BRIEFING PAPER

CUTS Centre for International Trade, Economics & Environment
CUTS CITEE

1/2010

India ASEAN FTA

A Move towards Multilateral Free Trade Agreements?

Background

The Association of Southeast Asian Nations (ASEAN)-India FTA (AIFTA) was inked on August 13, 2009 in Bangkok after six long years of negotiation which started in 2003 as a part of the Framework Agreement on Comprehensive Economic Cooperation Agreement (CECA) between India and the 10 Southeast Asian countries. The AIFTA, which at present only includes an agreement on trade in goods (TIG), became effective from January 01, 2010. Once negotiations on services and investment agreements are finalised, the trade in goods agreement will graduate into the initially envisioned CECA.

The signing of this agreement is an important milestone in India's 'Look East Policy'. In addition to providing access to a large and growing market, this is a stepping stone towards India's participation in the larger Asian community, ultimately culminating into the Asian Union in the long run. This agreement, however, has also created controversies with substantial domestic resistance, particularly from the plantation sectors in the southern states of the country.

The objectives of this briefing paper are to examine the significance of AIFTA for the existing trading relationships between India and ASEAN countries and the modalities of the Trade in Goods Agreement, and assess the concerns and criticisms emerging from different circles.

Significance of ASEAN- India FTA

Historically, India's engagement with Asia has mostly been on shared cultural, geographical and colonial ties. With the shift in power dynamics from the West to the East leading to a new world economic order and the end of the cold war, India launched its 'Look East' Policy in 1991, essentially to bolster its economic and political relations with the East and Southeast Asian neighbours. The inking of the ASEAN-India FTA is a significant step in this direction. India's Look East Policy holds more relevance today as countries from this region are some of the most dynamic growth areas. According to figures from the first quarter of 2008-09, India's export share with ASEAN was at 12.44 percent against 10.43 percent with the US. Slow economic growth of India's traditional trading partners such as the UK and US implies that creating and expanding markets for trade and investment in the Asian region is a good strategic decision for both economic and political gains.

China has been influential in the region in different arenas and also has a FTA with ASEAN already in place, while the US held the first ever summit with leaders of Southeast Asia on the sidelines of the annual Asia-Pacific Economic Cooperation (APEC) gathering in Singapore in November 2009 with the intention of becoming more active in the region. India's current engagement with ASEAN has carved out an important place for India and is expected to provide India with a better sense of ownership while negotiating new pan-Asian agreements. Moreover, this is a stepping stone for strengthening India's role in the envisioned Asian Economic Community ultimately leading to an Asian Union.

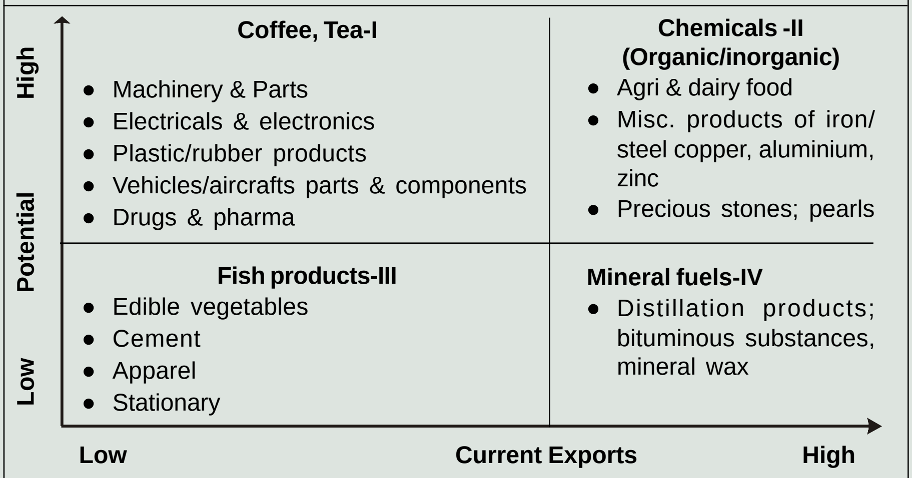
The ASEAN India FTA has created one of the largest regional trade blocs in the world. The 11 countries have a combined Gross Domestic Product (GDP) of US$2.4tr, total merchandise trade of US$1.7tr and foreign direct iInvestment (FDI) inflows of US95.7bn with a total population of 1.7 billion people[1]. ASEAN is India's fourth largest trading partner after the EU, US and China, although owing to the recent financial crisis, trade with ASEAN has overtaken that with the US. Total bilateral trade between India and ASEAN amounted to US$47bn in 2008, up from US$39bn the previous year. Trade is expected to increase by an additional US$10bn in the first year after the activation of the FTA[2]. Indian exports to the region grew at an annual average rate of about 23 percent over 2003-04 to 2007-08 while India's overall exports to the world grew at 20.6 percent during the same period.

