# Utility of Regional Trade Agreements: Experience from India's Regionalism

*by*

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# Executive summary

This paper formulated in the context of the Indian experience in regionalism. In the past decade, India's trade policy has seen a marked shift towards regionalism with the signing of many regional trade agreements (RTAs). As of May 2011, 13 RTAs were in force, with at least eight more under negotiations. This paper explores whether these RTAs were ultimately of use to Indian traders. To assess the usefulness of an RTA to traders, percentage ratios, like utilization, product-coverage and utility ratios, are generally calculated. Use of these ratios has been boosted by United Nations Conference on Trade and Development (UNCTAD) assessment of the use of Generalized Scheme of Preferences (GSP) tariff preferences by developing countries. However, the lack of data in official statistics on India's preferential trade limits the use of this methodology here. Thus, this paper explores an alternative route to find utility of RTAs to the traders.

First, using available official trade statistics, aggregate trade trends are compared with trends in trade of preferential items for each RTA; the gap between the two gives an idea of the extent of importance of preferences in trading with the RTA partners,. Next, a primary survey of certifying agencies, undertaken to find out the level of utilization of preferential schemes by Indian exporters, is reviewed. The results show that after the RTAs came into effect, both exports and imports from the RTA partners increased significantly. However, an interesting contrast was found amid preferential exports and imports; while preferential imports were the driving force behind the substantial increase in total imports from the RTA partners, preferential exports – despite increases in value – could not explain the level of increase in total exports to RTA partners. This indicates that non-preferential items accounted for much of the increase in post-RTA exports. Therefore, the RTAs per se cannot be said to have greatly benefited Indian exporters.

From the primary survey three main points emerge:

(a) GSP is a better utilized preference scheme than all of India's RTAs put together;

(b) Among the RTAs, most Certificates of Origin (CoO) are issued under the India-Sri Lanka Free Trade Agreement (ISFTA), implying that exporters are using ISFTA more than the other RTAs. Given the wide coverage under this Agreement, this is understandable; however, when compared with overall exports to Sri Lanka, only 11 per cent of total export transactions to Sri Lanka in 2008-2009 were issued with CoO. This tallies with the low utilization of preferential schemes seen in other RTAs among developing countries;

(c) Rules of origin (RoO) maybe a culprit with regard to the low level of utilization as it was found from the survey that when there is more than one RTA available for exporting to a particular country, exporters choose the RTA that has lower value added norms for satisfying RoO.

# Introduction

The world trading system has witnessed an increasing number of regional integration initiatives in recent times. The basic premise of such initiatives is to liberalize trade among the members by granting tariff concessions for, or eliminations of selected products. Regional integration initiatives can be of various types, depending on their degree of integration:

(a) Preferential trade agreements (PTAs) form the first tier arrangement, where trading partners grant partial tariff reductions to each other;

(b) The second tier is the free trade agreement/area (FTA), in which members eliminate all tariffs among themselves, but with each member retaining its own tariff rates on imports from non-members;

(c) Third, members of a customs union (CU) set a common level of tariffs vis-à-vis non-members;

(d) The fourth tier is a common market, which also allows free movement of factors of production;

(e) The last tier is the economic union, which involves integrating national economic policies and adopting a common currency.

The World Trade Organization (WTO) uses the umbrella term of RTA for all such initiatives. The welfare effects of RTAs are traditionally ascertained using trade creation/trade diversion analyses (Viner, 1950). However, theoretical and empirical research has not been able to provide a clear answer as to whether RTAs are necessarily welfare-augmenting (more trade-creating than trade-diverting). Meade (1955), Lipsey (1970) and Summers (1991) showed instances of trade-creating RTAs whereas Grossman and Helpman (1995) and Bhagwati and Panagariya (1996) provided examples of trade-diverting RTAs.

Opinions are also divided among economists as to whether RTAs are "building blocks" or "stumbling blocks" with respect to multilateral trade liberalization under WTO, the essential question that was posed first in Bhagwati (1991). As Baldwin (1997) noted, the debate on RTAs may be divided between the Larry Summers school (Summers, 1991) and the Jagadish Bhagwati school (Bhagwati and Krueger 1995); the former school looks at regional (i.e., discriminatory) liberalization and sees only liberalization, whereas the latter school sees only discrimination. Despite the debate, RTAs are the current reality of the global trading order with all but two members of WTO (Mauritania and Mongolia) being engaged in at least one regional integration initiative. Keeping this recent march of regionalism as its backdrop, this study attempts to deal with the essential question: "Are the RTAs of use to traders?"

The paper is made in the context of the Indian experience in regionalism. In the past decade, India's trade policy has seen a marked shift towards regionalism with the signing of numerous RTAs. Thirteen RTAs are in force and at least eight more are under negotiation. This paper attempts to find the answer to whether such RTAs have ultimately been of use to Indian traders. In order to ascertain the usefulness of an RTA to traders, percentage ratios, (like utilization, product-coverage and utility ratios) are generally calculated (Inama 2003; and Candau, Fontagne and Jean, 2004). The use of these ratios has been boosted by UNCTAD assessment of the use of Generalized Scheme of Preferences (GSP)[1] tariff preferences by developing countries. However, the lack of data in official trade statistics on India's preferential trade limited the use of this methodology in this study. Firm-level studies have been conducted by a few authors on the use of RTAs (Takahashi and Urata, 2010; and Kawai and Wignaraja 2010). However, since firm-specific surveys are outside the scope of this paper an alternate route has been used in finding the utility of RTAs to the traders. Using available official trade statistics, this paper first compares aggregate trade trends with trends in trade of preferential items for

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[1] GSP schemes are trade preference provision schemes whereby developed countries unilaterally grant tariff preferences to developing and least developed countries.

each RTA; the gap between the two gives an idea of the extent of the importance of preferences in trading with the RTA partners.

Second, a primary survey of certifying agencies on the utilization of preferential schemes by Indian exporters is reviewed. With regard to the utilization of RTAs by importers, the required information from the Indian Customs was unavailable. However, some earlier studies that assessed the use of RTAs by exporters in India's RTA partners, especially Sri Lanka (de Mel, Jayaratne and Premaratne, 2011), reflect utilization from the perspective of Indian importers. Thus, this paper focuses on the utility of RTAs from the Indian exporters' perspective only. Section A gives a brief review of literature on RTAs. Section B details India's initiatives in regionalism. Section C gives the methodology and section D presents the results. In conclusion, taking into consideration the results, section E considers the utility of RTAs from an Indian perspective.

