



India-ASEAN FTA A Critique

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The India-ASEAN Free Trade Agreement (FTA) was signed in Bangkok on 13 August 2009. The signing took place on the sidelines of the ASEAN Economic Ministers Meeting. The agreement, which only deals with trade in goods, is India's first FTA with a trade bloc. ASEAN is India's fourth largest trading partner. The eleven member economies of the FTA have a combined Gross Domestic Product (GDP) of over US\$2 trillion and a population of 1.6 billion. India's trade with ASEAN, which was worth US\$9.7 billion in 2002-2003, increased to a value of US\$40 billion in 2007-08. The FTA aims at further enhancing this trade relationship through the elimination of tariffs on about 80 percent of the traded goods, that is about 75 percent of the total trade between the two regions. The tariff liberalization schedule is to begin in January 2010 and is to be fully implemented by 2013 and 2016 in respect of the items on the two 'normal tracks'.

A timeline has also been agreed upon for the sensitive list items, with 489 items excluded from the list of tariff concessions. The items thus excluded pertain to farm products, automobiles, some auto parts, machinery, chemicals and textile products. In respect of the sensitive items like crude and refined palm oil, tea, coffee and pepper, tariff concessions will be graduated over a period of ten years. There is huge potential for furthering India-ASEAN economic relations and the FTA is expected to open new opportunities in this direction. However, several elements of the FTA call for a more cautious conclusion in this regard, when more carefully analyzed.

I FTA: PROLONGED NEGOTIATIONS

It is well known that the India-ASEAN FTA was signed after a six year period of negotiations. The

framework agreement was signed in 2003 and the negotiations were expected to be completed by 2005. An Early Harvest Programme (EHP) had been envisaged as part of the framework agreement. However, as negotiations progressed it soon became clear that the initial deadlines would not be achieved. The EHP was dropped from the implementation schedule.

Two contentious elements of the FTA, which contributed to the protracted negotiation process, were the rules of origin (RoO) and the size and composition of the negative list. In respect of both, India seems to have compromised its initial stand. As regards the RoO, India has traditionally specified these in terms of two criteria. These are change in tariff heading (CTH) and value addition (VA). Similar 'twin criterion' based RoO were however rejected by ASEAN. The final agreement has India agreeing to a mere 35 per cent value addition criterion for RoO. The dilution is significant in light of both the twin criterion and the 40 per cent VA rule that is operative in the cases of the India-Singapore and India-Thailand FTAs as both are member countries of ASEAN. It is hard to comprehend the reasons behind India's contradictory stand in the two instances.

In terms of the negative list, the original 1410 items, which India presented to ASEAN faced outright rejection and exposed India's lack of preparedness to negotiate on the negative list items. However, the final number of 489 is a huge climb down for India. The Indian government justifies the reduced size of the final list by saying that the concerns and sensitivities of Indian farmers have been taken note of by the inclusion of agricultural items, textiles and chemicals and the extended schedule for items like pepper, coffee, tea, oil and rubber. The government adds that duties on these items will only be reduced in 2019. However, the number of

items from the ASEAN side, though not yet publicly available, is stated to be the same as that specified for the ASEAN-China FTA, which may actually be much larger. If this is true, the disproportionate size of the ASEAN list would be hard to justify, especially when the negotiations have been prolonged for so long only so that India would reduce the number on its list in deference to ASEAN demands and their irreconcilable stand on the issue.

Despite the fact that a differential timeline has been specified for the sensitive commodities, it is doubtful if the underlying differential in productivity and competitiveness between India and ASEAN countries in the respective sectors can be eliminated in ten year period. This is particularly true of the plantation sector which is likely to be the hardest hit given the relative advantage that the ASEAN countries have in commodities like tea, pepper, coffee and palm oil. Productivity of pepper is 380 kilograms per hectare in India while it is 1,000 kilograms per hectare in Vietnam and 3,000 kilograms per hectare in Indonesia. Similarly, coffee productivity in India stands at 765 kg/ha while Vietnam produces 1.7 tonnes/ha. Higher wage and input costs in India further aggravate this differential. Fisheries and marine products are the other sectors that are likely to suffer as a consequence of the agreement. The threat from Thailand, the world's largest exporter of farmed shrimp and Vietnam which is the world's eighth largest seafood exporter is imminent.

