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Fresh approaches seen in India's two new FTAs

Author

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Cover Photographs:

Minister of Commerce & Industry Piyush Goyal signs the Comprehensive Economic Partnership Agreement (CEPA) with the UAE Minister of Economy Abdulla bin Touq Al Marri in New Delhi, February 18, 2022. Source: All India Radio News.

Minister of Commerce & Industry Piyush Goyal at the virtual signing ceremony of India-Australia Economic Cooperation and Trade Agreement (IndAus ECTA), April 2, 2022. Source: Twitter @PiyushGoyal.

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Introduction

Two new free trade agreements have been signed by India this year, with negotiations completed in months rather than years. The India-UAE Comprehensive Economic Partnership Agreement (IUCEPA) was signed on 18th February 2022 after only 88 days of negotiations and has already come into force on 1st May. The India-Australia Economic Cooperation and Trade Agreement (IAECTA) was signed on 2nd April 2022 and will come into force once both sides complete their ratification procedures[1]. This agreement was also wrapped up within seven months after formal relaunch of negotiations on 30th September 2021.

No doubt the UAE deal had been preceded by India's earlier negotiations with the GCC, of which UAE is a member, and the two countries may not have been altogether unfamiliar with each other's issues and concerns. Similarly, with Australia, the bilateral negotiations date back to 2011, when they commenced but got stalled in 2015. The two sides were also in the negotiating rooms of RCEP from 2013 to 2019, till India decided to pull out of this mega regional agreement. Both sides therefore had even more opportunities to understand each other's sensitivities and expectations, facilitating an early outcome.

The question therefore is why has India changed course after a decade of 'FTA-pause' from 2011, after the FTAs with Malaysia and Japan came into force[2]. One reason could be that this was also the decade when India's goods exports remained stagnant around a figure of US$ 300 bn per annum. Political capital is available when exports show dynamism, as they have done after a long time in the year 2021-22, with exports reaching US$ 422 bn, a significant increase over the previous best of US$ 330 bn in 2018-19. India's exports of commercial

[1] It is assumed in this brief that the new Australian government and Parliament just elected will approve the deal concluded by the earlier Conservative government.

[2] India has signed a Comprehensive Economic Cooperation and Partnership Agreement in February 2021 but in terms of tariff reduction/elimination coverage it does not score high. See https://commerce.gov.in/wp-content/uploads/2021/08/India-Mauritius-CECPA-Text-for-Upload.pdf

services are also expected to have crossed US$ 250 bn in 2021-22[3], lending further support.

Another reason could have been to emphatically convey that even as India was focusing on its 'aatmanirbhar' approach, it was equally keen to enhance economic engagement with the world, particularly with those countries that showed a willingness to be accommodative of India's trade sensitivities. This may have been considered necessary particularly after India's withdrawal from the RCEP.

India has also been also facing pressure in the WTO and related trade negotiation platforms about joining plurilateral negotiations on e-commerce, investment facilitation and other subjects, all of which it has kept away from. In talking about these new issues, Commerce Secretary Subrahmanyam has argued that India did not have much experience or capacity in these new areas and bilateral FTAs could help build such capacity. He has further stated that India can "Cut our teeth (in bilateral FTAs) and once you have a certain comfort level, when you have broken down domestic opponents to understand the benefits of these particular areas, then you actually multilateralise it. We actually look at these as stepping stones on which we will build up a larger multilateral agreement"[4]. This new perspective may be yet another reason why the government is showing more openness now to FTA negotiations.

FTA partner selection

This then raises the question whether indeed the two new FTAs carry some distinguishing new approaches in relation to earlier FTAs. Before we come to this aspect, the issue arises also of FTA partner selection.

The UAE is India's second or third largest export destination and import source for merchandise goods. Bilateral services trade covers several areas and the two way investment flow is also substantial. Further, it is the top destination for Indians seeking work abroad[4] and their current number is estimated at around 3.3 mn[5].

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[3] https://www.business-standard.com/article/economy-policy/services-exports-touched-all-time-high-at-250-bn-in-fy22-piyush-goyal-122041301298_1.html

[4] See the news item https://www.business-standard.com/article/economy-policy/commerce-ministry-likely-to-soften-stance-on-21st-century-issues-at-wto-121121601476_1.html

[5] See the author's earlier DPG brief No.36, Volume 6, on 'Challenges in negotiating the India-UAE CEPA' dated 17 November 2021

While Australia figures eleventh in India's bilateral goods trade, it is India's fourth largest source of import of commercial services.

