India and Preferential Trade Agreements

The Path Traversed and the Road Ahead

CUTS International

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Acronyms

AEU	Asian Economic Union
AIELTF	ASEAN-India Economic Linkages Task Force
ASEAN	Association of Southeast Asian Nations
BIST-EC	Bangladesh-India-Sri Lanka-Thailand Economic Cooperation
BIMSTEC	Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation
BPO	Business Process Outsourcing
BTAs	Bilateral Trade Agreements
CECA	Comprehensive Economic Cooperation Agreement
CEPA	Comprehensive Economic Partnership Agreement
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GCC	Gulf Cooperation Council
GDP	Gross Domestic Product
EFTA	European Free Trade Association
EHP	Early Harvest Programme
EHS	Early Harvest Scheme
EM	European Market
EU	European Union
FDI	Foreign Direct Investment
FTA	Free Trade Agreement
IBSA	India-Brazil-South Africa
ICT	Information and Communication Technology
IMF	International Monetary Fund
IPRs	Intellectual Property Rights
ISLAFTA	Indo-Sri Lanka Free Trade Agreement
LDCs	Least Developed Countries
LDCS	Least Developed Contracting States
MFN	Most Favoured Nation
MRAs	Mutual Recognition Agreements

NAFTA	North American Free Trade Agreement
NTBs	Non-Tariff Barriers
NLDCS	Non-Least Developed Contracting States
PTA	Preferential Trade Agreement
QRs	Quantative Restrictions
RoO	Rules of Origin
RTA	Regional Trade Agreement
SAARC	South Asian Association for Regional Cooperation
SACU	South African Customs Union
SAFTA	South Asian Free Trade Agreement
SAPTA	South Asian Preferential Trade Agreement
S&DT	Special and Differential Treatment
SPS	Sanitary and Phyto-Sanitary Measures
T&C	Textiles & Clothing
TRQ	Tariff Rate Quota
WTO	World Trade Organisation

1 *Introduction*

The 1990s is widely seen as the decade of globalisation, during which India, with around one-sixth of the world's population, shed off its protective cocoon to participate more vigorously in the world's economy. All along, this decade saw a spate of new generation preferential/regional/free trading agreements[1] (PTAs/RTAs/FTAs) all over the world. Among the early new generation agreements were a single European Market (EM) by the European Union (EU) in 1992 and North American Free Trade Agreement (NAFTA) in 1994. Since the 1990s bilateral trade agreements (BTAs) have been negotiated by countries as diverse in size, location and affluence as Chile, China, US, Japan, South Africa, Australia, Singapore and Switzerland.

These new generation RTAs, unlike the ones from the previous generation[2], are characterised by very deep integration with strong rules of origin (RoO) and a mobility of capital and sometimes even labour. Currently, around 300 such PTAs are under negotiation and more than 50 percent of world trade is being conducted on preferential rather than on most favoured nation (MFN) basis. The parties to such negotiation include many developing countries (see RIS Policy Brief, 2005).

The rationale behind PTAs is that PTA members become more attractive destinations for trade and investment than non-members. Thus, formation of PTAs causes non-members to themselves enter into new PTAs or become members of existing PTAs. While multilateralism is the best policy for nations if the objective is maximisation of global welfare a multilateral agreement on many controversial issues does not yet seem to be in sight. PTAs remain the best answer for developing countries like India when others have already started entering into such agreements.

Such regionalism should not be misconstrued as going against globalisation. In fact, this trend known as "New Regionalism" has been interpreted as being caused by the desire of major developed countries to strengthen the competitiveness of their industries in the context of completion of the Uruguay Round of trade negotiations. The integration caused by these RTAs is motivated by a desire to exploit economies of scale and specialisation.

There is also another objective behind PTAs. The world's most powerful governments like the US and the EU are competing more and more to sign bilateral/regional deals with the same countries in order to serve their distinct geopolitical and strategic agendas.

India's first new age PTA was signed with Sri Lanka in 1998. Till date, India has signed only five FTAs and six other PTAs.

However, India's participation in the New Regionalism is sure to receive a boost as a large number of agreements are currently being negotiated. This paper assesses the evolution of India as a PTA participant and reviews its role in PTAs so far. It puts forward policy implications for India's future participation in PTAs.

2
India's Progression: From a Closed Economy to Involvement in PTAs

Till the mid-1980s the Indian economy was characterised by the *License Raj*, i.e. economic activity was regulated by a proliferation of license requirements which limited freedom in entrepreneurial activity. India was also protected from the outside world by high tariff walls and non-tariff barriers (NTBs), especially quantitative restrictions (QRs). Import substituting industrialists who held the quota of licences provided by the government could produce and reap profits with scant regard for efficiency (for a short and succinct description of the Indian economy in that period, see Panagariya, 2004).

Things started turning around in the 1980s. Some delicensing and deregulation was undertaken in certain segments of the economy which introduced competition in these segments. Competition increased efficiency which meant that the there was an increase in the number of entrepreneurs who could produce for the world market. This phenomenon led to the beginnings of a powerful export lobby.

India has always been a key participant in multilateral negotiations ever since the formation of the General Agreements on Tariffs and Trade (GATT). In fact, Indian negotiators played an important role even in the Tokyo Round in the 1970s. However, India's role in such negotiations had been driven mainly by the government and the diplomatic community. With the domestic deregulation of the 1980s an export lobby emerged which influenced the Indian stance at multilateral negotiations. The tariff reduction by developed countries in the Uruguay Round was leveraged partially by Indian exporters who wanted to avail cheaper imports of capital goods and other inputs (see Baldwin, 2006 for a discussion on similar but not identical leveraging caused by formation of export lobbies).

