CUTS Submission to the Parliamentary Standing Committee on Commerce

India's Engagement with Free Trade Agreements
Opportunities and Challenges

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1. Background: Factors Influencing India's Foreign Trade Policy

1.1 Over the past two decades, international trade has become one of the cornerstones of India's plan for economic development, which saw rapid expansion of India's trade relations with rest of the world, helping the country to advance towards its development goals. This is owing to thoughtful steps taken by the leadership regarding participation in trade negotiations at the multilateral level (World Trade Organisation, WTO) as well as at the level of its engagement in trade negotiations with individual and groups of countries which are of strategic importance to India. Though India's approach toward deepening existing free trade agreements into comprehensive economic cooperation/partnership agreements and signing of new agreements is progressing well, the country is currently faced with the challenge of rebalancing its trade strategies because of some significant changes occurring in the global economic environment.[1]

1.2 Since the slowdown in the on-going Doha Development Round of multilateral trade negotiations among the WTO members, most of them have started focusing on enhancing trade relations through regional and bilateral trade agreements. Deepening regionalism in other parts of the world is reducing India's export shares in her traditional markets. About one-third of India's exports are currently exported to markets in North America (the US and Canada) and western European countries. In 2001, it was close to 50 per cent. Deeper integration in such traditional markets through the implementation of the North American Free Trade Agreement and the European Common Market is forcing India to explore new markets elsewhere and/or take steps to its advance trade integration with these regions.

1.3 Moreover, the financial crisis which was originated in the west since mid-2008 is now getting transformed into a sovereign debt crisis in the Euro region and is threatening to pull back the global economy from its recovery. A strategic re-thinking is needed at this juncture, examining our present trade policy content and direction, the current mix of trade agreements and on-going negotiations in an evidence-based manner. This is also important from the point of view of arresting India's burgeoning overall trade deficit which has registered a 7 per cent growth over the previous year to reach US$ 1.47 billion during April-December 2012 (Ministry of Commerce, Monthly Bulletin).

1.4 While maintaining its positions at the WTO with respect to special and differential treatments to developing countries which suits their developmental needs and maintain the letter and the spirit of the Doha Development Agenda, India has to shape its policies toward free trade agreements which should enable it to adapt itself to the changing global economic conditions as well as realise the long-term objectives of Foreign Trade Policy (2009-14), viz. technological up-gradation, promotion of labour intensive sectors, encouraging domestic manufacturing through programmes like Focus Market Scheme, and in coherence with other major macroeconomic policies such as the National Manufacturing Policy.

1.5 This memorandum is prepared with the objective of highlighting the challenges and opportunities for India with respect to its free trade agreements.

[1] Free trade agreements include preferential trade agreements, comprehensive economic cooperation agreements and comprehensive economic partnership agreements.

2. Opportunities and Challenges of Free Trade Agreements

2.1 As on today, India has signed 15 FTAs with various countries/region/block and about as many number of agreements are currently under negotiation. In 2011, India's trade in goods with its FTA partners was about 39 per cent of its total trade. This figure has not registered much change since 2006 (Table 1). This means that the country has not derived any specific advantage from its FTAs in recent years. One of the reasons is some of the most important agreements with high potential (such as CEPAs with Japan and South Korea, CECA with Malaysia) were signed recently and are yet to generate notable results for India.

2.2 Though earlier agreements like India-Sri Lanka FTA and India-Singapore CECA were beneficial, Sri Lanka and Singapore remain as small trading partners in terms of India's share in their overall trade volume. In the case of Singapore, it maintain a very low level of most-favoured nation tariff rates, which is offered to all of its trading partners and, thereby, the India-Singapore CECA could not generate sufficiently large tariff preferences for Indian exports.

2.3 From this past experience two important things are to be noted. First, trading partners to be included in an FTA are to be selected by keeping in mind potential economic costs and benefits. In this respect, the mandate of appointed joint task forces should be rigorous in conducting thorough cost-benefit analysis of proposed FTAs/PTAs/CEPAs/CECAs. This will help India to prioritise and optimally employ its negotiating capital.

