after the year, 2004-05 overwhelming proportions of these investments are directed to developed countries and the gap between the two has diverged considerably. Initially, the outflows to high income and developing countries were in the ratio of 60:40, but it has now become 85:15.

Indian industrial houses like the Tata group, Birla, Reliance, Ranbaxy, ONGC, Infosys and etc. are now more interested in cross-border acquisitions. The driving forces for these firms to invest abroad are their huge supply of funds, globally competitive business practices, volumes and growth prospects. The inclination for cross border acquisitions by Indian corporate suggests that they have started bidding for much larger businesses than their own and for those that are based in high-income countries. Expansion of overseas activities and so the FDI activities of Indian companies in developing and high-income countries are gaining importance.

The FDI scenario of India has changed enormously after the liberalization of Indian economy. The total FDI equity inflows to India has gone up multiple time recent years. The FDI equity inflows have reached 2,347 million USD in 2002 from 165 million USD in 1991. It further reached up to 37,096 million USD in 2008. The total FDI to India was 34,621 million USD and 22,789 million USD in 2011 and 2012 respectively. The total FDI equity inflow to India is presented in Table 5.1.

Table 5.1: FDI Equity Inflow to India (In million USD)

Year	***FDI to India (in Million USD)***	***Year***	***FDI to India (in Million USD)***
1991	165	2002	3,359
1992	393	2003	2,079
1993	654	2004	3,213
1994	1,374	2005	4,355
1995	2,141	2006	11,120
1996	2,770	2007	15,921
1997	3,682	2008	37,096
1998	3,083	2009	27,044
1999	2,439	2010	21,007
2000	2,347	2011	34,621
2001	3,520	2012	22,789

Source:*DI Synopsis, Department of Industrial Policy and Promotion, Mini stry of Commerce and Industry, Government of India*.

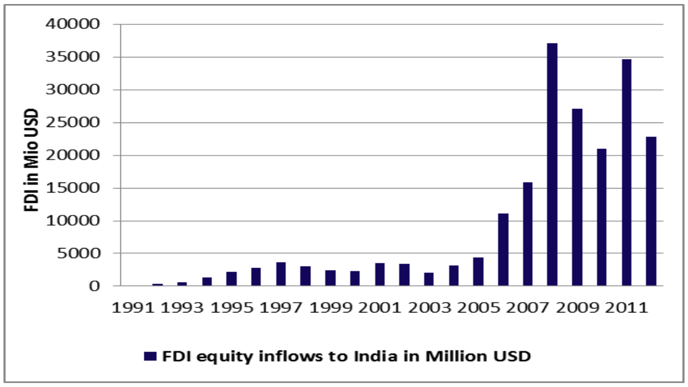


Figure 5.1: FDI Inflows to India during 1991 to 2012

5.2 Foreign Direct Investment Inflows from EU to India:

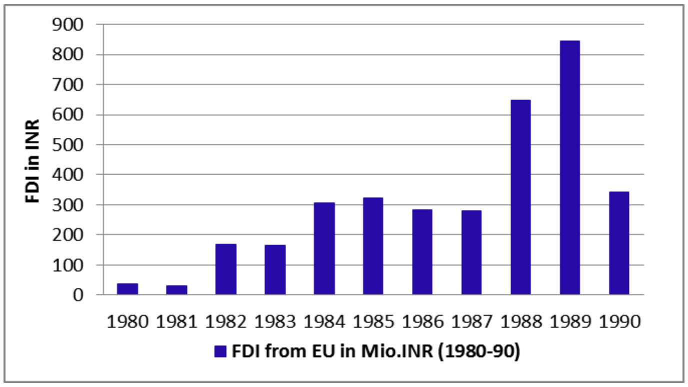
EU is an important source of FDI inflows for India. During 1980s the annual average rate of growth of FDI flow to India from EC was 25 % per annum, which increased up to 27% percent per annum during 1990s. Table 5.1 shows the FDI inflows from EU to India during 1980 to 2002.