Both the UAE and Australia are resource rich and a source of raw material and fuel supply for India. These products account for over 55% of India's imports from the UAE. In the case of Australia, it is even more, ranging from 75 to 85% annually. So there is economic complementarity to a significant degree apart from growing trade, which provides room for arriving at a mutually beneficial outcome. Beyond trade, political ties with the two countries are growing, billed bilaterally in both cases as comprehensive strategic partnerships. India and Australia are members of the QUAD in the Indo-Pacific, with which India is collaborating to promote supply chain resilience. Similarly, India and the UAE are members of another Quad (India, UAE, Israel and the US) in West Asia.

That said, there were also aspects that needed to be kept in view. The UAE is a re-export hub that has, on the one hand, positive spillovers in respect of India's exports being able to also go to third countries, particularly countries in West Asia and Africa. But there are also risks of imports into the UAE from other countries getting re-exported to India under the IUCEPA stream, which is meant only for products which have undergone substantial transformation in the UAE.

In respect of Australia, the main concern was how to keep clear of a steep rise in farm imports, particularly of sensitive products like dairy items, cereals, and sugar.

Thirdly, the UAE has free market arrangements with Arab countries and is a member of the Gulf countries' customs union (GCC). Australia is also already a party to 17 FTAs that include the two mega deals RCEP and CPTPP. Both countries are also negotiating more FTAs. An FTA between India and these two countries will therefore be meaningful only if it provides, in terms of market access, at least a level playing field vis-a-vis third countries which are either their existing FTA partners or could be potential ones in the future. Whether the two FTAs address these points is thus an important aspect to examine.

Two negotiations, two routes

In terms of the negotiations themselves, the two FTAs have followed different routes. The IUCEPA is a comprehensive agreement covering not only trade in goods and services but also investment, IPRs, digital trade, government procurement, environment and competition. But IAECTA is only an interim, even if very substantial, agreement limited to core market access issues in both goods and services. Further negotiations are to take place between India and

Australia to make it more comprehensive and these are expected to commence soon, when some of further areas may also be included.

However, what has been already agreed upon in these two FTAs indicates several new markers in India's approach to FTA negotiations. The prominent ones are detailed below[6,7].

Fresh approaches seen in the two new FTAs

Market access for goods

- Both the FTAs will allow for deep access into the FTA partners' markets for India, unlike some of India's earlier FTAs. This will happen once the tariff reductions are complete, which will be ten years for the UAE and 5 years for Australia. But even as the agreements enter into force, 90% and 98% respectively of India's exports to the UAE and Australia will become tariff free. UAE's eventual tariff elimination reduction will cover 97.6% of lines extending to 99% of India's exports to it. In the case of Australia, tariffs on all the lines will be free in five years' time for India. That said, however, tariffs are already free or have a negligible average for China and ASEAN countries in the Australian market under their respective FTAs[8]. Indian exporters will therefore not enjoy any preferential access vis-a-vis these countries. Even so, they have to try hard to enhance exports to Australia aided by a more level playing field now.

- India will be undertaking tariff elimination/reduction in 90.3% of the total lines with the UAE. Around 9.7% of them will remain excluded from any reduction, and these will cover dairy and several agricultural items, automobiles and parts, several consumer items and medical devices. In respect of Australia, India will eliminate tariffs on 40% of tariff lines at the time of IAECTA coming into force. Another 30.3% of the lines will have tariffs eliminated or reduced in 5/7/10 years. Around 29.8% of India's tariff lines will be excluded from any tariff reduction. Agricultural items such as dairy products, sugar, rice, wheat, walnut, apple, pulses and oilseeds have been

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[6] The text of IUCEPA can be accessed at https://commerce.gov.in/international-trade/trade-agreements/comprehensive-economic-partnership-agreement-between-the-government-of-the-republic-of-india-and-the-government-of-the-united-arab-emirates-uae/

[7] The text of IAECTA can be accessed at https://www.dfat.gov.au/trade/agreements/negotiations/aifta/australia-india-ecta-official-text

[8] See page 45 of WTO Secretariat document Australia's trade policy review in 2020 available at https://www.wto.org/english/tratop_e/tpr_e/s396_e.pdf

excluded. While coal, which accounts for over 50% of India's imports from Australia, has been included for tariff elimination (Indonesia is the other major source for India and tariffs have already been eliminated for it under the India-ASEAN Trade in goods agreement), iron ore has been excluded.

