A Note on Free Trade Agreements and Their Costs

What are FTAs (Free Trade Agreements)?

FTAs are arrangements between two or more countries or trading blocs that primarily agree to reduce or eliminate customs tariff and non tariff barriers on substantial trade between them. FTAs, normally cover trade in goods (such as agricultural or industrial products) or trade in services (such as banking, construction, trading etc.). FTAs can also cover other areas such as intellectual property rights (IPRs), investment, government procurement and competition policy etc.

Why are almost all the countries signing Free Trade Agreements?

- By eliminating tariffs and some non-tariff barriers, FTA partners get easier market access into one another's countries.
- Exporters prefer FTAs to multilateral trade liberalization because they get preferential treatment over non-FTA member country competitors.
- Possibility of increased foreign investment from outside the FTA.

For example, Consider 2 countries A and B having an FTA. Country A has high tariff and large domestic market. The firms based in country C may decide to invest in country A to cater to A's domestic market. However, once A and B sign an FTA and B offers better business environment, C may decide to locate its plant in B to supply its products to A.

India’s trade theory and patterns

The export performance is mainly measured along the following lines:

- **Diversification across destinations, products and services**
  - Overall trade (exports plus imports) ~ 40% of GDP.
  - Its trade deficit has grown from USD 6bn in FY01 to USD 109bn in FY17.
  - Exports have diversified since 1990s, both geographically and product wise.

    - Export to developed countries has declined and that to emerging economies has increased.
- **Composition of export basket**
    - More high-value products like **manufactured goods and petroleum products** (together ~85% of total exports in FY17) being exported
    - Foreign value addition in the exports has also more than doubled across all the industries.
- **India’s export potential**
    - According to International Trade Centre (ITC)
    - India’s untapped export potential = USD 201.4bn
    - India’s untapped import potential = USD 181.8bn
    - Markets with greatest potential for INDIA, USA, China and UAE

Drivers of India’s export

- India now exports more income sensitive items like engineering goods, petroleum, gems and jewelry and chemical products.
- Indian exports are sensitive to:
    - Price changes
    - Global demands
    - Supply side bottlenecks like energy shortages
    - External demands
    - Higher logistic costs
- Indian export is more sensitive to changes in external demands than to price changes.
- India ranked 40, while China ranked 27 in **Global Competitiveness Index** 2017-18.
- India’s CIP (Competitiveness of Industrial Production) score improved from 0.04 in 2000 to 0.07 in 2010, and yet the improvement rate is **far behind that of China.**

India’s experience with Free Trade Agreements

- Regional Trade Agreements today go beyond tariff cuts in trade in goods and incorporate various other components like liberalization in services, investment etc.
- The first RTA of which India became a member was the **Bangkok Agreement in 1975**. In 2005, this reincarnated as **Asia Pacific Trade Agreement (APTA)**.
- India’s first bilateral FTA with Sri Lanka (ISFTA) came into effect in March 2000.
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    - India's exports to FTA countries has not outperformed overall export growth or exports to rest of the world.
    - FTAs have led to increased imports and exports, although the former has been greater.
    - India’s trade deficit with ASEAN, Korea and Japan has widened post-FTAs.

    - According to Economic Survey 2016-17, FTAs have had a bigger impact on metals on the importing side and textiles on the exporting side.
    - Utilisation rate of FTAs by exporters in India is very low (between 5 and 25%).
- Diversification of India's export basket is more responsible for India's export surge than RTAs.

Assessment of India's FTA with ASEAN, Japan, Korea, Sri Lanka

- Bilateral trade increased post signing of all the above FTAs
- **Imports from these FTA partners into India increased more than India's exports** to partner countries post signing of FTAs
- As imports from Korea, Japan and ASEAN have shot up after the respective agreements came into force, **India's trade deficit with these countries has increased** since then. Only exports to Sri Lanka have increased much more than imports into India from Sri Lanka.
- **Overall trade deficit with ASEAN, Korea and Japan doubled** from FY11 to FY17.
- **Quality of trade has also deteriorated** under India ASEAN FTA.
- The analysis shows that **trade balance has worsened** (deficit increased or surplus reduced) for 13 out of 21 sectors. Sectors where trade deficit has worsened account for approximately 75% of India's exports to ASEAN.

India and China - Foreign trade Agreements

China is India's biggest trading partner accounting for almost **10% of India's overall trade**.The Sino-Indian trade scenario can be summarized as:

- India's overall trade deficit with China has risen thirteen fold in the past decade. In fact, China now accounts for about **50% of India's trade deficit**.
- India's exports to China have grown at an average of **13%** since FY04 while Chinese imports into India have increased at **26%** y-o-y
- India tends to **export primary materials** such as ores, minerals and cotton, whereas **Chinese exports to India** are mostly a wide variety of sophisticated products **higher up in the value chain**.
- China's export basket is better diversified than that of India's.
- Nearly one-sixth of **anti-dumping cases** on China are from India.
- Except Thailand and Malaysia, all other ASEAN countries having FTA with China are running in a trade deficit.

India and RECP

What is RCEP	Regional comprehensive Partnership Agreement (RCEP) is a proposed free trade agreement (FTA) between 10 ASEAN countries and their six FTA partners, namely Australia, China, India, Japan, Korea and New Zealand.
Why it worth of so much attention	It accounts for: • 25% global GDP • 30% global trade • 26% FDI flows • 45% of the total population
The significance for India	For India RCEP accounts for: • 27% total trade • 15% exports • 35% imports • $83 billion of trade deficit (in 2017) out of which China alone accounts for 60%
Challenges it poses	• India's trade deficit with the bloc has risen from $9 billion in FY05 to $83 billion in FY17 • India's trade deficit with the bloc has risen from $9 billion in FY05 to $83 billion in FY17 • India is not able to negotiate on the terms • Tariff cuts under RCEP overlap with existing FTAs • China seems to benefit the most out of the RCEP, gaining in exports to other countries • Existing FTAs are lying unutilized

Some policy recommendations

1. Review and assess its existing FTAs in terms of benefits to various stakeholders and changing trade patterns, before signing new ones.
2. Negotiate bilateral FTAs with countries where trade complementarities and margin of preference is high.
3. Reduce compliance cost and administrative delays is extremely critical to increase utilisation rate of FTAs.

4. Proper safety and quality standards should be set to avoid dumping of lower quality hazardous goods into the Indian market. Circumvention of rules of origin should be strictly dealt with by the authorities.
5. RCEP negotiations especially with China need to be properly pondered upon and planned.