

Dossier on Preferential Trade Agreements

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1. Guyana and Indonesia sign reciprocal trade agreement

Guyana and Indonesia signed a reciprocal trade agreement here on 30th January, 2008 (the negotiations for which started in 2004 after the two countries commenced diplomatic relations in 1999) to promote trade and investment in the two countries and bring their business communities closer. The agreement hopes to bring Indonesian investment and expertise in wood and forestry products to Guyana, which has large forestry reserves. The agreement with Indonesia has coincided with the signing of an Economic Partnership Agreement (EPA) by Guyana with the European Union and has just preceded Guyanese negotiations for similar arrangements with Canada.

CUTS Comments India's trade with Indonesia is huge; its exports to Indonesia stood at US\$2026mn in 2006-07 while imports from Indonesia were US\$4166mn, implying a huge trade deficit to India. Indian exports to Indonesia are mainly confined to mineral fuels (mainly coal), prepared animal food, organic chemicals, sugar, iron & steel, fruits, etc and its imports from it to vegetable oils crude oil, ore, ash, slag, nuclear reactors, electric machinery etc. On the other hand, the Guyanese economy produces rice, sugar, molasses, bauxite, gold, furniture etc. Its main export items are rice, sugar, bauxite and gold. These products are being exported to the US, EU, Canada etc. As a result of the mentioned reciprocal trade agreement, Guyana might export sugar and rice to Indonesia.

There is no significant potential trade overlap between Indo-Indonesia trade and Guyana-Indonesia trade except for sugar which features on the list of exports from both India and Guyana to the rest of world. In particular, sugar is also an item of export from India to Indonesia. However, trade between Guyana and Indonesia is yet to begin. Therefore, some substitution of Indian sugar exports by Guyanese sugar is probable but not certain because of inability to predict trends on the basis of past history (which is absent in this case) and limited knowledge about whether Guyana is augmenting its sugar production to generate exports to a new country or reallocating sugar supply to potential importers.

A Joint Study on economic cooperation between India and Indonesia is currently underway which would suggest ways to promote trade and economic cooperation, including a free trade agreement. India has recently asked Indonesia to eliminate non-tariff barriers on Indian pharmaceutical products, stationery items wheat flour and milk products. India is currently also negotiating a FTA with ASEAN, of which Indonesia is a member. In course of time when the Indo-ASEAN (or for that matter Indo-Indonesia) FTA comes into operation, competitiveness between Indian and Guyanese exports to Indonesia might change in India's favour.

However, the magnitude of the shift, if any, would depend on tariff concessions obtained, composition of negative lists etc. For example, a reduction in the tariff rate on Indian sugar would help Indian sugar exports displace Guyanese sugar from the Indonesian market. However, if sugar is placed on the negative list by Indonesia or ASEAN no such advantage will accrue to India.

Food for Thought

1. Given the limited size of the Guyanese economy and also its distance from Indonesia, will Guyana-Indonesia reciprocal trade agreement affect India's exports to Indonesia, especially in sugar and rice, significantly?

2. India is also negotiating an FTA with Indonesia, in addition to the one with ASEAN (Indonesia being its member). Will such preferential trade arrangements improve trade relations amongst members of the arrangement and to what extent?

2. Bangladesh: FTA with India will make us a captive market

At a seminar on the “Regional Trade Arrangements (RTAs) in Asia-Pacific: Impact on Bangladesh,” organised by the Federation of Bangladesh Chambers of Commerce & Industry (FBCCI), most speakers warned that a FTA with India would make Bangladesh a captive market for Indian products and in the process ruin domestic industries. A senior official of Bangladesh's foreign ministry, Hamidur Rashid cautioned that a FTA with India is likely to be “trade diversionary” in favour of Indian exports.

While commenting that SAFTA (South Asian Free Trade Agreement) would have a negligible effect on regional trade flows, Dr. Rashid said “a free trade arrangement with India may increase consumer surplus but is likely to have little or no impact on increasing Bangladesh's manufactured exports to India” and suggested that Bangladesh must avoid being a “spoke”.

Taking a different view, the World Bank economist, Zaidi Sattar suggested that more tariff liberalization would help promote international trade as Bangladesh is still a “highly protected” economy. Sattar opined that RTAs are reducing the cost of industrialization in many countries. Bangladesh's stumbling export diversification efforts need to be resurrected for the future growth of industry and the country as a whole.

A business leader stressed the need to build capacity for trade negotiations in the private sector, trade bodies and government institutions and to restructure the business chamber, the Federation of Bangladesh Chamber of Commerce & Industry (FBCCI).

CUTS Comments *The current business and political atmosphere prevailing in Bangladesh does not favour an FTA with India as there are apprehensions of Bangladesh becoming a “spoke”, although this concern is not supported by most of the research studies on Bangladesh's trade prospects (see, for example, “India-Bangladesh Bilateral Trade and Potential Free Trade Agreement”, Bangladesh Development Series Paper No. 13, The World Bank, Dhaka, December 2006). This concern also seems unjustified if we compare India's pre and post-FTA trade with Sri Lanka; the India-Sri Lanka FTA has helped Sri Lanka to increase exports (and imports as well) to India and has also attracted more Indian foreign direct investment into Sri Lanka.*

To further emphasise the fact that Bangladesh's fears about being reduced to a spoke are unjustified consider the effect of the South Asian Free Trade Agreement (SAFTA), which was signed in 2004 and operationalised in 2006, on trade between India and Bangladesh. There has been steady rise in Bangladeshi exports to India. In 2005-06 Bangladesh's exports into India were valued at US\$127mn, which almost doubled in 2006-07 to US\$228mn at current prices, a rise of about 80 percent. Even in terms of constant dollars (a unit of currency adjusted for inflation which facilitates accurate comparison across years) this is an increase of 70 percent. On the other hand, Indian exports to Bangladesh during the same period showed a decline by 2 percent from US\$1664.4mn to US\$1628.6mn at current prices and by about 5 percent in terms of constant dollars. Though even now Bangladesh runs a huge trade imbalance with India, Bangladesh's import-export ratio vis-à-vis India has improved over this period (from the Bangladeshi point of view) from 13:1 to 7:1. A Bangladesh-India FTA should carry this further and will be in Bangladesh's interests. This is a very important fact that should be highlighted by Indian policy makers advocating for the FTA. It seems that the Bangladeshi industrialists who are crying foul are those that will be displaced by Indian exports due to inefficiency in their own production.

