Dossier on Preferential Trade Agreements

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1. China-New Zealand FTA signed

On April 7, 2008 China signed its first-ever free trade agreement with a developed country; this agreement with New Zealand covers trade in goods and services and investment. It is worth mentioning that New Zealand was the first developed country to sign China's accession to the World Trade Organisation and the first to recognise China as a full market economy – a concession the US and the EU have refused to make.

Any agreement for free trade is largely based on the geopolitical relationship between the negotiating countries; however, successful completion and its sustenance depend to a large extent on the willingness to cooperate and mutual trust between the contracting parties. The China-New Zealand FTA illustrates this well, given the short period in which it was concluded.

The deal was finalised in just 3 years after 15 rounds of negotiations between December 2004 and December 2007. During this period bilateral trade between the two countries grew annually by around 26 percent to reach US$3.7bn in 2007. The agreement provides that New Zealand will gradually remove all tariffs on imports from China by 2016, while China will take 3 more years (i.e. 2019) to phase out tariffs on 96 percent of its imports from New Zealand. The first tariff cuts will take place on October 1, 2008.

The FTA, in addition to goods, includes the services sector such as banking, environment, education, entertainment, construction and transport. As per the agreement, New Zealand would allow 1,288 Chinese people each year to work in areas such as traditional Chinese medicines, language teaching, Chinese martial arts training, tourism, auditing, food services etc. The agreement would also provide for setting up of mechanisms for investment promotion and cooperation in customs, quality inspection and quarantine and intellectual property rights (IPR) protection.

Currently tariffs on goods coming into New Zealand range from 10 to 20 percent and are almost 15 percent for agricultural goods such as dairy products and wool, two of its biggest exports. According to New Zealand Trade Minister Phil Goff the trade pact will result in growth of exports of between 225mn NZ dollars (US$176.5mn) and 350mn NZ dollars (US$274.56mn) over the baseline projections for each year and in due course a reduction in tariff payments worth 115mn NZ dollars (US$90.21mn).

As per the statistics released by the Chinese embassy in New Zealand, by the end of 2007 New Zealand had invested US$750mn in China in 1,301 projects, while China had invested US$52.24mn in New Zealand's non-financial sectors, including shipping, trade, forestry and tourism. The two countries also have enormous potential for cooperation in environmental protection and mining.

CUTS Comments *Though India's exports to New Zealand are insignificant (less than 0.4 percent of its total exports) its items of export to New Zealand do overlap significantly with Chinese exports; therefore, this FTA should have a depressing effect on India's exports to New Zealand. Given that India is also negotiating deals with small countries, the swiftness with which the China-New Zealand deal was concluded constitutes an important case study for Indian negotiators.*

Food for Thought

1. Can India and New Zealand gain significantly from a FTA given the limited scope of trade between the two countries? Or is it possible to have a limited PTA for some identified products in which both countries enjoy a relative comparative advantage?

2. What would be the likely scenario in terms of trade creation and trade diversion if India goes in for a PTA/FTA with both New Zealand and China, thus completing the FTA triangle? This would be an interesting empirical question.

2. GCC and EFTA in agreement for an FTA

A free trade agreement was finalised between the Gulf Cooperation Council (GCC) and European Free Trade Association (EFTA) on 26th April, 2008 at Geneva marking the culmination of five rounds of talks. The EFTA is composed of four European states: Iceland, Liechtenstein, Norway and Switzerland.

The agreement seeks to improve economic cooperation and increase trade in goods and investment opportunities involving the two regions. The GCC, comprising of Kuwait, Bahrain, Oman, Qatar, Saudi Arabia and the United Arab Emirates, is all set to negotiate free trade deals with EU, Iran, Korea, and India. It has already finalised a free trade agreement with Singapore.

CUTS Comments *Both GCC and EFTA will gain through the FTA; however, it will lead to some adverse effects on India in terms of trade diversion. The reason for this is sufficient trade overlap between India-GCC trade and GCC-EFTA trade; therefore, it is in India's interest to finalise an FTA with GCC at the earliest. India is already in an advanced stage of negotiations for FTAs with both these regional associations.*

Food for Thought

1. Will it be possible for India to reduce or eliminate tariffs on POL (petroleum, oil and liquid gas) imports from GCC countries? It will be an interesting empirical question to estimate loss of government revenue vis-à-vis increase in consumer surplus on account of reduction in landed POL prices in the domestic market.

3. Chile offers FTA with India

Chile has made an offer to India to upgrade the current bilateral PTA (which was signed by the two countries in March 2006 and operationalised in September 2007) to a FTA. The Chilean President Michelle Bachelet made this offer to the visiting Indian President, Pratibha Patil on 22nd April, 2008. It is worth mentioning that the Framework Agreement for Economic Cooperation (including FTAs) between India and MERCOSUR was signed as early as 2003; however, the Brazilian Parliament is yet to implement it despite full support extended to it by the highest authority, the Brazilian President. While hosting a ceremonial welcome to the Indian President, Pratibha Patil the Chilean President has said, "Chile can be a platform for India in Latin America as it has all the required infrastructure-- roads, ports, buildings, telecommunication-- for operating business in entire Latin America."

