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India and Mercosur:
Boosting Trade through Regionalism

There has been a plethora of new regional trade agreements (RTAs) mooted and formed in the past decade. One of the RTAs ,with the greatest potential in increasing trade and investment, is arguably the initiative between India and the Mercado Común del Sur (Mercosur – 'Southern Common Market'), whose members are Argentina, Brazil, Paraguay and Uruguay. Not only are both regions two big, growing markets, but the current trade flows between them are very low in relative terms.

Although inter-regionalism presents India and Mercosur with an opportunity to increase trade flows and strengthen the economic relations of the two regions – and, as a corollary, benefit their respective economies – it is clear that there is a long way to go in their ambition to create a Free Trade Area (FTA). Moreover, this process has to be accompanied by efforts to raise the involvement and support from various stakeholders as well as to address constraints such as the lack of information and knowledge in the two regions about one another, poor transportation connections and cultural differences, including language.

Background

In early 2004, India and the Mercosur countries signed a preferential trade agreement (PTA). This marked the first step between the parties towards the creation of an FTA and, it is hoped that greater economic cooperation between the two regions is on the anvil. Although it is too early to draw any firm conclusions, several questions arise: what the possible impact and outcomes of the PTA and an FTA might be on trade between India and Mercosur; what constraints the parties face in developing an FTA; how the India-Mercosur RTA engagement fits into the trading system, and how stakeholders have responded to the initiative. These are the main issues addressed in this paper.

At the outset, it should be mentioned that in addition to its members, Mercosur has also granted associate membership to Bolivia, Chile, Colombia, Ecuador, Peru and Venezuela. Mexico has currently get an observer status in the trading bloc, waiting to be approved as associate member.

Genesis

It is not hard to see the potential benefits of stronger economic ties between India and Mercosur. India is home to over one billion people and today ranks as the world's 10th largest economy. It is one of the world's major emerging economic powers, with an annual average gross domestic product (GDP) growth rate of 5.9 percent during 1980-2003. Formed in 1991, Mercosur has a combined population of some 220 million. Hovering around two percent, its annual average GDP growth in the past decade has been more modest than that of India. Nevertheless, it makes up as one of the largest integrated markets in the world. Just the sheer size of the Indian and Mercosur economies, therefore, indicate that they have a lot to offer to each other.

Moreover, despite their immense markets, trade and investment between the two regions is small and the potential for developing their economic relations is, therefore, huge. In 2003, for instance, India's trade with Mercosur accounted for only 0.9 percent of its total trade, whereas the equivalent figure for Mercosur was about 1.2 percent. The limited trade also explains the volatility of the trade flows between the two regions. Reasons often mentioned to explain these low levels are: a lack of information and knowledge in the regions about one another; geographic distance coupled with poor air and shipping connections; and cultural differences, including language.

Table 1: India: Trade with Mercosur and Rest of the World, 2003 (US$mn)

	Exports	Imports	Total
Mercosur	388.1	838.2	1,226.3
- Argentina	86.2	517.7	603.9
- Brazil	272.2	309.7	581.9
- Paraguay	10.4	0.7	11.2
- Uruguay	19.2	10.1	29.3
RoW	62,640.7	76,363.1	139,003.8

Source: UN Comtrade Database

As would be expected, it is primarily Brazil and Argentina that make up virtually all of Mercosur's trade flow with India. The main product categories exported to India are edible oils (primarily soya bean), metalliferous ores, metal scrap and non-electrical machinery, with soya bean oils comprising by far the largest export (around two-thirds of all exports). Some three-quarters of the soya bean oils are from Argentina, while most of the other major items primarily come from Brazil (its largest export).

India's major exports to Mercosur are drugs, pharmaceuticals and fine chemicals, transport equipment, inorganic/organic/agro chemicals, cotton yarn and cotton and manmade fabrics, makeups, readymade garments, dyes, intermediates and coal tar. Brazil is the main trading partner in most commodities, with transport equipment exported to Argentina being one of the few exceptions. However, Argentina's main import is chemicals.