Table 5.2: FDI Inflow from EU to India During 1980-2000

Year	*FDI*	*Compound Annual Average Growth Rate*
	(In millions of Indian Rupees)	*1980-1990*
1980-81	38.19	24.5%
1981-82	29.38	
1982-83	166.87	
1983-84	164.79	
1984-85	307.26	

Year	*FDI*	*Compound Annual Average Growth Rate*
	(In millions of Indian Rupees)	***1980-1990***
1985-86	324.15	
1986-87	281.73	
1987-88	280.14	
1988-89	648.76	
1989-90	844.97	
1990-91	341.49	
		1991-2000
1991-92	1,785	
1992-93	4,718	
1993-94	10,310	
1994-95	26,255	
1995-96	73, 290	
1996-97	68,849	27.2%
1997-98	102,621	
1998-99	90,471	
1999-00	85,394	
2000-01	15,591	

Source: *FDI Synopsis, Department of Industrial Policy and Promotion, Mi nistry of Commerce and Industry, Government of India.*



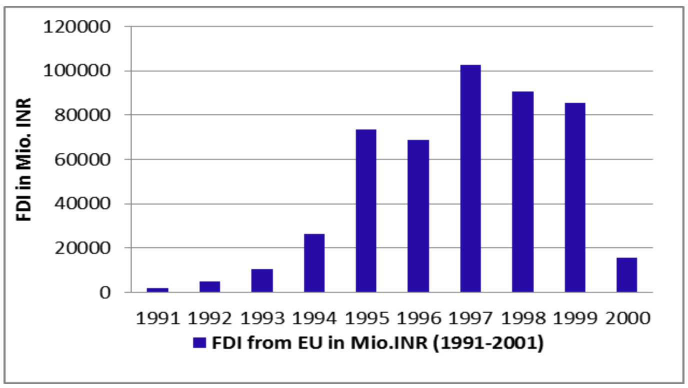


Figure 5.2: FDI Inflows from EU to India during 1980 to 2000

FDI equity inflow from EU to India is approximately 25 percent during the period January 2000 to December 2012 (*Source: FDI Synopsis on Country European Union, Table No. 6.1. (B), DIPP, Government of India*). The FDI equity inflows from EU to India increased from 574.78 million US$ in the year 2000 to 6,350.56 million US$ in the year 2012, recording a CAGR of 22.17% per annum. Year-wise total FDI equity inflow to India from all countries as well as from EU countries during 2000 to 2012 is presented in Table 5.3.

Table 5.3: FDI Equity Inflows[18]

Year (January-December)	*FDI Equity Inflow from all Countries (million USD)*	*FDI Equity Inflow from EU Countries (million USD)*	*FDI Equity Inflow from EU as Percentage of Total FDI inflows (%)*
2000	2,347	575	24
2001	3,520	1,006	29
2002	3,359	824	25
2003	2,079	658	32
2004	3,213	1,056	33
2005	4,355	665	15
2006	11,120	2,928	26
2007	15,921	2,445	15
2008	37,096	6,259	17
2009	27,044	4,563	17
2010	21,007	4,522	22
2011	34,621	15,260	44

[18] These amounts include the inflows received through FIPB/SIA route, acquisition of existing shares, RBI's automatic route, RBI's –NRI schemes.

On the basis of Clarification received from RBI, the amount of stock swap & advances has been deleted from the cumulative FDI data.

The amount of FDI equity inflows, in respect of country/sector specific data was not provided by RBI, Mumbai, prior to January 2000.

2012	22,789	6,350	28
Cumulative Total	***188,471***	***47,110***	***25***

Source: FDI Synopsis on Country European Union, Table No. 6.1. (B), DIPP, Ministry of Commerce and Industry, Government of India.

Figure 5.3 shows, the total FDI equity inflows to India from all the countries and from EU (in million US$) during 2000 to 2012.

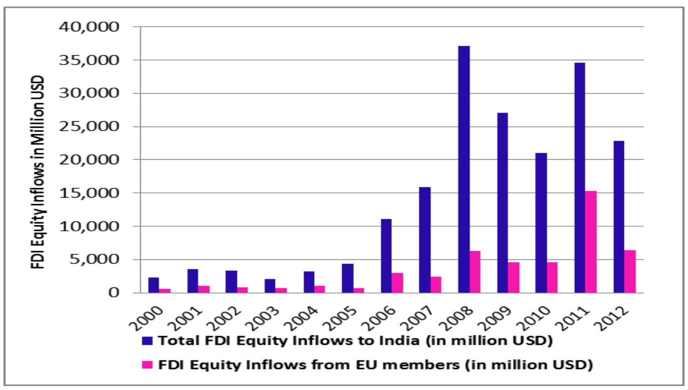


Figure 5.3: Total FDI Equity Inflow to India during 2000 to 2012

Table 5.4 presents FDI inflow from EU member nations to India during 2000 to 2012.