- India has, for the first time, offered tariff rate quotas (TRQs) as a means of providing limited access to the FTA partners in certain sensitive sectors. These include a few agricultural items. In the case of UAE, however, TRQs have also been set up for items like gold and gold jewellery, copper wire and primary polymers. In respect of Australia, a TRQ has been provided also for extra-long staple cotton. Some of these items could help in building value chains with supply of raw materials at competitive rates.

- The TRQ to UAE for 200 tonnes of gold (120 tonnes in year 1 that will rise to 200 tonnes in the year 5) is particularly relevant here. This is when imports into India from the UAE, say in 2019-20, were only around 60 tonnes of gold valued at US$ 2.7 bn. India has also offered a TRQ for gold jewellery of upto 2.5 tonnes, with duty reduced by 5%. In return, India has secured a tariff reduction from the UAE, from 5% to nil, in cut and polished diamonds and gold jewellery, as well as in all other HS 71 items. India's exports of these items (HS 71) to the UAE totalled US$ 9.43 bn in 2019-20, and most of them faced 5% duty at the UAE end. Will this bring about an efficient value chain and help build India into a greater jewellery making centre? The government is certainly expecting it will boost the jewellery sector in India[9].

- The market opening for the UAE in India includes tariff free access for refined petroleum oils, aluminium ingots etc., that have not been offered to other FTA partners. All these are domestically sensitive products in which oil rich UAE has particular strengths, and their impact will need to be watched. The UAE has also been accorded a TRQ at a reduced rate of duty for several primary polymer lines, on which duty concessions have been offered only to Singapore.

- The UAE being an attractive investment destination, particularly for Indian businesses, could at the same time also encourage investment diversion from India. Indian companies can locate manufacturing units in the UAE and export products to the Indian market, using the IUCEPA. TRQs for

[9] See https://www.businesstoday.in/latest/economy/story/india-uae-trade-pact-jewellery-sector-to-get-export-boost-says-commerce-secy-323212-2022-02-19

jewellery or reduced tariffs for refined oils and petrochemical products, among others, hold those possibilities[10].

Rules of origin (ROO)

- In respect of the main rule of origin (ROO), the two FTAs have raised the bar. The minimum local value addition (VA) required has been raised to 40%, apart from requiring the product to have had a change in tariff sub heading at the 6-digit level (CTSH). This is higher than in the FTAs with Japan, Korea and Malaysia in which the VA was pegged at 35%, apart from CTSH. The 'melt and pour' requirement for steel products is also a new requirement that appears gaining wider global usage after its use in some recent agreements, including the EU-US agreement[11] on steel items.

- For India's exports which have faced difficulties because of inadequately negotiated ROOs in past FTAs – fishery items, cut and polished diamonds and jewellery[12] – the IUCEPA has provided flexibility. However, for refined petroleum oils, a key item in India's export to the UAE, meeting the CTSH plus 40% VA may be difficult, unless the crude refined is of Indian or UAE origin. In the IAECTA, the ROO provides flexibility for gold jewellery that requires VA of only 1.5%. The issue does not arise for other products, since the MFN duties in Australia for most fishery items, refined petroleum products and cut and polished diamonds are themselves zero.

- Under the IUCEPA, the issuing authority for ROO in the UAE is the Ministry of Economy itself, which will perhaps ensure that re-exported goods do not somehow come on to the IUCEPA stream. Both the FTAs also now incorporate strengthened verification mechanisms in line with the CAROTAR rules adopted in India[13]. That said, there is also the challenge of making the certification and verification process quick, with a minimum cost for those exporters with a good compliance record. Both IUCEPA and

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[10] See for example the news item 'RIL inks pact for US$ 2 bn UAE deal: in talks with ADNOC', by Viveat Susan Pinto, 27 April Business Standard. The news item inter alia notes that the TAZIZ project to which the investment is intended would benefit from the India-UAE CEPA .

