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.