India and an Enlarging European Union

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Each enlargement of the European Union has had both positive and negative experiences for both existing member states and the new entrants. Each membership change has altered the power structure and the sharing of costs and benefits of membership for all concerned since each enlargement influences to some extent the functioning and the evolution of the EU itself. Each new member state inevitably brings its own traditions, preferences, interests, strengths and weakness. Membership negotiations therefore involve the most protracted and intense bargaining amongst member states. The fifth enlargement on 1 May 2004 is the largest, most complex, and the most difficult round of enlargement in the history of the European Union.

The EU of 25 will consist of six large states (France, Germany, Italy, the United Kingdom, Spain and Poland) and the remaining 19 will be small states. This will basically alter the very nature of the European Union. After enlargement, we are likely to witness more flexible and policy-oriented coalitions. With greater heterogenity, the relative influence of the Franco-German motor is going to decline somewhat because there are many issues on which there is conflict of interest between the east and the west, between the south and the north and between the rich and the poor. There do not seem to be easy solutions to these complex problems.

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German unification in 1990 and the fifth enlargement are likely to fundamentally disturb the Franco-German equilibrium, as it had hitherto existed in three profound ways. First of all, it has increased Germany's freedom of manoeuvre in European politics as it has now emerged as the richest and most populous state of the EU. Its linkage with a Franco-centric Western Europe has considerably weakened. Secondly, EU's eastward enlargement coupled with northern enlargement has transformed Germany into the core of Europe. The gravity of Europe has, in fact, shifted more to the centre. Germany is the leading player in this region in terms of trade, foreign direct investment, etc. Thirdly, eastern enlargement may perhaps contribute in some ways to reorienting the foreign policy priorities of the EU in the sense that it has pushed the south policy of Europe and French security way down the agenda because stabilization of the east has been a prime consideration for Germany.

Implications for Indian Foreign Policy

The transformation of the geopolitical milieu and foreign policy priorities and perspectives of Central and East European countries (CEECs) in the post-Cold War era have had significant repercussions on Indian foreign policy. India's trade (both exports and imports) from Central and Eastern Europe declined progressively till the mid-1990s because of the transition from a centrally planned socialist economy to a market-oriented sytem, the disruption of old trading arrangements, the increasing demand for sophisticated and quality goods and competion from other countries, and their emergence as increasingly competitive markets as they switched to trading in hard currency. There were apprehensions that as the CEECs, especially the Visegrad Four (Poland, Hungary, the Czech Republic, and Slovakia) were elevated in the European Union's hierarchy of trade preferences and gradually reached the apex of the "pyramid of privilege" sooner than later, India was likely to face serious challenges and confront fiercer competition and severe adjustment problems in its traditional Western markets.

Unlike the past, the Central and East European countries in the post-Cold War era no longer perceived India with Moscow's eyes. The 1990s witnessed radical shifts in their perceptions and assessments of Indian domestic and foreign policy. India could no longer take their political and moral support on various international issues for granted.

India has "welcomed" the enlargement of the European Union and the ongoing discussions on its future evolution. At the fourth Indo-EU summit in New Delhi (29 November 2003), both India and the European Union "affirmed" that deepening and widening of the EU would further strengthen relations between them.

For decades, trade has been the driving force behind Indo-EU relations. Despite the commonality of positions on many strategic issues, it is unlikely that enlargement would lead to any immediate or appreciable change in the near future on the nature and content of India's political and strategic dialogue with the European Union. Much prior to their accession, the Accession Countires had already realigned their foreign policy priorities with those of the European Union and its member states. In fact, they were either less appreciative of or openly critical of India's stand on issues of vital concern to India, viz. nonproliferation, Kashmir, human rights, and policy towards neighbours.

An enlarged European Union will be characterised by greater heterogeneity as the new members will bring in their own national identities, national interests, and role perceptions. A EU of 25 members will have greater diversity of interests and a greater multiplicity and complexity of problems to be solved. Enlargement will bring the European Union closer to troubled areas on the periphery of its new boundaries to both the east and the south, thereby reinforcing the trends towards a more Eurocentric Europe. The Accession Countries' perception of threats and security interests differ from the existing member states. They are likely to urge that greater attention be paid to promoting stability and prosperity in eastern and southeastern Europe as well as Central Asia and the Caucuses. The ACs will be too busy with making a success of their EU membership and therefore, there will be neither much sympathy nor interest in Third World problems.