India has been a strong supporter of multilateralism, evidenced by its relatively small number of preferential trading engagements till date. In recent years, there has been a rise in the number of preferential trading agreements of which India has been a party and there also appears to be two important features in this trend. First, there has been a move towards preferential trade agreements with regional blocs and second, towards comprehensive agreements on not only goods and services trade but also covering investment chapters instead of the 'traditional goods only' agreements. AIFTA which reflects both these moves is India's first multilateral preferential trade agreement with a regional bloc that is not a customs union, and also one of the most complex agreements that it has negotiated in recent times.

Table 1: India's Merchandise Trade with ASEAN Countries						
Country	Exports (US$mn)		Average Annual Growth (in percent)	Imports (US$mn)		Average Annual Growth (in percent)
	2003-04	2007-08		2003-04	2007-08	
Brunei	4.59	10.45	17.89	0.34	225.81	266.82
Cambodia	18.60	53.45	23.51	0.28	2.87	59.27
Indonesia	1,127.20	2,160.18	13.89	2,122.06	4,826.06	17.86
Lao, PDR	0.43	3.83	54.86	0.13	0.11	-3.29
Malaysia	892.76	2,568.84	23.54	2,046.55	6007.84	24.03
Myanmar	89.64	185.43	15.65	409.01	809.94	14.64
Philippines	321.53	618.95	14	122.11	204.74	10.89
Singapore	2,124.83	7,371.15	28.25	2,085.37	8,121.61	31.25
Thailand	831.68	1,808.79	16.81	609.05	2,302.13	30.47
Vietnam	410.43	1,603.16	31.33	38.21	173.47	35.33
ASEAN	5,821.69	16,384.25	22.99	7,433.11	22,674.58	24.99
World	63,842.55	162,983.90	20.62	78,149.11	251,562.3	26.34

Source: EX-IM databank, Department of Commerce

Figure 1: Trade Potential with ASEAN



Source: Bhardwaj, A. (2009), 'New Opportunities in Asean markets' The Financial Express, October 16, 2009.

Trade between India and ASEAN

India's exports to ASEAN have registered an average annual growth rate of about 23 percent over 2003-04 to 2007-08 while imports from the region have gone up by about 25 percent per annum. Meanwhile, India's trade deficit with the region has increased from US$1,611mn to US$15,241mn. Singapore is India's largest trading partner in ASEAN accounting for 40 percent of trade, which may be partly attributed to the India-Singapore CECA. Malaysia, Indonesia and Thailand are also major trading partners from ASEAN.

Petroleum oils account for about 29.6 and 24.3 percent of total exports and imports from ASEAN. Other top export items to ASEAN are oil cakes, copper, diamonds, organic chemicals, light vessels and floats, maize, aluminium and meat. Imports are dominated by petroleum oils, palm oil, coal briquettes, electrical and electronic equipment, wood and articles of wood, organic chemicals, parts and accessories of nuclear reactors/boilers and dried leguminous vegetables.

At present, Indian exports to the ASEAN market are dominated by mineral fuels with a value of US$5.6bn, accounting for around 29 percent of India's total exports to ASEAN. Industry studies indicate that this large share could be a result of rise in oil prices during the period and potential for further growth is limited. Exports of items in quadrant III – fish products, edible vegetables, cement, apparel and stationary- are low and have less scope for further expansion in ASEAN markets (see figure 1). Export of items in quadrant II – organic and inorganic chemicals, agricultural and dairy products, iron, steel, copper, aluminium, zinc products and precious stones and pearls – are currently high and have further potential for growth.

Items which figure low in India's basket of exports to ASEAN countries but identified to have high potential are meat, coffee, tea, machinery, electrical and electronics, plastic and rubber products, parts and components of vehicles and aircrafts, drugs, pharmaceuticals and leather products. However, the unorganised sectors, both in manufacturing and agriculture are expected to be adversely affected as a result of inflow of cheap products, particularly, due to the low productivity of unorganised firms[3].

