

CUTS Dossier on Preferential Trade Agreements

October-December 2019

(Volume XIII, No. 4)

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Seoul, Beijing, Tokyo agree to accelerate trilateral FTA talks

Top trade officials from South Korea, China and Japan agreed to accelerate their trilateral free trade talks and ramp up efforts to conclude a mega Asia-Pacific trade deal, Seoul's trade ministry said.

South Korea's Trade, Industry and Energy Minister Sung Yun-mo met China's Commerce Minister Zhong Shan and Japan's Economy and Trade Minister Hiroshi Kajiyama for talks in Beijing on how to accelerate regional free trade negotiations, according to the Ministry of Trade, Industry and Energy.

The trilateral meeting of trade ministers from the neighboring countries came as economic ties between Seoul and Tokyo have been facing an unprecedented deadlock since Japan imposed restrictions on exports to Seoul of three key industrial materials critical for South Korea's chip and display industries. Japan later removed Seoul from its list of trusted trading partners.

(<http://www.koreaherald.com/view.php?ud=20191222000213>)

CUTS Comments

In order to analyse the impact on India of trilateral FTA between South Korea, China, and Japan, exports from India to each of these countries have been individually examined and compared with exports from other two countries.

a) Impact on Indian Exports to China

India's key exports to China include: organic chemicals; ores, sag and ash; natural pearls, precious stones and precious metals; cotton, including yarns and woven fabrics thereof; fish and crustaceans, molluscs and other aquatic invertebrates. Japan's key exports to China include: parts and engine of motor vehicles, optical devices, parts and machinery of some Information and Communication Technology (ICT) goods. South Korea's key exports to China include: electrical machinery and equipment, and parts and equipment of ICT goods sector.

In order to understand impact on Indian exports to China, three types of analysis have been conducted: FKI (Finger Kreninin Index) analysis, RECPI (Relative Export Competitive Pressure Index) analysis (see **Annexure I**). The FKI analysis measures the degree of similarity between product baskets of two source countries in export of goods to a given destination country. Table 1 shows FKI values for India over a period of five years in Chinese market while considering Japan and South Korea as India's competitors. As indicated in the figure, limited similarity is found in exports of India and two of her competitors. Also, SMART (Simulation-based Market Analysis Tool) analysis has been done to capture India's expected trade diversion in the markets of those countries which are entering into FTAs.

Table 1: India's FKI with Japan and South Korea in China

Competitor	2014	2015	2016	2017	2018
Japan	0.13	0.15	0.15	0.15	0.14
South Korea	0.13	0.12	0.14	0.17	0.19

Source: CUTS Calculations using data from UN Comtrade via WITS 6-digit database and TradeSift software

Despite being substantially different, some of India's exports are common to exports from Japan and South Korea to China. For instance, both India and Japan export human hair, wool/other animal hair, compression-ignition and combustion piston engine to China. Similarly, both India and South Korea export para-xylene, polypropylene, human hair, and wool/other animal hair to China.

The RECPI analysis compares the degree of competitiveness between India and its competitor countries in exporting common products to a particular destination market, China in this case. Table 2 below presents findings of RECPI analysis of India in Chinese market with Japan and South Korea as two competitors. While Japan does not appear to have competitive advantage over India in export of common products to China, South Korea appears to have gained such advantage, especially since 2015.

Table 2: India's RECPI with Japan and South Korea in China

Competitor	2014	2015	2016	2017	2018
Japan	0.59	0.84	0.89	0.81	0.58
South Korea	0.94	1.01	1.28	1.58	1.82

Source: CUTS Calculations using data from UN Comtrade via WITS 6-digit database and TradeSift software

The SMART analysis provides an opportunity to obtain a better insight of trade diversion that India may experience on account of FTA between other countries. Table 3 showcases trade diversion (and extent thereof) likely to be experienced by India in the Chinese market as a result of Japan and China entering into an FTA. Exports from India of refined copper cathodes and sections of cathodes, nucleic acids and salts, are likely to be adversely impacted.