Until recently, Indian policy-makers viewed "East Europe" through the Russian prism. In most of the new member states, India has yet to forge closer political ties with new elites[1] though there was a spate of high-level visits in 2002-2003 from Croatia, Poland, and Hungary. There is a considerable information deficit in India about the European Union in general and the new Accession Countries in particular.

Economic Implications

The admission of ten new states—eight of which are from Central and Eastern Europe—on 1 May 2004 will lead to the creation of EU-25 comprising over 450 million people — the world's largest regional trading bloc representing 20 per cent of the total world trade, 26 per cent of inbound FDI and 46 per cent of the total outbound investments. In view of the relatively small size of the economies most of the ten new candidate countries, their accession is not likely to dramatically change the EU's foreign economic relations.

Trade

Enlargement will increase the size of the EU single market in which non-member countries and their exporters will have a single set of tariffs, trade rules, and administrative procedures, which would provide a simplified and enhanced access to the markets of the new member states. There would be a sharp reduction in paperwork and entry requirements earlier involved in trading with ten independent sttes to just one set of documents. This should bring down transaction costs for Indian exporters. However, increase in trade would not automatically result from these changes. This will be contingent on the ability of Indian business to reposition their existing products and create markets for new products to take on increased competition, not only from the Accession Countries but also from countries with which the EU has free trade agreements. ACs will become a party to about 30 free trade agreements that the EU has with countries outside the region. As a result, India's exports to third countries might lose their existing competitive advantage vis-a-vis the ACs.

Enlargement will have some trade creating effects. Each of the ten accession countries have had to terminate or modify its international agreements and comply with the EU's multilateral trade commitments and obligations. The most immediate and direct impact of enlargement will be the replacement of the tariff regime of the accession countries with the EU's Common External Tariffs, which will significantly alter the terms of access of Indian goods to these markets and help to bring down transaction costs. The replacement of ten tariff regimes with one, and the general bias towards tariff reduction (from the average of around 9 per cent to the EU level of 3.5 per cent) and simplification inherent in the change should facilitate access by Indian exporters to these markets.

More generally, the gradual convergence in levels of prosperity between the accession countries and the European Union will imply a larger and more affluent market with increased export and investment opportunities for Indian companies. Enlargement, according to a rather optimistic estimate, could result in greater economies of scale and increased intra-industry trade, improve financial and banking arrangements and air and sea linkages, and could serve as "a gateway" for goods and services to the vast EU and CIS markets.[2]

India's trade with the Accession Countries is meagre: about Euro 500 million against Euro 26 billion with the EU-15. India has varying levels of trade the ten new member states, with negligible or no trade with Cyprus, Estonia, Lithuania, Latvia and Malta. Poland, Hungary, Czech Republic and Slovenia account for India's largest trade partners. The Czech Republic accounts for nearly 40 per cent of total Indian imports from the accession countries.[3]

While an enlarged European Union brings with it a larger market for Indian goods and services, in overall terms the opporunities created may be limited primarily because the accession countries will only add five per cent to the current GDP levels of the EU. Only three have populations of more than 5 million and most of them have high unemployment rates. The prevalent volumes do not really reflect potential for enormous growth. This is primarily because of the lack of trade awareness among businesses on both sides, infrequent business promotion and networking events, inadequate commercial arrangements to facilitate trade payments such as correspondent banking, lines of credit, export guarantee insurance trade documentation and legalisation procedures, and insufficient links as in air routes, and visa and consular arrangements.[4] Consequently, market demands in accession countries were either unmet or were seviced through other entry points in Europe and often with more competitive products.

Awareness levels of EU enlargement are deemed “very low” among Indian business persons. There has been “no, or negligible, internal research” on the impact of EU enlargement in industry organisations and trade bodies, at the product group level. Business continues to preceive EU not “as one entity, but as a conglomerate of states”, as a result of which the business focus continues to be at the member state level. There is no perception of the EU as a common trade entity, except among policymakers and, to an extent, the apex trade organisation.

With enlargement, the CEECs as “insiders” would benefit from the variety of interventionist barriers erected by EU against non-EU imports in the so-called sensitive products (e.g. bulk chemicals, textiles, clothing and footwear as well as agricultural and food products). Post-communist economies have included very high shares of products in these product groups.[5] Though the commodity structure of their exports was expected to change over time to more sophisticated, value-adding products, the process would tend to be “necessarily a slow one” with the result that in the next 10 to 15 years, sensitive products will continue to play a large even if declining—in these countries’ exports as these countries maintain and even expand its labour-intensive, standard technology exports and diversify the basket of exportable manufactures.[6] The export potential which a larger EU market would offer the developing countries is not perhaps likely to offset their losses in the agricultural and textiles sectors as a result of their East European competitors.