Besides pruning the negative list by one-third (from 744 to 500) for least developed countries (LDCs) under SAFTA (Bangladesh being one of these LDCs), India has offered unilateral duty-free-quota-free market access to these SAFTA LDCs into the Indian market. These measures would certainly help Bangladesh to improve its trade balance with India. In addition, the bilateral FTA with Bangladesh is being negotiated by India on very liberal terms and, therefore, should take care of the latter's overall interests.

Food for Thought

- 1. Can India and Bangladesh increase its trade and investment by just trade facilitation and further trade liberalization measures or is an FTA the only solution?*
- 2. Why is there an apprehension in Bangladesh that a FTA with India would endanger domestic industry? Why is the enormous success of the India - Sri Lanka FTA not moving stakeholder opinion in favour of the Indo - Bangladesh FTA? How crucial are political relations for such shift in opinion?*
- 3. What should be the role of domestic stakeholders, including the civil society organisations in Bangladesh, in mitigating such fears and apprehensions and in highlighting the advantages of access to its neighbour's huge market?*

3. FTA transforms India-Sri Lanka relations

The India - Sri Lanka FTA has proved to be a harbinger of peace between the two countries. The relationship between New Delhi and Colombo has now ceased to be overly political, and more cultural and economic, thanks to the phenomenal success of the FTA. The growth of trade between India and Sri Lanka has been significant since 2000 when the FTA was implemented. In 2000 India's exports to Sri Lanka stood at \$600 million and Sri Lankan exports to India at US\$58mn. In 2007 these figures increased to US\$1.88bn and US\$ 400mn respectively.

Even in terms of constant dollars, there has been a 150 percent increase in India's exports to Sri Lanka and a 450 percent increase in Sri Lankan exports to India. The trade ratio (exports/imports) has improved significantly for Sri Lanka from 10.3:1 to 3.7:1 in just 6 years of the agreement. Sri Lanka is now India's biggest trade partner in South Asia and India is the largest source of imports into Sri Lanka. India became the third biggest trading partner for Sri Lanka in 2006 from a lowly rank of 16th in 2000.

There is a significant trade overlap between India and Sri Lanka. Both countries are significant producers and exporters of tea, rubber, garments, etc and therefore have a vested interest in protecting their own domestic producers from competition by the other country. Naturally, these products have been included in negative lists for tariff elimination. However, India has still given Sri Lanka 4,150 zero duty tariff lines in return for 1,208 such lines from it under this FTA. Moreover, Sri Lanka has been given a longer time than India to adjust its tariffs downwards.

Experts from Sri Lanka say that Sri Lanka still has scope to penetrate the vast Indian market of over one billion consumers as its products have been confined to South Indian markets. There is a need for Sri Lanka to expand its export basket, which is heavily dominated by a few products, of which non-ferrous metals and vanaspati account for over half of its exports to India.

Encouraged by the success of the FTA, the two countries are contemplating its expansion to include more items, remove non-tariff barriers, liberalise rules of origin and undertake trade facilitation. They are now negotiating for a Comprehensive Economic Cooperation Agreement (CECA).

CUTS Comments Both India and Sri Lanka hail the FTA as a success story and it is disappointing that there are so many roadblocks to India's repeating the same story with other neighbouring countries such as Pakistan and Bangladesh. Although all four countries are members of SAFTA and the tariff liberalization programme is already operational yet not much improvement has taken place in trade and investment flows among them. The biggest hurdle to a FTA being inked between India and Pakistan, as frequently reported, is the Indo-Pak political relationship. Though India has taken several positive steps, many of them unilaterally, to promote trade and investment with Pakistan (such as MFN status) the latter has been extremely slow to reciprocate.

Both Pakistan and Bangladesh have apprehensions of being swallowed up by India, which is better placed in terms of industrialisation and competitiveness in several commodities, and become its captive market when bilateral FTAs with India are inked. These fears seem to be unfounded given the benefits that India and Sri Lanka have both derived from their FTA, despite the significant overlap of exportables from these countries. As mentioned above, various stakeholders both within and outside Pakistan and Bangladesh should advocate for a bilateral FTA for not only trade and investment promotion but propagation of peace and friendship. The signing of such a FTA would not make them captive markets of Indian products as amply demonstrated by the success of the India-Sri Lanka FTA.

Food for Thought

- 1. Indian fisheries and vegetable oil industries have persistently complained about the fallout from the FTA between the two countries in spite of protection offered by the Government through short term measures such as tariff rate quotas and hikes in tariff rates. What long term measures can be used to satisfy the demands of these stakeholders?*
- 2. Sri Lanka has also signed a FTA with Pakistan. It would be of great interest to find out the growth of trade between Sri Lanka and Pakistan in those product lines in which India too engages in trade with these countries. How has Pakistan fared in terms of FDI in Sri Lanka as opposed to the progress of Indian FDI in the same country?*
- 3. Is peace a precondition for a successful FTA or does a FTA lead to greater peace between two nations? This question has to be analysed with respect to India's political and trading relations with Sri Lanka and other South Asian countries.*