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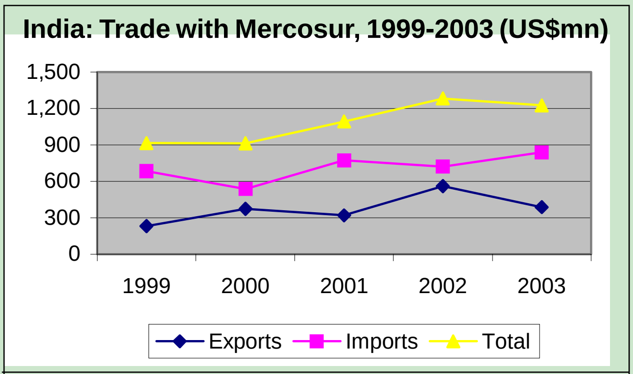
Based on the foregoing, it is clear that boosting trade and investment between the two regions and enabling them to tap into each other's huge markets would have provided the Indian and Mercosur governments with an obvious incentive to engage in an RTA. However, other factors would play a role as well. For one thing there has been a push to increase South-South Cooperation (SSC), with momentum increasing especially as a result of the Cancún debacle and the formation of the G-20 (in which Brazil and India play key parts). It should be mentioned, though, that the Framework Agreement between India and Mercosur to strengthen relations was signed before the Cancún ministerial.

For another, there has been a surge of new RTAs in the past decade, in part due to the slow progress of the Doha round, and the India-Mercosur FTA is only one of many like initiatives. Whereas Mercosur is an RTA by definition, it is only in the past few years that India has jumped on to the RTA bandwagon and it is currently engaged in some 14 RTA negotiations.

Furthermore, from India's perspective, developing economic relations with Mercosur can also be seen as part of India's 'Focus: LAC' programme. Launched in November 1997, this programme aims to further the commercial linkages with the Latin American region.



Source: UN Comtrade Database

In all, there were, therefore, several factors – economic as well as political – that prompted India and Mercosur to the negotiation table to forge closer ties. This resulted in the 'Framework Agreement', which was signed on June 17, 2003. The aim of the Agreement was to "strengthen relations between the Contracting Parties, to promote the expansion of trade and to provide the conditions and mechanisms to negotiate a Free Trade Area in conformity with the rules and disciplines of the World Trade Organisation" (Art. 2). It was also agreed that the parties would, as a first step toward the aim, conclude 'a limited scope Fixed Preference Agreement'.

India-Mercosur PTA

On January 25, 2004, India and the Mercosur countries signed a PTA 'as a first step towards the creation of a Free Trade Area' (Art. 2). The Agreement grants preferential market access for certain product categories and contains provisions on trade measures such as trade remedies and technical barriers to trade (TBTs), generally referring them to the relevant WTO agreements. The parties also agreed to create a Joint Administration Committee that would, amongst others, evaluate the process of trade liberalisation established, study the development of trade between the Parties and recommend further steps to create an FTA.

The India-Mercosur PTA consists of five annexes. The substance of the annexes is yet to be negotiated on the date of signing and the Agreement would not come into force before these negotiations were concluded. Six rounds of negotiations later and the two parties signed the annexes on March 19, 2005, thus paving the way for the PTA to become operational upon ratification.

The first two annexes are the offer lists of product categories subject to tariff concessions of Mercosur and India, respectively. Mercosur's list contains 452 products, while that of India has 450 commodities. Annex 3 refers to rules of origin, Annex 4 is on safeguard measures and Annex 5 contains the dispute settlement procedure.

Possible Impact and Outcomes

Because the India-Mercosur PTA is so recent, it has not yet been possible for there to be any significant effect on the parties' trade flows and economic relations. Nevertheless, there are a few indicators that hint at the likely impact and outcomes of the Agreement.

A cursory look at the respective offer lists show that more than half (250) of the products included by Mercosur fall under the category – organic chemicals. As this is India's main export to the South American trading bloc, its inclusion is definitely to India's advantage. Moreover, India's export share in organic chemicals in the region is sizeable, but there should be scope for expanding it. On the other hand, the majority of the sub-categories of organic chemicals have a common external tariff (CET) of two percent, to which India has often been granted a 10 percent concession. This suggests that the potential for gaining market share is still limited.