These could also be some trade diversion effects. After accession, the ten new states will enjoy duty-free and quota-free entry for all their exports. Their trade advantage is offset to some extent by the preferential entry Indian exports to the EU are entitled to under the EU’s Generalised System of Preferences. Among the ACs, Poland and the

Czech Republic are India's main competitors. Poland competes with India in 46 of its top exports to the EU whereas the Czech Republic does so in 34 items. Some of these products include footwear, leather products, automative components, synthetic yarn, etc.[7] The other disadvantage for India could be the result of a decline in EU demand for many hitherto imported Indian goods and services as the enlarged market would be seeking the same from its new members.

One area of major concern in India is about the likely impact of enlargement on textiles and clothing product exports to the European Union, which accounts for about 40 per cent of textiles and clothing products. The EU had increased the quotas on its imports from India and other developing countries, on the basis of the average of the last three years' imports into the ten new member states.[8] However, with the removal of the quota regime on 1 January 2005, competition is likely to increase for Indian exporters from other non-member countries, especially China. Accession Countries may not pose major competition in this sector since they already have unrestricted access to the EU market. However, enlargement could result in the strengthening of investment and sub-contract relationships in the textiles and clothing sector and enhance outward processing to take benefit from the relatively cheap labour force in the Accession Countries. Indian capabilities to benefit from the removal of quotas is contingent on its ability to change from simple fabrication in a buyer-driven value chain to meeting the requirement of one that is market-driven.

With better possibilities of intra-EU labour mobility, especially of young and relatively skilled persons, India may face stiff competition on two counts, viz. temporary movement of its natural persons to the EU and business processing outsourcing by EU to India. There are also apprehensions that enlargement could also have adverse implications for business process outsourcing (BPO) operations from India. The offshoring business remains predominantly English-speaking. After the United States, Britain remains the largest market for Indian companies. Although India has led the way, competition is growing from China and Eastern Europe, which might lead to the mutuation of off-shoring into "near-shore" outsourcing.[9] With the addition of ten new countries mainly from East Europe, geographical proximity to Western Europe, relatively lower wages, and the greater potential for labour mobility within the European Union was likely to put more pressure on Indian firms for IT Enabled Services (ITES), BPO compelling them to remain even more competitive through value addition. However, the excessive red tape and the narrowing of wage differentials with the rest of Europe with the entry of countries like the Czech Republic and Poland was likely to eradicate much of the rationale for shifting offshore business to Eastern Europe.[10] Thus, India was likely to remain the most attractive offshoring destination for the near future because of its large and talented pool of relatively cheap graduates, most of whom speak good English, lower wages, quality work, and the improvement in the quality and price of international telecommunications.

Enlargement would lead to the extension of non-tariff barriers and stringent standards relating to sanitary and phytosanitary standards and food safety issues that have hindered the growth of Indo-EU trade. As member states, the accession states will participate in EU trade policy actions as they affect Indian exports, for example by imposing anti-dumping duties in line with EU decisions to deal with allegedly "unfair competition" from Asian exporters. With enlargement protectionism will remain an "ongoing issue of discussion" for India with the European Union.[11]

Foreign Direct Investment

Several studies have concluded that EU enlargement would boost both trade and FDI flows between the European Union and Central and East European countries.[12] India is a modest investor in some Central and East European countries. Even prior to enlargement, Indian companies were not seriously perceiving them as potential gateways to penetrate the EU markets. FDI by the new accession states in India is very modest, though one exception is the steel sector, where the Netherlands-based Laxmi Narain Mittal has acquired major steel plants in Poland and the Czech Republic. Between 1991 and 2002, FDI approved by India from them was Rs3742.84 million or US$83.17 million. This is indeed a very low share of total FDI approved into India. However, flows could go up after enlargement.[13] Enlargement offered "a new and much larger context for future investment possibilities within a stable and well-regulated framework".[14]

As regards investment flows into India, Hungary, Poland and the Czech Republic already feature along with India among the top 10 destinations for FDI. However, as wage levels rise gradually after accession, their present low-cost advantage will decline. India can gain in the process provided it improves its infrastructure and provides an investor-friendly policy environment. There are also apprehensions that in future investment would tend to flow more strongly into the new EU countries rather than into the developing countries because wages in central and eastern Europe are far below those in high-cost "old" Europe.[15] It is therefore essential for India to seek to become more competitive, improve infrastructure and provide a more investment friendly policy environment in order to maintain and enhance present levels of investment originating from EU member states.