II

FTA AND/IN INDIA'S LOOKEAST POLICY

The expected gains from the FTA have been cited in terms of taking India's "Look East" policy a step forward. Undoubtedly, the FTA helps institutionalize the growing economic relationship between the two regions. It is in line with India's growing integration with the world economy through increased trade liberalization. Moreover, while

With the West still not being out of the woods regarding the economic slowdown is concerned, the East Asian countries may just be able to provide the right stimulus as a substitute export market for India in place of the traditional EU and US markets. The FTA provides India with access to a market of an additional 600 million people.

India continues to remain a World Trade Organization (WTO) loyalist, the FTA reflects the realization that regional and bilateral deals need to be accorded their rightful role as important instruments in the country's economic engagement with the world.

With the West still not being out of the woods regarding the economic slowdown is concerned, the East Asian countries may just be able to provide the right stimulus as a substitute export market for India in place of the traditional EU and US markets. The FTA provides India with access to a market of an additional 600 million people. However, before we eulogize the trade pact as an instrument of furthering India's trade with ASEAN the gains need to be put into perspective.

India's share in ASEAN's trade is very small. It constitutes about 2 per cent of ASEAN's total trade. Over the last few years India's imports from ASEAN have been increasing at a faster rate than India's exports to the regional bloc. Furthermore, India's tariff levels today are such that the concessional treatment on offer in the FTA will imply definite advantages for the ten country regional bloc, as will the 1 billion large Indian market that will be opened up to the ASEAN member countries as a consequence of the FTA.

ASEAN tariffs on the other hand have been low for some time and the FTA concessions may not mean much for India in terms of additional gains. The meager gains that the current deal is therefore likely to yield for India in terms of goods trade have apparently been accepted because of the larger gains that India envisions will come in the future through the yet to be negotiated services and investment component of the comprehensive economic partnership/cooperation pact between the two regions. Indeed, the potential for services trade and investment opportunities is large. India is among the top ten services exporting nations globally while ASEAN is a major importer. At US\$150 billion, ASEAN's imports in this sector are almost half as large as those of the USA. However, given that the goods arrangement has taken so long to attain its final shape, the gains through services and investment may not be certain or imminent. The sensitivities of the ASEAN countries with regard to a freer flow of labour further reinforce this apprehension.

Several other concerns also come to the fore with regard to the FTA. Is it really a good strategy to trade future gains for present costs, especially when those who bear the burden in the present

are not likely to be beneficiaries of the gains that may accrue some time in the future? The state's role assumes importance in this respect. It is for the state to redistribute these inter-temporal gains in a manner that ensures that nobody is a loser as a consequence of the FTA in the long run. Will the Indian state be able to do this, and is there any evidence of progress in this area?

Government of India has launched few schemes to improve productivity and competitiveness in the plantation sector. The Department of Commerce has launched a Rs14 billion scheme for improving social infrastructure in tea gardens. The tea gardens of Tripura, the Cachar valley and Tamil Nadu have been identified under this scheme. The Government of India has also announced a Rs4.9 billion Special Purpose Tea Fund (SPTF) as a 15 year productivity boosting programme. Last year the Coffee Board proposed a Rs1.05 billion scheme to replant 45,000 hectares of coffee plantations. Similar schemes, are said to be in the pipeline for coffee and pepper. However, the implementation or the performance on the ground of these schemes is not yet known. Had the last six years, when negotiations were protracted on account of contentious discussions on the composition and size of the negative list, been utilized for enhancing productivity, or even initiation of reform in the agricultural sector the FTA deal may have received a more positive response from all sectors.

III

THE CHINA FACTOR

The ASEAN-China FTA has already been implemented. It is therefore useful to consider whether China's prior entry into ASEAN has an adverse impact on the India-ASEAN FTA. The adverse impact would have been limited, had it not been for the fact that the India-ASEAN FTA has come after a long delay. The time that has elapsed may have actually given China the time to catch up or even take over in some sectors where the existing comparative advantage was in favour of India.

India and China are not really in a competitive framework at either the global or the regional level. It has been amply documented that China is a rising economic power and that India remains an emerging economic power. China's contribution to world growth and trade over the last decade has been in double digits and is therefore much larger than India's. The two economies have followed differential paths of growth particularly with regard to the

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manufacturing sector. China has experienced active growth in its manufacturing skills, specialization pattern and consequently export structure. China's manufacturing sector accounts for 41 per cent of its GDP. Exports from the manufacturing sector constitute over 93 per cent of its exports. India's manufacturing sector on the other hand is about 17 per cent of its GDP and comprises a much smaller fraction of its exports.