2.4 Secondly, though trade in goods is the first stage in economic integration, services, investment, competition, government procurement, safeguards, intellectual property rights, dispute settlement mechanisms to address non-tariff barriers, etc are essential ingredients for a successful and mutually beneficial international economic cooperation arrangement. Currently the coverage of these subjects is low in India's FTAs (Table 3). Therefore, specific focus has to be given in deepening the coverage of existing and currently negotiated FTAs. Proposed CECAs/CEPAs with ASEAN, Sri Lanka, Canada, New Zealand, Australia and Indonesia provides India with an opportunity to do so.

2.5 Three most important opportunities for India are South Asian Free Trade Agreement, which is under implementation and progressively making progress in its coverage and the currently negotiated India-EU Bilateral Trade and Investment Agreement and India-EFTA free trade agreement comprising Iceland, Lichtenstein, Norway and Switzerland. While SAFTA is yet to generate significant benefits because of lack of coverage of supportive trade-plus subjects, India-EU BITA and EFTA-India FTA have met with negotiating differences.

2.6 It is now widely understood that SAFTA has huge economic potential (CUTS Research Report titled "Cost of Economic Non-Cooperation to Consumers in South Asia") and it is worthwhile for India to take leadership in advancing it further. In the case of India-EU BITA and EFTA-India FTA, weakening macroeconomic situation in the Euro zone area and some other parts of the west provides an opportunity to revive negotiating positions, which may provide India an opportunity to push for a final deal to be implemented in a gradual manner.

3. Implications of FTAs on Indian Agriculture and Industry

3.1 Agriculture

3.1.1 India, agriculture continues to be the single most important means of livelihood, employing about 55 per cent of its working age population but contributing to just about 20 per cent to its national income. India's policy on trade in agricultural items is guided by the twin objectives of ensuring food security and building export markets. As per Trade Statistics 2011, published by the World Trade Organisation, in 2010, India's agricultural exports amounted to US$ 23.2 billion with a 1.7 per cent share of world trade in agriculture. On the other hand, India's agricultural imports amounted to US$ 17.5 billion with a 1.2 per cent share of world trade in agriculture.

3.1.2 Given the highly protected nature of agriculture in most developed countries and also the high intensity of agricultural trade among them, the signing of trade agreements with developed economies may turn this trade balance into deficit. For instance, even though the EU has relatively low tariffs on agricultural goods, it provides huge subsidies to its agricultural sector which work both as a protective instrument in its domestic market as well as a competitiveness enhancing instrument for its exporters. However, some major agricultural products of India's long-term interest such as cotton, sugar continue to face with tariff escalation and tariff peaks in many developed countries. Furthermore, Indian products are facing high non-tariff barriers related to sanitary and phyto-sanitary measures and technical barriers to trade in EU markets, making exports difficult. Given the structure of tariff and non-tariff measures in the two countries/region, the EU has much more to gain if tariffs are reduced while India can gain if and only if subsidies are significantly reduced and non-tariff measures are removed/harmonised through better regulations.

3.1.3 Therefore, it is an imperative to evolve concrete long-term strategies to make Indian agriculture competitive and enhance its efficiency. For this purpose, we should continue to seek substantial reduction in agricultural subsidies in the developed world and address issues relating to the removal/harmonisation of non-tariff barriers.

3.2 Industry

3.2.1 In terms of percentage of gross domestic product, India's deficit in merchandise trade is one of the highest in the world. Not only that it is reducing its tariffs in line with its commitment at the WTO but also there is significant autonomous reduction in its tariff levels. Between 2006-07 and 2010-11, simple average MFN tariff rate declined from 15.1 per cent to 12 per cent in 2010-11. More than 70 per cent tariff lines on industrial products are between 5 to 10 per cent.