There is no denying that the AIFTA brings strategic gains to India; however, economic gains can be substantial only if supply chains are developed with a focus towards intra-industry trade. With rising incomes and a shift towards manufacturing and service based economies, there is a need for product differentiation to leverage the scope for achieving economies of scale in intra-industry trade and use such trade as an engine of growth in the region. The goods in trade agreement provides increased scope for integration of supply chains in the machinery, electrical and electronics sectors, which could be further supplemented by inclusion of services trade and investment in the ambit of such agreements in the near future. However, for such export potential and product integration to be realised, facilitation of business to business connections, information flow, harmonisation and mutual recognition of standards as well as removal of other such non-tariff barriers are crucial[4] .

Modalities of AIFTA

The AIFTA also holds significance due to it being the first multilateral FTA that India has signed. It took six long years for the agreement to reach a fruitful conclusion as every nation in the regional bloc had to individually agree to Indian tariff lines. Disagreements arose over the sensitive issue of opening up markets for agricultural products and India's initially proposed negative list of 1,400 items which was eventually reduced to 489 in the final agreement.

The trade in goods agreement of the proposed CECA contains phased elimination/reduction of custom duties on imports from signatory countries. The objective of the agreement is to reach a zero customs duty regime for 'substantially all trade' between India and ASEAN countries. The time frame for phasing out of tariffs varies by country and product grouping. Once the agreement comes into full implementation, tariffs will be eliminated on 80 percent of traded goods between India and ASEAN countries on the basis of contributions to value of trade. The tariff liberalisation schedule for AIFTA has five components – (i) Normal Track; (ii) Sensitive Track; (iii) Special Products; (iv) Highly Sensitive List; and (v) Exclusion List. Brief descriptions of the modalities are outlined in box 1.

The timeline for tariff liberalisation of the components listed in box 1 are different for various country groups. India and the five ASEAN member countries – Brunei Darussalam,

Box 1: Tariff Liberalisation Schedule of ASEAN- India FTA

1. **Normal Track:** Gradual reduction and subsequent elimination of custom tariffs on 4000 products that account for 80 percent of traded goods.
   ***1.1 Normal Track 1 (January 01, 2010 to December 31, 2013)*:** Tariffs will be eliminated on 3,200 products under 7,788 tariff lines. These are mostly products with 7.5 to 10 percent duties and the average reduction rate will be 1.5 to 2 percent per year.
   ***1.2 Normal Track 2 (January 01, 2010 to December 31, 2016)*:** Tariffs will be eliminated on 800 products under 1,252 tariff lines. These are mostly products with 7.5 to 10 percent duties and the average reduction rate will be 1 to 1.5 percent per year.
2. **Sensitive Track:** Tariffs will be reduced on about 560 products that account for 10 percent of traded goods. Applied MFN Tariff rates above 5 percent will be reduced to the level of 5 percent.
   ***2.1 Structure 1 (January 01, 2010 to December 31, 2016)*:** Duties on items with MFN applied tariffs of more than 5 percent will be reduced to 5 percent. This can be maintained up to 50 tariff lines.
   2.2 Structure 2 (January 01, 2010 to December 31, 2016): For remaining products from tariff lines beyond 50, duties on products with MFN applied tariff rates higher than 5 percent will be reduced to 4.5 percent and then eventually to 4 percent.
   2.3 Structure 3 (January 01, 2010 to December 31, 2019): For products with 4 percent duty rates in the sensitive list (products to be identified), tariffs will be eliminated in a phased manner.
3. **Special Products *(January 01, 2010 to December 31, 2019)*:** Tariff reduction for products such as crude and refined palm oil, coffee, black tea and pepper phased over ten years for India.