The product categories on India's offer list are less concentrated than that of Mercosur. The main categories are machinery and mechanical appliances and parts thereof (95 products included) and tanning or dyeing extracts (74 products). As opposed to Mercosur's list, therefore, India's list does not feature much of Mercosur's main export, soya bean oils (one product, only for Paraguay). However, Mercosur already holds an aggregate market share of some 90 percent, which suggests that the scope for expansion is limited. By contrast, the trading bloc should have the prospect of increasing its market share in machinery and mechanical appliances as well as tanning or dyeing extracts.

Another approach to evaluate the offer lists is to look at how they play out against India's and Mercosur's respective revealed comparative advantages (RCA). RCA is a measure of relative export performance by country and industry, defined as a country's share of world exports of a good divided by its share of total world exports. In a compilation of studies by the United Nations Conference on Trade and Development (UNCTAD) office in India, it is shown that India has a high RCA in textiles and garments, pharmaceuticals, organic chemicals, leather handbags, carpets and floor coverings, tea, and spices. As has already been seen, India's advantage in organic chemicals is well reflected in Mercosur's offer list.

Of the other commodities, the list also features concessions on pharmaceuticals. However, the ones that are covered only represent some five percent of India's export value of pharmaceuticals to the trading bloc. In terms of RCA, therefore, Mercosur's list seems to be limited to India's advantage in organic chemicals.

Brazil's RCA lies in *inter alia*, meat products, fish products, lentils, oil seeds, grapes, soybeans, whole milled wheat and peppermint. Of these, some meat and fish products feature on India's offer list. However, India's import of these products is minute and none of them are currently imported from Brazil or any of the other Mercosur members.

The UNCTAD India paper also looks at the extent to which products are complementary between India and Mercosur, i.e. it

Table 2: India: Five Largest Exports to Mercosur, 2003		
	Value (US$mn)	% of total Exports
Organic chemicals	109.9	28.3
Pharmaceuticals	43.7	11.3
Chemical products	40.1	10.3
Mineral fuels & oils	22.5	5.8
Tanning or dyeing extracts	16.4	4.2
Other	155.6	40.1

Source: UN Comtrade Database
Note: Products are at the two digit-level of the HS2002 classification system.

identifies products that are exported by one country to the rest of the world, and for which there is significant import demand in the other country. It is found that of India's exports to Mercosur, the main complementary products that have potential to grow are: petroleum products; pharmaceuticals; antibiotics; motor vehicle parts; parts and accessories for data processing; and new pneumatic and rubber tyres used for buses and lorries. All of these categories feature on Mercosur's offer list to a lesser or greater extent, apart from pneumatic and rubber tyres.

As for Mercosur's exports to India in terms of complementary products, the paper highlights petroleum oils; transmission apparatus for radio telephony; gold in semi-manufactured form; copper ores; soya bean oils; cotton, not carded or combed; and motor vehicle parts. With the exception of the one concession to Paraguay in soya bean oils mentioned above, none of the identified products feature in India's offer list.

Based on the above, it seems that the India-Mercosur PTA will, on the whole, have a fairly limited direct impact on trade flows between the parties. The indications suggest that Indian exports of organic chemicals and parts and accessories for data processing in particular might rise as a result of the Agreement. Conversely, Mercosur might see a growth in its exports of primarily machinery and mechanical appliances, tanning or dyeing extracts, and organic chemicals, including antibiotics.

While the direct result of the Agreement on trade flows is likely to be modest, it is less clear what indirect effects it might have. This would depend on the consequences it would have on the underlying constraints in the regions' economic linkages – particularly their knowledge of one another; the groundwork it will have laid for an India-Mercosur FTA; and, more generally, the contribution it would make for relations between the regions overall. These are admittedly 'soft' issues that are difficult to measure. For this reason, as well as the Agreement being hot off the press, only very tentative conclusions can be drawn at this stage. Nevertheless, as the discussions in the following sections show, the impact of the PTA on these issues – like that on trade flows directly – appears likely to be limited.

Constraints and Potential of an FTA

One of the main objectives of the Framework Agreement and the India-Mercosur PTA is to create an FTA. Much work to attain this goal lies ahead, however.