## A. RTAs and their effects: A brief review

A striking development in the recent history of the world trading system has been the unprecedented surge in RTAs. Figure 1 shows the significant increase in the number of RTAs entering into force from the mid-1990s. The continuity of such a trend in recent years is also clear from the figure. Prior to the mid-1990s, in some years only a few RTAs came into force, while in many years no new RTAs came into force. The WTO database on RTAs[2] states that between the inception of the General Agreement on Tariffs and Trade (GATT) up to the establishment of WTO (i.e., from 1948 to 1994), GATT received 123 notifications of RTAs, which covered mainly trade in goods. In contrast since the creation of WTO in 1995, more than 300 additional arrangements covering trade in goods and/or services have been notified.

The regionalism of the 1990s is referred to as the second wave of regional initiatives, or "new regionalism", to distinguish it from the first round of RTA formations that occurred as after-effects of the European Economic Community (EEC), that was established in 1957. The inception of the EEC led to signing of a few RTAs in Africa and Latin America from the 1960s to the 1980s, but the EEC remained the only successful regional integration initiative until the mid-1990s, when another wave of regionalism occurred, as shown in figure 1. In addition, most of the Agreements notified to WTO in 1970s and 1980s were those in the European Community[3] enlargement notifications. The "new regionalism" of the 1990s differed from the first wave of regionalism as it went beyond the tariff preference exchanges in goods, as it covered the entire globe rather than just Western Europe, and had a growing interregional dimension as many of the RTAs were no longer between countries of the same region (Busse and Koopmann, 2002).

There are, in general, three objectives for forging regional alliances:

(a) To promote economic cooperation among countries forging such alliances;

(b) To build a sense of security in order to facilitate political harmony within a region;

(c) To enable the countries concerned to achieve international competitiveness in the current era of globalization.

Although these objectives provide a politico-economic rationale for establishing RTAs, they cannot explain why there has been a sudden spurt in such agreements across the world as is evident from Figure 1. According to many economists, such as Bhagwati (1994), Krugman (1993) and Panagariya (1999), the proliferation of RTAs in recent years was due to the slow progress of GATT/WTO, as witnessed by the long-drawn out rounds as well as the bitterness in negotiating issues

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[2] WTO Regional Trade Agreements Information System (RTA-IS), available at
http://rtais.wto.org/UI/PublicMaintainRTAHome.aspx (accessed 30 April 2010).
[3] The European Economic Community was renamed as the European Community in 1993.

between the developed and developing nations, as seen in the Doha Development Round. This may have led to the forging of more regional partnerships to liberalize trade in recent times. Baldwin (1997) refuted this argument that the "new regionalism" has stemmed from frustrating WTO talks by stating that it was the regionalism in the European Community and the United States of America that actually had a "domino effect" in getting other countries to follow suit. Countries do not want to be left out of the RTA process as they fear that they will otherwise lose out on market access. So slow progress under GATT/WTO is not the catalyst for the "new regionalism", as GATT/WTO rounds have traditionally been long-drawn out; rather, a "domino effect" explains the new drive towards the growth in regional initiatives.

**Figure 1. Number of RTAs entering into force, 1958-2009**
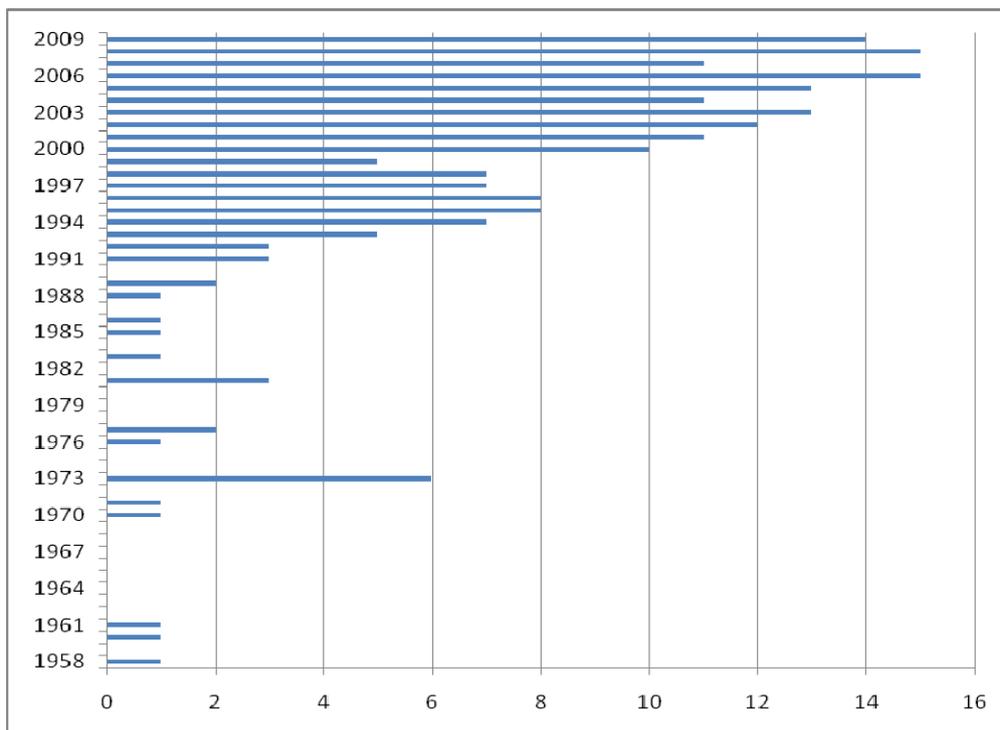


*Source*: Author's calculation, based on the WTO RTA-IS database.
*Note:* 1958 – EEC comes into effect; 1973 – first EEC enlargement with the inclusion of the United Kingdom of Great Britain and Northern Ireland, and other countries; 1981 – second EEC enlargement with the inclusion of Greece; the third and fourth enlargements in 1986 and 1995; the fifth and last enlargement in 2004.

The traditional theory of gains from free trade suggests that the removal of trade barriers allows consumers and producers to purchase from the cheapest and most competitive sources of supply. This enhances efficiency and increases welfare. Following this logic, it was traditionally believed that regional trade blocs should generate gains from trade as and when member countries eliminated trade barriers among themselves. However, studies carried out in this area have found that RTAs do not necessarily result in welfare gains either for all the members or for the world as a whole. Viner (1950) introduced the concepts of trade creation and trade diversion, and showed that the net welfare effect of trade liberalization on a regional basis was not unambiguously positive. He pointed out that RTAs could lead to trade creation if, due to the formation of a regional agreement, the members switched from inefficient domestic producers and imported more from efficient producers of other RTA members. In this case, efficiency gains arise from both production efficiency and consumption efficiency. On the other hand, trade diversion takes place if, because of the RTA, members switch imports from low-cost producers in the rest of the world to higher-cost producers

within the region. Trade diversion lowers welfare of not only the RTA countries but also that of the rest of the world.