[11] https://www.commerce.gov/sites/default/files/2021-10/US%20232%20EU%20Statement.pdf

[12] Fish meat, for whose processing an imported additive is required, could not always benefit from IJCEPA in the Japan market because the ROO was 'wholly produced'. The petroleum oils had the ROO of 40% plus CTSH as the requirement in the India ASEAN FTA which was not possible to achieve. In the Korean and ASEAN FTAs the ROO for cut and polished diamonds was a high level of value addition which again was not feasible.

[13] https://www.cbic.gov.in/resources//htdocs-cbec/customs/CarotarBrochure_8thOct2020.pdf;jsessionid=6CB9E84F93157145753E2FF59766DFA2

IAECTA provide for in-built negotiations for authorised exporters to be allowed that facility. This will need follow-up monitoring in due course.

Bilateral safeguards in case of surge in imports

- The IUCEPA has provided for bilateral safeguard measures (BSMs) that will be permanent. In the IAECTA it is time bound, but extends upto fourteen years after the completion of tariff elimination/reduction for each product. This extended duration will help assuage sensitivities in the Indian industry and agriculture sectors about possible surges in imports.

Product standard approval and certification

- Both FTAs have made some advance in respect of pharmaceuticals and organic products. IUCEPA carries a clear commitment for fast track product registration and time bound marketing authorisations for exporting Indian pharmaceutical products to the UAE which have received such approvals from the regulatory/reference authorities of Australia, EU, Japan, UK or the USA. India and the UAE are also committed to finalise an annex on organic products in one year. Similarly, in the IAECTA, there is a commitment to conclude negotiations on a Mutual Recognition Assessment of organics equivalence. The IAECTA annex on pharmaceuticals is, however, less final. It only commits the therapeutic regulators in the two countries to utilise reports on pre-market evaluation of products and on inspection of usage of good manufacturing practices from third country regulatory bodies recognised by each one of them as a comparable regulator. Clearly, far more work will be required for obtaining product approvals for other items and agricultural products, particularly in the Australian market.

Trade in Services

- Services sector commitments extend to 111 out of 160 sub-sectors by the UAE and to 100 by India in the IUCEPA. In the AIECTA they extend to 135 by Australia and 103 by India, the highest by India in its FTAs. In the latter, Australia is also committing to MFN treatment for 120 sub-sectors (that is any opening up in the future to third countries will automatically apply also under IAECTA) and India has done the same for 31 sub-sectors. While the IUCEPA commitments have been inscribed on a positive list basis as in the GATS, the AIECTA has used the hybrid approach as in RCEP. Australia has taken its commitments on a negative list basis but India, which has inscribed its commitments on a positive list basis, has to transition to a negative list scheduling in six years' time, which will be a first for India.

- On movement of natural persons (Mode 4), the IUCEPA has specific commitments on business visitors, intra-corporate transferees (ICTs) and contractual service providers (CSPs). The IAECTA is more expansive and adds the categories of individual service professionals and installers and servicers. The UAE sets a limitation for ICTs at 50% of the total number of managers, executives and specialists of each service supplier. Australia has indicated it may conduct economic needs test for ICTs and CSPs. It has, however, specifically committed to a combined annual intake of 1800 qualified Indian professional chefs and yoga instructors under the CSP category.

- What is evident in the IAECTA is the apparent understanding between the two countries to show some accommodation towards the special interests of each party towards the other – education services in respect of Australia and IT and IT-enabled services in the case of India. Australia has made a commitment that it will amend its domestic taxation law to stop taxation of offshore income of Indian companies providing technical services to Australia. Australia has also added a sweetener in the form of extending the permitted stay under post study work visas for Indian nationals studying in Australia in various courses at different levels[14]. Further, to promote mobility and people to people ties, Australia has committed to annually grant 1000 multiple entry 'work and holiday visas'[15] for temporary stay of one year for Indian nationals.

- In a first, the IAECTA also has a separate annex on professional services whose main purpose is to provide a framework for recognition of professional qualifications and experience, and registration and licensing of professionals of one party in the other. This will need effective follow-up and both the Indian government and professional bodies need to make this possible, at least in a few areas like architecture, accountancy, nursing and medical services. In some ways, due to the English language being a common factor and Australia showing relative openness to external sourcing for talent, it could be a good partner for India to make progress on this matter, unlike other FTA partners.