Table 3: India's Expected Trade Diversion from Japan in China

Product Code	Product Description	Trade Diversion Effect (in thousand US\$)
670300	Human Hair, Wool/oth Animal Hair	-6564.48
840890	Compression-igntn Int Combustion Piston Eng	-4062.42
740311	Refined Copper Cathodes and Sections of Cathodes	-3590.02
290243	Para-xylene	-3513.07
293499	Nucleic Acids & Salts	-2028.19
850440	Static converters	-1378.50
870840	Gear Boxes for Motor Vehicles	-1366.44

Source: CUTS Calculations using data from UN Comtrade via WITS 6-digit database and TradeSift software

Table 4 showcases trade diversion (and extent thereof) likely to be experienced by India in Chinese market as a result of South Korea and China entering into an FTA. Exports from India of polyethylene having a spec gravity and polypropylene are likely to be adversely impacted.

Table 4: India's Expected Trade Diversion from South Korea in China

Product Code	Product Description	Trade Diversion Effect (in thousand US\$)
290243	Para-xylene	-9053.15
390210	Polypropylene	-2213.53
670300	Human Hair, Wool/oth Animal Hair	-1455.82
390120	Polyethylene Having a Spec Gravity	-1318.95

Source: CUTS Calculations using data from UN Comtrade via WITS 6-digit database and TradeSift software

As can be inferred from the tables above, some products are exported by all three countries: India, Japan, and South Korea to China. These include para-xylene, human hair, and wool/other animal hair. In case of a tripartite FTA between China, Japan and South Korea, exports of such products from India to China may be substantially adversely impacted.

Food for Thought

Owing to a tripartite FTA between China, South Korea and Japan, India faces the prospect of substantial trade diversion to Japan and South Korea with respect to some of its exports to China. This may result in widening of already expanding trade deficit between India and China.

Consequently, India may need to bargain for special tariff lines for some of its exports with China. It will also need to enhance domestic competitiveness by promoting effectively competition in domestic markets and enabling access to inputs at globally competitive prices. India may also need to look for other export destinations for products likely to be adversely impacted by the tripartite FTA, and may also need to promote innovative value-added variants to strengthen its position in products facing competitive pressure in destination countries like China.

For instance, it has been reported that global paraxylene markets are witnessing price declines owing to dull demand trends.¹ Environment related concerns have also led to promotion of renewable alternatives like bio-paraxylene to petroleum-based paraxylene.² India should consider focusing research and development efforts on such products to counter possible trade diversion effects owing to the tripartite FTA.

b) Impact on Indian Exports to Japan

Key products exported from India to Japan include: petroleum products, chemicals, elements, compounds, non-metallic mineral ware, fish & fish preparations, metalliferous ores & scrap, iron & steel products, and machinery etc. Key products exported from China to Japan comprise ICT goods. These are not similar to exports from India. However, both India and South Korea export some common petroleum products to Japan.

This can be verified by FKI analysis. As highlighted in table 5 below, limited similarity exists in product baskets of India and China when it comes to exports to Japan. The similarity increases when comparison shifts to product baskets of India and South Korea for exports to Japan.

Table 5: India's FKI with China and South Korea in Japan

Competitor	2014	2015	2016	2017	2018
China	0.14	0.16	0.17	0.17	0.18
South Korea	0.28	0.25	0.22	0.21	0.25

Source: CUTS Calculations using data from UN Comtrade via WITS 6-digit database and TradeSift software

Key common exports from India and China to Japan include blouses, shirts, container bags etc. Key common exports from India and South Korea to Japan include food preparations, ferromanganese etc. The RECPI analysis suggesting competitiveness among source countries to Japan indicates in table 6 below that China has recently caught up with India on exports of common products. It appears that South Korea has always been ahead of India in terms of exporting common products and has been extending its lead by improving competitiveness in recent years.