There is a major ongoing debate among the trade theorists and empiricists about the relative dominance of these two effects. Some studies have shown that the balance between trade creation and trade diversion is more likely to favour trade creation (a) when MFN tariffs before the formation of RTAs are low (Meade, 1955); or (b) if member countries of an RTA are already large trading partners (Lipsey 1970); or (c) transportation costs are low (Summers, 1991). However, Grossman and Helpman (1995) claimed that the formation of trade-diverting RTAs was the most likely case as viability of a potential FTA increases only with enhanced protection for most domestic sectors. Also, according to Bhagwati and Panagariya (1996), if members of an RTA are small in relation to the outside world, very little trade creation will take place and trade diversion is likely to be the more dominant effect. Existing empirical studies do not provide any definite conclusion on the net welfare effect (Pomfret, 1988). The World Trade Report (2003) stated that the evidence drawn from econometric analysis produced different results for different RTAs in this regard and that a general conclusion could therefore not be drawn.

The effects of RTAs have also been analyzed using gravity models. The results have generally shown an increase in bilateral trade due to RTAs (Frankel, 1997; Soloaga and Winters, 2001; Martinez-Zarzoso and Nowak-Lehmann, 2003; Feenstra, 2004; and Bergstrand, Egger and Larch, 2007). The gravity model of trade predicts bilateral trade flows based on the economic sizes (GDP) of two countries and the distance between them. Policy variables such as RTAs are introduced as dummy variables in order to find their effects on bilateral trade. Gravity modeling of trade, though popular, has theoretical issues. With the advent of multi-country, multi-sector computable general equilibrium (CGE) models, techniques available for analyzing RTAs have improved substantially. These models can be used to predict the impact of an RTA on an economy-wide basis: they can evaluate the production, employment, consumption, trade, price and welfare effects of the formation or the expansion of an RTA. The general conclusion from studies using CGE models is that formation of an RTA leads to more trade creation than trade diversion and that welfare effects increase for all members of an RTA (Robinson and Thierfelder, 2002). Again, however, there is an ongoing debate on the use of CGE models for studying RTAs as such models have poor econometric foundations (Hertel, and others 2007).

Utilization of tariff preferences by firms is an area where some empirical work on regional integration has been presented recently in the literature. When preferential trade data are available, utilization by exporters can be easily found, using the percentage ratios mentioned above (product-coverage, utilization and utility ratios). For example, Cadot and others (2002) calculated the average utilization rate for NAFTA in 2000 and found it to be 64 per cent. Inama (2003) calculated utilization of GSP schemes by using the same percentage ratios and found that only 39 per cent of eligible products entered the Quad countries[4] from developing beneficiary nations under GSP.

Primary surveys have also been undertaken by some authors to ascertain use of RTAs by traders. Those studies found that utilization of most RTAs involving developing countries was much lower compared to developed country RTAs; for example, between 17 per cent and 25 per cent of the firms in South-East Asia use FTAs (Kawai and Wignaraja, 2010), while between 12 per cent and 33 per cent of Japanese companies use the various FTAs with the developing countries (Takahashi and Urata, 2010). Almost all the studies point to the restrictive role of Rules of Origin (RoO), which they say deters the use of RTAs. RoO are the requirements that a product must satisfy in order to be eligible for being declared as "originating" in a beneficiary country. If a traded product contains imported components, there are three general rules for determining "origin" – (a) change in tariff classification, (b) local value-added and/or (c) a technical rule. These rules are negotiated during the

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[4] Quad countries is the term used by WTO to refer to the four major industrialized economies, i.e., the United States, European Union, Canada and Japan.

drawing up of an RTA, and different combinations of such rules can be found in RTAs around the world. They are designed to support a commercial policy; however, because of the way in which they have evolved, they have become commercial policy instruments in themselves (Vermulst and Waer, 1990). Krueger (1993), Palmeter (1993), Estevadeordal (2000), Brenton and Manchin (2003), and Krishna (2005), among others, described the role of RoO in RTAs.

Both at the theoretical and empirical level, economists are divided over the desirability of RTAs in a multilateral trade regime. Some envisage RTAs as "stumbling-blocks" to multilateral trade liberalization whereas others contend that they can act as "building-blocks", terminology introduced by Bhagwati (1991). Even after many years of debate, no consensus has been reached on this issue. As Herrmann (2008) noted "...it seems that even from a purely economic perspective – which is not necessarily best suited or conclusive for all problems of international political economy – no clear-cut case can be made for or against RTAs with regard to their impact on welfare and multilateral institutions". Herrmann also stated that each RTA would be different and hence should be assessed on its own. Thus, for this study, each of India's RTAs were analyzed to ascertain their effects on bilateral trade. Both secondary data sources and a primary survey were used to determine the use of RTAs by exporters, thereby contributing to the small, yet growing, literature that attempts to ascertain use of RTAs by traders.

# B. RTAs: India's initiatives

Seshadri (2009) traced the evolution of Indian RTAs, from limited scope and sometimes non-reciprocal PTAs with developing countries (such as the PTA with Nepal) to comprehensive and reciprocal arrangements with developing countries (e.g., the FTA with Sri Lanka) and then to the recent RTAs that India has negotiated with developed countries (e.g., European Union members).

The first RTA entered into by India was in 1975 when the Government signed the Bangkok Agreement. It started as a regional initiative between developing countries of the Asia-Pacific region but was very limited in its scope; in fact, it was only in 2005 that it was reincarnated as the Asia-Pacific Trade Agreement (APTA) and trade liberalization started in a meaningful way between its members (Bangladesh, China, India, Republic of Korea, Lao People's Democratic Republic and Sri Lanka). Members of the South Asian Association for Regional Cooperation (SAARC)[5] formed a PTA (SAPTA) in 1995, which was another regional initiative between the nations of South Asia under the ambit of SAARC. It was upgraded to an FTA (SAFTA) in 2006. India's first bilateral FTA was with Sri Lanka – the India-Sri Lanka Free Trade Agreement (ISFTA). It came into effect in March 2000. Subsequently, many other RTAs were signed and currently, as of May 2011, 13 are in operation. Annex I provides information on these RTAs. From the annex it is clear that in the past decade India has signed and implemented many RTAs. India is focusing on signing many more RTAs in the near future, particularly with its major trade partners such as the European Union and Japan. Table 1 lists the preferences exchanged under the bilateral RTAs covered by this study.