[14] https://www.dfat.gov.au/sites/default/files/aiecta-side-letter-post-study-work-australia-to-india.pdf

[15] https://www.dfat.gov.au/sites/default/files/aiecta-side-letter-work-and-holiday-visas-australia-to-india.pdf

Government Procurement

- The inclusion of commitments on government procurement in a separate chapter in the IUCEPA, and an indication in the IAECTA that there will be a chapter on it in the eventual comprehensive agreement with Australia, perhaps constitute the most significant markers and shifts in India's policy towards FTAs. It is not clear what prompted this shift. It could be that this issue would in any case arise for consideration in the FTA discussions with the EU and other developed partners, and it may be a good idea to set a template in the FTA with the UAE. The threshold set in the IUCEPA is SDR 20 m for each contract for India (a little over Rs. 200 crores at current rates), and it is limited to procurement by 34 central government ministries (and not their subordinate offices and other entities). On its part, the UAE has committed to opening its procurement by 41 government ministries and other entities above the lower threshold contract limits of SDR 34,000 (around Rs 35 lakhs) for goods and services and SDR 5.844 m (around Rs. 60 crores) for construction services. The supplies will be in accordance with market access provisions in the agreement on goods and services. Both countries can accord preferences for procurement from SMEs and rule out infrastructure and construction projects. UAE has inscribed preferences for procurement of 'green goods' and from 'green suppliers'. Further, India's procurements will also not cover those procured under the Public Procurement order of 2017 giving preference to 'Make in India'[16] as also "any other order issued by the Central Government, as amended from time to time". It is this catch-all reservation that leaves the whole scope of what is actually covered unclear. Further clarity will be necessary, if it is intended to serve as a template, since even in the Q&A given on the Ministry website[17] it is noted that "There is no commitment on any additional market access as both the parties reserved their rights based on their existing and future domestic laws and regulations as well as programmes on domestic preferences."

- An implication of opening government procurement in the IUCEPA is that Japan can seek negotiations with India for being accorded a similar treatment under the 'non-discrimination' provisions on government procurement in the IJCEPA[18]. That said, India too, under the same non-discrimination provisions in the IJCEPA, can ask for a similar treatment as

[16] https://dpiit.gov.in/sites/default/files/publicProcurement_MakeinIndia_15June2017.pdf

[17] See https://commerce.gov.in/wp-content/uploads/2022/05/FAQs-on-CEPA_For-Uploading-on-DoCs-website-05-May-2022.pdf

[18] Articles 111 and 114 of IJCEPA

that extended by Japan under CPTPP to countries like Vietnam, Malaysia and others which are not members of the GPA of the WTO.

Digital Trade

- Another marker is the inclusion of a chapter in the IUCEPA on digital trade and the indication in the IAECTA that there will be a separate chapter on this subject in the eventual comprehensive deal with Australia[19]. This is even as India is not a participant in the plurilateral negotiations underway on e-commerce in which 86 members of the WTO are currently involved. The chapter in the IUCEPA has provisions on paperless trading, authentication, on-line consumer protection, dealing with unsolicited commercial messages, personal data protection, regulating cross border flow of information, promotion of digital invoicing and benefits of maintaining open data. Obligations are however couched in best endeavour terms and are focused more on creating a conducive environment for growth of digital trade and less on creating disciplines which have been allowed to be domestically driven. The chapter is not subject to dispute settlement. On cross border data flows, for example, the IUCEPA merely commits the two parties to endeavour to promote electronic information flows across borders subject to their laws and regulatory frameworks. But both parties are committed to not denying the legal validity of electronic signatures, except as provided by their respective laws. They will also maintain their current practice of not imposing customs duties on electronic transmissions subject to any adjustment each party may make following a future WTO decision on this issue.

Trade and Investment

- Unlike India's earlier comprehensive FTAs, the IUCEPA chapter on investment (actually it is on Investment and Trade) is not subject to dispute settlement and focusses on investment promotion and facilitation and establishes a UAE-India Technical Council for this purpose. However, on investment protection, the two parties have agreed to finalise a new agreement by June 2022 that will replace the UAE-India bilateral investment agreement signed in 2013. It is to be seen if this separation of investment protection from the FTA will mark a new trend in India's FTAs, since the IAECTA also does not specifically refer to a chapter on investment in the eventual CEPA between India and Australia.

