IND0036 UK Trade Policy Observatory (UKTPO)

About UKTPO

- The UK Trade Policy Observatory (UKTPO), a partnership between the University of Sussex and Chatham House, is an independent expert group that initiates, comments on and analyses trade policy proposals for the UK; and trains British policymakers, negotiators and other interested parties through tailored training packages.
- The UKTPO is committed to engaging with a wide variety of stakeholders to ensure that the UK's international trading environment is constructed in a manner that benefits all in Britain and is fair to Britain, the EU and the world. The University of Sussex has the largest collection of academic expertise on the world trading system in the UK, with specialists on trade policy, trade law and trade politics and European law and economy. The team includes experts in economics, international relations and law.

This written evidence responds to the following questions: Q1, Q2, Q4, Q5 and Q11.

Summary

- The UK economy stands to benefit from an FTA with India in a number of ways, including the removal of trade policy uncertainty.
- In addition, relaxed visa rules for Indian citizens could have positive impacts on the UK higher education sector, including domestic students, and on domestic firms through a higher rate of innovation and productivity.
- The Government's Negotiating Objectives appear to be 'cautiously ambitious', with a focus on early gains. However, pursuing an interim agreement may pose a risk to achieving the full FTA as similar early agreements (such as India-Thailand) have thus far failed to reach the full FTA stage.
- Addressing the needs of businesses such as smooth permit processes and equivalent data protection laws would make a material difference for UK businesses seeking further market access in India.
- The UK could make valuable negotiation offers on products not currently covered by the Generalized System of Preferences (GSP), and/or further reductions on those that are. However, these products may potentially be in competition with domestic UK production.
- Taking into account India's development needs and its current GSP status, symmetric liberalisation will be substantially more demanding for India than for the UK. Thus negotiations that aimed at reducing the degree of asymmetry in depth, breadth and pace of the liberalisation could be viewed as a successful outcome for the UK.
- A UK-India FTA is likely to have ramifications for other developing countries. In industries such as textiles, the FTA would erode the current competitive advantage that other countries (e.g. Bangladesh and Pakistan, in textiles) have over India. Second, as the largest member currently in the UK GSP,

India’s exit would dramatically alter the competitiveness of the remaining GSP members relative to – and amongst – each other.

Full response

1. What are the potential benefits for the UK of an FTA with India, and what are the potential downsides?

A UK-India FTA would confer a wide range of benefits, including lower costs of inputs for businesses and higher consumer welfare though lower prices and more choice for consumers. That said, we would like to highlight in particular the positive impact of certainty for businesses emanating from an agreement. India has recently increased some of its applied tariffs, and it could potentially raise tariffs even further as there is still considerable room between currently applied Indian rates and its bound MFN rates. Hence, permanently locking in favourable market access conditions through an FTA will benefit UK exporters.

India too would benefit from the removal of uncertainty that is currently associated with its exports to the UK under the GSP regime. Indian exports to the UK is currently governed by the UK Developing Countries Trading Scheme (DCTS, formerly known as UK Generalized System of Preferences, GSP), which is a unilateral preferential scheme offered by the UK to India as a developing country, under which UK imports from India in selected products benefit from lower than Most-Favoured Nation tariffs. However, GSP treatment is reviewed in periodic intervals and therefore Indian exporters have thus far been at risk of losing GSP preferences every three years. Hence, the transition to a bilateral FTA, conferring deeper preferences (on products considered ‘sensitive’, the maximum tariff cut with respect to MFN tariffs is currently 3.5 percentage points) on a wider range of products, more long-term certainty, and encompassing also services, will certainly be very welcome to exporters in India.

2. In what ways may the UK or specific sectors (e.g. education and research) benefit from relaxed visa rules for Indian citizens? Might India’s demands for relaxed visa rules go beyond what would benefit the UK economy? If so, how could such risks be mitigated?

Visa regulations for foreign students and/or foreign-born college-educated workers can have several positive impacts on an economy, in both the short-term and the long-term. Virtually no negative effects have been found in the economic literature on these topics. In what follows we draw on evidence obtained for other countries, mostly the US; however, we believe that valuable insights for the UK could be learned from these studies.