In this policy shift towards RTAs, one worrying trend is the overlapping of such agreements. India's RTA trade partners are part of more than one RTA in some cases, e.g., while trading with Sri Lanka there are currently four RTAs that can be used for preferential trade and if the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC)[6] FTA comes into force there will be yet another RTA route for trading with Sri Lanka. Figure 2 shows the overlap of

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[5] Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka established the South Asian Association for Regional Cooperation (SAARC) on 8 December 1985 to facilitate regional cooperation. In April 2007, at SAARC's fourteenth summit, Afghanistan became its eighth member.
[6] BIMSTEC was set up in 1997 to foster socio-economic cooperation among Bangladesh, India, Sri Lanka of SAARC, and Thailand and Myanmar of ASEAN. Bhutan and Nepal joined the initiative in 2003. BIMSTEC is viewed as a "bridging link" between the two major regional groupings of SAARC and ASEAN. Negotiations are ongoing on establishing an FTA between the members.

RTAs already in operation. The "spaghetti bowl"[7] of RTAs is causing much confusion and difficulty among the trading community as the rules governing each RTA are different.

**Table 1. Tariff concessions exchanged on number of products (HS 6-digit level)**

| RTA | India's concession to partner's exports | Partner's concession to India's exports |
|---|---|---|
| Sri Lanka FTA | 5024 | 4004 |
| Afghanistan PTA | 23 | 8 |
| Thailand FTA (EHS)[8] | 82 | 82 |
| Singapore CECA | 5121 items (8-digit) | All items |
| Chile PTA | 178 items (8-digit) | 296 items (8-digit) |

*Source*: Author's compilation based on information available at the Ministry of Commerce website, http://commerce.gov.in/trade/international_ta.asp?id=2&trade=i.

**Figure 2. Overlapping Indian RTAs**



*Source*: Author's depiction.

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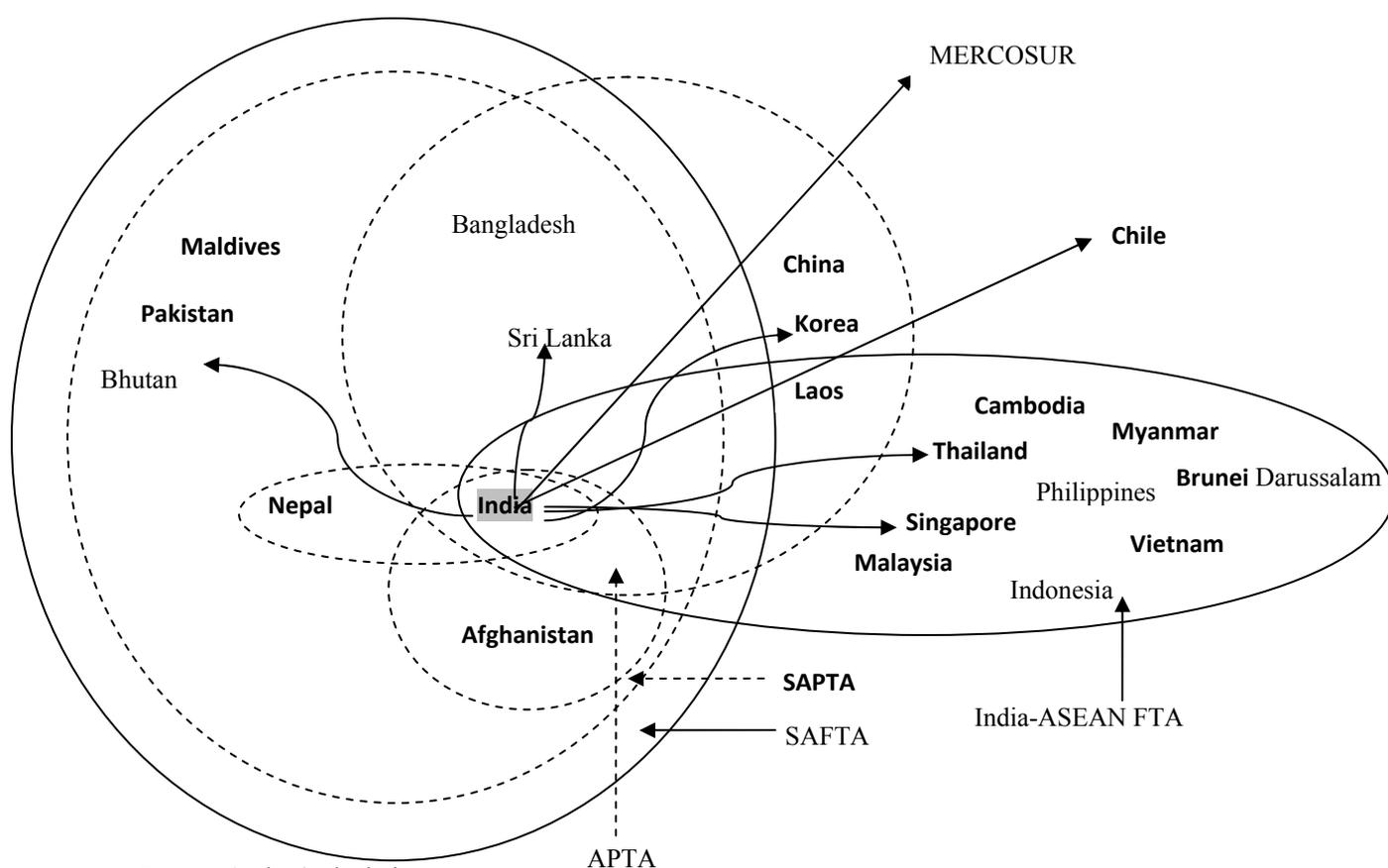
[7] Bhagwati (1995) compared the overlapping RTAs with a "spaghetti bowl" and the complex RoO of such overlapping arrangements as "the mess created on the tie and shirt of the person eating the spaghetti".
[8] The Early Harvest Scheme covers areas of economic cooperation and has a common list of items for exchange of tariff concessions as a confidence-building measure.

