

## Free Trade Agreements (FTAs)

### What is the issue?

- India's decision not to join the Regional Comprehensive Economic Partnership (RCEP) could be looked based on many factors.
- One source of insight that can be used to find the effect of this decision is the experiences countries have had with free trade agreements (FTAs).

### Do FTAs lead to an increase in exports?

- Along with the FTA, the factors based on which the effects can be analysed are exports, investments, integration into the global value chain (GVC) and domestic industry.
- **Current FTAs** - Few economists have argued that by not signing the RCEP, Indian exporters would miss on exporting to RCEP countries.
- They forget that India already has FTAs with the Association of Southeast Asian Nations (ASEAN), Japan, South Korea, and three-fourths of the bilateral trade already happens zero duty.
- India also has a small preferential trade agreement with China.
- **No guarantee** - But, mere signing of an FTA does not guarantee an increase in exports.
- If import duty in the partner country is high, there is a likelihood of an increase in exports by 10% when this duty becomes zero.
- But the chances of exports increasing are low if import duty of the partner country is low at 1-3%.
- From this count, FTAs are of no use for exporting to Singapore, Hong Kong, as regular (Most Favoured Nation) import duties are zero.
- FTAs with Malaysia, Japan, Australia, etc. benefit few product groups only, as more than 60% of imports into these countries happen at zero duty for all countries.
- There is little additional market access.
- But even the high import duties coming down to zero through the FTAs do not guarantee exports.
- FTAs cut import duties, but this is only one of many factors that decide if exports will increase.

### Does a lower import duty regime help in getting significant investments?

- Most experts have argued in its favour.
- **India** could attract significant investments, for example, in the **car sector** on account of high import duties.
- This resulted in the development of an indigenous car and auto component industry.
- Now, with the car industry maturing, India can think of lowering import duties to promote competition.
- Most investments are a result of the package such as tax cuts, cheap land, power, etc. offered by the host country.
- **Generally**, if a country is not the most efficient economy, some level of an import wall helps in getting external investments.
- Without an import wall, many firms may shift production to the more efficient FTA partner countries for exporting back to the home market.
- But the quality of investments increases as a country moves towards becoming a more efficient economy.
- Such countries are in an ideal position to become manufacturing and services hubs.

### **Do FTAs ease entry into Global Value Chains (GVCs)?**

- **GVC** - Most commentators have expressed grief that by not signing RCEP, India will miss becoming part of GVCs.
- It is not so simple. Actual value chain activities are time critical.
- A country cannot become a significant part of such value chains unless it has an **efficient infrastructure** such as ports, customs, shipping, roads and a regulatory compliance infrastructure.
- GVC production also requires harmonisation of product and quality standards.
- For these reasons, FTAs alone don't make a country part of a value chain, which will be disrupted if a shipment is delayed or is of non-standard quality.
- **Asian RVC**- ASEAN, Japan and Korea constitute the core of the Asian regional value chain (RVC).
- But despite FTAs with these countries, India has a weak presence in the electronics, machinery or apparels value chains.

### **Is Indian industry protectionist?**

- Consider the impact of reducing import duty on an engine from 20% to zero for an FTA partner.
- Cheaper imports may replace products from domestic industries.
- But, if the duty on a product is low, the local industry may not care much about the duty elimination through any FTA.
- Countries that have reached this stage are comfortable doing FTAs with

fewer worries.

### What effective steps can be taken?

- An FTA's possible impact on the economy or exports is subject to many caveats.
- The FTAs can ensure market access to only the right quality products made at competitive prices.
- **Improvement in firm-level competitiveness** is a must.
- The **government** can help by,
  1. Ensuring lower duties on raw materials and intermediates than on the concerned finished products.
  2. Setting up an elaborate quality and standards infrastructure for essential products.
- Most countries regulate imports through such requirements and not through tariffs.
- Finally, about India turning inward.
- India ranks higher than the U.S., Japan, and China in the trade openness ratio, the globally accepted measure.

**Source: The Hindu**

### Quick Facts

#### What is the RCEP?

- It is a trade deal that is currently under negotiation among 15 countries.
- These countries include 10 member countries of the Association of Southeast Asian Nations (ASEAN) and 6 countries with which the ASEAN bloc has free trade agreements (FTA).
- The ASEAN countries have FTAs with India, Australia, China, South Korea, Japan and New Zealand.
- India recently decided not to join RCEP.