Table 5.4: FDI Inflow to India from EU-28 during 2000 to 2012

(In million USD)[19]

Sl. No.	***Country***	***2000-2005 Jan.-Dec.***	***2006 Jan.-Dec.***	***2007 Jan.-Dec.***	***2008 Jan.-Dec.***	***2009 Jan.-Dec.***	***2010 Jan.-Dec.***	***2011 Jan.-Dec.***	***2012 Jan.-Dec.***	***2000-2012 Jan.-Dec.***	***% of Total FDI 2000-2012***
1	Austria	19.35	1.7	3.78	26.47	23.42	24.34	43.78	41.37	184.19	0.098
2	Belgium	74.61	85.88	20.16	103.15	30.94	32.71	107.66	38.99	494.11	0.262
3	Czech Rep.	0.55	0	0.02	16.21	0.4	0.01	0.11	0.03	17.34	0.009
4	Cyprus	92	56.21	536.91	1,318.10	1,609.56	919.48	1,306.82	960.67	6,799.76	3.605
5	Denmark	102.54	5.32	6.21	15.8	23.04	48.66	51.72	95.09	348.39	0.185
6	Estonia	0	0	0.19	0.06	0	0	0.00	0.04	0.30	0.000
7	Finland	23.53	1.69	23.11	10.7	96.24	12.18	103.00	3.43	273.87	0.145
8	France	502.14	85.43	125.87	467.89	296.92	745.86	495.09	688.01	3,407.21	1.807
9	Greece	0.06	0	0.29	0	0.46	0.71	0.26	1.94	3.72	0.002
10	Germany	677.84	312.7	343.16	788.78	599.93	197.66	1,484.26	729.12	5,133.46	2.722

[19] Amount includes the Inflows Received through SIA/FIPB route, acquisition of existing share and RBI's automatic route only.

No FDI inflows have been received from Lithuania during the period.

11	Hungary	0.13	0	0.02	0	6.85	2.82	0.13	0.25	10.2	0.005
12	Ireland	13.32	13.78	4.23	44.25	27.3	1.05	39.11	10.93	153.98	0.082
13	Italy	246.78	56.53	27.91	366.23	150.84	183.33	134.04	76.85	1,242.5	0.659
14	Latvia	0	0	0.06	0	0	0	0.00	0.00	0.06	0.000
15	Luxembourg	28.83	27.96	11.2	41.94	30.87	183.23	62.83	72.25	459.10	0.243
16	Netherlands	1,379.27	494.9	680.99	988.92	832.81	1,146.59	1,268.73	1,675.91	8,468.13	4.490
17	Poland	1.84	0	0	0.04	26.14	14.17	9.56	516.78	568.53	0.301
18	Portugal	0.71	0.19	1.87	5.7	2.05	0.55	2.65	7.68	21.40	0.011
19	Slovakia	1.82	0.56	2.02	0	0	0.82	0.00	0.00	5.22	0.003
20	Spain	25.25	29.04	96.66	290.37	91.5	229.84	214.92	434.91	1,412.48	0.754
21	Sweden	329.23	6.01	83.93	92.78	245.37	27.16	32.47	164.62	981.55	0.520
22	Slovenia	8.23	0	0	0	0	0	0.00	0.00	8.24	0.004
23	UK	1,254.80	1,749.84	469.66	1,681.60	468.21	748.10	9,902.00	829.45	17,103.65	9.068
24	Malta	0.25	0	6.3	0	0	2.94	0.94	2.27	12.71	0.007
25	Romania	-	-	-	-	-	-	4.02	0.00	4.45	0.002
26	Bulgaria	-	-	-	-	-	-	0.07	0.00	0.36	0.000
27	Croatia	-	-	-	-	-	-	0.00	0.00	0.52	0.000
28	Lithuania	-	-	-	-	-	-	0.00	0.00	0.00	0.000
Grand Total		***4,783.08***	***2,927.74***	***2,444.55***	***6,258.99***	***4,562.85***	***4,522.21***	***13,230.49***	***6,133.37***	***47,124.43***	***24.99***

Source: FDI Synopsis on Country European Union, Table No. 6.1. (B), Annex, Department of Industrial Promotion and Policy, Ministry of Commerce, Government of India.

