

Dossier on Preferential Trade Agreements

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1. China-Peru sign free trade pact

Chinese President, Hu Jintao and Peruvian President, Alan Garsia signed a free trade agreement between China and Peru, paving the way forward for further cooperation between the two nations and broadening China's influence in Latin America. The deal with China would open new opportunities for Peru in agriculture and manufacturing and an agreement on customs cooperation would protect sectors such as textiles where there were concerns about dumping. Agriculture and fisheries would immediately gain from tariff reductions.

The Chinese President landed in Peru along with a delegation of twelve ministers and almost 600 business leaders who accompanied him to the weekend's Asia-Pacific Economic Cooperation (APEC) summit in Lima. The scale of the Chinese delegation as well as the signing of the FTA by the two countries, even before the summit officially kicked off, underscores expectations in the region about China's future role amidst the global financial crisis. It is expected that the FTA will result in China overtaking the United States as Peru's biggest trade partner.

Mineral rich Peru, which is endowed with large deposits of iron ore and copper, would play a larger role in China's relentless quest for raw materials. The Aluminum Corporation of China Ltd, for instance, recently signed a US\$2.2bn deal to extract more than 7 million tons of copper from Peru's Toromocho mine. China has made similar forays into other South American countries, such as Chile, where it signed a free trade agreement in 2005. Last year, China superseded the United States as Chile's top trading partner. Analysts see a similar situation unfolding in Peru. Similarly, China has made inroads into the crude oil sector exploration sector in Ecuador, Colombia and Venezuela.

Though the United States would continue as an important trade partner, the trade pact with China would diversify Peruvian export markets and thus would minimize the adverse impact of the current recession in the US and the EU and slowing down in Japan on the Peruvian economy. While China has been slow to pick up investment in Latin America compared with Africa, trade between Latin America and the Caribbean and China jumped 13 fold from 1995, to US\$110bn in 2007.

In addition to Peru and Chile, China has already signed free trade agreements with Costa Rica and Cuba. With Cuba, China has signed almost a dozen agreements, including plans to upgrade infrastructures and buy sugar and nickel.

CUTS Comments *China has of late become an important trade partner of India. India's exports to China rose from US\$8.29bn in 2006-07 to US\$10.83bn in 2007-08. India has also initiated negotiations for a FTA with China. Though India's export trade with Peru is relatively insignificant (total trade estimated at US\$125mn in 2006-07) implying that expected loss from diminution of exports due to competition with China is minimal. However, there is some overlap between Peruvian exports to China and Indian exports to the same country. India's exports to China include, among others, commodities like iron & steel, ores, slag, ash, copper, mineral fuels, etc. Some of these items also feature in Peru's list of exports and in course of time the China-Peru FTA may thus affect India's export interests.*

Food for Thought

Should India try for a FTA with Peru or is a FTA with China enough to neutralise the deleterious effects produced by the Sino-Peruvian FTA?

2. Thailand set to sign ASEAN-South Korea free trade agreement

Thailand is expected to sign the ASEAN-South Korea free trade agreement (AKFTA) within this year, negotiations for which started in 2005. All ASEAN members except Thailand signed the agreement on trade in goods and dispute settlement mechanism in May 2006, which took effect two months later. Earlier, Thailand had declined to sign this agreement over differences with Korea regarding the latter's treatment of some agricultural products, particularly rice and livestock. After almost a year of negotiations, Thailand concluded the talks with Korea after Seoul allowed an extension for import tariff reductions on Thai goods from 2010-12 to 2016-17.

South Korea is Thailand's eighth largest trade partner, with a bilateral trade value of nearly US\$7bn. The items given extensions for tax cuts and/or waivers include steel and steel products, cosmetics, raw hides, tanned leather and leather goods. Other products that would benefit from Korea's pledged tariff cuts include electrical appliances, particleboard, plywood, cane molasses, yarn, frozen shrimp, tapioca starch and squid. Thailand will also negotiate with South Korea and the ASEAN for mutual recognition agreement (MRA) for three professions – physicians, dentists and accountants – allowing personnel in these three areas to work freely in ASEAN.