To begin with, the PTA is, as stipulated in the Framework Agreement, limited in scope. The two offer lists cover some 450 product categories each out of more than 5,000 categories. Although there are many products that are not applicable to the trade between India and Mercosur, there are some sensitive ones that are relevant and that will prove difficult to negotiate. On the part of Mercosur, these include tyres and textiles; while in India the same thing goes for *inter alia*, vegetable oil and certain food products (e.g. mangoes and maize).

Nevertheless, an India-Mercosur FTA offers great potentials, as already discussed above. In concrete terms the UNCTAD India paper estimates that, based on the findings of the complementary products analysis discussed in the previous section, the 'indicative trade potential' of exports from Mercosur would be up to US$13.6bn and that it would be up to US$12.7bn for exports from India.

As for trade creation and trade diversion, a thorough analysis would be required for any conclusive evidence. However, the intuition is that an India-Mercosur FTA would overall lead to trade creation; simply because their trade flows are so low relative to their competitive productivity in certain sectors. Trade creation rather than trade diversion is also the tentative conclusion reached in one of the studies in the UNCTAD India paper (*India-Mercosur Trade Cooperation in Assorted Manufactured Goods* by Rajesh Mehta and Parul Mathur) which focuses on trade in assorted manufactured goods.

Whereas the PTA covers goods, there is not a single mention in the Agreement of either services or investment. Services and investment were not within the purview of the PTA, but that only means that work has yet to begin on these issues. Moreover, services and investment are often more difficult to negotiate than goods and there is no reason why this would be otherwise for India and Mercosur. It should be mentioned, however, that the Framework Agreement is vague about services and investment and it is not clear that either would in fact be included in an FTA. With regard to services, it stipulates that the parties "shall promote the expansion and diversification of trade in services between them" as decided by a negotiating committee (Art. 8). As for investment, it merely says the parties shall stimulate that trade promotion activities "in order to broaden reciprocal knowledge about trade and investment opportunities" (Art. 6).

In the end, it seems questionable whether an FTA in itself would provide a great boost for trade flows between India and Mercosur. Impediments such as a lack of knowledge about each other, poor transport connections and cultural differences are possibly far greater constraints for higher levels of trade than tariffs and other trade policy instruments. On the other hand, this does not preclude that an FTA could make a contribution in reducing these impediments.

The RTA in the Trading System

The India-Mercosur RTA is of course only one of many trade liberalisation initiatives in the world. On the regional level, there is a plethora of RTAs being mooted and formed around the world. Examples include Mercosur's protracted negotiations with the European Union (EU) and India's RTA engagements with the Association of South East Asian Nations (ASEAN). At the multilateral level, there is the WTO and the current Doha

Table 3: India: Five Largest Imports from Mercosur, 2003		
	Value (US$mn)	% of Total Imports
Animal or vegetable fats & oils	575.3	68.6
Ores, slag and ash	35.9	4.3
Organic chemicals	35.8	4.3
Machinery and mech. appliances	34.3	4.1
Raw hides and skins and leather	23.7	2.8
Other	133.3	15.9

Source: UN Comtrade Database
Note: Products are at the two digit-level of the HS2002 classification system.

Development Agenda. It is worthwhile to place the India-Mercosur RTA in this broader context and see how it fits into the trading system as a whole.

As mentioned above, the Framework Agreement stipulates that an India-Mercosur FTA is to be compatible with the rules and disciplines of the WTO. Even so, there is always the issue about whether the FTA would help or hinder the world trading system, which feeds into the debate on regionalism and multilateralism. Without getting into that debate, it seems reasonable to infer that an India-Mercosur FTA would not by itself have any wider implications on the world trading system – at least not for quite some time.

The main reason for this is that it is neither as comprehensive nor as temporally advanced as other RTAs, such as the Mercosur agreements with the Andean Community (Bolivia, Colombia, Ecuador, Peru and Venezuela) or the South Asia Free Trade Agreement (SAFTA) between the South Asian Association for Regional Cooperation (SAARC) members (Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka).