Adoption of the Euro

Enlargement does not imply that the Euro would immediately be extended to all the ten accession countries. Though the ten new member states will become members in the Economic and Monetary Union at the time of accession, but they will not be permitted to immediately adopt the Euro. They will be required to abide by the same convergence criteria stipulated in the Maastricht Treaty. They will be required to participate for a minimum of two years in the Exchange Rate Mechanism of the EU, wherein their currencies may fluctuate against the Euro no more than plus or minus 15 per cent. In accordance with the procedures stipulated in the Maastricht Treaty, the European Council will decide which accession countries have fulfilled these conditions and when they can replace their national currencies with the Euro. The ten new accession countries are legally committed to joining the eurozone. None of the applicants have been given an opt-out clause like Britain. The new members are also bound by the EU's Stability and Growth Pact, but are given extra time to comply with its three percent of GDP deficit ceiling.

For the near future, there would only be a modest impact on India's trade with these countries as all the accession countries' exports and imports are almost exclusively invoiced in either dollars or Euros. Therefore, it is unlikely that the domestic adoption of the Euro would have a significant effect on its use in the foreign trade of new member states. The eventual adoption of the Euro by the new member states by the end of the decade would however enable Indian exporters to enjoy the benefits of single currency transactions.

Development Policy

The accession of ten countries in May 2004 is not likely to have any tangible impact on EU's development aid policy to India. Budgetary allocations for development aid in the new member states remains meagre, accounting for, on an average, not more than 0.3 per cent of the Gross Domestic Product on development cooperation in contrast whereas the OECD average is almost ten times larger. Amongst these countries, the OECD members, viz. the Czech Republic, Hungary, Poland and Slovakia, have begun to adapt the normal rules of the Development Assistance Committee.[16] If the accession countries were to make a similar contribution as existing member states, that would signify a substantial rise in their currently low spending on development cooperation, which was unlikely.[17]

Government commitment to development cooperation in the accession countries is generally very low because of scarce resources, budgetary constraints, and weak political will and partly because of the lack of a significant constituency for development cooperation. The bulk of ODA of the candidate countries is concentrated on neighbouring post-communist countries, especially in the former Soviet Union and the Balkans. Poland -- the largest donor with $35.5 million in ODA in 2001 -- preferred to give only humanitarian aid to Asian and African countries except countries like Vietnam and Yemen which had strong traditional links with the East European bloc. In the case of the Czech Republic -- the second largest donor in 2001 with $26.5 million -- over half of its ODA went to the near abroad and was driven by security and trade-related aid.[18]

As in the case of earlier enlargements, coupled with the redefinition of development aid policies of most member states of the European Union as well as changes in the developing world, the fifth enlargement is bound to have an impact on the structure and regional focus of EU development policy. The "relative stabilisation in central and eastern Europe resulted in a redistribution of priorities: crisis areas in eastern and south-eastern Europe like the Balkans, the Caucasus or central Asia are increasingly being included in the traditional tasks/areas of development policy."[19] However, in view of "the small weight (particularly in terms of national income and foreign trade) the effect will be modest.

The new members are likely to have "little sympathy" with the traditional regional focus and priorities of EU development aid policies, viz. towards the ACP countries. They are likely to urge the inclusion of their own "historical partners" like Vietnam, Yemen and lay greater stress in enhancing cooperation with Southeast Europe, the Caucasus and Central Asia in order to develop and economically and politically stabilise their immediate or near neighbours.[20] None of the new EU-10 are likely to be either keen or willing to devote scarce financial resources to countries either in Asia or Latin America. It is also not probably that aid money which had previously been allocated to Central and Eastern Europe would be diverted to developing countries outside of Europe. In fact, in recent decades EC ODA to the least developed countries has been declining although absolute volumes have increased. Both political priorities and public opinion trends have tended to shift emphasis of EU development policy on the eastern and southern neighbours of the European Union.

Conclusion

After enlargement, EU decision-making processes would become even more complex and potentially more difficult for Indian policymakers to interpret and to influence. Indian foreign policy has tended to traditionally concentrate on four large member states of the European Union, viz. France, Germany, the United Kingdom, and Italy, since they are major players in trade, FDI, joint ventures, industrial collaborations, and technology transfer. However, in the "new" Europe, India needs to devote greater political energy and attention to developing closer linkages with some of the new entrants especially Poland (apart from Spain). For many Indians, the enlarged European Union requires a reprofiling of mindsets about a changing European Union in a changing Europe, which will in some respects no longer be what it used to be.