Tariff Line	Base Rate	AIFTA Preferential Tariffs										
		Not later than 1 January										31.12.2019
		2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	
CPO	80	76	72	68	64	60	56	52	48	44	40	37.5
RPO	90	86	82	78	74	70	66	62	58	54	50	45
Coffee	100	95	90	85	80	75	70	65	60	55	50	45
Black Tea	100	95	90	85	80	75	70	65	60	55	50	45
Pepper	70	68	66	64	62	60	58	56	54	52	51	50

Source: India-ASEAN FTA Framework; Note: CPO- Crude Palm Oil; RPO- Refined Palm Oil

4. **Highly Sensitive List:** Reduction of tariffs for products in a phased manner for Asean countries.
   ***4.1* Category 1:** Reduction of applied MFN tariff rates to 50 percent of the base rate.
   ***4.2* Category 2**: Reduction of applied MFN tariff rates by 50 percent of the base rate.
   ***4.3* Category 3**: Reduction of applied MFN tariff rates by 25 percent of the base rate.

5. **Exclusion List:** List contains 489 items out of which 302 are from agriculture sector, 81 from textiles, 52 items from machinery and auto, 17 from chemicals and plastics.

Source: Government of India (2009); BMR Advisers (2009); Assocham (2009)

Indonesia, Malaysia, Singapore, and Thailand will eliminate tariffs under *Normal Track 1* and *Normal Track 2* by December 31, 2013 and 2016 respectively. India and the Philippines will mutually eliminate tariffs under the mentioned two normal tracks by December 31, 2018 and 2019 respectively. Least developed country (LDC) members – Cambodia, Lao PDR, Myanmar, and Vietnam will eliminate tariffs by December 31, 2018 and 2021 for *Normal Track 1* and *Normal Track 2* components respectively.

Likewise, timeline for tariff reduction of items in the *Sensitive Track – Structure 1* follows that of *Normal Track 2* schedule. Special arrangements for Thailand are in place under the *Sensitive Track* component, while this modality does not apply to Singapore. India and the mentioned five ASEAN nations have until December 31, 2019 to eliminate tariffs under *Sensitive Track – Structure 3*; India and the Philippines will mutually do so by December 31, 2022, and the four LDC members have until December 31, 2024.

The *Special Products* list is maintained by India, while a similar list – the *Highly Sensitive List* – is in place for ASEAN countries. However, this modality does not apply to Brunei Darussalam, Lao PDR, Myanmar and Singapore. A look at these components and the varied timelines negotiated for tariff liberalisation under AIFTA is indicative of the complexity of this multilateral free trade agreement. India's exclusion list contains products such as coconut, cashew, vanilla, nutmeg, coriander, cardamom, ginger, turmeric, copra, coconut oil, tobacco and natural rubber which will not be subjected to tariff liberalisation but will undergo an annual review with the view of improving market access.

Rules of Origin in AIFTA

Under origin requirements, preferential tariff treatment is available for the following two categories of products:

(i) wholly produced or obtained products such as plants, animals and products obtained from plants and animals (ii) not wholly produced or obtained products which, however, meet the following criteria:

1. Value addition is at least 35 percent or more with provisions for regional cumulation.
2. Non-originating materials have undergone change in (6-digit) tariff sub-heading.
3. Final process of manufacture is in the exporting country.

There have been some criticisms that the rules of origin in AIFTA are relatively lax and therefore could facilitate entry of non-member country goods into India through the preferential route. The value addition criteria for India-Singapore CECA and for India-Thailand FTA are at least 40 percent or more. Additionally, the change in tariff classification norm for non-originating material in these mentioned bilateral agreements are at the 4 digit level, which is also relatively more restrictive than the '6 digit' in ASEAN agreement.

Another structural difference between AIFTA and India-Singapore CECA pertains to the absence of 'Advance Ruling' mechanisms in AIFTA while it is present in the India-Singapore CECA. This mechanism allows the importer/ exporter prior to importation or exportation to utilise a competent customs authority to determine whether or not the concerned product qualifies as an originating product. Advance Ruling is mostly applied to determine classification, origin and customs value and is a proven trade facilitation tool providing transparency and certainty in customs operations[5].

In addition to sensitive and negative lists, bilateral safeguard measures can also be used to ensure adequate protection of the domestic industry. In the case of an influx of large quantities of foreign goods, safeguard measures are allowed for a period of up to three years with a probable extension of up to one additional year. These measures, however, cannot be applied for a product import from a country which accounts for less than three percent of total imports of that product from other parties by the importing country. The agreement has also placed emphasis on transparency, simplification and harmonisation of custom procedures and prohibition on imposition of non-tariff barriers (NTBs).

Concerns and Criticisms of AIFTA

Given that Indian tariff levels are generally higher than tariffs of ASEAN nations, it is predicted that India has relatively less to gain from this trade in goods agreement. India's average tariff rate in agriculture is about 34 percent against 13 percent for ASEAN. Likewise, India's average MFN tariffs for manufacturing goods are 11.5 percent compared to 7.5 percent for ASEAN[6] . Currently, about 75 percent of Indian products already enter the ASEAN market at duty-free tariff rates[7] . According to an internal government note, duties would be eliminated for about 70 percent of tariff lines by 2013 which account for 55 percent of India's yearly global imports. This suggests that there may be some scope for trade diversion as ASEAN countries may increase their exports to India at the expense of India's other trading partners. It is estimated that market access for India will increase by only 20 percent against 75 percent for ASEAN as a result of this agreement[8] .

As mentioned, the leniency in regard to rules of origin in AIFTA is one criticism while inconsistencies in items included in the negative list in AIFTA, especially when compared to the India-Thailand FTA and India-Singapore CECA, constitute another one. The exclusion or negative list in India-Singapore CECA amounts to 6,551 products at the 8-digit HS code. While trade may not occur in all the products specified in this list, there are many traded items on this list which are under normal track slated for tariff elimination in AIFTA. For example, a large range of products under precious stones and metals are under normal track liberalisation under AIFTA but protected via the negative list in the India-Singapore CECA. The current duty on gold is at 10 percent and India being the largest gold consumer in the world, zero-duties on gold imports after 2013 will enable gold sellers of Singapore and Thailand to enhance their shares in the Indian market at the expense of traditional gold exporters such as South Africa, Switzerland and UAE.

Agriculture under AIFTA is also a controversial issue. India is one of the largest consumer and producers of spices accounting for 48 percent of spice trade in volume and 44 percent in value. Kerala contributes to 92 percent of pepper exports, 74 percent of cardamom, and 63 percent of ginger, making up 67.5 percent of total national spice exports. The state also accounts for about 90 percent of India's annual rubber production of 850,000 tonnes and 90 percent of the country's produce of 11,000 tonnes of cardamom, and exports 80 percent of its farm produce. Various reports have indicated that the AIFTA would adversely affect about 2 million workers in the plantation sector in Kerala as it accounts for 45 percent of national plantation crop production providing livelihood support to about one fifth of the state's population. Therefore, these sectors primarily from Kerala have been strongly vocal against the AIFTA since its inception.

Figures from table 2 show that India has maintained a small trade surplus with ASEAN in agricultural products, with agricultural exports growing annually by 19.14 percent against 2.75 percent by imports over the last five years. However, there is a small trade deficit for cash crops and India's cash crop imports from ASEAN have been growing faster than exports (see table 2). Trade surplus exists in spices, tea and marine products and export growth in tea and spices, particularly pepper, is higher than corresponding growth in imports from ASEAN.

On the other hand, India has trade deficits in coffee and natural rubber with the region which are getting exacerbated as imports are rising faster than exports (see table 2). Most of these products have been protected with high tariffs or through their inclusion in sensitive and negative lists in India's preferential trade agreements. The scenario is not any different in the AIFTA as these products are sheltered via their inclusion in sensitive list, negative list or are given special products status, along with provisions for safeguard measures.

Low productivity, high production costs and adverse climatic conditions are said to be major factors contributing to the distress in Kerala's agriculture and plantation sector. Kerala's productivity in items such as pepper has declined from 358 kg/ha to 315 kg/ha over 1994-95 to 2004-05. Likewise, coffee and tea yields have gone down from 833 kg/ha and 2003kg/ha to 642 and 1413kg/ha respectively over the same period[10].

Even compared to the neighbouring states of Karnataka and Tamil Nadu, Kerala's productivity in the plantation sector is relatively low. For example, the base output of Robusta coffee per day per worker in Karnataka is 75 kgs against Kerala's 50 kg, while that of tea is 17-35 kgs per person in Tamil Nadu *vis-à-vis* Kerala's 16-21 kgs.[11]

ASEAN productivity in similar sectors is much higher due to low labour costs, low taxes and use of virgin lands for new plantation production. Countries such as Sri Lanka, Kenya, Vietnam, Malaysia, Thailand and Indonesia have moved towards plantation crops geared for exports in the last decade. Brazil and Vietnam account for about 45-50 percent of total world coffee production while India's share is less than 4 percent[12] . China has replaced India as the world's largest tea producer while Vietnamese pepper has displaced Indian pepper from a large portion of the US market.

Therefore, rather than protection, the plantation and farm sectors require additional investment support and reforms to tackle structural problems and enhance competitiveness. Additionally, cold storage facilities and transport logistics need to be improved. Behind the border impediments to trade such as technical barriers and standards also need reforms for deriving substantial gains from this FTA[13] .

Towards a Comprehensive Agreement

It has been argued that India has conceded too much in the goods trade agreement with ASEAN in order to leverage better deals in the services sector, where it has the strategic advantage. Being the 9th largest exporter of services, accounting for 2.73 percent share in world exports of commercial services, this is where India's competitiveness lies. Moreover, ASEAN is a net importer of commercial services, with service imports amounting to US$180bn in 2007.

Services imports by ASEAN have been rising at a fast rate in recent years, which is indicative of the skill shortages in the region. Indian professionals can contribute significantly towards filling this gap and providing cost-effective services in the region. The areas of mutual interest

Table 2: India and ASEAN Trade Growth in various Agricultural Products

Commodities	Exports (US$mn) 2007-08	Average Annual Export Growth (in percent) 2003-04 to 2007-08	Imports (US$mn) 2007-08	Average Annual Import Growth (in percent) 2003-04 to 2007-08
All Products	16,384.25	22.99	22,674.58	24.99
Agriculture Trade (HS 1-24, HS 40)	2,819.84	19.14	2,713.43	2.75
Cash Crops (HS 03, 08, 09, 18, 20, 40)	410	14.84	418.59	17.52
Fish and crustaceans (HS 03)	83.72	-1.36	1.79	-2.39
Tea, coffee, mate and spices (HS 09)	162.78	40.35	81.69	12.10
Natural Rubber (HS 4001)	27.44	25.03	177.38	30.74
Coffee (HS 0901)	0.17	-29.84	21.38	38.93
Tea (HS 0902)	14.58	30.11	4.30	5.56
Pepper (HS 0904)	107.7	56.94	24.42	11.94
Other spices (HS 0905 - 0910)[9]	40.32	24.15	30.58	4.97

Source: EX-IM databank, Department of Commerce identified for gains from services trade are in finance, education, health, IT and telecommunications, transport, movement of professionals and other business services.

ASEAN is not yet adequately integrated on the services front and also remains relatively closed to foreign service providers. Hence, a preferential deal on services trade with the region will bring significant gains to India. However, the very fact that service sector in the region is protected through strict domestic regulations and various restrictive requirements could make it difficult to reach a fruitful conclusion in services trade. For example, Thailand is already alluding to the need for adequate safeguard measures for protecting its domestic service sector.

Reaching a consensus on liberalising domestic regulations for services trade and Mutual Recognition Agreements on qualifications in professional services, and licensing equivalence agreements are more time consuming and complex compared to tariff reduction modalities. A fruitful conclusion of the agreement on trade in services and investment pertaining to the envisioned Indo-ASEAN regional trade and investment area is expected to bring substantial benefits to India compared to the trade in goods agreement currently in place.

Conclusion

Political intent to deepen ties between India and ASEAN countries appears to overshadow the economic gains. The AIFTA with trade in goods alone is expected to bring modest benefits to India and it is through inclusion of services that this partnership might yield substantial gains to the country. India is eyeing the growing service sectors of ASEAN countries, particularly those with large English speaking populations, given its own competence in these sectors.

India's farm and plantation sectors appear to be well protected via negative and sensitive list in the trade in goods agreement. Criticisms are still being voiced from these sectors on the adverse impact of this FTA on livelihoods of farmers, particularly in the South states specialised in plantation crops. Interest groups are concerned about the short to medium term impacts of this FTA. Nevertheless, it is important to have the larger picture in mind and focus on the long term benefits rather than remain bogged down by the short to medium term transitional costs. However, adjustments in the form of increased investment and reform in the agriculture and plantation sectors could be the need of the day.

Full implementation of the AIFTA will come into force in the next 10 years only. During this 10 year timeframe, many other outcomes such as conclusion of the Doha Round, inking of India-EU FTA, conclusion of various comprehensive regional agreements with Asian countries along with progress in the country's domestic reforms can shift India's competitiveness towards new areas with a change in the country's priority sectors.

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