At the ASEAN Summit in December this year two more agreements are scheduled to be signed. They are ASEAN Trade in Goods Agreement (ATIGA) and the ASEAN Comprehensive Investment Agreement (ACIA). ATIGA is an amendment to the ASEAN Free Trade Area Common Effective Preferential Tariff Scheme, which focuses on tariff reduction or elimination for trade in goods while ACIA is also an improvement over two existing ones: the ASEAN Investment Area (AIA) and ASEAN Investment Guarantee Agreement (IGA). ATIGA comprises both tariff and non-tariff elements, including trade discipline on sanitary and phyto-sanitary measures, customs procedures and trade facilitation, among others. The refinements are part of an effort to create a broader ASEAN Economic Community by 2015.

Thailand has been engaged in talks about its role in other free trade agreements under the ASEAN framework including ASEAN -India, ASEAN -Australia and ASEAN-New Zealand.

CUTS Comments *India has already entered into an FTA with Thailand (2003) and as a consequence bilateral trade is increasing, albeit slower than expected. Indian exports were valued at US\$1.81bn and imports at US\$2.3bn in 2007-08, thus corresponding to a trade deficit for India. This trade deficit has appeared in the last two years due to operationalisation of the early harvest scheme (2005-06) contained in the agreement. The industry associations of India have detected and objected to the inverted duty rate structure. Inverted duty rate problem arises when the import duty rate rise along the vertical production chain, i.e., lower duty on raw materials and higher duty on intermediate and final products. There is a significant overlap between exports from India to Thailand and those from Korea to Thailand. For example, commodities like organic chemicals, pearls, precious and semi precious stones, iron and steel and articles thereof, electric machinery etc which are being exported by India to Thailand also appear in the export list of South Korea; therefore, a FTA between South Korea and Thailand will displace Indian goods entering into Thailand.*

India is negotiating a FTA with South Korea. Due to the time lag in the implementation of such an agreement there is a possibility of a trade diversion from India in the interim. South Korea is India's tenth largest export destination capturing about 5.6 percent of India's total exports of US\$159bn in 2007-08. India has significant trade gap with South Korea as its exports are less than half of its imports from Korea. Commodities like organic chemicals, electric machinery, precious and semi precious stones which were hitherto imported by South Korea from India might in the future be procured by it from Thailand.

Food for Thought

India has just concluded FTA negotiations with ASEAN, of which both South Korea and Thailand are members. India has already in place FTA with Thailand. India has invested significantly in Thailand and South Korea while South Korea has also invested heavily in India. It is an interesting empirical question as to how and to what extent India's FTA with ASEAN benefits South Korea and Thailand.

3. Peru, Japan sign investment agreement, eye free trade talks

Peru has signed an investment protection agreement with Japan that may pave the way forward for a free trade agreement (FTA) between the two countries; the talks for a trade accord would begin in February next year when the Peruvian President visits Japan. Trade between Peru and Japan, mainly metals and fish products, jumped 70 percent to about US\$3bn in 2007.

Peru, which has just concluded trade talks with China and announced plans for free trade negotiations with South Korea, is seeking new markets for its products to offset slumping demand in the USA, Peru's main trading partner.

Peru is the gateway that links Asia to the Americas. Relations between Peru and Japan had been strained ever since former Peruvian President Alberto Fujimori, the son of Japanese immigrants, fled to Japan in 2000 as his administration collapsed amid charges of corruption. Japan recognized him as a citizen and denied Peru's extradition requests. He was extradited

last year from Chile. “It was a fundamental objective to rebuild Peru-Japan relations. It has been a steady task to regain trust that never should have been lost”, said Peru’s President.