During the same time, the Government started using fiscal policies to increase domestic demand and stimulate economic growth (see Panagariya, 2004). With fiscal and balance of payments deficits rising, matters came to a head in 1991 due to which the government was forced to undertake a significant unilateral liberalisation of its trade policies which included reduction in its tariff as well as NTBs. From all accounts this had the partial backing of the new generation of entrepreneurs who had prospered without some of the tight controls of the *License Raj* and were eager to seize the advantage that cheaper imports would bestow on their productivity.

With the help of efficiency inducing competition and cheaper imports the Indian exporting class soon came into its own. In 1990-91, exports as a percentage of gross domestic product (GDP) was 5.72 percent. By 1995-96, this ratio touched almost nine percent (see www.indiastat.com for figures on Indian exports) despite a rate of growth in GDP which had reached six percent per annum.

The growth of exports meant that the Indian export lobby became sizeable. In sum, unilateral liberalisation led to a larger export lobby which was hungry for more growth and could impact India's stance in multilateral negotiations to a greater extent (see Baldwin, 2006 again for the relationship between lobby size and lobbying power). Unfortunately, the effects of greater lobbying power in the post 1991 period have not been seen explicitly yet because of the hiatus in the Doha Round.

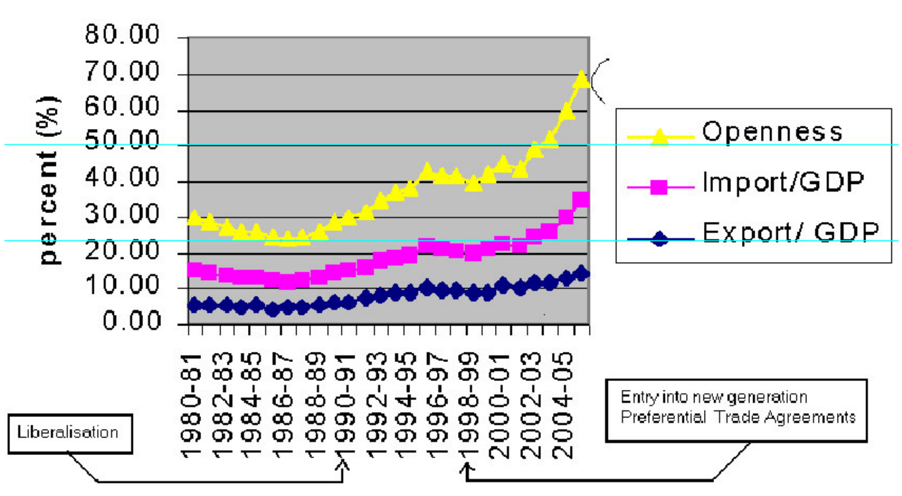
India's recent involvement in PTAs can be seen as partially an outcome of the impasse in the Doha Round which has blocked the expansion in trade as desired by the export lobby (see Mehta and Narayanan, 2006 for an excellent discussion of the motivation underlying India's involvement in RTAs) and partially related to the fears of getting left behind in the new global engagement in PTAs. Like other countries India was influenced by the success of early new generation PTAs such as the NAFTA and the EM.

India apparently remains committed to the World Trade Organisation (WTO) and sees its engagement in PTAs as a progression towards the next breakthrough in multilateralism. Even the WTO Consultative Board Report (2004) known as the Sutherland Report acknowledges the potential benefits of EU and NAFTA as it spurs the "more hesitant development of the Multilateral System".

Moreover, as Baldwin (2006) points out, towards the end of the 20th century there were a lot of activities in Asia as far as entering into PTAs was concerned. China's entry into an FTA with Association of Southeast Asian Nations (ASEAN) meant that countries not in this coalition had to find other ways of attracting trade and investment. This probably explains, at least partially, why India has recently entered into so many PTA negotiations including one with ASEAN +3 (including China).

However, other considerations have also motivated India's engagement in PTAs. First, it is an obvious reaction to increasing participation by neighbours in such agreements with India not wanting to suffer through RTA based discrimination (that comes from not being part of a RTA) as well as WTO consistent treatment such as safeguards. Second, India wants to diversify its markets and its engagement in PTAs is part of its "Look East" Policy. Third, there are some geo-political-economic considerations. The give and take involved in RTAs, it is felt, might result in more friendly relations with its neighbours (peace dividend).

Figure 1: Trends in Export/GDP, Import/GDP and Openness Ratios (1980-2006)



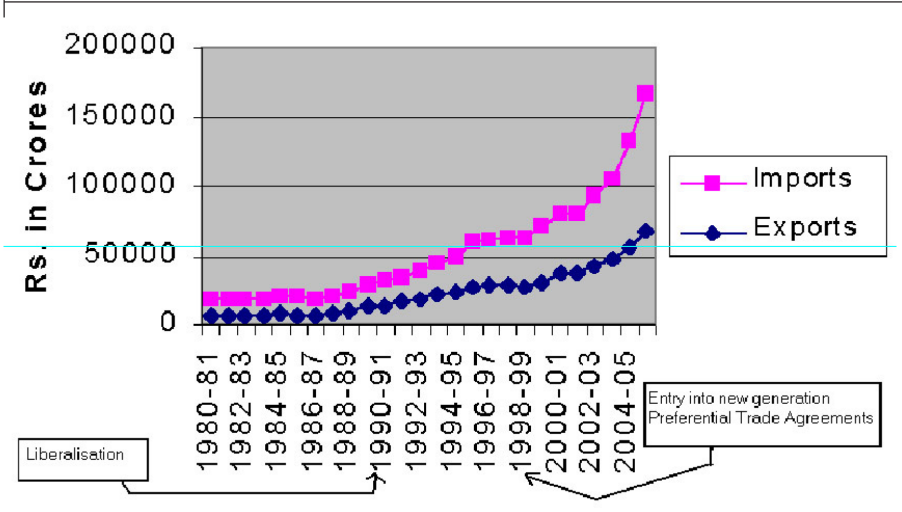
Source: Derived from official data compiled by www.indiastat.com

Moreover, these would stimulate the Mutual Recognition Agreements (MRAs) that are needed for trade in services and the establishment of practices by Indian professionals abroad. Last, more trade with neighbours would facilitate a greater welcoming attitude to Indian foreign direct investment (FDI) in these countries. India and its neighbours also hope to gain from a restructuring of industry that would exploit the potential for economies of scale in this region through common markets for many products and possible diffusion of the best technologies and practices.

A retrospective look at the last quarter century of Indian trade performance does provide an idea of the future prospects of India's engagement in PTAs. The period from 1980-81 onwards can be split into three parts: multilateralism without liberalisation (1980-81 to 1990-91); multilateralism after unilateral liberalisation (1991-92 to 1997-98); and engagement in new generation PTAs (1998-99 onwards, with India continuing to participate in multilateralism). Over the first phase which was an 11-year period, India's export to GDP (X/GDP) ratio increased from 5.16 percent to 6.37 percent and exports grew at an annual average rate of 6.68 percent (see Figures 1 and 2 for a comparison of export and import performance over the three phases). The 8-year long second phase saw a much steeper increase in the X/GDP ratio from 6.37 percent at the end of the first phase to 8.67 percent with the annual growth rate of exports also increasing to 9.28 percent.

The third phase has seen Indian engagement in new generation PTAs but it has also been accompanied by other significant developments such as the dismantling of tariff barriers in the developed world (as well as a reduction in their levels in developing countries including India). This phase has been marked by an even faster spurt in the X/GDP ratio from 8.67 percent at the end of the second phase to 14.04 percent in 2005-06. Exports too have grown at a faster annual rate of 13.69 percent per annum. Thus,

Figure 2: Trends in Exports and Imports (1980-2006)



Source: a) Derived from official data compiled by www.indiastat.com b) All values are at 1980-81 prices

engagement in PTAs has been associated with an improvement in India's export performance. At least some of it can be directly attributed to successful PTAs such as the India-Sri Lanka FTA which has generated a boom in the trading relations between the two countries.

An appeal to trade data can be used to estimate the contribution of PTAs to the export boom in the third phase. The combined share of PTAs in India's export has been in the range of 7-11 percent. Data also indicate that in the period 1999-2006 the annual rate of growth of India's exports to its PTA partners has been about 12 percentage points higher than that for India's total exports.

Given the share of these countries in India's total exports, we can say that exports to these countries have been increasing the rate of growth of Indian exports by 1.4 percentage points every year, i.e. in the absence of this positive effect the rate of growth of total Indian exports for this period would have been around 12.3 percent per annum and the X/GDP ratio would have reached 12.9 percent in 2005-06 instead of the actual figure of 14.04 percent. In other words, we can conclude that PTAs contributed 1.24 percentage points out of the 5.35 percentage point increase in the X/Y ratio in this period, i.e. around 23 percent of the total. Thus, PTAs have already played a considerable role in export augmentation which holds promise for the future.

We can do a similar analysis for the trends in the import/GDP (M/GDP ratio) with the three landmarks, including: 1990-91 (beginning of unilateral liberalisation); 1995-96 (further liberalisation of Indian tariffs); and 1998-99 (the beginning of India's engagement in PTAs). Starting with an M/GDP ratio of 9.64 percent in 1980-81 the value of this ratio declined to 8.45 percent in 1990-91 and then recovered to new highs in 1995-96 (11.5

percent), 1998-99 (12.05 percent) and 2005-06 (20.31 percent). Thus, both tariff decreases (whether unilateral or dictated by multilateral agreements) and engagement in PTAs led to an increase in the M/GDP ratio; however, the rise in the M/GDP ratio in the period of PTA engagement has been much steeper than before.

It deserves mention though that much of the rise in imports has been dictated by the fact that India has entered a higher stage of development. The rise of the middle class has resulted in a growth in the demand for edible oils which our domestic agriculture is unable to meet on a competitive basis. An increased demand for crude oil, which India has to meet primarily through imports, has resulted also from a higher level of economic activity. Another reason for the increase in the import to GDP ratio is the rise in imports needed to complement FDI coming into the country or that required to feed export oriented production (gems and jewellery, steel, plastics etc).

3
India's Current Engagement in PTAs

The gains and losses from PTAs are in the form of trade creation and diversion. Trade creation, from the Indian perspective, refers to the phenomenon of economies reducing their tariffs *vis-à-vis* Indian exports which encourages these exports to penetrate their markets. Thus, Indian exporters benefit as their foreign market share increases. However, in turn, the Indian Government also has to reduce its tariffs *vis-à-vis* exports from the country which is party to the agreement. This implies that the exports from this country become cheaper for Indian consumers, i.e. they substitute exports from other countries (trade diversion).

An associated phenomenon is that tariff collections of the government from such goods fall. This is known as the effect of trade diversion, which can work in the interests of the importing country despite the loss in tariff revenues. For example, suppose India enters into a PTA with Japan and accords preferential access to its capital goods, these goods now become available at lower prices to its entrepreneurs. The cost of production of some of its consumer goods are lowered with the result that some domestic prices decrease with corresponding increases in consumer welfare and the emergence of some new possibilities for export.

Moreover, a recent study (IMF, 2006) shows that Asian RTAs have not led to trade diversion as there was no corresponding decrease in trade of RTA members with non-members. This was probably because the degree of openness which members exhibited with non-members in Asia was higher than that exhibited by RTA members with non-members elsewhere. This in turn implied that RTAs in Asia were chiefly associated with positive effects such as trade creation. We should note that the IMF study was based on a cross-country gravity model, a method which often does not satisfy many trade theorists. It is alleged that there is a considerable possibility of error in the results generated through such models.

India's engagement in PTAs attracted serious attention only after 1998 with the signing of the India-Sri Lanka FTA. However, even in 2008 India has effectively implemented only 5 or 6 FTAs and around the same number of other PTAs. Moreover, the volume of trade generated within the PTAs in force is still not a very sizeable proportion of India's total trade. India has signed a Comprehensive Economic Cooperation Agreement (CECA) with Singapore in 2005 and Framework Agreements to establish CECA with Thailand in 2003, ASEAN in 2003 and Bay of Bengal Initiative for Multi-Sectoral

Technical and Economic Cooperation (BIMSTEC) in 2004. The Framework Agreement with Thailand consists of an Early Harvest Scheme (EHS), which requires that tariffs for a limited number of products be liberalised within three years of the signing of the agreement. India has also entered into an FTA with South Asian countries by signing the Agreement on South Asian Free Trade Area (SAFTA) as well as other PTAs with MERCOSUR (2004) and Chile (2006).

The implementation of tariff concessions with MERCOSUR is yet to begin as Argentina and Brazil are yet to ratify the agreement; the PTA with Chile has been implemented in September 2007. Some other agreements are being negotiated with Japan, Korea, Malaysia, EU, Mauritius, South African Customs Union (SACU), Brazil and South Africa as part of India-Brazil-South Africa (IBSA) and Gulf Cooperation Council (GCC). The exploration of the possibilities of negotiating CECAs with China, Australia, New Zealand, Indonesia, European Free Trade Association (EFTA), Russian Federation etc., is being done through Joint Study Groups or Joint Task Forces in which both sides are participating in discussions.

The PTA negotiations are not just restricted to goods. Rather they cover areas as diverse as services, investments, rules of origin, MRAs which facilitate trade in goods as well as services, preferential safeguard measures and dispute settlement modalities (see Mehta and Narayanan, 2004). The performance of the agreements signed and implemented so far by India and the lessons learned for future policy purposes are discussed.

Indo-Sri Lanka Free Trade Agreement

This is the most significant PTA negotiated by India since the 1990s. In the past, there had been some talk of an FTA between the two countries but it was only when political ties improved remarkably in the mid-1990s that an FTA followed. The bilateral Indo-Sri Lanka Free Trade Agreement (ISLAFTA) was signed on December 28, 1998 and was subsequently operationalised from March 2000. The two countries agreed to the elimination of tariffs in a phased manner: India by 2003 and Sri Lanka by 2008.

Taking into account the difference in the size of these two countries and therefore in the chances of market penetration, a certain asymmetry has been built into the agreement (see Kalegama and Mukherji, 2006 and Weerakooon and Theenakoon, 2007). For example, as provided by the Agreement India has already completed its tariff liberalisation programme on March 18, 2003, thereby granting duty free status on 81 percent of all items. On the other hand, Sri Lanka has a much longer time period at its disposal and is expected to complete its trade liberalisation programme by 2008, which would result in duty-free status to India on 77 percent of all items.

Similarly, the negative list of items (for which tariff concessions are not available) facing India is much longer than that facing Sri Lanka. India has 429 tariff lines (8.4 percent of a total of 5112 tariff lines) in its Negative List as compared to 1180 for Sri Lanka (23 percent of the total).

There has been a steady expansion of trade between the two countries ever since the treaty was signed and operationalised. This paper offers only the Indian viewpoint. India's exports to Sri Lanka were just US$499.27mn in 1999-2000. By 2006-07, their magnitude touched US$2.25bn. In terms of real value, exports from India to Sri Lanka grew by 267 percent during this period at an annual rate of growth of 20.4 percent[3]. Compare this to an annual growth rate of around 15.7 percent of India's total exports to see that the FTA really had an impact. For India's imports from Sri Lanka, there was around a nine fold increase implying that the FTA facilitated import growth as well.

Another important lesson of the ISLAFTA is that deepening of bilateral trade ties does lead to an increase in FDI. In 2000, Indian FDI in Sri Lanka was less than US$50mn. By 2005, it reached around US4500mn. Assuming a rate of inflation of around four percent of the US$ this amounts to a rate of growth of 52 percent per annum. The growth in Indian FDI has much to do with the increase in ease of entry faced by Sri Lankan exports as a result of the PTA (see Kalegama and Mukherji, 2007).

This is indicated by the fact that in the PTA regime products produced through Indian FDI in Sri Lanka have been exported back to India on a large scale. This has resulted in a win-win situation for both countries, i.e. India has been able to utilise Sri Lanka's pool of manpower, liberal FDI regime and other resources to get high private and social returns on capital investments whereas Sri Lanka has been able to derive both consumption and employment benefits from such FDI.

The liberalisation of goods exports from India to Sri Lanka has implied that India has been able to take advantage of the complementarity between goods and services to enter the service sector in Sri Lanka. Thus, Sri Lankan liberalisation of its retail sector under General Agreement on Trade in Services (GATS) has acted in synergy with the preferential access to goods guaranteed by the PTA to attract franchise led Indian retail services such as Titian, Usha, Godrej, Bajaj etc.

Currently, both India and Sri Lanka are negotiating a CEPA to build upon the ISLAFTA by deepening and widening the coverage through inclusion of trade in services, investment, economic cooperation etc., however, no date has been set for completion of the negotiations. Both countries were keen to conclude negotiations and have the CEPA in place by the end of 2007 but this deadline has already passed without any further progress in the matter.

Box 1: India-Sri Lanka FTA

- Asymmetric structure: Indian negative list was smaller and preferential list was larger
- Very high growth rate of Indian exports as well as imports
- Synergy generated between exports in goods, FDI and services
- Preferential treatment by India has been distorted by differential incidence of state taxes on domestically produced goods and Sri Lankan goods

South Asian Free Trade Agreement (SAFTA)

The South Asian Association for Regional Cooperation (SAARC), a regional cooperation agreement, was signed by seven South Asian countries, viz. India, Bangladesh, Bhutan, Maldives, Nepal, Pakistan and Sri Lanka, on December 07-08, 1985 at Dhaka[4] . Much later in April 1993 the member countries of the SAARC signed a SAARC Preferential Trading Agreement (SAPTA) to provide limited preferential market access (operationalised in 1995). The South Asian Free Trade Agreement (SAFTA) was signed during the 12th SAARC Summit held in Islamabad during January 04-06, 2004.

The SAFTA, along with its four annexes, came into force from January 01, 2006. India, Pakistan and Sri Lanka were categorised as Non-Least Developed Contracting States (NLDCS) and Bangladesh, Bhutan, Maldives and Nepal were categorised as Least Developed Contracting States (LDCS). The preferences exchanged under SAPTA will continue to be available to SAARC members until the tariff liberalisation under SAFTA is complete (2008 for NLDCS member preferences for the LDCs and 2012 for LDCS member preferences).

In SAPTA, during the first three rounds of negotiations India offered tariff concessions at the HS six-digit level on 2,576 lines; additional concessions were given on 364 HS six-digit level tariff lines in the fourth round. Special concessions were granted for LDCs. Despite four rounds of preference negotiations, SAPTA remained almost ineffective in raising intra-regional trade levels by substantial amounts, mainly because of limited product coverage and the limited range of tariff concessions. Thus, SAFTA with its objective of bringing down tariffs to zero offers much hope. The LDCs of the region have suffered from structural constraints such as low savings rate, technological backwardness etc (Ratna and Sidhu, 2007). This has led to a low capacity to export.

Under SAFTA, the LDCS and the NLDCS are maintaining sensitive lists with the former maintaining longer sensitive lists than the latter. India has accepted asymmetrical responsibilities with only around 15 percent of its total product lines falling under the sensitive category whereas for Bangladesh, Nepal and Sri Lanka the corresponding figures are around 24 percent, 25 percent and 21 percent respectively. However, India seems to have negotiated well as these smaller countries have much more lopsided export baskets. Thus, for example, India has denied unlimited and unrestricted preferential trade access to textiles and textile products from Bangladesh.

SAFTA is different from India’s other RTAs as many of the countries falling under the SAFTA umbrella already have a BTA with India, Bangladesh, Sri Lanka, Nepal and Bhutan. In certain cases, the constraints imposed on trade by SAFTA might be more stringent than those imposed by the BTA in which case India’s bilateral trade with partner countries will not be affected. The success of SAFTA would also depend on the negative lists in this agreement as compared to those in India’s future RTAs, the time frames for tariff liberalisation etc. It is possible that India’s SAARC partners might get locked out of the Indian market because of better preferential access granted to some other country in future RTAs.

The success of SAFTA is also not certain because of major drawbacks – long negative lists, fairly long time frames for tariff liberalisation, no commitment to establish a duty-free regime etc. There is no provision for trade in services as well. This is not good for the overall volume of trade, as trade in goods as well as in services is complementary to each other. This implies that countries are unable to take advantage of the short distances separating them and associated low travel/transport costs to promote mutually beneficial trade in services based on travel by nationals of one country to another, i.e. Indian teachers traveling to Nepal to teach software programmes.

Box 2: Major Features of SAFTA
• Was preceded by SAPTA among the same nations which was a failure due to limited product coverage • Asymmetric structure again similar to that in ISFTA • Is hampered by long negative lists, long time frames for tariff liberalisation and coverage only being extended to goods • Future RTAs by India can lock the other SAARC countries out of India's market

Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC)

Thailand took the initiative to establish Bangladesh-India-Sri Lanka-Thailand Economic Cooperation (BIMSTEC) in 1994 to explore economic cooperation on a sub-regional basis involving the contiguous countries of Southeast and South Asia grouped around the Bay of Bengal. Myanmar was admitted in December 1997 and the initiative was renamed as BIMST-EC. During the first BIMSTEC Summit held in July 2004 the initiative has been renamed as the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Co-operation (BIMSTEC) with the admission of Bhutan and Nepal as members of the grouping.

It may be mentioned that the initiative involves five members of SAARC (India, Bangladesh, Bhutan, Nepal and Sri Lanka) and two members of ASEAN (Thailand and Myanmar) and is, therefore, visualised as a 'bridging link' between two major regional groupings, SAARC and ASEAN. BIMSTEC is an important element of India's "Look East" strategy and adds a new dimension to India's economic cooperation with South East Asian countries.

In February 2004, BIMSTEC members signed a Framework Agreement to form an FTA by 2012. Although this Agreement provides for negotiations to be concluded on goods by December 2005, and on services and investment by 2007, these deadlines have not been met due to the complexity of issues involved and economic and political developments in member countries.

Box 3: Salient Features of BIMSTEC
• Bridging link between ASEAN and SAARC • Important element of India's "Look East" strategy • No agreement even at deadline dates

India-Thailand FTA

The Framework Agreement for establishing an FTA between India and Thailand was signed on October 09, 2003. It provided for free trade in both goods and services and also an EHS for 82 products at the HS six-digit level, i.e. tariffs were to be reduced in phases from September 01, 2004 and eliminated by September 01, 2006.

There have been serious concerns raised by Indian industry especially about the early harvest structure as entrepreneurs in many domestic industries have not had sufficient time to switch from one line of production to another in response to sudden tariff liberalisation, thus making their products non-competitive in the home market. These industries should have been given a sufficiently long period of about 7 to 10 years for necessary adjustment rather than the three-four years actually provided. There is also the problem of an inverted duty structure, i.e. tariffs on intermediate goods remain high while the final good they help to produce suffers from a reduction in duty. This affects the profitability of the final good.

Box 4: Salient Features of India-Thailand FTA
• EHS: tariff liberalisation achieved within a short time frame (three-four years) • Above feature led to inverted duty structure (tariffs on intermediate goods becoming much higher than that for the produced good in the export market)

India-Singapore Comprehensive Economic Cooperation Agreement (CECA)

These two countries signed the Comprehensive Economic Cooperation Agreement (CECA) on June 29, 2005, which came into operation from August 01, 2005. The Agreement provides for an EHS and phased reduction/elimination of duties on products other than those on India's negative list by April 01, 2009. It is to be noted that Singapore has already eliminated duties on all products originating from India from August 01, 2005.

The CECA also covers investment, services, MRAs and customs cooperation. India's negative list in this Agreement includes agricultural products, alcoholic beverages, minerals, chemicals, rubber products, and textiles and clothing (T&C) products. However, the Agreement does provide Singapore access to the Indian market for a wide range of services. India's commitments on financial services go beyond its commitments in the GATS and include those in life insurance services, non-life insurance and banking (commercial presence of 3 banks from Singapore, including up to 15 branches over 3 years).

Other services include business services, communication (telecommunications and audiovisual), construction, distribution, health, tourism, recreational and transport (maritime) services, temporary movement of natural persons and media. The Agreement also covers investment, standards, sanitary and phyto-sanitary (SPS) measures, intellectual property rights (IPRs), science and technology, education and dispute settlement. The first review of India-Singapore CECA, after its signing in August 2005 (two years of existence) reveals that it has been fruitful for India on the FDI front.

Singapore is now the 6th largest FDI investor in India with a total investment of US$2.1bn in the period from April 2005 to June 2007. The trade related gains for India from this PTA have not been very heartening as Singapore practices free trade or near free trade in all goods with all countries.

The focus of talks between Singapore and India now would be on facilitation of the movement of Indian professionals to Singapore to meet the agreement's stated objectives. In this area there has been no substantive progress. Both parties have not made much progress with respect to MRAs – a necessary condition for facilitating movement of professionals from one partner to the other.

Box 5: India-Singapore CECA
• Not much change in Singapore's treatment of Indian goods as duties were already close to or at zero and Indian gains from trade were not very significant • Singapore service sector made major inroads into India (construction, communication, business services, insurance, banking) • Not much progress in facilitation of movement of Indian nationals into Singapore

India-Nepal Treaty of Trade

The Treaty of Trade regulates bilateral trade between India and Nepal and both governments have decided to renew it in its current form. Under the Treaty, there is free trade on mutually agreed upon primary products. The treaty also requires India to give duty free non-reciprocal access to Nepalese manufactures without quantity restrictions. There are four exceptions to such access: *vanaspati* (fully or partially hydrogenated vegetable cooking oil), copper products, acrylic yarn and zinc oxide, which are allowed under tariff rate quota (TRQ)[5] . The treaty provides for setting up of a joint committee in the event that imports result in injury to the domestic industry of either country.

From India's point of view this bilateral treaty seems to have been successful with exports increasing at the rate of 38.15 percent per annum during the period 2001-06. Imports however, declined at the rate of 0.75 percent per annum. Trade surplus with Nepal increased from a level of around US$140mn to US$440m.

Box 6: Indo-Nepal Treaty of Trade
• Free trade in primary products • Free non-reciprocal access by India to Nepalese manufacture without quantity restrictions • Huge increase in India's exports to Nepal during 2001-06 • No matching increase in India's imports • Huge increase in trade balance with Nepal

4
The Future: PTAs on the Horizon

EU-India Bilateral Trade and Investment Agreement

On June 28, 2007, India and the EU began negotiations on a broad based bilateral trade and investment agreement in Brussels, Belgium. These negotiations have been built on the commitment made by political leaders at the India-EU Summit held in Helsinki, on October 13, 2006 to move towards a broad-based trade and investment agreement. There has already been significant preparatory work. The India-EU High Level Trade Group has been preparing the ground for these negotiations since October 2005 and its report will form the basis for further deliberations. India and the EU expect to promote bilateral trade in goods and services and investment across all sectors of the economy.

The EU, even without a BTA with India, is its most significant trading partner, accounting for around 20 percent of India's exports and 16 percent of its imports. India exports mainly T&C, agricultural products and chemicals to the EU. In monetary terms, Indian exports came to US$26.78bn in 2006-07 (Export Import Data Bank, Department of Commerce, 2008).

On the other hand, its imports from EU touched US$29.8bn though India even now accounts for only about 1.8 percent of total EU trade. The EU is also India's largest source of FDI and invested •2.2bn (US$3.3bn) in India in 2005, which nevertheless was only 1.3 percent of total EU investment (see European Commission website: www.ec.europa.eu). Trade in services has been growing substantially, especially in the information and communication technology (ICT) sector, as illustrated by the high incidence of business processing outsourcing (BPO) and healthcare/medical outsourcing by EU from India and the provision of banking services by EU to India. Retail and wholesale trade also have been playing an important role in generating employment (Rao, 2001).

The EU-India FTA negotiations started in June 2007 and are meant to be completed in two years. However, the negotiations on a bilateral trade and investment agreement between the "two largest democracies in the world" are paradoxically highly secretive. A quick analysis of the contour of this negotiation shows that the EU would like to link concessions in trade to the fulfillment by India of various conditions related to sustainable development.

The following are the premises on which the proposed EU-India FTA is based:

- The EU feels that it can open its markets further to Indian manufactures, a move which may spur growth in the relatively small Indian manufacturing sector.
- The EU is of the opinion that India can reciprocate by lowering its tariff and NTBs to European exports, which might be beneficial for the Indian services and industry sectors as they will get cheaper, better quality inputs. Much of India's manufacturing imports from Europe are inputs into industry and services. The EU is also eager to tap India's burgeoning middle class market, especially in the sphere of retail.
- The EU also feels that India should encourage European FDI in the fields of infrastructure capital and infrastructure support services because of the European expertise in such fields.

The visit of the EU's Trade Commissioner, Peter Mandelson in the last week of November 2007 to India offered further confirmation that the India-EU FTA is round the corner and the Indian side hopes to complete the trade pact by the end of 2008. However, there are some differences between the two sides on the treatment of some contentious issues like government procurement in certain segments of the Indian economy, lack of competition in certain sectors of the Indian economy as perceived by the European side and non-trade issues like labour and animal welfare which the EU feels India is not addressing adequately. Mandelson said the EU would like to see "openness in services and investment trade extended into government procurement in India and would reciprocate any new access India offered." However, the Indian Trade and Industry Minister said that public procurement could not be part of the FTA negotiations. There is a possibility of such disagreements drowning the final pact as India is not in a stage to sacrifice economic progress at the altar of non-economic issues.

Box 7: Scope of EU-India FTA

- EU is India's largest trading partner even though there is yet not any PTA between the two
- EU's market can absorb output from India's manufacturing sector
- Indian economy can absorb manufacturing goods as well as infrastructure services from EU as inputs
- EU is also eyeing India's massive retail market
- Some attempt has been made by EU to link the agreement to matters with which India is not comfortable like labour and animal welfare procurement

Pan-Asian FTA

Consultations between India and ASEAN Economic Ministers were held on September 15, 2002 when it was decided to establish an ASEAN-India Economic Linkages Task Force (AIELTF) to prepare a draft Framework Agreement to enhance bilateral trade. The first ASEAN-India Summit was held on November 05, 2002 in Cambodia, where India committed, *inter alia,* to provide special and differential treatment (S&DT) to ASEAN members based on their level of development, and to align its peak tariffs to East Asian levels by 2005. India and ASEAN heads of state signed the Framework on CECA on October 08, 2003.

The Agreement includes trade in goods, services and investment. The EHP, including exchange of tariff concessions, was supposed to commence on January 01, 2007. However, due to differences regarding RoO on considered products both sides decided to drop the EHP. The negotiations on trade in goods are still on and the agreement has not been finalised yet.

India has expressed support to the Japanese suggestion for a 16-country FTA zone encompassing the 10 ASEAN countries and Japan, China, India, South Korea, Australia and New Zealand even as Asia consolidates its position in the global economy. Asia, the most buoyant region, has more than doubled its share of global GDP to nearly 30 percent over the past 50 years. The share is projected to go up to above 40 percent by 2050, double that of North America and almost four times that of Europe. Asian majors indeed have a large stake in tapping synergies and boosting trade to make full use of the unfolding potential. In fact, India's decision to enter into a treaty with ASEAN has been driven by the entry of countries like China into an agreement with ASEAN. There seems to be a feeling that with more and more countries entering into a coalition India might be denied of certain trade benefits unless it too becomes a coalition member.

Table 1 shows India's trade with different regional blocs after India initiated wide-ranging economic reforms including forming the RTAs. EU was the most significant trading partner capturing nearly 28 percent of India's total trade in 1995, though this share has declined to 18 percent in 2006. India's trade with NAFTA remained more or less static at around 15 percent of total trade during the period 1995-99, though subsequently there was a steep decline. The ASEAN+3 bloc has increased its share in India's total trade from 18 percent in 1995 to around 28 percent in 2006. Thus, India's PTAs with Singapore and Thailand seem to have given a boost to its trade with South-East Asian countries. However, a major contributor to the rising share of ASEAN +3 in Indian trade has been trade with China which is still being conducted on MFN basis. The share of SAARC countries in India's trade has shown no definite trend over time; at present, it is lower than its 1995 level implying that SAPTA has not been much of a success.

India's trade (exports and imports) with ASEAN is growing at a much faster rate than that with the rest of the world. Out of the 10+3 ASEAN countries, 3 countries, viz., China, Japan and Singapore featured among India's top 10 trading partners in 2003.

Table 1: Shares of Select Trade Blocs in India's Total Trade (in percent)

Year	EU 15	EU25	NAFTA	MERCOSUR	ASEAN	ASEAN+3	SAARC
1995	27.4	28.0	14.9	0.8	7.8	18.1	2.9
1999	23.5	24.0	15.2	1.1	8.5	17.5	2.1
2003	20.2	20.7	12.9	0.9	9.3	19.9	3.4
2006	17.36	18.0	11.2	2.2	9.8	22.8	2.8

Source: Adopted from Batra. Amita (2007). "South Asia's Free Trade Agreement: Strategies and Options" EPW, September 22, 2007, Table 5, p.3882 and Export Import Bank of Department of Commerce, Government of India.

Singapore and China first emerged among its top 10 trading partners in 2000 and have remained so since then. After China, India has become the most attractive market for Korean, Malaysian and Thai exports. Such fast growing trade relations hint at complementarities between India and these Asian nations. Thus, there is a persuasive case (supported by the views of a large number of experts and policy makers) for a Pan-Asian FTA, with the ultimate aim of its conversion into an Asian Economic Union (AEU) on the lines of the EU.

But the changeover to a single Asian market is not going to be easy. A calibrated approach to opening up the market is necessary. Negotiations have to drive events in a manner that does not compromise domestic interests. This calls for regular stakeholder consultations.

Box 8: A Single Asian Market-Facilitating and Hindering Factors

- Trade relations with ASEAN countries increasing at a rapid pace
- With more and more countries entering into a coalition others are bound to follow
- India's negotiations with ASEAN seem to be in a stalemate.

5
Conclusion and Policy Implications

While studies almost always point out the welfare advantages of multilateralism over bilateral trading agreements it is also clear that "if the multilateral road is closed (as is temporarily the case now) then countries have to explore other roads (Frankel, 1998)". Moreover, when a few countries in a region enter into a PTA then non-signatory countries lose out by not entering into PTAs themselves. This is because PTAs/RTAs make members more competitive partners in trade than non-partner countries (RIS, 2005). With the hiatus in the Doha Round it is therefore natural for all countries including India to engage in PTAs/RTAs. As the Sutherland Report points out, such RTA formation might be a stepping stone for successful multilateralism.

India's experience with PTAs shows that these are able to generate synergies among trade in goods, foreign direct investment and trade in services in such a way so as to make participation very fruitful. More liberal trade in goods often facilitates trade in services. This is shown by India's experience with Sri Lanka where greater ease in exporting goods to Sri Lanka has provided the backward linkages necessary for services trade and the forward linkages that spur Indian FDI into Sri Lanka.

What these synergies (goods and services, services and FDI, FDI and goods etc) indicate is that there are enough complementarities that nations can exploit in PTAs with each other. For example, large and small countries can generate complementarities through asymmetric preferential treatment provision. Again a large country like India might be able to attain economies of scale in production of certain items (such as automobiles) which a small country (like Bhutan) might not be able to generate. In that case it is better for both countries if India supplies these goods to the small country. Complementarities exist between countries characterised by a disparity in per capita income.

There are some products in the richer country which are a necessity in that country and a luxury in the poorer country. The rich country can exploit its economies of scale in these goods to provide a supply of this luxury in the poorer country without the associated increase in total supply leading to any discernible increase in the supply price. Apart from complementarities generated by disparities in affluence and size other disparities might be generated by compensating differences in natural and human resources (India and EU, India and US). The point is that two countries or two regions will not have to search very hard in order to find complementarities that they can harness through cooperation.

As the Sutherland Report[6] points out such PTAs do not go against globalisation or multilateralism. Rather experience teaches us that as more and more countries enter a grand coalition such as ASEAN or EU other countries are bound to follow suit as trade relations inside the coalition are denser than those reaching outside the coalition. As more and more nations join a grand coalition we have the arrangement of PTAs all over the world tending to multilateralism.

Thus, to supplement multilateralism which is engineered by multi-party bargaining among all nations of the world we can have a slow evolution towards tighter multilateralism which is guided by the self interest of nations. Thus, bilateralism which leads to coalition formation is actually a process of evolutionary multilateralism. In that sense there is no harm in keeping both types of processes on.

Whenever a new tighter multilateral agreement is reached on the basis of multiparty bargaining then there is no harm in accepting the rules of the game which such bargaining generates. However, the rules of the game might permit nations/regions to have special arrangements with others. In that sense negotiated multilateralism would continue to be permissive of bilateral coalition formation, i.e. evolutionary multilateralism.

If various nations can agree upon a set of rules that is so tight that no preferential treatment can be accorded then negotiated multilateralism will supersede evolutionary multilateralism and the latter will die out automatically. Thus, what we have is a race between bilateralism (evolutionary multilateralism) and negotiated multilateralism to the same finish line – the richest and most meaningful economic cooperation and exchange between nations.

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Endnotes

1 PTAs are defined as trading arrangements which result in two or more countries extending preferential tariff or non-tariff treatment to each other. FTAs are those PTAs which result in the lifting of all restrictions on trade between partner countries, especially tariffs. RTAs are PTAs involving countries that belong to a region.

2 Baldwin (2006) lists two types of trade blocs that preceded the new generation PTAs – the defensive trade blocs of the 1930s and the hub and spoke trade blocs that were formed in the middle of the twentieth century.

3 Given that dollar prices increased by around 23 percent during this period the value of exports in 2006-07 in terms of "1999 dollar prices" was US$1.8bn. This gives us a figure of 20.4 percent for average annual growth.

4 Afghanistan was admitted as the 8^{th} Member in 2007.

5 TRQ is defined as minimum import opportunities for products previously protected by NTBs (OECD Glossary of Statistical terms).

6 World Trade Organisation (2004), *The Future of the WTO: Addressing Institutional Challenges in the New Millennium*. Report by the Consultative Board (Chairman: Peter Sutherland) to the Director-General, Supachai Panitchpakdi.

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