3.2.2 In order to have better market access opportunities on industrial products as well as to fulfill the objectives of the National Manufacturing Policy, there should be a judicious harmonisation of our industrial and trade policies including adequate safeguard measures but balancing them between producer and consumer interests.

3.2.3 Keeping in mind the future growth of local industries for employment generation and other objectives, FTAs should have clauses to promote labour intensive industries with adequate exceptions and exemptions so as to effectively strengthen backward and forward linkages.

4. Implications on Services

4.1 Services have become a vital source of driving India's economic growth, contributing to more than 55 per cent of its national income. Between 2006-07 and 2010-11, India's share in global trade in services has increased from 1.65 per cent to 3.18 per cent.

4.2 Between 2000-01 and 2010-11, India's export of services has grown by seven times. However, its FTAs had not contributed much to this growth and this is mainly because of low coverage of services in such agreements. It was due to our comparative advantage in trade in services. Among others, India has advantage/interest in supply of skilled and semi-skilled labour, in sectors such as tourism, healthcare, tertiary education, transport, communication and in providing cross-border services in a range of other sectors, particularly in computer-related services and information technology and IT enabled services. India has to press for more coverage of services trade liberalisation in its ongoing trade negotiations.

4.3 The recently concluded services agreement with the group of Association of South East Asian Nations is expected to enhance the flow of skilled professionals and semi-skilled labour, tourism services, and healthcare services from/to India, which aligns with our economic interests. The second generation FTAs which India has/is negotiated/negotiating can leverage better market access if we manage to put our demographic weight behind the negotiation process. In addition, regulatory reforms and harmonisation are needed in those sectors where we can develop comparative advantages.

5. Implications for Investment

5.1 Foreign direct investment is a key source for creating tangible as well as intangible assets. It provides much-needed resources such as finance, technology and skills that are often lacking in developing countries. Although countries themselves are responsible for creating the conditions for generating the resources for sustainable and inclusive development, FDI has an important complementary role in this process. Despite its benefits, channelling FDI into productive industries remains a challenge for many developing countries including India.

5.2 FTAs can reduce trade cost between partner countries and as a result firms attracting vertical FDI (green-field investments) will benefit from such arrangements. On the other hand, there will be less incentive for horizontal FDI (acquisitions and mergers) owing to FTAs. Vertical FDI dominates horizontal FDI in countries where skill difference is large. Hence, FTAs should have a positive effect on FDI when member countries like India have large differences in skill levels. Free trade agreements will enable us to attract investments into green-field projects. In the recently concluded services and investment agreement with ASEAN, India is likely to get a boost to FDI in green-field projects, particularly from newly industrialised economies of the ASEAN group such as Singapore.

5.3 Therefore, it will be beneficial for India to enhance the scope and coverage of its existing bilateral investment treaties with developed countries as far as inflow of FDI to green-field project is concerned. There should be specific chapters on investment in India's FTAs including those with other developing countries/regions as that will enhance South-South flow of investment including through mergers and acquisitions along with appropriate transfer of technology and also to protect the interests of Indian investors in foreign countries.

6. FTAs and Capacity Development

6.1 According to a report prepared by Standard & Poor, India needs to reform policies concerning project execution and long-term funding to overcome its infrastructure challenges, which could prevent it from achieving its target of 9-9.5 per cent annual growth during 2012-2017. Building infrastructure, both physical and human, is crucial for India to achieve a higher rate of sustainable and inclusive growth. Infrastructure development through investment and trade facilitation via FTAs is a vital source for a capital scarce country like India with moderate saving rate.

6.2 High transactions cost arising from inadequate and inefficient infrastructure prevents our economy from realising its full growth potential regardless of the progress on other fronts. FTAs will enhance the movement of low cost products such as construction materials and machineries through reduction of taxes. Also, there will be enhanced availability of technologies and managerial skills.