NOTES

1 For instance, a Polish Prime Minister visited India in February 2003 after a gap of nearly eighteen years.

2 "India-Poland Bilateral Relations, December 20003," www.meaindia.nic.in (New Delhi: Ministry of External Affairs).

3 India's main exports to the 10 new EU member states include textiles, agriculture commodities (like tea, coffee, tobacco), gem and jewellery, durgs and pharmaceuticals, leather goods, electronic goods, organic and inorganic chemicals, machinery and instruments and other engineering goods. The major imports from these countries are leather and readymade garments, medicinal and pharmaceutical products, fertiliser, electronic goods, rubber, chemicals, industrial machinery and metal scrap.

4 Federation of Indian Chambers of Commerce and Industry, *EU Enlargement and its Implications for India: A Preliminary Study* (New Delhi), April 2004, p. 5; Speech by Y.K.Modi, President, Federation of Indian Chambers of Commerce and Industry at Roundtable on "India and New Europe: Emerging Perspectives," New Delhi, 28 April 2004, p. 4.

5 Jan Winiecki*, Transition Economies and Foreign Trade* (London: Routledge, 2002), pp. 121-122.

6 Ibid., pp. 122-123.

7 Malcolm, Subhan, "India Looking Forward to Enlarged EU," *The Financial Express*, 14 October 2003, pp. 1-4.

8 Malcolm Subhan, "After Enlargement comes the 'real big bang' on January 1, 2005," *The Financial Express* (New Delhi), 8 May 2004.

9 Companies are seeking to outsource service operations ranging from call centres to sophisticated software development. About 15 multinationals, including International Business Machines, Fiat and KPMG, an accountancy firm, have already established

business service centres in Poland, employing about 3,000 people. McKinsey estimates that this could grow to 200,000 by 2008. Stefan Wagstyl, "The next investment wave: Companies in East and West prepare for the risks and opportunities of an enlarged EU," *Financial Times*, 27 April 2004.

10 "Relocating the Back Office -- Offshoring -- The Benefits of Offshoring," *The Economist*, 13 December 2003.

11 Remarks by Foreign Secretary Kanwal Sibal at a press conference on the eve of the third India-EU summit, Copenhagen, 9 October 2002. Cited in Amit Baruah, "India will not raise U.N. seat issue at E.U. Summit," *The Hindu*, 10 October 2002.

12 See, for example, Bas van Aarle and A. Skuratowicz, "Trade and Foreign Direct Investment Flows between the EU and Central and Eastern Europe: Possible Effects of EU Enlargement," in P. Karadeloglou, ed., *Enlarging the EU: The Trade Balance Effects* (Houndmills: Palgrave Macmillan, 2002), pp. 237-260.

13 Keynote address on "Enlarged EU and India in the WTO Context," by Michel Caillouet, Ambassador and Head of Delegation of the European Commission to India, at the Confederation of Indian Industry seminar on "EU Enlargement: Implications for India," New Delhi, 9 July 2003, p. 5.

14 Remarks by R.P. Agrawal, Minister in the Indian Embassy to the European Union. Cited in Malcolm Subhan, "India Looking Forward to Enlarged EU," *The Financial Express* (New Delhi), 14 October 2003.

15 Between 1989 and 2003, cumulative flows of foreign direct investment into the Accession Countries of Central and Eastern Europe were US$117 billion with the largest share going to Poland ($42 billion), the Czech Republic ($38 billion), and Hungary ($21 billion). These inflows were made in anticipation of accession. For that reason, they are unlikely to accelerate "dramatically" thereafter. Martin Wolf, "Coming Together: A small step for Europe's Economy but a giant leap for the continent," *Financial Times*, 26 April 2004.

16 Michael Dauderstaedt, "Eastern Enlargement and Development Policy," in Michael Dauderstaedt, ed., *EU Enlargement and Development Cooperation* (Bonn: Friedrich Ebert Stiftung), November 2002, pp. 5, 7.

17 Ibid., p. 9.

18 Development Strategies, "The Consequences of Enlargement for Development Policy, Volume I, Final Report, September 2003," pp. 7-9. http://europa.eu.int/comm/development/body/organisation/assess_enlarg_en.htm.

19 Dauderstaedt, n. 18, p. 10.

20 Ibid., pp. 10-11.