¹ <https://www.fibre2fashion.com/market-intelligence/textile-market-watch/paraxylene-price-trends-industry-reports/15/>

² <https://mcgroup.co.uk/researches/paraxylene-px>

Table 6: India's RECPI with China and South Korea in Japan

Competitor	2014	2015	2016	2017	2018
China	0.34	0.51	0.66	0.49	1.01
South Korea	0.94	1.01	1.28	1.58	1.82

Source: CUTS Calculations using data from UN Comtrade via WITS 6-digit database and TradeSift software

A better understanding of trade diversion likely to be experienced by India from China with respect to its exports to Japan is provided in Table 7 below, which highlights findings of the SMART analysis. Exports of key products from India likely to be adversely impacted include women or girl's cotton readymade garments, and footwear, owing to favourable export terms likely to be experienced by Chinese industry as a result of the FTA.

Table 7: India's Expected Trade Diversion from China in Japan

Product Code	Product Description	Trade Diversion Effect (in thousand US\$)
620630	Blouses Shirts & Shirt Blouses Cotton, not Knit	-3902.16
620442	Women's or Girls' Dresses of Cotton, Not Knitted	-2297.27
420292	Container Bags, Boxes, Cases And Satchels Others	-2199.65
640399	Footwear, Outer Sole Rub etc & Leather Upper	-1523.68
621142	Cotton Track suits, ski suits, swimwear of women and girls	-1043.17

Source: CUTS Calculations using data from UN Comtrade via WITS 6-digit database and TradeSift software

Similarly, Table 8 highlights trade diversion likely to be experienced by India from South Korea in Japanese market. Despite enjoying higher competitiveness and prospect of favourable duties, the trade diversion advantage experienced by the South Korean industry may not be substantial, perhaps owing to the limited quantity of exports from India to Japan of such common products.

Table 8: India's Expected Trade Diversion from South Korea in Japan

Product Code	Product Description	Trade Diversion Effect (in thousand US\$)
210690	Food Preparations Nesoi	-158.95
720211	Ferromanganese	-145.03
290391	Chlorobenzene	-127.11
130219	Vegetable Saps And Extracts	-120.64
210120	Tea or Mate Extracts/essences/concentrates & Preps	-111.23
320417	Pigments & Preparations Based Thereon	-100.35

Source: CUTS Calculations using data from UN Comtrade via WITS 6-digit database and TradeSift software

Food for Thought

Owing to the tripartite FTA between South Korea, Japan, and China, Indian readymade garment exports to Japan face the prospect of experiencing substantial competitive pressure from Chinese products. To address such concerns, India may need to negotiate special tariff lines with Japan, and leverage the full potential of the Comprehensive Economic Partnership Agreement between India and Japan.³ India will also need to work towards improving its domestic competitiveness of the industry which burdened with high costs and stringent compliances.⁴ It is heartening to note that the Government of India has invited proposals to study Japan's textile and apparel industry to boost domestic exports and enhance mutual collaboration.⁵ These steps are in right direction and would need to be pursued vigorously.

c) Impact on Indian Exports to South Korea

Key exports from India to South Korea include: intermediate inputs of heavy industries: not alloyed aluminium; zinc; lead; copper; ferrochromium; and iron ores etc. China's key exports to South Korea include: high-tech ICT goods. Japan's key exports to South Korea include: mix of intermediate inputs of heavy industry; machines, parts, and accessories of high-tech knowledge based electric industry. It appears that some petroleum products are common in export baskets of India, China, and Japan to South Korea.

This can be validated through findings of FKI analysis of product baskets of India, China and Japan for exports to South Korea, as highlighted in Table 9 below.

Table 9: India's FKI with China and Japan in South Korea

Competitor	2014	2015	2016	2017	2018
China	0.12	0.13	0.13	0.13	0.13
Japan	0.12	0.13	0.14	0.13	0.15

Source: CUTS Calculations using data from UN Comtrade via WITS 6-digit database and TradeSift software

Common exports from India and China to South Korea include sesamum seeds, vegetable saps etc. Common exports from India and Japan to South Korea include synthetic organic pigments, electrical control and distribution boards. In order to gauge competitiveness among countries in such common products, RECPI analysis was conducted, findings of which are presented in Table 10 below. It appears that while India enjoyed competitive advantage over China and Japan with respect to exports of common products to South Korea, these countries have begun to catch-up.