During 2000 to 2012; % of total FDI equity inflow to India from UK, Netherlands, Cyprus and Germany were highest among the EU member nations.

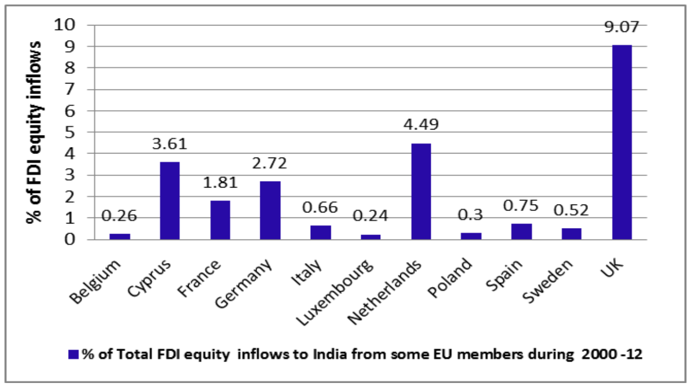


Figure 5.4: Total FDI Equity Inflows to India from some EU members during 2000-2012

5.3 Factor Influencing FDI Equity Inflows from EU to India:

The literature on FDI explains cross-country variations in FDI inflows in terms of country-specific characteristics encouraging or discouraging such flows. These can be broadly classified into *economic* factors impacting returns from investment e.g. host country market size, exchange rate stability, degree of openness of the economy, investment potential, country's debt position etc., host country *policies* for instance, outward-orientation, tax rates, investment incentives and *institutional* factors influencing investor outlooks such as, political stability, ease of doing business, cultural differences from home countries, language. While all these factors, individually and/or collectively, influence inward FDI, it is important to determine which of these are more significant in explaining the ability of some economies to consistently attract more FDI over time.

The existing empirical literature on determinants of FDI into developing countries has not devoted adequate attention to country-specific features that constitute sources of dynamic comparative advantages for attracting FDI. In this regard, exchange rate stability, investment potential, national debt, degree of openness can be key factors. It is well known that all these factors not only leads to productivity gains, but also production efficiency and higher returns on investment. Developing economies that have successfully made themselves attractive destinations for FDI are taking care of the above-mentioned.

Empirical research on FDI in India has mostly focused on the impact of FDI upon macroeconomic fundamentals. The limited literature on host-country determinants of FDI inflows points to such FDI that are essentially domestic market-oriented (Banga 2003, Guha and Ray, 2004). India also appears to enjoy the advantage of low wage costs (Guha and Ray, 2004; Gupta and Mehra, 1995). However, there is hardly any empirical analyses that describe economic strengths have influenced inward FDI in India from EU. A close look at the likely impact of these factors on FDI inflows becomes essential with India emerging as a leading recipient of FDI.

GDP of a country is an indicator of the size of the market. A growing and potential market with substantial size ensures economies of scale and gives opportunities to the investors for investment. Foreign investors get attracted towards a country with stable or accelerating growth of output. Similarly, the fluctuation of exchange rate plays a vital role for the firms making investment abroad. With the fluctuation the firms prefers to reinvest or repatriate the earnings, change the location to other markets, or goes for mergers and acquisitions or consolidation for maximization of benefits. The depreciation of currency increases the ability of the foreign firms in comparison to local firms as it helps in doing more activities with less foreign exchange.

The critical role of the above-mentioned determinants in explaining inward FDI in developing countries, however, is practically unexamined. Here, we have attempted to identify empirically India's specific features, particularly the role of GDP, domestic capital formation, degree of openness of the economy, exchange rate stability, debt in explaining the pattern of FDI inflows from EU to India.

We have analyzed the potential determinants of FDI equity inflows from EU to India during the period 2000 to 2012 with the help of an econometric model used by UNCTAD to determine the determinants of FDI to various countries in 1993. The FDI model used is as given below.