The Chilean President further stated that India is a leader among all developing nations and it would be fruitful for Chile to have more and more business coming from India. The bilateral trade between Chile and India got a boost with the signing of the PTA in 2006. Under the PTA, India has offered to provide fixed tariff preferences ranging from 10 percent to 50 percent on 178 tariff lines at the 8 digit HS level to Chile while the latter has offered a similar range of tariff preferences on 296 tariff lines at the 8 digit level to India.

The preferential tariffs apply to the following products imported from Chile: meat and fish products, rock salt, iodine, copper ore and concentrates, chemicals, leather products, newsprint, paper and particleboards and some industrial products. Chile's preferential tariffs with reference to India include agriculture products, chemicals and pharmaceuticals, leather products, textiles and clothing and some industrial products.

CUTS Comments *After India's signing of a PTA with Chile the bilateral trade volumes have witnessed a continuous rise and therefore it would be useful if this arrangement is converted into a FTA, which covers all trade in goods and services as well as opportunities for foreign direct investment. India then would be able to use Chile as a platform to widen its trade and other economic relations with Latin American countries. India can make suitable FDI in Chile to produce goods and services which can then be imported to all parts of Latin America – an arrangement through which it can greatly economise on transport costs.*

India and Brazil are engaged in the India, Brazil and South Africa (IBSA) initiative. India has also signed a PTA with MERCOSUR of which Brazil is an important member, along with 3 other countries (Argentina, Paraguay and Uruguay); Chile and Bolivia are associate members of MERCOSUR.

Food for Thought

Standard trade theory suggests that benefits (from trade creation) of a FTA are more for geographically contiguous countries. The gravity models used for evaluating costs and benefits of such FTAs also point to this fact. On the basis of this criterion, India being quite distant from Latin American countries is not well suited for FTAs with them. However, the PTA between India and Chile has produced immense gains for both countries. Moreover, FDI arrangements built in to a FTA between India and Chile might allow India to evolve deep economic relations with distant Latin American countries. A cost-benefit analysis of the likely FTA after taking these considerations into account is required.

4. ASEAN-Japan Comprehensive Economic Partnership Agreement signed

The 10 member Association of South East Asian Countries (ASEAN) and Japan have signed an Agreement on Comprehensive Economic Partnership (to be known as the 'AJCEP Agreement') on 14th April, 2008. The Agreement is comprehensive in scope, covering trade in goods and services and economic cooperation. It is expected that Japan and the member countries of ASEAN would ratify the agreement soon to make it operational.

CUTS Comments *India is also negotiating a FTA with ASEAN and after several hiccups it is close to finalisation. The contentious issues in the India-ASEAN FTA talks, which have been responsible for obstructing the FTA deal so long relate to import duty cuts on four products (palm oil, pepper, tea and coffee) from three countries (Malaysia, Indonesia and Vietnam). However, official sources indicate the near resolution of issues related to Malaysia and Vietnam. Both ASEAN and India export significant amounts of fishery products to Japan. It is therefore likely that the FTA between Japan and ASEAN would lead to diversion of Japanase fishery imports from India and ASEAN will gain.*

Food for Thought

1. There is sufficient trade overlap between India on the one hand and the ASEAN and/or Japan on the other; What would be the extent of losses from trade diversion for India as a consequence of the ASEAN-Japan CEPA?

2. From the political economy aspect it is worth evaluating the extent to which the ASEAN-Japan CEPA and the likely inking of the India-Japan CEPA and the India-ASEAN FTA would help to establish the Asian Common Market.

5. Pakistan and Sri Lanka to expand the scope of FTA

Pakistan and Sri Lanka, two important member countries of the South Asian Free Trade Agreement (SAFTA), have decided to expand the scope of their FTA to include areas, which have been out of the scope of their comprehensive economic partnership agreement this far. The Presidents of the two countries met on the sidelines of the Boao Forum in the Chinese city of Hainan in April this year; the bilateral talks between the two Presidents have elevated the trade between the two nations to the highest level. Sri Lanka is the second country after China with which Pakistan has signed a free trade agreement. The trade agreement has opened the doors of the Central Asian countries adjacent to Pakistan for Sri Lankan exports.

CUTS Comments *India and Sri Lanka have a comprehensive FTA with FDI arrangements thrown in and so do Pakistan and Sri Lanka. Through this network of arrangements a lot of products of Indian origin might find their way to Pakistan and vice-versa. This might lead to economic integration between these countries and emergence of a common sub-continental market.*

Food for Thought

1. What would be the impact of bilateral FTAs within South Asia on the South Asian Free Trade Agreement?