<u>High-skilled workers permits</u>

Several recent works have studied the impact of the introduction of the H-1B Visa programme the in 1990 in the US. The H-1B scheme provides temporary work permits for college-educated foreign ‘specialty workers’, and has been an important channel for foreign workers to enter STEM graduate-education, or

STEM occupations in the US. Growth in the skilled immigrant workforce generated large increases in innovation, with no evidence that natives were crowded out of jobs (Kerr and Lincoln, 2010). On the contrary, wages of native skilled workers have been found to increase, both in STEM and in non-STEM occupations (Peri et al, 2015). The number of workers that can enter the US on an H-1B Visa every year is (heavily) capped, and reductions in the cap number have not been found to raise native-born employment (Mayda et al, 2018). Finally, the lottery allocation of H-1B visas, which was introduced to cope with the large excess demand over the limited supply of visas, has reduced the probability for firms to be matched to a H-1B employee: these firms, which offered to sponsor an H-1B position but were unable to secure a visa applicant, have experienced a reduction in employment, sales, profits, R&D, market value, and capital expenditure, relative to firms that were not using the H-1B visa programme to hire workers. In other words, rationing of foreign-born skilled workers has been shown to be very harmful for the affected firms, and not to benefit native workers (Mayda et al, 2020).

Student Visas

Student Visas, together with the conditions offered post-graduation for students to find employment in the local labour market, can result in increased exports of educational services. Again, we find evidence obtained for the US that, due to its similarity in reliance on exports of education services, can provide a good comparison for the UK. Tuition revenue is crucial for many Universities, especially in those countries in which central government funding constitutes a small share of Higher Education funding.

Increases in international student numbers, other than leading to an increase in tuition revenues, do not crowd out local students (Chen 2021). To the contrary, Universities are found to increase the intake of local students and graduate more of them (1.4 extra domestic student graduates for every 1 additional foreign student enrolled). Thanks to larger tuition revenue, Universities are able to keep per-student spending (a measure of school quality, or prestige) constant. Put slightly differently, international students could effectively cross-subsidize domestic students (Shih, 2017).

Taken together, these results on the impact of migrant workers and foreign students can have important implications for negotiations of trade deals. Facilitating the process to obtain student visas, and providing prospects for successful foreign-born graduate to stay in the UK labour market for a number of years (along the lines of what the UK Graduate visa scheme does), can boost the UK economy through several channels: higher tuition revenues (i.e. higher exports of education services), higher number of domestic students (through domestic-foreign student cross-subsidization), and a higher rate of innovation and productivity for domestic firms, which in turn can lead to increases in wage and employment prospects for native workers. As Indian students are the second largest international student population in the UK, these potential benefits could therefore be considerable.

4. How do you evaluate the Government's Negotiating Objectives (Outline Approach) and initial economic scoping assessment included in the Government's strategic approach? Are the UK Government's aims sufficiently ambitious? If you represent a sector, we would be interested to hear about any objectives your sector would like to see achieved.

The UK Government's negotiating objectives for a UK-India FTA appear to be 'cautiously ambitious'. There's quite a lot in terms of scope (ambition) but the focus thus far appears on early gains from reduced trade barriers for goods/services relative to the GSP regime, with significant caution on critical regulatory aspects, like data localisation, tax treatment and regulatory co-operation.

Further, while the agreement on an early harvest is fairly likely – especially as it aims to achieve partial removal of barriers and is likely to exclude sensitivities, this may pose a risk to achieving the actual FTA, as we have seen with similar early agreements in the past. For instance, India has signed an interim FTA with Thailand in 2004 that has never been converted into a full FTA. In April 2022, India has also signed an interim agreement with Australia rather than a full FTA. There might therefore be a real possibility that the process between the UK and India stops at the interim agreement without ever proceeding to the full FTA stage. A more selective interim agreement, in turn, could be less likely to satisfy the comprehensiveness requirements set out for FTAs under WTO law (Art. XXIV).

In our joint work with UKIBC (UK India business council), businesses highlight that in the past, lengthy process of securing business permits and the absence of data protection GDPR equivalent law in India were sticking points for the UK. Achieving progress here would be of key interest for UK businesses seeking further market access in India. UK businesses would benefit from reduced trade barriers & regulatory alignment – there is also a potential sizeable share for UK Small & Medium Enterprises in the services space (subject to any risks of unfair competition between larger and smaller business).

5. What should UK negotiators be aiming for on tariffs, rules of origin, services, digital trade, intellectual property, mutual recognition and mobility?