5.4 FDI Model:

$$\boldsymbol{FDI_t = \beta_0 + \beta_1 GDP_t + \beta_2 I_t + \beta_3 DEBT_t + \beta_4 XR_t + \beta_5 OP_t + \beta_6 TEU_t + \sigma}$$

FDI_t = Inflow of FDI in year t
GDP_t = Level of GDP in year t
I_t = Domestic Capital Formation (DCF) in year t
$DEBT_t$ = Debt in year t
XR_t = Exchange Rate (US$ vs. INR)
OP_t = Degree of openness of the economy in year t measured as the ratio of exports plus imports to GDP $(X+I/GDP)_t$
TEU_t = Trade (export and import) with EU in year t
XI_t = Total Trade (export and import) of India in year t
σ =random error.
β_0 = Constant

β_1, β_2, β_3, β_4, β_5 and β_6 are coefficient of various determinants of FDI inflows such as GDP_t I_t, $DEBT_t$, XR_t, OP_t and TEU_t, respectively. The significance of these coefficients has been analyzed with the help of regression analysis.

5.4.1 Assumptions:

We have assumed that the Gross Domestic Product (GDP), Domestic Capital Formation (I), Debt, Openness of the Economy (OP), Trade (export and import) with EU (*TEU),* Exchange Rate (XR) are the main determinants of FDI equity inflows from EU to India. The following assumptions about the variables have been considered.

(i) There exist a positive relationship between size and growth of GDP and FDI equity inflows;

(ii) Domestic Capital Formation (I) attracts foreign investors to increase their operation;

(iii) The degree of openness of an economy attracts more FDI equity inflows;

(iv) The level of indebtedness (DEBT) of a country is negatively related to FDI inflows;

(v) Trade (total exports and imports) position with the partner countries is an important determinant of FDI inflows;

(vi) The fluctuation in exchange rate (XR) is negatively related to FDI inflows.

5.4.4 Data:

The summary data used for this analysis are presented in Table 5.5. These data have been compiled from various sources and all the data used in the analysis are of time period 2000 to 2012. The data source is mentioned separately in Table 5.6.

Table 5.5: Data used in the Analysis

Year	*FDI*	*GDP*	*I= DCF (Domestic Capital Formation)*	*X+I (EU27) $EU_{(X+I)}$*	*Debt*	*Exchange Rate (XR)*	*Degree of Open ness = OP_t*
	Mio. USD	*Mio. USD*	*Mio. USD*	*Mio. USD*	*Mio. USD*	*1 USD = INR*	*(Exp.+Imp.)/ GDP*
2000-01	575	498,205	120,909	213,69	101,326	43	0.2
2001-02	1,006	501,244	113,497	208,04	988,43	45	0.2
2002-03	824	485,362	116,899	247,21	104,914	48	0.2
2003-04	658	543,309	142,314	295,91	112,653	46	0.3
2004-05	1,056	645,973	201,989	375,51	134,002	46	0.3
2005-06	665	770,145	263,020	492,27	139,114	44	0.3
2006-07	2,928	880,438	310,786	566,88	172,360	45	0.4
2007-08	2,445	110,978,4	414,737	729,85	224,407	41	0.4
2008-09	6,259	124,062,8	433,699	820,85	224,498	43	0.4

Year	*FDI*	*GDP*	*I= DCF (Domestic Capital Formation)*	*X+I (EU27) $EU_{(X+I)}$*	*Debt*	*Exchange Rate (XR)*	*Degree of Open ness = OP_t*
	Mio. USD	*Mio. USD*	*Mio. USD*	*Mio. USD*	*Mio. USD*	*1 USD = INR*	*(Exp.+Imp.)/ GDP*
2009-10	4,563	126,341,9	468,577	744,61	260,935	48	0.4
2010-11	4,522	156,852,4	576,997	905,79	305,931	46	0.4
2011-12	15,260	117,551,1	455,605	109,428	104,32	48	0.7
2012-13	6,350	108,451,1	422,383	102,696	5,208	54	0.7

Source: Data source is given in Table 5.6 below.

Table 5.6: Data Sources

Data	***Data Source***
FDI	Annual Data of Department of Industrial Promotion and Policy (DIPP), Ministry of Commerce & Industry, Govt. of India (various issues)
GDP	Central Statistical Organization (CSO), Govt. of India (various issues)
Investment (I)	Reserve Bank of India (various issues)
Exchange Rate (XR)	Reserve Bank of India (various issues)
Debt	Reserve Bank of India and Economic Survey (various issues)
Export-Import (X+I)	Trade Statistics, Ministry of Commerce & Industry, Government of India

5.5 Result of the Analysis:

A regression analysis was carried out with the data presented in Table 5.5. In this analysis, we have considered FDI as dependent variable and all others variables (assumed determinants) as independent variables. The summary result of the regressions is presented in Table 5.7. Some of the explanatory variables specified in the econometric functions are seen to be significant elements in attracting FDI in India.

