

The impact of regulatory heterogeneity on export performance: An assessment of the proposed EU-India FTA framework

Sangeeta Khorana*

Anand Asthana**

Extended Abstract

Background and Context

The European Union (EU) and India are currently negotiating a bilateral free trade agreement (FTA) and investment framework, which aims to liberalise trade, address 'behind-the border' barriers and focus on policy issues such as regulations, competition policy, and procurement. The proposed FTA is expected to be a "stepping stone" for "deeper integration" between the EU and India as trading partners. Existing studies focus on the economic effects of trade agreements through trade diversion and creation, political and international business effects. For instance, economists argue that FTAs improve access to growing markets, level playing field, and build alliances for World Trade Organization (WTO) negotiations but some cast doubts as to the benefits of individual FTAs between large economies and smaller ones, and the wisdom of limited agreements (see Viner 1960, Baldwin 1991, 2008; Bhagwati 1995, Wei and Frankel 1996, Bhagwati and Panagariya 2002, Baldwin 2002, 2006, 2011, 2013; Khorana and Garcia 2013). Political economists find that FTAs carry significant political motivations, ranging from altering domestic coalitions against liberalization, to locking in domestic reforms, or emulating others (Ravenhill 2003, Aggarwal and Shuijiro 2006). None of the existing studies highlight the impact of regulatory heterogeneity between partner countries and how this can manifest in losses for exporters.

Research Aims

This paper addresses the broader concern of whether the proposed agreement will act as a "building block" given regulatory heterogeneity between the EU member states and India. The proposed paper focuses on: firstly, the existing regulatory incompatibility issues within the proposed EU-India FTA framework. Secondly, based on empirical evidence from field survey of small and medium firms

* Keele Management School, Keele,

** Professor in International Business, Pontifical Catholic University of Peru.

in India, we show how differences in regulatory regimes between partner countries can impact on firms' export performance. Thirdly, suggests the way forward to address regulatory differences from a developmental perspective.

The focus sectors are leather and footwear (L&F) and textiles and clothing (T&C) sectors, which export over one-third of the total Indian goods traded with the EU. We interview a total of 120 firms located in the production clusters of east, west, north and south regions of India.

Methodology

The study employs SPSS software to analyse 120 interview results econometrically. It identifies 'behind-the border' barriers that result from diverse regulatory regimes and impede trade between the EU and India. Exporters' perceptions on the incidence of 'behind-the border' barriers are assessed using a five point Likert scale (from 5 to 1). The analysis provides empirical evidence on firstly, whether size of the exporting firms in India matters in exporting to the EU; and, secondly, for the set of 'behind-the border' barriers identified, whether the variables, i.e., firms' size and total export experience, impact on firms' exporting performance. Our paper addresses the following questions:

- (i) Does firm size matter? Overall, is there a systemic relationship between the size of the firm and its perceptions about the severity of 'behind-the border' obstacles encountered in exporting to the EU?
- (ii) How significant is export experience as a variable? Is there an overall relationship between total export experience and exporters' perceptions about barriers faced?

Main results

This paper finds that under the present EU-India trade arrangements, 'behind-the border' barriers result from regulatory heterogeneity, variations in product standards, labelling and packaging requirements. Since production processes in both these sectors are chemical intensive, restrictions are imposed on the grounds of consumers' health and safety under REACH legislation of the EU. This is a significant problem particularly for small Indian exporters that are more vulnerable than the larger firms to cost increases. These lead to high compliance costs that necessitate additional engineering costs, purchase of specialised equipment for production and effluent treatment to meet the buyer specific requirements. In turn these lead to higher manufacturing costs and loss of economies of scale which has potential to dilute the benefits of the proposed FTA between the EU and India. We suggest that 'behind-the border' barriers inflict costs without any of the compensating benefits of competition and scale. Thus, the focus of the proposed EU-India agreement should be on 'deep integration' and we propose that there is need to address regulatory liberalisation i.e., product standards, testing and certification, customs procedures and red tape if the benefits of the FTA are to be reaped by partner countries.

Organisation of the paper

This paper is organised as follows: Section 2 highlights the debate on increasing bilateral trade agreements and discusses the ongoing EU-India FTA talks. Section 3 discusses the regulatory compatibility issue, it analyses the practical implementation of legislation in different EU member states and discusses how this manifests as 'behind-the border' barriers to trade. Section 4 presents the results of interviews and provides insights on how differences in regulatory regimes have the potential to impede trade between partner countries. Section 5 uses a multinomial logistic

regression (MLR) model (SPSS) to analyse Indian exporters' perceptions on 'behind-the border' barriers within the context of FTA talks. Section 6 discusses the economic implications of the proposed FTA and suggests how the regulatory incompatibilities between the EU and India can be addressed within ongoing FTA negotiations.