# C. Methodology

Since the RTAs came into force India's trade, both exports and imports, has increased with most of its RTA partners, as indicated by the official trade statistics. The question here is whether such an increase is due to the preferences exchanged under the respective RTAs or for other reasons. The official trade data, available from secondary sources, does not give the amount of trade done on preferential basis – there are no data that show the amount of trade that occurs with CoO.[9] If this data were available for India's exports and imports, the extent of utilization of preferences by traders could have been calculated easily and the usefulness of the RTAs to traders commented upon. In the absence of such data two steps were taken: (a) aggregate trends were compared with the trend in preferential items – the gap between the two gives an idea of the extent of importance of preferences in trading with the RTA partners; and (b) a primary survey of certifying agencies was undertaken to ascertain the utilization of preferential schemes by Indian exporters.  In the first step, the preferential items were noted from the RTA texts, available on the Ministry of Commerce website. In some agreements, such as the India-Afghanistan PTA (IAPTA), and the India-Chile PTA (ICPTA), the items given preferences are listed directly. In most other agreements, there is a negative list that includes all items not given preferences. By deducting their collective trade value from total trade, the value of the preferential items is arrived at. Also, the top 10 commodities, value-wise, are calculated at the 6-digit HS[10] level (preferences are generally exchanged at the 6-digit HS level). As trade in such disaggregate items fluctuates year to year, a simple average of the past three years is taken to ascertain the top 10 products traded with RTA partners. Whether these items are being granted preferences under the RTAs is ascertained next. These two exercises were carried out for India's bilateral (and reciprocal) RTAs with Afghanistan, Chile, Singapore, Sri Lanka and Thailand.

The Export Inspection Council (EIC) in New Delhi is the main certifying agency for issuing CoO to India's various preferential schemes. An exporter wishing to export through any of the RTAs needs to apply to EIC for the requisite CoO. For most of the RTAs (Sri Lanka FTA, Afghanistan PTA, Thailand FTA, Singapore CECA, SAFTA, MERCOSUR PTA, Republic of Korea CEPA and ASEAN CECA), the EIC, through its field organizations in various Indian cities, is the sole authority for issuing CoO. EIC was visited a number of times in order to collect the data on the annual number of CoO that are issued to exporters under each RTA. This number is then compared with the total number of transactions that exporters make annually with RTA partners. This data is collected from the Directorate-General of Commercial Intelligence and Statistics (DGCI&S), Calcutta. DGCI&S comes under the Ministry of Commerce of India, and is the official organization for collection and dissemination of India's trade statistics. The number of transactions made annually by exporters with regard to a partner country is not available in official trade statistics. Visits to DGCI&S made it possible to ascertain this number for Sri Lanka. Thus, the number of transactions with CoO was obtained from EIC (each consignment receives with one CoO, so number of CoO issued under ISFTA implies the number of consignments, i.e., transactions that are going annually to Sri Lanka). Data on the total number of annual transactions that exporters are making with Sri Lanka were acquired from DGCI&S. A comparison of these two sets of numbers gives an approximate measure of the use of the ISFTA preferential scheme by Indian exporters.

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[9] To utilize preferences under any RTA the traded items need to satisfy Rules of Origin (RoO) and their exporters need to get a CoO from a government agency and then ship it to the importer who can then avail the lower preferential tariffs. The CoO states that the product shipped satisfies RoO and thereby 'originates' in the exporting country. It is important to help check trade deflection, whereby third country firms can route their products through the lowest tariff member in an RTA to other member markets. RoO check such simple transshipment by requiring traded products to 'originate' in the exporting member country. The rules may be a change in tariff classification or a minimum percentage of value to be added domestically or any other specific requirements.

[10] The Harmonized Commodity Description and Coding System (HS) is a coded classification of traded products that is managed by the World Customs Organization. The classification, which is based on the nature of the commodities, first came into use in 1988. It is now used by more than 200 economies for customs purposes.

# D. Results

Bilateral trade, in both exports and imports, with India's RTA partners increased substantially after the RTAs came into effect. This can be clearly seen from figures 3 and 4. Within three years after ISFTA, the first bilateral FTA for India, came into force in 2000, India's exports to Sri Lanka doubled from about US$ 500 million to close to US$ 1 billion. In 2009 (i.e., 2009/10) the figure was close to US$ 2.1 billion. Imports from Sri Lanka, although much less in value than exports, increased by twelve times to reach around US$ 630 million in 2007 but then declined to US$ 390 million in 2009. However, that drop can be explained by the global financial crisis.

After IAPTA, exports to Afghanistan rose from a meagre US$ 25 million in 2002, a year before the PTA came into effect, to US$ 464 million in 2009; similarly, imports increased from around US$ 19 million to US$ 125 million in just six years after the PTA came into force.

For the Thailand FTA, under an EHS list a total of 82 common items were made duty-free for bilateral trade. Exports to Thailand increased from US$ 900 million from the EHS launch in 2004 to US$ 1.7 billion in 2009. Imports from Thailand increased much more during the same period from US$ 610 million to US$ 2.9 billion.

Under the Singapore CECA, Singapore exempted payment of MFN duty on all export items from India, whereas India gave preferential access to about 5,121 items at the 8-digit level. (Table 1 lists the concessions exchanged under these RTAs.) After CECA came into force in 2005, exports increased from US$ 4 billion in 2004 to US$ 7.5 billion in 2009 while imports increased from US$ 2.6 billion to US$ 6.5 billion during the same period. There has been a decline in trade values in the past two years, which again can be explained by the global financial crisis.

The Chile PTA came into effect in 2007. The global financial crisis set in just after that, so in the subsequent two years exports to, and imports from Chile saw a decrease. In the case of imports by India from Chile, the main reason of the decrease was due to the decrease in copper ore imports, which is Chile's main export item. The dip in the value of copper imports can be attributed to the low international price of copper ore since 2007.