After specializing in unskilled labour intensive (ULI) sectors like toys, footwear, apparel and light manufactures in the 1990s, China has since advanced to office machinery, electrical and electronic equipment and appliances. Today China is the manufacturing hub of the world. India on the other hand has continued to specialize in ULI and does not really compete with China in the global or regional market. Sectors where we may have some advantage but where China is clearly ahead of us such as organic chemicals, cotton and articles of apparel and accessories, not knit or crochet, are known losers for India.

However, there are other sectors where for some commodities India does have a comparative advantage but will lose out purely on account of the period that has elapsed because of its delayed entry into ASEAN. These commodities are identified in sectors like organic chemicals, rubber and articles thereof and articles of iron or steel.

IV

CONCLUSIONS: TOWARDS REGIONAL INTEGRATION

The claim that the India-ASEAN FTA takes us a step closer to the Asian Economic Community (AEC), is a concept that we cherish, but that may yet be a distant goal. It is true, that the FTA puts us in the same league as the other plus three economies of China, Korea and Japan and Australia and New Zealand, all potential members of the composite identity that we hope will emerge as the AEC.

Several aspects of this process however need prior resolution. It is evident that the process is likely to take shape in the form of an ASEAN-centric

grouping. While the India-ASEAN FTA can be a potential contributory factor to this grouping, ASEAN first needs to complete its own integration process. As of now ASEAN remains an association of ten diverse nations. The process of ASEAN integration was given a reasonable push forward at the ASEAN 2007 summit when the ASEAN Charter issued a declaration for the implementation of the ASEAN Economic Community by 2015. The Charter is a blueprint for the ASEAN Economic Community aimed at transforming ASEAN into a single market and production base. However, it needs to be realized that the Charter is aimed at an ASEAN integration process.

Therefore, even though the ASEAN Plus Six may be an optimum mechanism for realizing gains for economic cooperation and signaling to the rest of the world that Asia can create inclusive forums to enhance its voice in global affairs, it is not yet a part of the formal ASEAN vision. To cite the gains of the India-ASEAN deal as a step which furthers the idea of a composite grouping and establishes our credentials therein thus seems premature.

Even if we were to believe that the six ASEAN Plus One agreements can be ingredients of the final outcome in the form of the AEC, an essential precondition is the compatibility of these ASEAN Plus One agreements. Compatibility requires a greater focus on harmonization and consistency, for example with respect to the RoO that at present may be scattered and inconsistent with one another.

Finally, can the India-ASEAN agreement, as has been often suggested, be the appropriate vehicle to take forward the process of developing India's northeast? There is a possibility that greater links with Southeast Asia, which may be facilitated through the FTA, will help the northeast region that shares its borders and several potential complementarities with Southeast Asian countries. While this may be seen as an important by-product of the India-ASEAN FTA, the advantages of the potential connectivity offered by the FTA will only contribute positively to the region's growth process if it is first lifted out of its current low economic equilibrium.

Prior development of India's northeast is a precondition to its ability to exploit the benefits of connectivity with the ASEAN countries. There have been earlier agreements – the Bangkok Agreement and BIMSTEC, which have member nations from across the two regions and for which connectivity has been a special focus area. If

these agreements have not been able to accomplish what is desired for the northeast region, how the India-ASEAN agreement would now make it possible calls for some introspection.

The many benefits that could have resulted from this FTA have been lost largely on account of the unusually long time taken to negotiate the India-ASEAN FTA agreement. This time could have, for example, been utilized to make Indian agriculture more competitive. It is time that India accepts the fact that regional and bilateral trade agreements need to be integrated in India's trade liberalization strategy and that with careful prior preparation these agreements can be designed so as to be potentially gainful for all member nations

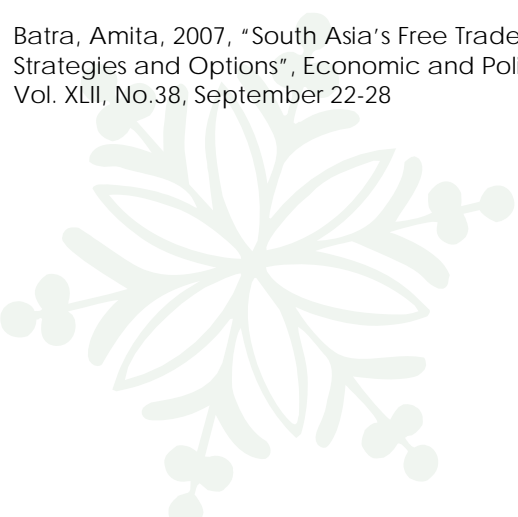
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