Table 5.7: Result of Regression Analysis

Dependent Variable (Y)	*Independent Variable (X)*	*R^2*	*t-Statistics*	*Coefficients*	*Significance*
FDI	GDP	0.74	5.66	2.18	+Ve
	DCF=I (Investment)	0.73	5.46	1.49	+Ve
	$EU_{(X+I)}$	0.80	6.71	1.56	+Ve
	OP_t	0.72	5.35	2.19	+Ve
	Exchange Rate	0.11	1.18	5.07	-Ve
	Debt	0.12	-1.22	-0.30	-Ve

The above results explain about 95 % of the variation. Summary results are presented below:

(i) The coefficient +2.18 implies that variable GDP is a significant determinant of FDI equity inflows. Here R^2 value 0.74 and t – Statistics 5.66 are significant.

(ii) The domestic capital formation (I) with a coefficient of +1.49 is significant determinant of FDI inflows. The R^2 value 0.73 and t – Statistics 5.46 values are also significant.

(iii) The coefficient of +1.56 also implies that India's trade (exports and imports) with EU ($EU_{(X+I)}$) is another significant determinant of FDI equity inflows. Here R^2 value 0.80 and t –Statistics 6.71 are significant.

(iv) The degree of openness (OP_t) of the economy with a co-efficient of +2.19 and R^2 value 0.72 and t –Statistics 5.35 turns out to be a significant determinant of FDI equity inflows.

(v) The coefficient of +5.07 with a low R^2 value of 0.11 and t-statistic of 1.18 for exchange rate implies it to be a non-significant determinant of FDI equity inflows.

(vi) India's debt position with a coefficient of – 0.30 and R^2 value + 0.12 and t –Statistics of -1.22 turns out to be a non-significant determinant of FDI equity inflows.

5.6 Observation

The above analysis shows that GDP of the country, domestic capital formation, India's trade position with EU and degree of openness of the economy are significant determinants of FDI equity inflows from EU to India during the period 2000-2012. However, the debt position of the country and the exchange rate found to be non-significant determinants.

Chapter 6

Prospects of India-EU Trade and Foreign Direct Investment

6.1 Prospects:

The major items that India imported from EU during 2009 to 2013 are vegetable products, minerals, chemicals, textiles and textile products, base metals, precious metals, transport equipment and machinery & appliances. The major items of India's export to EU during this period were products of chemical and allied industries, plastics, rubber and articles thereof, pearls, precious metals and articles thereof, machinery and appliances, transport equipment and optical and photography instruments. The export-import performance implies that trade in certain agricultural products, almost all chemical products, items of textiles and textile products and items of pearls, precious metals and articles thereof, machinery and appliances, transport equipment belong to high potential areas. Rather than diversifying into many areas, India should concentrate on trade of some selected areas where its potential is much high in EU market.

Further, in spite of the concerted efforts made both by India and EU in liberalizing tariff and non-tariff barriers, there has been growing apprehension that non-tariff barriers will emerge as major challenge to the free trade in the years ahead. It is in the interest of both EU and India to remove existing non-tariff barriers restricting market access to each other.

The strengthening of trade relation with EU could be reinforced through serious reconsideration of removal of existing trade irritants, starting the business dialogue through interaction between EU-India, simplification of unnecessary and complicated administrative procedures, curtailment of quantitative restrictions, tackling of trade defense instruments. Trade negotiations, trade summits reduce the discomforts in trade and investment bottleneck between two trading partners thus helps in boosting up the trade and investment process. The proposed Free Trade Agreement (FTA) and other supportive trade policies should be given highest priority.

India had maintained a good performance in export sectors. However, India's market share is under-utilized. There is a need for value additions, brand names, innovative designs and improving the quality and standards in India's traditional export. Further, there is also a need to adhere to environmental and hygienic standard in more sensitive areas.

Stable economic environment in India is responsible for steady FDI inflow. The stable economic environment depends upon the macroeconomic performance and supportive policies.

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End Notes: