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Economic Effects of Third Party PTAs on India

Analyses of Some Selected Cases

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Preferential Trade Agreements (PTAs) have proliferated across the globe since 1950s due to many benefits it has offered. When multilateral systems (i.e. WTO in the present context) are hard to coordinate among its entire member countries along with its complex modalities, a PTA can be an alternative mechanism that involves only a selected number of countries with a preferable easy platform to negotiate. This briefing paper intends to identify sectors (in India's export basket) which face competitive pressure from some important third party PTAs and highlight the importance of policy preparedness for safeguarding India's interests in such sectors.

Introduction

The world has witnessed proliferation of PTAs since 1950s (particularly after the formation of WTO in 1995) due to many benefits it has offered across the globe. Given the fact that it benefits only the member countries while affecting non-members therefore, it (the PTAs) offers some creative tension for non-members to think of new trade equations with PTAs members. Analysing effects of PTAs are not an easy task. However, the major effects of PTAs in the short run are to gain market access and attract more investment along with many socio-political benefits.

In addition, proliferation of PTAs and their effects has triggered parallel eruption of research in this area.[1] Between 1950 and 2012, 511 notifications of PTAs have been received by the General Agreement on Tariffs and Trade/World Trade Organisation (GATT/WTO), which have opened many avenues to work closely on their effects on countries.

This briefing paper provides fresh perspectives and insights into some sectors and selected PTAs with economic effects on India from a third party PTAs.

PTAs: Origin and Evolution

The origin of trade in preferential basis has occured long before the creation of the GATT in 1947.[2] However, in modern arrangements, it is the India-Bhutan treaty in 1949 which is regarded as the first formal PTA.[3] But, some of the current literature state that the Treaty of Rome, the precursor to today's European Union (EU), became the first such modern agreement to enter into force in 1958.

Since then, the number of PTAs has grown dramatically, and their economic significance has expanded. Such trade agreements have spread widely throughout the world since the early 1990s, with the total number of PTAs notified to WTO reaching more than 500 in 2012; up from around 50 in 1990. However, it is believed that most successful PTAs have been initiated by the developed countries, particularly EU and the North America. Till recently, all the WTO member countries are holding at least one PTA in their name, except Mongolia.

Role and Importance of PTAs

PTAs in the international trading environment has significantly regulated the day-to-day conduct of international transactions since 1950s after the formation of GATT. In particular, such agreements have rapidly spread after the formation of WTO in 1995 due to slow negotiation processes in the multilateral forum, thus, the importance of PTAs was felt across the globe.

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It is consistent with the fact that PTAs are signed particularly to gain preferential market access and attracting investments. In addition to the above, it is argued that PTAs will go deeper and beyond WTO rules and, also to supplement and complement the multilateral trading system. Also, there exist, socio-political benefits as it deepens and promotes democracy and political stability along with peace and security across the regions.

PTAs: New Dimension of International Trade

Global experience of PTAs shows that in the last two decades, the number of PTAs has increased more than fourfold (WTO Report, 2011). Apart from there are hundreds of PTAs in force that are not being notified to the WTO. Unlike earlier agreements, the motive of PTAs is not limited to avoid relatively high most favoured nation tariff rates, instead the recent PTAs are being motivated with a desire for deeper integration.[4]

The agreements now contain the provisions for broader policy reforms such as services, investment, intellectual property, technical barriers to trade, competition rules, government procurement, commitments on labour environmental issues and even dispute settlement clauses among others.

India maintains a vibrant trade policy with an urge to enhance its global engagements. Keeping in pace with the global expansion of PTAs, India is leading the group of developing countries in signing PTAs not only within the group but also with the developed countries.

Until now, India has passed through three distinct PTA negotiating phases: till 1975, political motivation was the main force behind its PTAs negotiation, up to mid-1990s economics consideration was the guiding force behind, and there after both political and economic consideration drive the negotiating processes. Till now, India has signed nearly 19 PTAs out of which 12 have been notified to the WTO and another 22 are under negotiation.[5]

Economic Impacts of Selected Third Patry PTAs on India

Reductions in tariff and other border measures on a preferential basis can both increase trade among members and decrease trade among non-members. These impacts are termed as trade creation (due to reduced barriers, there is an increase in trade flows between countries) and trade diversion (due to reduced barriers being offered to one or more countries, goods imported from lower-cost suppliers are displaced by goods from higher-cost suppliers due to these suppliers facing lower barriers).

In this brief analysis, some selected PTAs and Regional Trade Agreements (RTAs) namely US-Korea FTA, Turkey-Korea FTA, Chile-Thailand Agricultural Agreements, China-New Zealand FTA, and MERCOSUR-SACU FTA which have been signed or modified recently are taken into consideration to assess their impacts on India's direction of trade and other areas.

The above PTAs have been selected on the basis of their economic proximity, economic supremacy and strategic location with India. In addition to these, future prospects have also taken as a basis because these PTAs will facilitate to explore new avenues.

US-Korea FTA (KORUS)

Recently, US-Korea FTA (KORUS)[6] came into force. India has not signed any such agreement with US, while India-Korea Comprehensive Economic Partnership Agreement (CEPA) is effective since January 01, 2010. Though India is a valued partner to both, the new US-Korea trade equation will have some direct impact on India's trade flows to these countries. Whether or not trade diversion is likely to be significant depends on the difference between preferential and non-preferential tariff lines proposed in the US-Korea Free Trade Agreement (FTA).

On the basis of International Trade Centre (ITC) database for 2011, India and Korea have competitive interest in the US market in at least five product categories, namely mineral fuels, oils, distillation products, etc.; organic chemicals; machinery, nuclear reactors, boilers, etc.; electrical, electronic equipment; and articles of iron and steel in the US market. There are some products in which India has global comparative advantage and may lose the market share in US to Korea under the new scenario.

India and US compete in four product segments in the Korean market, which includes mineral fuels, oils, distillation products; iron and steel; organic chemicals; and machinery, nuclear reactors, boilers, etc. Under the new scenario, the existing competition will get further aggravated and also minimise the advantage of the distance factor which India enjoys now. In the service sectors both US and Korea will be benefited from the strong Intellectual Property Right (IPR) laws present in both countries thus trade diversion will take place at the cost of India's services exports.

Under KORUS, 80 percent of industrial and 70 percent of agricultural exports originated from the US gain duty free entry to the Korean market. Nevertheless, the US exports have shown a

Table 1: Sectors Facing Competitive Pressure in Selected Products			
HS Code	**Product Description**	**India's Competitors**	
I	**US – Korea FTA**	Korea (in US market)	US (in Korean market)
85	Electrical, electronic equipment	✓	
84	Machinery, nuclear reactors, boilers, etc.	✓	
27	Mineral fuels, oils, distillation products, etc.	✓	✓
29	Organic chemicals		✓
72	Iron and steel		✓
II	**Turkey – Korea FTA**	Korea (in Turkey's market)	Turkey (in Korean market)
87	Vehicles other than railway, tramway	✓	
84	Machinery, nuclear reactors, boilers, etc.	✓	✓
39	Plastics and articles thereof	✓	
27	Mineral fuels, oils, distillation products, etc.		✓
72	Iron and steel		✓
III	**Chile – Thailand Agricultural Agreements**	Thailand (in Chilean market)	Chile (in Thai market)
87	Vehicles other than railway, tramway	✓	
84	Machinery, nuclear reactors, boilers, etc.	✓	
85	Electrical, electronic equipment	✓	
03	Fish, crustaceans, molluscs, aquatic invertebrates nes		✓
72	Iron and steel		✓
IV	**China – New Zealand FTA**	New Zealand (in Chinese market)	China (in New Zealand market)
85	Electrical, electronic equipment		✓
62	Articles of apparel, accessories, not knit or crochet		✓
39	Plastics and articles thereof		✓
V	**MERCOSUR – SACU FTA**	SACU (in MERCOSUR market)	MERCOSUR (in SACU market)
27	Mineral fuels, oils, distillation products, etc.	✓	
84	Machinery, nuclear reactors, boilers, etc.	✓	✓
39	Plastics and articles thereof	✓	
87	Vehicles other than railway, tramway		✓
85	Electrical, electronic equipment		✓

Source: Author's compilations based on ITC database, Geneva.

remarkable average annual growth during 2007-11 in competitive product segments, such as mineral fuels, oils, distillation products, etc.; iron and steel; and machinery, nuclear reactors, boilers, etc. which can further increase under this FTA.

Turkey-Korea FTA

Korea and Turkey signed an FTA on August 01, 2012, and is expected to be effective as of January 01, 2013. India has not signed any such agreement with Turkey, while India-Korea CEPA is effective since January 01, 2010. Turkey is geopolitically very important because it connects Europe, Asia, the Middle East and Africa. Once the Korea-Turkey FTA comes into effect, Korean companies will invest more in Turkey. Under the Korea-Turkey new trade equation Korea may get an edge over India, given its competitive presence *vis-a-vis* India.

India faces stiff competition from Korea in the Turkey's market in about six product categories (ITC, 2011). In all of these six categories India's exports lack behind Korea's one. These categories are plastics and articles thereof; vehicles other than railway, tramway; electrical, electronic equipment; machinery, nuclear reactors, boilers, etc.; manmade filaments; and iron and steel. Though India has global advantage in some product categories still it faces stiff competition from Korea.

India and Turkey do not have much competitive interest in the Korean market in value terms. However, it has competition in some products where India is good at exporting. Trade statistics (ITC, 2011) clearly demonstrate that there are four product segments in the Turkey's top ten export products which give competition to the Indian products and also, its exports growing at a convincing pace over 2007-11. Under the new scenario India may lose some market share to Turkey.

Chile-Thailand Agriculture Agreements

Chile and Thailand signed two agriculture agreements on August 15, 2012, as a step to set a common protocol for agricultural exchange and sanitary practices. India has signed an PTA with Chile and a framework agreement under negotiation. However, the PTA is limited in scope and its impact on trade flows and economic benefits is likely to be minimal. India has signed an FTA with Thailand.

The Chile-Thailand new agriculture agreements will pose a threat to India's agricultural exports to Thailand, as Chile is agriculturally vibrant. Once the Chile-Thailand agricultural agreements come into effect, Chilean companies will invest more in Thailand and take advantage of the tariff concession and higher degree of export complementarity exits between them.

Under the new scenario, the existing competition will get further aggravated and also minimise the advantage of the distance factor which India enjoys now. India needs to increase its competiveness in the existing exported products in order to stabilise its current position.

India has a PTA with Chile and, therefore, one can expect that the impact on Indian exports will not be significant as a result of signing of this agreement. However, in non-competing product segments like plastics and articles thereof; rubber and articles thereof; and articles of apparel, accessories, knit or crochet, India could gain in near future as it has a comparatively better average annual growth in these product segments during 2007-11.

The existing trade data show that competition between India and Chile is not intense in the Thai market. However, it is also observed that two countries compete with each other in two product segments, namely iron and steel; and fish, crustaceans, molluscs, aquatic invertebrates' nes. In these two products segments India is better positioned than Chile, but it needs to further strengthen its position in these segments and other non-competing product segments to maintain its edge.

China-New Zealand FTA

On April 07, 2008, New Zealand and China signed a comprehensive bilateral FTA. It was the first bilateral FTA that Beijing signed with a so-called developed country. It entered into force on October 01, 2008. There is no such agreement between India and New Zealand as of now. After China-New Zealand FTA, China's exports to New Zealand increased considerably, whereas India's export (in value term) is not at all convincing (ITC database).

Trade statistics (ITC, 2011) clearly demonstrate that four product categories in China's top ten products compete with the exports from India. These include electrical, electronic equipment; other made textile articles, sets, worn clothing etc.; articles of apparel, accessories, not knit or crochet and; plastics and articles thereof. However, more importantly, China has a definite edge over India in export of all of these four product segments (ITC data base, 2011). India and New Zealand do not have competitive interest in the Chinese market even after signing of China-New Zealand FTA, which clearly show that higher degree of trade complementarity exist between India and New Zealand in Chinese market.

MERCOSUR-SACU FTA

The MERCOSUR-SACU FTA which was signed in the previous decade is regarded as the first ever PTA between two customs unions. India is negotiating a PTA with Southern African Customs Union (SACU) and has already a PTA in operation with MERCOSUR since 2009. The increasing engagements of India with these regional groups will further enhance its plurilateral trade relations. However, in the future there may arise some new equations given their scale effects and distance factor.

In 2011, India's export to MERCOSUR was about six times more than that of SACU and the average annual growth is in favour of India. It appears that the competition between India and SACU is not that intense in the MERCOSUR markets (ITC database 2011). Within MERCOSUR, Brazil is the leading partner with around 100 percent share in India's exports. It may intensify an idea to negotiate a PTA between India and SACU as a result India could gain an edge in some non-competing product segments.

In 2011, India's exports to SACU were nearly 1.5 times more than that of MERCOSUR. Though South Africa has the major share in all product segments which India exports to SACU, it will be beneficial for India to intensify deeper trade relationship with SACU. During 2007-2011, India's exports to SACU increased by about 108 percent, while MERCOSUR exports to SACU has declined (ITC database, 2011).

Table 2: India's Exports in Products Facing Competitive Pressure from PTA Partners (in US$mn)								
Country	**Product Code**	**27**	**29**	**39**	**72**	**84**	**85**	**87**
	Year / RCA 2011	*1.14*	*2.20*	*0.55*	*1.05*	*0.36*	*0.37*	*0.58*
Korea	2001	0.0	38.7	3.6	28.6	10.4	9.3	3.8
	2006	742.3	159.1	8.6	145.9	60.5	18.4	48.9
	2011	4672.6	461.7	35.7	479.5	124.5	78.4	29.3
US	2001	1.7	229.61	79.0	96.0	230.0	238.4	106.8
	2006	237.5	654.6	307.9	763.1	936.3	921.0	463.6
	2011	3258.8	2033.8	419.2	528.6	1896.2	1533.5	970.1
Turkey	2001	0.0	12.4	10.8	13.1	6.3	8.2	7.4
	2006	134.8	90.1	69.9	44.3	47.6	29.5	84.0
	2011	2883.3	416.9	298.2	182.6	229.8	250.7	290.9
Thailand	2001	0.0	52.4	8.1	44.4	16.0	10.5	4.7
	2006	158.9	96.8	18.7	106.8	63.5	16.7	52.7
	2011	151.3	195.2	55.4	174.5	290.9	101.3	188.8
Chile	2001	-	3.4	0.6	2.7	0.8	0.4	4.2
	2006	0.01	8.7	6.1	11.5	12.5	4.8	18.1
	2011	0.6	31.7	14.8	14.2	34.0	16.3	138.7
China	2001	1.4	99.9	114.2	25.0	8.8	8.9	2.1
	2006	61.2	518.5	403.4	404.9	175.8	67.5	6.3
	2011	94.9	989.9	693.9	325.6	478.6	430.6	65.3
New Zealand	2001	0.0	0.8	0.6	1.2	2.2	2.2	0.3
	2006	382.0	2.3	2.7	3.6	4.4	4.0	1.3
	2011	2.2	3.7	6.0	2.8	5.6	10.5	6.5
SACU	2001	0.0	8.9	6.3	16.5	17.7	11.9	16.8
	2006	783.3	61.9	28.8	140.9	75.1	45.4	337.7
	2011	1357.6	116.6	81.7	84.9	164.0	245.1	685.3
MERCOSUR	2001	12.6	101.7	8.7	10.2	12.4	17.9	25.2
	2006	894.3	185.4	38.0	52.8	55.4	28.8	52.4
	2011	3433.7	552.4	158.5	-	304.3	232.6	150.0

Source: ITC Data base, Geneva

ITC Product Code Description:
27 - Mineral fuels, oils, distillation products, etc.; 29 - Organic chemicals; 39 - Plastics and articles thereof; 72 - Iron and steel; 84 - Machinery, nuclear reactors, boilers, etc.; 85 - Electrical, electronic equipment; 87 - Vehicles other than railway, tramway.

RCA 2011: India's Revealed Comparative Advantage (RCA in absolute numbers) in 2011 under respective product codes.

The SACU-MERCOSUR PTA is unlikely to lead to significant trade creation so far trade statistics is concerned. However, a trade complementarity is being found among India, Brazil and South Africa leading to a strong case for IBSA and will further deepen engagements in information technology, biotechnology and pharmaceuticals given its trade potentials.

Conclusion and Recommendations

From the above clinical analysis (on the basis of ITC data and PTA documents), it is observed that there are some sectors[7] namely mineral fuels, oils, distillation products, etc.; organic chemicals, plastics and articles thereof; iron and steel; machinery, nuclear reactors, boilers, etc.; electrical, electronic equipment and vehicles other than railway, tramway putting pressure on Indian exports in the PTAs member markets.

India's export to PTA partners in these products segment is given in Table 2. It shows that in these products segment, exports from India has been increasing in some cases to some countries and decreasing in others due to the presence of new trade equations among the PTAs partner. In these competitive products segment, India has Revealed

Comparative Advantage (RCA) in three products out of seven and in others India do not have, which has to be improved in the future to stay alive in these markets.[8]

To counter the newly formed PTAs, India is also moving in the direction of forming PTAs with these countries. For example, India has signed agreements with Korea, Chile, Thailand, and MERCUSOR, while negotiating and upgrading (the existing ones) with others (in these cases). We are now moving beyond the traditional PTAs with limited scope to a more comprehensive and reciprocal arrangements having wider dimensions. In a proxy to a new dynamic India (so far trade is concerned) we have brought significant domestic policy reforms in the arena of competition policy, IPR regime and environmental issues among others in the line of multilateral commitments.

In order to gain substantially in the sectors from those India is facing competitive pressure from the PTAs; the national government should help the producer to improve its competitiveness. India needs to adopt trade diversification measures, which will increase its competitiveness by broadening the productive base particularly in the manufacturing sectors which have lots of untapped potential. India has to focus on making the processes more efficient, improve its fundamentals, and increase capabilities to effectively integrate with the fast growing PTA regime across the world.

Accordingly, India should cautiously move forward in its current PTA negotiations and support its domestic industries to become more efficient in order to gain benefits from PTAs under negotiations.

Endnotes

1 The WTO and Preferential Trade Agreements: From co-existence to coherence. The World Trade Report 2011 describes the historical development of PTAs and the current landscape of agreements. It examines why PTAs are established, their economic effects, and the contents of agreements themselves. Finally, it considers the interaction between PTAs and the multilateral trading system

2 The World Trade Report 2011

3 India's Experiences on Preferential Trade Agreements, (a CUTS Publication) which states that India has started its PTAs negotiation with Bhutan in 1949

4 In international economic relations and international politics, "most favoured nation" (MFN) is a status or level of treatment accorded by one state to another in international trade. The term means the country which is the recipient of this treatment must, nominally, receive equal trade advantages as the "most favoured nation" by the country granting such treatment

5 Ministry of Commerce and Industry website

6 The entry into force of the US-Korea FTA on March 15, 2012 means countless new opportunities for US exporters to sell more Made-in-America goods, services, and agricultural products to Korean customers – and to support more good jobs here at home. If you are an American exporter, here are resources to answer your questions about how the US-Korea FTA can work for you: www.ustr.gov/trade-agreements/free-trade-agreements/korus-fta

7 Seven potential products face competition in these markets. Please see Table 2

8 RCA has been calculated using the following formula: RCAij = (Xij/ Xwj)/(Xi/Xw) Where, Xij = ith country's export of commodity j Xwj = world exports of commodity j Xi = total exports of country i; and, Xw = total world exports. An RCA index value of more than one reveals that the country has a comparative advantage. The data for calculation of RCA has been taken from Trade Map database of International Trade Centre, Geneva

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