**Figure 3. India's exports to bilateral RTA partners**
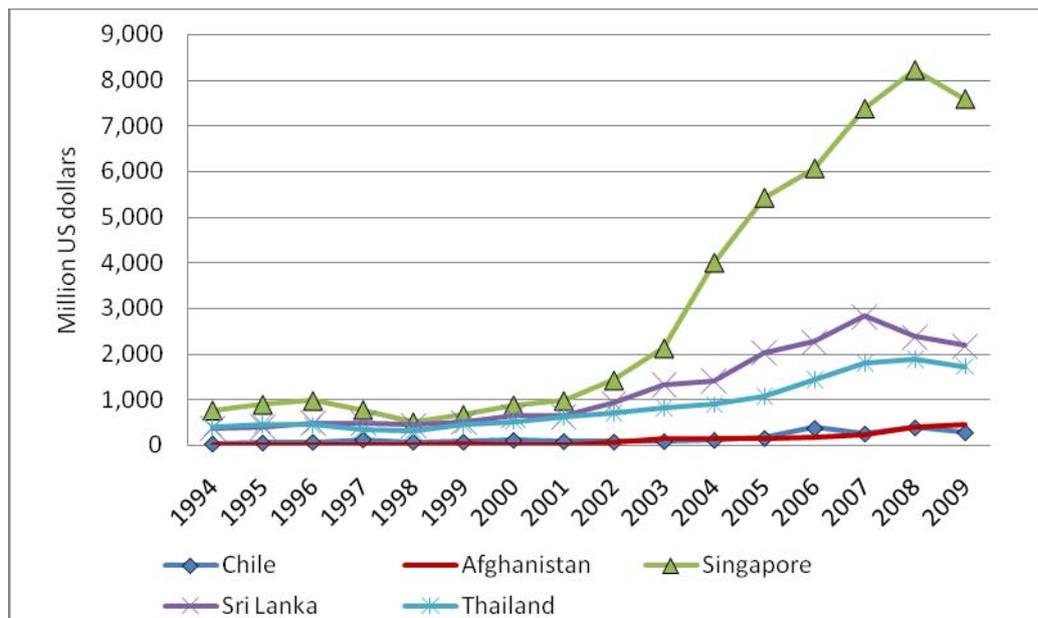


*Source*: Calculated from data available at the India Trades database.

Given the absolute increase in trade following the coming of RTAs into force (except in the case of Chile), the question comes to mind of whether or not it was because of the RTAs, i.e., because of an increase in trade of items that received preferences? To find the answer, the trade value of preferential items have been calculated for each of the RTAs and then compared with the total exports/imports under those RTAs, as shown in annex II, figures 1-5. What is interesting is that imports of preferential items are driving total imports from RTA partners (note the figures for Sri Lanka, Afghanistan and Chile), whereas increased Indian exports to those countries are not due to increases in preferential items. It can be said that since India has granted more concessions to its partners (as indicated in table 1) within the agreements (except for the Singapore CECA and the Chile PTA), this result is not surprising. However, if the agreements are looked at carefully, it becomes evident that the RTA partners have been able to gain concessions for the items of interest to them; thus, after the RTAs' entry into force, they have been able to expand exports of such items given the tariff preferences. Even in the case of the Chile, which has granted preferences for a greater number of items, India is still exporting products that are not covered by such preferences but with which it enjoys a comparative advantage. India's main imports from Chile are copper ore and concentrates, which accounted for more than 90 per cent of total imports from Chile in 2006, the year before the PTA came to force. In contrast, India's exports of all the preferential items taken together were approximately 50 per cent of the country's total exports to Chile in the same year.

**Figure 4. India's imports from bilateral RTA partners**
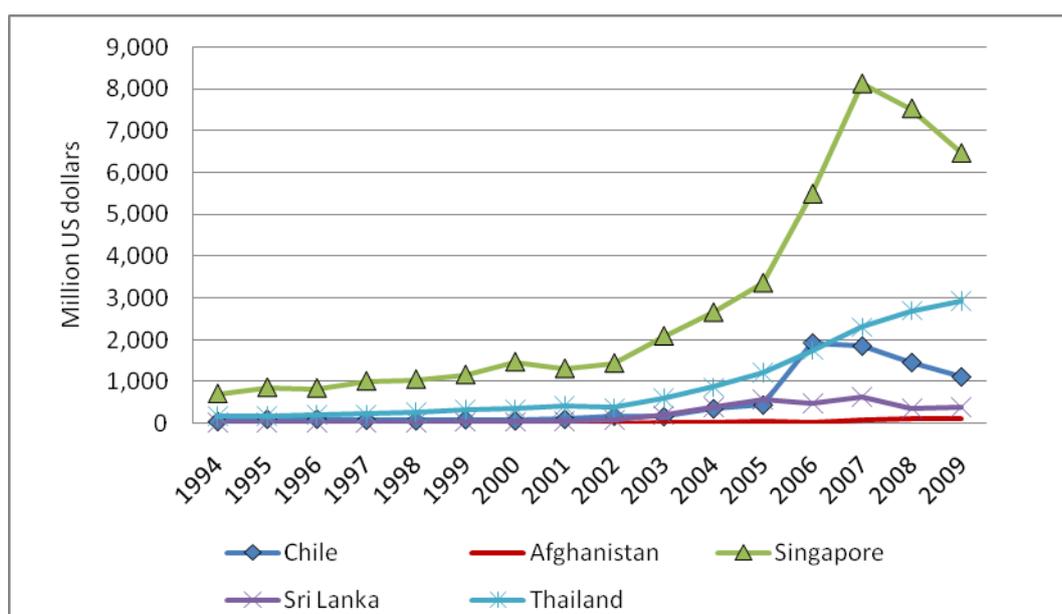


*Source*: Calculated from data available at the India Trades database.
Note*:* Years refer to 1994/95 to 2009/10 financial periods.

Under IAPTA, India has granted Afghanistan preferences for only 23 items at the HS 6-digit level. These are items of export interest to Afghanistan, i.e., dried fruit and nuts. In the case of Sri Lanka, India received tariff concessions for about 4,000 items, whereas it granted concessions for 5,000 Sri Lankan products. Almost 96 per cent of current imports from Sri Lanka are preferential items whereas only about 40 per cent of India's current exports are eligible to receive preferences.

In the case of the Thailand EHS, both countries have a common list of items. Figure 3 of annex II clearly shows that Thailand has been able to export a greater volume of such items than India, as most of these items are electrical machinery products in which Thailand has a comparative advantage. Tables 1-10 in annex III, show that the top imports from India's RTA partners are mostly

preferential items (shaded), whereas few of India's top exports come under the preferential category (the exceptions are the Singapore CECA and the Chile PTA). It is clear that although India's exports to its RTA partners have increased, it is not because of the RTAs. So the RTAs per se have not been useful in helping exporters to increase their share in partner markets. The only exception appears to be the Singapore CECA, under which all Indian exports are duty-free and increases in exports may be attributable to preferences.

The RTAs may have helped Indian importers. From the figures shown in annex II, it can be assumed that the increase in imports from partner countries reflects the increase in imports of preferential items. It still has to be assumed that this is due to the RTAs; even though imports of preferential items have been the driver of increases in total imports from some of the RTA partners, it is still not certain whether such imports are coming with proper CoO and that the importers are therefore actually gaining benefits from the preferences under the respective RTAs.

To find the extent of use of preferential schemes by exporters, a primary survey was undertaken. The number of CoO issued to exporters annually (figure 5) was found from EIC data. It should be noted that the issued CoO listed in the data were requested by exporters for the preferential scheme. The data do neither show whether the scheme was finally used by the exporter at the time of exporting, nor whether the importing country's customs authority accepted it. It can be seen that the greatest number of applications from exporters was under ISFTA. Given the extensive coverage by the agreement, compared to other agreements (except the Singapore CECA whereby all exports from India are duty-free), this fact is not surprising.

The next most frequently applied for RTA is APTA, followed closely by SAPTA. Even where SAFTA provides more preferences, use of SAPTA was predominant among exporters. Compared with the GSP schemes, however, the issue of CoO is much less for all the RTAs taken together: of the total number of CoO issued by EIC under different schemes, 96 per cent on an average were under the GSP schemes.

**Figure 5. Certificates of Origin issued annually by EIC**
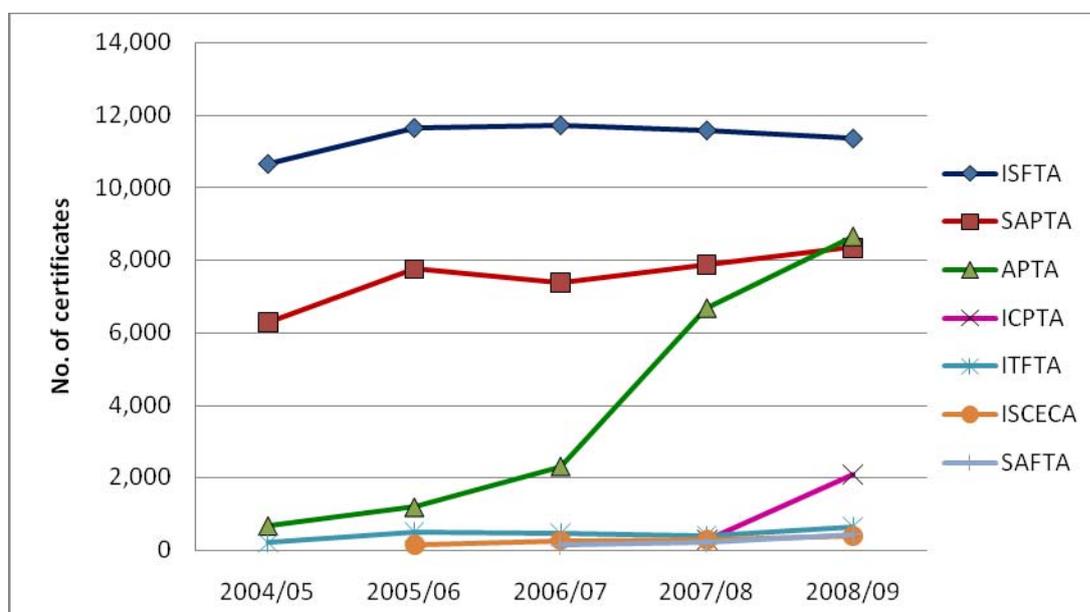


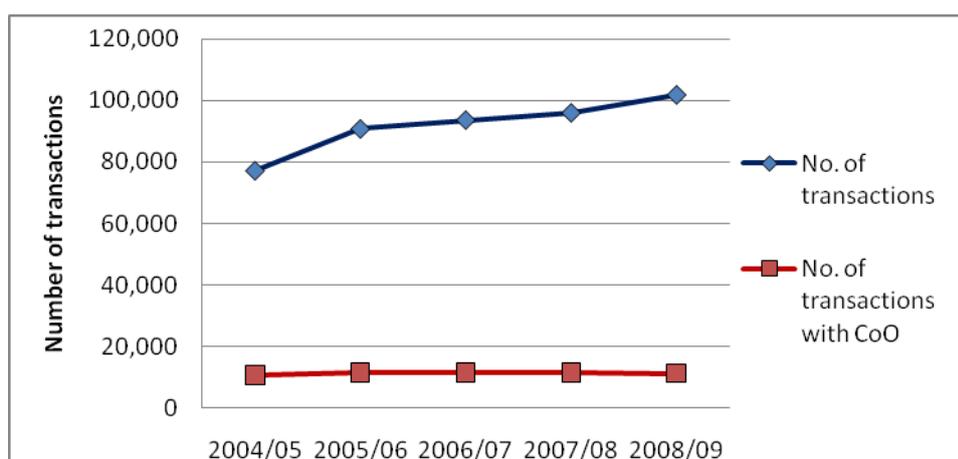*Source*: Calculated from data collected by the EIC primary survey.
*Note:* Prior to 2005/06, APTA was called the Bangkok Agreement, which had a very low level of exchange of concessions.

The number of annual CoO issued by EIC under ISFTA, the most applied-for RTA route, was then compared with the number of export transactions going to Sri Lanka annually. The latter data were supplied by DGCI&S, Calcutta. Since the Sri Lankan FTA is the most applied-for RTA, the data were collected for Sri Lanka only to gain an idea of the proportion of the most applied-for route in total trade transactions with RTA partners. A comparison of the two numbers provides an approximation of the extent to which exporters use ISFTA (figure 6). As figure 6 indicates, there is a significant gap between total export transactions and export transactions with CoO.

More importantly, there has only been a marginal increase in the issue of CoO (the number of transactions with CoO) under ISFTA over the years, even though the total number of transactions has increased. In 2008/09, approximately 11 per cent of the total export transactions were issued CoO. This can be taken as the upper boundary of utilization by Indian exporters of the ISFTA preferential scheme if it is assumed that all CoO issued by EIC under ISFTA are being used by exporters and accepted by the Sri Lankan customs authority. However, it cannot be considered as the usual utilization ratio, as not all exports to Sri Lanka are covered under ISFTA preferences. (The utilization ratio is the percentage of trade going through the preferential route with regard to the product coverage of an agreement.) So the 11 per cent figure only gives an approximate idea of how frequently exporters use the ISFTA scheme out of the total transactions with Sri Lanka. Like other studies with respect to other developing countries (Kawai and Wignaraja, 2010; Takahashi and Urata 2010), this small amount is not surprising as utilization of most RTAs involving developing countries is negligible.

Last the data collected on the use of RTA routes (in cases where there is more than one RTA under which exports are made to a partner country) is detailed in table 2. For Sri Lanka, ISFTA CoO are sought the most by exporters. For Bangladesh, the SAPTA route is more preferred. Although SAFTA provides very good product coverage compared to SAPTA, and is on a par with ISFTA, Indian exporters make greater use of SAPTA and ISFTA. Maybe RoO are the reason. A comparison of RTA usage and their RoO appears to indicate that exporters may choose RTAs based on value addition norms; lower value addition requirements, together with coverage by the agreements, may be prompting exporters to use a particular RTA when more than one RTA is available with a partner country.