CUTS Comments *Japan is one of India’s important trade partners in Asia. In 2007-08 India exported US\$3.85bn worth of goods, which, inter alia, included ores, lags, ash, mineral fuels, cotton, apparel, gems and jewellery, organic chemicals, etc. India is currently negotiating a free trade agreement with Japan. India’s trade with Peru was insignificant at US\$125mn in 2006-07. However, there are items of Indian export to Japan which also figure in the list of exportables from Peru to Japan. Thus, some trade diversion from India to Peru is possible.*

Food for Thought

As a consequence of the Peru-Japan FTA there are risks that India might suffer from trade diversion, Will India’s going for a similar free trade agreement with Japan neutralise some of the adverse effects of potential competition that Peru might pose for India in the Japanese market?

4. Canada and Colombia sign free trade agreement

Canada and Colombia signed a free trade agreement ahead of the Asia-Pacific Economic Co-operation (APEC) meeting held on the weekend in Lima, the Peruvian capital. “In a time of global economic instability free trade is more important than ever”, said the Canadian Prime Minister who has been promoting free trade as a solution to the global economic downturn. “By expanding our trading relationship with Colombia, we are not only opening up new opportunities for Canadian businesses in a foreign market, we are also helping one of South America’s most historic democracies improve the human rights and security situation in their country”, he said.

The agreement will provide greater market for Canadian exports such as wheat, pulses, barley, paper products, and heavy equipment. Under the agreement, Colombia will eliminate tariffs on 98 percent of current Canadian exports, some immediately and others over a 5 to 10 year period. Canada will eliminate tariffs on Colombian exports over a 3 to 7 year period. Top Columbian exports to Canada include coffee, bananas, coal, and fuel.

Two-way merchandise trade between Canada and Colombia summed to US\$1.14bn in 2007 with Canada accounting for US\$661.6mn in exports and Colombia US\$473.6mn. The two sides have also signed agreements to enforce labour standards and environmental and taxation rules. Under the labour agreement, Colombia agrees to respect and enforce labour standards such as elimination of child labour, forced labour and workplace discrimination as well as freedom of association and the right to collective bargaining.

The Colombian government has been subject to serious criticism on human rights violation and it is alleged that more labour leaders are killed every year in Colombia than the rest of the world. Canada sees the trade agreement as an opportunity for “deepening both economic and political engagement between the two countries through which Canada can support the citizens of Colombia in their efforts to create a safer and more prosperous democracy”, says the Canadian Prime Minister.

US President George W. Bush has also been a proponent of a free trade agreement with Colombia; however this agreement has been blocked in the Congress by the Democrats over

concerns about violence against labour organisers. US President-elect Barack Obama has also expressed that he is not in favour of a free trade agreement unless Colombia addresses this issue.

CUTS Comments *India's exports to Canada stood at US\$1.1bn in 2006-07, comprising textiles & clothing, chemicals, gems and jewellery, copper, iron & steel and articles thereof. In the absence of a free trade agreement between India and Canada, duty free export products from Colombia such as copper, iron & steel, chemicals etc. could possibly replace Indian exports to Canada.*

In 2006-07 India exported to Colombia US\$757.3mn worth of goods which consisted of mineral fuels, motor vehicles, organic chemicals, pharmaceutical products, iron and steel, electric machinery etc. Some of these commodities find place in the Canadian list of exportable to Colombia, which will now enter duty free; therefore in the absence of a FTA with Colombia, Indian export interests will be adversely affected.

Food for Thought

India's trade with Colombia is not very large. However, it has significant two-way trade with Canada. Trade with both countries, Canada and Colombia, is rising. Therefore, the important question is whether India should go for a FTA with Canada or Colombia or with both. As there are overlaps between India-Columbia and India-Canada trade on the one hand and Canada-Colombia trade on the other, the signing of an FTA with both would eliminate/minimise the adverse effects of possible trade diversion. India has already entered into a preferential trade agreement with Mercosur, of which Colombia is an associate member. But will signing a FTA with Canada neutralise some of the negative impacts of potential competition that Colombia might pose for India in the Canadian market?