6.3 India's on-going negotiations of FTAs should include these aspects and it is to be ensured that adequate provisions are there in the proposed agreements to facilitate capital goods and investment flow into local infrastructure. It is also important to ensure that the local regulatory environment is conducive for such inflows, especially by avoiding procedural delays in infrastructure projects.

7. FTAs and Environmental Concerns

7.1 Environmental concerns, particularly those related to climate change, are a contentious subject of trade negotiations. Export of energy-inefficient products is becoming a major issue. In order to reduce the emission of green-house gases, developed countries are repeatedly pressing for the use of energy efficient resources and technologies. On the other hand, disciplines to trade in environmental goods and services including technologies and facilitation of the reduction in carbon content of tradable products are weak.

7.2 Developed countries such as the EU and the US are aggressively putting environmental standards and concerns in their FTAs negotiations. It is an imperative for us to stress on development dimensions of linkages between trade and environmental standards and concerns by emphasising on a non-sanction-based approach through technical assistance and capacity building.

8. Recommendations

8.1 India has a huge potential to improve its trade competitiveness, especially in relation to those countries/regions with which it engages in a deeper trading relationship through FTAs/PTAs/CECAs/CEPAs. Export and import data till December 2012 show that the country is yet to reap optimal benefits from such arrangements. However and though FTAs may have facilitated more growth in imports than in exports, which is mainly due to their coverage and tariff structure in partner countries and in India, they are generating considerable amount of direct and indirect benefits as import intensity of India's exports is increasing, resulting in better allocation of domestic resources, making our exports more competitive and facilitating our producers to link with regional/global value chains. With further initiatives to deepen the coverage of these agreements, India can leverage huge opportunities to expand its market access in those countries and be more competitive.

8.2 For this to happen, the government should revisit these trade agreements through cost-benefit analyses including sustainability impact assessment of FTAs being negotiated or to be negotiated and regulatory impact assessment of existing FTAs. While negotiating new agreements, particularly deeper FTAs with developed countries, India needs to set its targets clearly and take steps for improving its domestic preparedness, particularly those of regulatory bodies. For instance, due to an unfavourable exchange rate regime and low difference between preferential and MFN tariff rates in Japan, India-Japan CEPA is not creating more market access opportunities for Indian products, but with diligent application of safeguards, careful selection of products/services sectors and complementary policies to attract Japanese investment with technology transfer, it is expected that there will be a huge overall gain to the Indian economy.

8.3 In the medium to long run, India needs to diversify its trade portfolio, which will increase its competitiveness by broadening the productive base, particularly in the manufacturing sector which has a lot of untapped potential. To become competitive in its exports to world markets, India should put all exports under a special Focus Market Scheme.

8.4 Furthermore, India needs to harmonise its industrial and trade policies in order to leverage more and better benefits from its trade agreements. Trade agreements are a mean to achieve better economic benefit and not an end in itself; therefore, domestic preparedness through regulatory reforms and harmonisation of regulatory measures is paramount to gain from international trade.

8.5 India’s strategy to negotiate and implement free trade agreements should take into account the following points:

- There should be a better alignment/coherence of India’s trade policy with the objectives of other major macroeconomic policies such as National Manufacturing Policy.

- The importance of inclusiveness in trade policy making is increasingly being recognised at the national level and this practice of good governance should be percolated to sub-national level. All relevant stakeholders such as business association including bodies representing micro, small and medium enterprises and civil society and community-based organisations should be given due representation in trade policy-making process and its implementation. This will ensure better political buy-in for India’s trade policy in general and trade negotiations in particular.

- Comprehensive analyses of market access and other opportunities in prospective partner-country markets including analyses of factors relating to enhancement of competitiveness of India’s exports through right mix of import intensity should be undertaken before initiating trade negotiations. Negotiations should start after a thorough understanding of sustainability impact of free trade agreements in respect to their economic, social and environmental sustainability.