This gives rise to the other issue of whether the other RTAs in which India and Mercosur are involved could trivialise the benefits of an India-Mercosur FTA. The negative response is that the relations between, say, Mercosur and other Latin American countries on the one hand and India and South, Southeast and East Asia on the other, are stronger and more important than those between India and Mercosur. The consequence is that neither India nor Mercosur would give their relation with one another a particularly high priority.

The positive response is that closer ties between India and Mercosur are highly prioritised by both parties – as indicated by the mere existence of the recent negotiations and agreements among them – and that their relation should be seen as a part in strengthening SSC. The suggestion of a trade alliance among India, Mercosur and the South Africa Customs Union (SACU) at a meeting involving India, Brazil and South Africa (IBSA) in March 2005 is one manifestation of that. Also, with India and the Mercosur countries all being members of G-20, closer relations between India and Mercosur could further strengthen that alliance and its negotiating position on the multilateral level.

The IBSA Initiative

In June 2003, the Foreign Ministers of India, Brazil and South Africa met in Brasilia, Brazil, to form the IBSA Dialogue Forum. The purpose of this initiative was to support political consultation and co-ordination as well as to strengthen cooperation in sectoral areas and to improve economic relations. In this way, IBSA also aims to strengthen SSC.

As for trade, the forum is looking to boost trade among each other from US$4.6bn to US$10bn by 2007. But beyond promoting the convergence of PTAs among each other, it is also trying to extend economic relations and involve the other Mercosur and SACU members as well. Mercosur has already PTAs with both India and SACU, whereas a Framework Agreement between India and SACU was finalised at the end of 2004, with negotiations for a PTA underway.

Involvement of Stakeholders

In the end, the success of an India-Mercosur FTA depends on what various stakeholders make of it. Without the interest and support of businesses, civil society organisations (CSOs) and the like, a political agreement will remain just that. In addition, constraints such as a lack of knowledge of one another, poor transport connections and cultural differences make the involvement of stakeholders in a deal between India and Mercosur particularly pertinent.

Whether the governments of India and Mercosur will have managed to successfully involve their respective stakeholders will become clearer a few years down the road. For now, though, the signs are that there is ample room for improvement. In India, for instance, vegetable and oil food industries have voiced concern over granting market access in products such as oilseeds, edible oils, *vanaspati*, refined sugar, mangoes and tobacco leaves. Another example is found in one of the studies in the UNCTAD India paper (*Preferential Trade Agreements between Mercosur and India: Its Standard Analysis of Potentialities from Argentina's Perspective* by Mariana Fuchs), which reaches the conclusion that, overall, Argentine private sector involvement in the negotiations of the India-Mercosur PTA had at that stage (mid-2004) been limited to responding to the requirements of the talks. Although the positions of businesses were heterogeneous, the more general feature was that a lack of knowledge on India translated into a defensive position and relatively less openness.

To be sure, there has also been encouragement from stakeholders, including the Federation of Indian Chambers of Commerce and Industry (FICCI) and Brazil's Chamber of External Trade (CAMEX). Nevertheless, greater involvement from stakeholders in order to increase mutual understanding and knowledge of one another and bridge cultural differences as well as to gain support for an India-Mercosur, FTA would be highly desirable.

Conclusion and Recommendations

It is still too early to say whether the "desire to … promote the development of reciprocal trade and investments" between India and Mercosur, as laid out in the preamble of the Framework Agreement, will be fulfilled as a result of the PTA and the future creation of a FTA. Based on the offer lists, comparative advantages and trade flows between the two regions, the indications are that the impact of the PTA will be limited. Admittedly, the scope of the PTA was never supposed to be far-reaching, but this also means that a long road lies ahead before the completion of an FTA.

The potential of greater economic relations between India and Mercosur is by all means immense, but even an FTA might prove to have limited effects for several reasons. First, neither services nor investment are certain to be included to any great extent in a future agreement. Second, constraints such as a lack of information and knowledge in the regions about one another, poor transport connections and cultural differences persist and would need to be addressed. Third, it appears as if the involvement of various stakeholders in the process has been limited and could be well improved upon. These issues would need to be addressed if India-Mercosur economic relations are to realise their potential and benefit both economies as a result.

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