Table 10: India's RECPI with China and Japan in South Korea

Competitor	2014	2015	2016	2017	2018
China	1.02	0.64	0.37	0.35	0.66
Japan	0.98	0.37	0.47	0.40	0.76

Source: CUTS Calculations using data from UN Comtrade via WITS 6-digit database and TradeSift software

³ <https://www.tpci.in/blogs/indias-apparel-exports-getting-back-to-the-drawing-board/>

⁴ https://www.business-standard.com/article/economy-policy/india-s-garment-exports-stagnant-on-high-costs-compliance-burden-119041800484_1.html

⁵ <https://www.outlookindia.com/newscroll/govt-invites-proposals-to-study-japans-textile-apparel-industry/1707261>

To better understand possible trade diversion from India to China in South Korea market owing to favourable duties as a result of the tripartite FTA, SMART analysis was carried out. Findings of such analysis are presented in Table 11 below, which highlight possibility of substantial trade diversion in exports of sesamum seeds and essential oils.

Table 11: India's Expected Trade Diversion from China in South Korea

Product Code	Product Description	Trade Diversion Effect (in thousand US\$)
120740	Sesamum seeds	-34231.32
130219	Vegetable saps and extracts nes	-3036.96
330190	Essential oils, terpenic by products etc., nes	-2491.48
540233	Textured yarn nes, of polyester filaments, not retail	-1977.68
560392	Nonwovens Not Of mmf	-1049.42

Source: CUTS Calculations using data from UN Comtrade via WITS 6-digit database and TradeSift software

Similarly, India's exports to South Korea of synthetic organic pigments and preps based thereon, diesel engines for motor vehicles, may be adversely impacted owing to favourable terms offered to Japan for export such items by South Korea, under the tripartite FTA. This has been highlighted in Table 12 below.

Table 12: India's Expected Trade Diversion from Japan in South Korea

Product Code	Product Description	Trade Diversion Effect (in thousand US\$)
320417	Synthetic organic pigments and preps based thereon	-1879.59
853710	Electrical control and distribution boards	-739.83
840820	Engines, diesel, for motor vehicles	-735.31
293090	Organo sulphur compounds	-706.77
293339	Heterocyclic compounds with unfused pyridine ring	-527.93

Source: CUTS Calculations using data from UN Comtrade via WITS 6-digit database and TradeSift software

Food for Thought

Sesamum seeds are one of the key export products of India. As indicated, India is likely to face competitive pressure from China for export of sesamum seeds to South Korea, owing to the tripartite FTA between China, South Korea and Japan. In order to avoid such adverse impact, India may need to negotiate special tariff lines from South Korea for export of sesamum seeds. It will also need to enhance domestic competitiveness to compete effectively with China. It has been reported that Indian exporters are facing challenges in exports of sesamum seeds to EU owing to some certification requirements.⁶ Such challenges will need to be resolved quickly to avoid possible adverse impact on India's exports.

⁶ <http://www.iopepc.org/from-chairmans-desk.php>

2. US and Japan to discuss next trade talks in early 2020, USTR says

The United States and Japan will begin consultations early next year in order to enter negotiations on a broader trade agreement than the one signed in October, 2019.

U.S. Trade Representative Robert Lighthizer said in the statement that President Donald Trump is expected to sign the implementing proclamation for the recently signed agreement next week.

The recently signed deal focuses on tariff cuts for goods things as agricultural and industrial products, while sidestepping more contentious areas such as automotive tariffs.

(<https://www.japantimes.co.jp/news/2019/12/05/business/us-japan-trade-talks-early-2020/#.XjFp4k8zaM9>)

CUTS Comments

a) Impact on Indian Exports to USA

USA is India's largest export destination. India enjoyed a positive trade balance with USA of USD 12.72 billion in 2018. Although India has no Free Trade Agreement with USA, however, it has been enjoying benefits under the Generalised System of Preferences scheme for exports of select products to USA. Such benefits were revoked in June 2019.