- Impact of third-party FTAs (that is between two or more countries with which India has significant trade relations but does not have a free trade agreement) on the Indian economy should be analysed. Given the limited nature of our negotiating capital, such analyses will help optimising our trade negotiations and drawing more benefits from them.

Table 1: India's Trade Share with FTA Partners & WTO Members

India's Share of Total Trade with FTA and WTO Partners (%)				India's Share in World Trade (%)			
Particulars		***2006***	***2011***	***Particulars***		***2006***	***2011***
With FTA Partners	Export	35	34	Goods	Export	1.01	1.69
	Import	40	43		Import	1.45	2.55
	Export (Without Petroleum)	32	32		Export (Without Petroleum)	1.00	1.66
	Import (Without Petroleum)	39	42		Import (Without Petroleum)	1.12	2.06
	Export (Without Petroleum and Precious metals)	37	39		Export (Without Petroleum and Precious metals)	0.87	1.38
	Import (Without Petroleum and Precious metals)	46	55		Import (Without Petroleum and Precious metals)	0.93	1.48
	Total	**38**	**39**	Services	Export	1.81	3.22
With WTO Members	Export	96	90		Import	1.48	3.14
	Import	85	92	Total Trade	Goods	1.23	2.12
	Export (Without Petroleum)	97	90		Services	1.65	3.18
	Import (Without Petroleum)	98	98	Total Trade	**Combined**	**1.31**	**2.32**
	Export (Without Petroleum and Precious metals)	96	89				
	Import (Without Petroleum and Precious metals)	97	98				
	Total	**89**	**91**				

Noted: Data with FTA partners include trade with which India has agreements under the Generalised System of Trade Preferences.
Source: CUTS calculation on Geneva-based International Trade Centre's database

Table 2: India's Trade Share with FTA Partners & WTO Members (Excluding GSTP)

		2006	**2011**
With FTA Partners	Export	29	28
	Import	28	31
	Export (Without Petroleum)	27	25
	Import (Without Petroleum)	37	40
	Export (Without Petroleum and Precious metals)	30	31
	Import (Without Petroleum and Precious metals)	43	52
	Total Trade	**29**	**30**
With WTO Members	Export	96	90
	Import	85	92
	Export (Without Petroleum)	97	90
	Import (Without Petroleum)	98	98
	Export (Without Petroleum and Precious metals)	96	89
	Import (Without Petroleum and Precious metals)	97	98
	Total Trade	**89**	**91**

Source: CUTS calculation on Geneva-based International Trade Centre's database

Table 3: Subject Coverage in Selected FTAs of India

FTAs/Coverage	Agriculture	Industrial Goods	Services	Investment	Government Procurement	Trade Facilitation	Competition, IPR and Other Issues	Remarks
Agreements under Implementation								
India - Sri Lanka FTA	**Moderate**	**Substantial**	**Not Covered**	**Not Covered**	**Not Covered**	**Substantial**	**Not Covered**	A comprehensive economic partnership agreement including services and investment is under negotiation.
SAFTA	**Moderate**	**Substantial**	**Not Covered**	**Not Covered**	**Not Covered**	**Substantial**	**Not Covered**	The revised sensitive list of Phase-II of SAFTA – Afghanistan (850); Bangladesh (987 for least developed countries, 993 for developing countries); Bhutan (150); India (25 for LDCs, 695 for DCs); Maldives (152); Nepal (998 for LDCs, 1036 for DCs; Pakistan (936); Sri Lanka (845 for LDCs, 906 for DCs)
India - Thailand FTA - Early Harvest Scheme	**Moderate**	**Not Covered**	**Not Covered**	**Not Covered**	**Not Covered**	**Substantial**	**Not Covered**	Elimination of agricultural tariffs on a fast track basis for 82 items of export interest to India. Thus, out of 811 tariff lines in agriculture, only 82 tariff lines are considered under this Early Harvest Scheme.
India - Singapore CECA	**Low**	**Substantial**	covered	Covered	**Not Covered**	**Not covered**	Covered	Tariffs on approximately 75% of Singapore's domestic exports will be eliminated or substantially reduced within five years.
India - ASEAN Trade in Goods Agreement	**Low**	**Substantial**	**Not covered**	**Not covered**	**Not covered**	**Substantial**	**Not covered**	Both parties have agreed to allow between 7 to 9% of tariff lines or products to be excluded from tariff reduction commitments.
India - South Korea CEPA	**Low**	**Substantial**	**Substantial**	**Substantial**	**Not covered**	**Substantial**	**Covered**	Tariffs will be reduced or eliminated on 93% of Korea's tariff lines and 85% of India's tariff lines.