[19] India did have a separate chapter on e-commerce in the ISCECA with Singapore but that was briefer.

Other issues

- The IUCEPA also has chapters on SMEs and economic cooperation, and provides for information sharing and enhancing cooperation on a variety of issues with specific work programmes. These include cooperation on competition policy, environment, and air services, but these chapters are also not subject to dispute settlement. The provisions on environment are more about the implementation and enforcement of relevant domestic laws by each party. Both parties also reaffirm their commitment to implement the respective multilateral environment agreements to which they are a party. Somewhat similar provisions are also included in the IJCEPA[20].

Mandatory review of the agreement

- While both the FTAs have provisions for periodic general reviews of the agreements, the IAECTA additionally provides for a more compulsory review of market access related aspects of the agreement on goods after 15 years of the agreement coming into force. If a party fails to respond to the request of the other party within 60 days to a request for such a review, or no satisfactory solution is arrived at for the proposal raised in the review within six months, then the other party will be able to implement the proposal through a written notice. This mandatory revision provision is a new element in India's FTAs and its inclusion may have been prompted by the relatively slow response to India's call for the review of some of its existing FTAs, for instance the CEPA with Japan.

Concluding Note

After a decade of 'FTA-pause', India is venturing into negotiating a new set of FTAs, two of which have been concluded. Economic complementarity has helped in arriving at their rapid conclusion. The idea of an interim agreement with Australia capturing the core market access issues has also enabled it to be quickly wrapped up. Readiness shown by India to adopt some new approaches could be yet another factor.

Both FTAs are deep, seen from India's access into these partners. They have also enabled India to shield some of the sensitive areas, including certain agriculture products, some through the use of TRQs. The jewellery package with the UAE makes a bold venture anticipating far more trade creation than the trade diversion that it will bring about, and making India a jewellery hub. While the Australia deal will result in 100% access into that market for India, it

[20] Article 8 of India-Japan Economic Partnership Agreement (IJCEPA)

will however still secure only a level playing field with China and ASEAN countries that already have such access. Duty concessions have also been attempted for the first time in refined petroleum oils and certain non-ferrous metal items. Their impact will need watching. Role of the UAE as a re-export hub has positive spill-overs for India in expanding export access to third markets, but imports will need scrutiny to avoid re-exported goods benefitting from IUCEPA concessions. Both the FTAs have also sought to address some of the gaps in the rules of origin in India's earlier FTAs, and made a beginning on including an Annexure to help facilitate improved access for India's pharmaceutical products, but more work is needed for other products.

Commitments and understandings reached in the services sector are promising, particularly in respect of Australia. They could help further consolidate the primacy of education in Australia's services exports[21] and of India in IT and IT enabled services. Other professional services could also expand with effective implementation of the related Annex. India is, however, now committed to moving to a negative list scheduling with Australia after a six-year period.

Government procurement (with market access) and digital trade chapters find inclusion in the IUCEPA and are also specified to be included in the eventual CEPA with Australia. Chapters on these subjects can now be expected to become a regular feature in future FTAs. Investment protection, however, has been kept out. While environment and competition aspects have been covered in the IUCEPA, these are not without precedents. It also appears that the Indian government has taken the viewpoints of the trade and industry sectors at every stage of the negotiations, which is welcome[22].

India's external trade has shown a sharp revival in 2021-22, which needs to be sustained. Enhanced market access through these new FTAs, and possibly those under negotiation can be of particular help. But concluding such agreements is only a start. Each of these FTAs also need to be accompanied by an effective follow-up implementation strategy, including securing recognitions in respect of other products and services and rendering utilisation easy. Further, activating a targeted export and investment promotion strategy

[21] Education services constituted 74% of Australia's services export to India See https://www.dfat.gov.au/sites/default/files/australias-trade-in-services-with-india.pdf

[22] See the article by the Director General of CII Chandrajit Banerjee accessible at https://www.livemint.com/opinion/online-views/indias-trade-pact-with-australia-will-click-it-ticks-the-right-boxes-11649014512186.html

towards these two countries will enable the realisation of the full potential of the two FTAs. Fresh initiatives are required on these aspects as well.

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