Currently there is a sizeable asymmetry in the tariff rates applying to UK-India trade, due to India benefiting from the unilateral GSP preferences. This has two main implications for FTA negotiations that aim at eliminating tariffs bilaterally across the board:

Even though UK tariffs on Indian products are already lower than the UK Global Tariff (UKGT) rates in about 66% of the products, this does not mean that the UK has little to offer in the negotiations. GSP preferences were granted in products where increased imports would not be in direct competition with domestic producers in the donor country. Furthermore, among products eligible for GSP preferences, there is an important distinction between sensitive and non-sensitive products: on non-sensitive products GSP tariffs are zero (regardless of the value of the UKGT tariff); on sensitive products, the largest preferential margin offered is at most 3.5 percentage below the UKGT rates (although on many products, such as textiles, the preferential margin is even less than 3.5 percentage points). This implies that further reductions in tariffs below the preferential GSP rates, or in products currently not covered in the GSP, will concern products that are potentially in competition with domestic UK production: these tariff reductions are valuable offers the UK can make during the FTA negotiations.

An FTA negotiation aiming at a symmetric liberalization will be substantially more demanding for India than for the UK. The level of Indian tariffs currently applied, and the range of UK products on which they apply, will require significant concessions from India if the outcome of the negotiations is an approximately symmetric liberalization.

On balance, therefore, an FTA which will eliminate tariffs on 'substantially all trade', as required for the FTA to be compatible with WTO Art. XXIV, will imply on one side the UK opening up to trade in sensitive industries, and on the other side India to make relevant concessions across the board. Taking into account India's development needs, we believe therefore that a negotiation that *reduced* the degree of asymmetry in favour of India in terms of depth, breadth, and pace of the liberation could be considered a successful one. A similar strategy appears to have been pursued in the Economic Cooperation and Trade Agreement signed between Australia and India in April 2022, whose deal eliminates tariffs on over 85% of Australian exports to India and 96% of Indian goods exported to Australia.

11. How may an FTA with India affect UK trade with other developing countries; if there is a risk of trade diversion, how could this be mitigated?

India is currently the largest member of the UK GSP. It is a member of the General Framework (GF), i.e. the least preferential of the three sub-schemes that the UK GSP currently features. In the GF, members obtain lower that UKGT tariffs in about 66% of the tariff lines but, as mentioned above, tariffs go to zero only on those products that are considered 'non-sensitive'. The second sub-scheme, the Enhanced Framework (EF), is more preferential, as members benefit from zero tariffs on all the products eligible for GSP (roughly, the same products as the GF). Lastly, the Least Developed Countries (LDC) Framework is more the most preferential scheme, as members benefit from zero import duties in the UK in all products except arms.

The three-tier structure of the UK GSP implies that EF countries and LDCs enjoy a competitive advantage over GF countries. For instance, in textiles GF countries face tariffs of about 5.66%[1] while other large exporters in this industry such as Pakistan and Bangladesh benefit from zero tariffs, as they are currently members of the EF and scheme for LDCs, respectively. In textiles, India

[1] Simple average based on 1,149 CN 8-digit products

currently faces the even higher UKGT rates (7%)[2], as GF preferences were removed due to a graduation. An FTA with India, where UK tariffs on textiles were brought to zero, would completely erode the competitive advantage that Bangladesh and Pakistan currently have over India. Preference erosion would of course occur in other industries and for other countries as well, as long as GF tariffs are not already zero. Whether this change in competitiveness will divert trade away from other developing countries and towards India will depend on the cost of rearranging trade routes and supply-chains: however, an FTA will likely make trade with India more attractive the higher the tariffs that currently apply to UK imports from India as a GF member.

Another notable consequence of India leaving the UK GSP and entering an FTA with the UK concerns India's size relative to the other (remaining) GSP members. We mentioned that India is the largest member currently in the UK GSP: its exit would dramatically alter the competitiveness of the remaining GSP members relative to each other. This is of relevance in light of the current mechanism governing graduations in the UK GSP scheme, which is based on beneficiaries' relative competitiveness (i.e. shares of UK imports) in specific product sections. India's exit will alter the competitiveness-balance among the remaining members, with repercussions on future graduations in the group of GF countries: the most noticeable changes will be in sectors where India is a large exporter of GSP eligible products (apparel and clothing, vehicles and transport equipment, machinery and equipment). Future graduations and losses of market access could potentially be avoided if the UK government was willing to enact suitable modifications to key elements of the graduation mechanism; for instance, a commensurate increase in the import-share thresholds determining the graduations.

[2] Simple average based on 1,632 CN 10-digit products

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