FTAs/Coverage	Agriculture	Industrial Goods	Services	Investment	Government Procurement	Trade Facilitation	Competition, IPR and Other Issues	Remarks
India – Japan CEPA	**Low**	**Substantial**	**Substantial**	**Substantial**	**Substantial**	**Substantial**	**Substantial**	About 94% of tariff lines will be eliminated within 10 years (about 97% by Japan and about 90% by India).
India - Malaysia CECA	**Low**	**Substantial**	**Substantial**	**Substantial**	**Not covered**	**Substantial**	Covered	Trade in goods package takes the tariff liberalisation agenda beyond the India-ASEAN FTA commitments.
Agreements Under Negotiation								
India - EU BTIA	**Low**	**Substantial**	**Substantial**	**Substantial**	**Substantial**	**Substantial**	IPR **Covered**	India and the EU have agreed to eliminate tariffs in over 90 per cent of all tradable goods during a 10-year period. EU's demand on wines and spirits, dairy products and automobiles remain unsolved.
India - ASEAN CECA	**Moderate**	**Substantial**	**Substantial**	**Substantial**	**Substantial**	**Substantial**	**Covered**	Main areas of differences revolved around sensitive agricultural products, mainly in the plantation sector.
India - EFTA BTIA	**Moderate**	**Substantial**	**Substantial**	**Substantial**	**Substantial**	**Substantial**	**Covered**	Negotiation is expected to be concluded in 2013.
India - SACU PTA	**Moderate**	**Substantial**	**Not Covered**	**Not Covered**	**Not Covered**	**Substantial**	**Not Covered**	SACU's applied simple average tariff on Indian imports are textiles and clothing (31.1%), footwear (27.5%), live animals and animal products (24.7%), raw hides (23.8%) and precious stones and metals (20%).
India - MERCOSUR PTA	**Moderate**	**Substantial**	**Not Covered**	**Not Covered**	**Not Covered**	**Substantial**	**Not Covered**	Agreed to provide tariff concessions ranging from 10% to 100% to each other on 450 and 452 tariff lines respectively.

FTAs/Coverage	Agriculture	Industrial Goods	Services	Investment	Government Procurement	Trade Facilitation	Competition, IPR and Other Issues	Remarks
India - Chile PTA	**Moderate**	**Substantial**	**Not Covered**	**Not Covered**	**Not Covered**	**Substantial**	**Not Covered**	India offered fixed tariff preferences ranging from 10% to 50% on 178 tariff lines; Chile's offer is on 296 tariff lines with margin of preferences ranging from 10% to 100%.
India - Canada CEPA	**low**	**Substantial**	**Substantial**	**Substantial**	**Substantial**	**Substantial**	**Covered**	More than 70% of total Indian merchandise exports to Canada will be covered.
India - Australia CECA	**Moderate**	**Substantial**	**Substantial**	**Substantial**	**Substantial**	**Substantial**	**Covered**	Expected to broaden the base of goods and services trade, harmonise non-tariff barriers and facilitate two-way investment.

Note: Coverage of the Issues has been classified as Substantial, Moderate and Low
Source: CUTS analysis based on various official online documents including those available at www.commerce.nic.in