The trade surplus enjoyed by Japan's in its trade with USA is more than four times of trade surplus enjoyed by India, amounting to USD 57.09 billion in 2018. Major contributors of such surplus include motor vehicles and auto parts, high value parts and machinery of aircraft, turbojets etc. Motor vehicles and its parts are also India's key export items to USA. However, export volume of such products from India is not as high as Japan. Other key export items from India include petroleum products, shrimps, diamonds, jewellery products, and cotton textile items.

Substantial difference exists between export baskets of India and Japan to USA, as has been validated by FKI analysis presented in the table 13 below. Naturally, given the small number of common products, the competitive pressures experienced by both the countries for exporting products to USA are also negligible. The RECPI analysis indicated in Table 13 also validates this assumption.

Table 13: India's FKI and RECPI with Japan in USA

India's FKI with Japan in USA					
Competitor	2014	2015	2016	2017	2018
Japan	0.15	0.15	0.15	0.16	0.18
India's RECPI with Japan in USA					
Competitor	2014	2015	2016	2017	2018
Japan	0.08	0.11	0.11	0.17	0.27

Source: CUTS Calculations using data from UN Comtrade via WITS 6-digit database and TradeSift software

To better understand possible trade diversions experienced by India owing to preferential treatment of Japanese industry under the USA-Japan FTA, a SMART analysis was conducted, findings of which are presented in Table 14 below. Given Japan's competitiveness in high value automobiles and similar products, India's exports of such products to USA may be adversely impacted.

Table 14: India's Expected Trade Diversion from Japan in USA

Product Code	Product Description	Trade Diversion Effect (in thousand US\$)
870323	Automobiles, spark ignition engine of 1500 3000 cc	-6016.88
848299	Bearing races, rings for bearing races	-2455.27
848220	Bearings, tapered roller, including assemblies	-1154.58
848390	Parts of power transmission etc equipment	-1103.21
848190	Parts of taps, cocks, valves or similar appliances	-523.91

Source: CUTS Calculations using data from UN Comtrade via WITS 6-digit database and TradeSift software

Food for Thought

Given the possibility of adverse impact on its export of automobile and related products to USA, India will need to speed-up its negotiations with USA for entering in an FTA. In the interim, it may negotiate special tariff lines for exports of such products to USA. It has been reported that India is likely to seek greater market access from USA for its automobile, auto components and engineering goods, which is a step in the right direction.⁷ However, India will need to do much more to revive the ailing domestic auto industry and enhance its competitiveness.⁸

b) Impact on Indian Exports to Japan

India's key export items to Japan are petroleum products, diamond, shrimp, cashew, not alloyed aluminium, ferrosilicon, ferrochromium, and Polyethylene etc. USA's key exports to Japan are petroleum oils, bituminous coal, propane, maize seed, fresh or chilled boneless bovine cuts, medicines and instruments for use in medical sciences etc.

It is evident from the FKI analysis mentioned in table 15 below that limited similarity exists among India's and USA's export baskets to Japan. Naturally, the RECPI analysis also suggests limited competitive pressure exerted by both exporting countries on each other for their exports to Japan.

⁷ <https://www.dailypioneer.com/2020/top-stories/us-trade-representative-lighthizer-likely-to-visit-india-next-month-to-finalise-trade-package.html>

⁸ https://www.business-standard.com/budget/article/budget-lacks-immediate-measures-to-revive-ailing-sector-auto-industry-120020101395_1.html

Table 15: India's FKI and RECPI with USA in Japan

India's FKI with USA in Japan					
Competitor	2014	2015	2016	2017	2018
USA	0.11	0.12	0.14	0.14	0.14
India's RECPI with USA in Japan					
Competitor	2014	2015	2016	2017	2018
USA	0.23	0.35	0.49	0.50	0.79

Source: CUTS Calculations using data from UN Comtrade via WITS 6-digit database and TradeSift software

To get a better understanding of possible trade diversion experienced by India from USA in Japanese market, SMART analysis has been conducted, findings of which are presented in Table 16 below. Owing to limited common products, the possible adverse impact on Indian industry is likely to be limited, despite USA benefiting from favourable trade terms under the USA-Japan FTA. Exports from India of egg yolks dried to Japan may be adversely impacted.

Table 16: India's Expected Trade Diversion from USA in Japan

Product Code	Product Description	Trade Diversion Effect (in thousand US\$)
40811	Egg Yolks Dried	-739.35
130219	Vegetable saps and extracts nes	-363.44
711319	Jewellery and parts of precious metal except silver	-306.53

Source: CUTS Calculations using data from UN Comtrade via WITS 6-digit database and TradeSift software

Food for Thought

Owing to USA-Japan FTA, Indian exports of egg yolks to Japan are likely to be adversely impacted. It has been reported that despite being one of largest egg producers in the world, India does not meet international standards, and Indian eggs are rejected in exports due to chemicals in and outside the shells.⁹ Also, India has handful of egg processing plants, which has resulted in India's potential in exporting egg yolks remaining unexplored.¹⁰ There is a need to address such challenges in export of egg yolks to prevent possible adverse impact on India's exports.

⁹ <https://www.thestatesman.com/supplements/8thday/quality-egg-issue-1502756802.html>

¹⁰ <https://indianexpress.com/article/india/poultry-industry-egg-india-chicken-6061353/>

Annexure I

FK Index

The Finger Kreninin (FK) index provides a way of measuring how similar are two sets of numbers. In principle it can be used to compare the similarity between either the structure of a country's imports or exports with any two partner countries, to indicate how similar is a country's export pattern to its import pattern, whether geographically or by product; or to compare the structure of production in two different countries.

FK to a Destination Country

This version of the FK index compares the export patterns of two countries into a given market (for example, UK and South Korea's exports to the world or to the European Union). Another way of thinking about this is that it compares how similar are the imports of a given country from two different suppliers. This version of the indicator is useful for example if you want to consider the overall similarity of the exports of two countries, and therefore their degree of competitiveness / complementarity either with respect to particular markets, or with respect to their trade with the world.

The formula for the FK index to a destination country is as follows:

$$FK_{i_1 i_2 j} = \sum_k \min \left[\left(\frac{x_{i_1 j}^k}{X_{i_1 j}} \right), \left(\frac{x_{i_2 j}^k}{X_{i_2 j}} \right) \right]$$

In the FKI by destination, i_1 and i_2 to the two source countries and j to the destination country. x^k refers to the trade flow in product k ; X to the total trade flow, so $x_{i_1 j}^k/X_{i_1 j}$ is the share of product k in country i_1 's total exports to the destination partner (j). $x_{i_2 j}^k/X_{i_2 j}$ is the share of product k in the comparator country's (i_2) total exports.

RECPI

The Relative Export Competitive Pressure Index (RECPI) is designed to explore the average degree of competition country i_1 faces in country j 's market from country i_2 , by taking into account both the structure and level of competing countries' trade. Country i_1 will be interested in the value of country i_2 's exports to country j , and also in the extent to which country i_2 's exports are in direct competition with country i_1 's exports.

RECPI is defined for exporter i_1 with respect to competitor i_2 in market j as:

$$RECPI = \frac{\sum_k s_{i_2 j}^k x_{i_2 j}^k}{\sum_k s_{i_1 j}^k x_{i_1 j}^k}$$

where k refers to the product, i_1 to the reporting country, i_2 to the competitor country, and the s and x data refer to a given export destination, country j . $x_{i j}^k$ is the value of country i 's exports to country j of good k , and s_i^k gives the share of good k in country i 's exports to country j . The RECPI is a summary measure which aggregates information from across a range of sectors, subsectors or products. Hence the index can be provided either for all trade, or for particular sectors – in all cases on the basis of more detailed sub-sectoral or product level detail.