**Figure 6. Use of Sri Lanka FTA by exporters**



*Source*: Calculated from data collected from the primary survey of EIC and DGCI&S.

**Table 2. CoO issued for overlapping RTAs**

|  | Percentage of CoO issued | RoO criteria* |
|---|---|---|
| **For Sri Lanka** | | |
| ISLFTA | 90 | CTH + 35 per cent VA |
| SAPTA | 9.8 | 40 per cent VA |
| APTA | 0.15 | 50 per cent VA |
| SAFTA | 0.05 | CTH + 40 per cent VA+ PSR |
| **For Bangladesh** | | |
| SAPTA | 86 | 40 per cent VA |
| SAFTA | 9 | CTH + 40 per cent VA + PSR |
| APTA | 5 | 50 per cent VA |

*Source*: Author's compilation.
*Note:* CTH = change in tariff heading; VA = value addition (i.e., the percentage of value to be added domestically to the export product); and PSR = product specific rules.
* For a comprehensive discussion on the different criteria of RoO see Brenton, 2003.

# E. Conclusion

This study was carried out in the context of the recent surge in RTAs in India's trade policy landscape. The focus of the study was whether such RTAs are of use to traders, the ultimate users of such schemes. Due to a lack of preferential trade data in official statistics, the study took recourse in the alternate route of using the value of each preferential trade item at the HS 6-digit (or 8-digit level in some cases) for each of India's bilateral RTAs, aggregated the values and compared them with the value of overall trends in trade. After the RTAs came into effect, both exports and imports from RTA partners increased significantly. However, an interesting contrast was found between preferential exports and imports – preferential imports were the driving force behind the substantial increase in total imports from RTA partners, whereas preferential exports, although increasing in value, did not explain the amount of increase in total exports to RTA partners. This indicated that much of the increase in post-RTA exports was in non-preferential items and that the RTAs per se were not of any great benefit to Indian exporters.

In recent years, India's top exports, worldwide, have been in gems and jewellery, petroleum products,[11] machinery (both electrical and non-electrical), vehicles, iron and steel and their products. Many of the items under these headings do not receive preferences under the RTAs. So it is no surprise that these items, even though appearing on the negative list of the RTAs, account for a larger proportion of total exports under the RTAs. At the same time, most of India's RTA partners have received preferential benefits for those items that are of export interest to them, e.g., spices from Sri Lanka,[12] electrical equipment from Thailand, copper ore and concentrates from Chile, and dried fruit and nuts from Afghanistan.

The primary survey revealed four important facts:

(a) GSP is a better preference-giving scheme than all of India's RTAs put together;

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[11] In the past few years, there has been a massive increase in India's export of petroleum oils such as light petroleum oils, aviation turbine fuel, high speed diesel etc.
[12] Under the Sri Lanka FTA, huge surges occurred in imports of items such as copper products and *vanaspati*, which, even though not of interest to Sri Lanka at the time of signing the agreement, suddenly became top export items for India in just a few years. It was found that Indian businesses had shifted to the island nation to exploit the FTA preferences in these items. Corrective steps were taken to stop the huge influx of these items, which was adversely affecting the domestic industry in India. Therefore, because of this experience under ISLFTA, more focus should be given to the role of RoO and their proper implementation under all RTAs. This is discussed in more detail in Jha, 2010.

(b) Among the RTAs, the largest number of CoO are issued under ISFTA, implying exporters are using ISFTA more than other RTAs. Given the wide coverage under the agreement, this is understandable;

(c) Even in the case of ISFTA, however, usage by exporters was only 11 per cent of India's total export transactions in 2008/09;

(d) When more than one RTA is available, exporters choose the RTAs that have lower value-added norms in the RoO.

Given the skewed preference exchange and the low use of preferences found from the analysis in this study, what is now clear is the need to first pause and reflect on the decade-long experience with the various RTAs, their effects on trade and their usefulness to Indian traders before deciding on the direction of future negotiations. What must be kept in mind is that the usefulness of RTAs goes beyond the economic outcome, as Europe's history in regional integration has proven. Also, joining more RTAs may bring long-term dynamic gains. Upgrading FTAs to CECAs/CEPAs/CECPAs may also bring more benefits in multiple areas; however, in order to reap all such future benefits, careful consideration should be given to the current planning of the agreements. Top priority should also be given to ensuring their effective enforcement so as to prevent trade malpractice, otherwise they will just become paper agreements with no real usefulness and, in some cases, even disutility.

Future research in this area will help to overcome the limitations of this study: a primary survey could be carried out at the Indian Customs in order to collect exact data on preferential trade with RTA partners. In addition, a primary survey of exporters and importers may help in pin-pointing operational problems with RTAs and thus reveal the reason for the low level of usage. The effects of RTAs on end-user industries can be explored through industry-specific case studies. A comparative study of India's RTAs with other RTAs will also be of enormous significance from both research and policy perspectives.

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# Annexes

## Annex I. Indian RTAs in force (as of May 2011)

| RTA | Signed | Status |
| --- | --- | --- |
| SAARC PTA | April 1993 | Started operation in December 1995 |
| India-Sri Lanka FTA | December 1998 | Operating from March 2000 |
| India-Nepal PTA | March 2002 | Operating from March 2002 |
| India-Afghanistan PTA | March 2003 | Operating from May 2003 |
| India-Thailand FTA | October 2003 | EHS started in September 2004 |
| South Asian FTA | January 2004 | Supersedes SAPTA; operating from January 2006 |
| India-MERCOSUR PTA | January 2004 | Operating from June 2009 |
| India-Singapore CECA[a] | June 2005 | EHS started in August 2005 |
| Asia-Pacific PTA | November 2005 | Broader tariff cuts in force from September 2006 |
| India-Chile PTA | March 2006 | Operating from September 2007 |
| India-Bhutan Trade Agreement | July 2006 | Operating from July 2006 |
| India-ASEAN CECA[b] | October 2003 | FTA in goods came into force in January 2010 |
| India- Korea CEPA | August 2009 | Operating from January 2010 |

*Source*: Author's compilation from information at the Ministry of Commerce website http://commerce.nic.in/trade/international_ta.asp?id=2&trade=i

*Notes:* (a) In a major policy shift, the Government of India has reportedly decided to convert all PTAs/FTAs into Comprehensive Economic Cooperation Agreements (CECAs). Apart from tariff concessions on goods, these CECAs will cover preferential relaxation of FDI rules vis-à-vis the partner country, tax holidays on investment and income, and easing of visa restrictions. Trade in services will also come under the purview of CECAs. (Comprehensive Economic Partnership Agreements and Comprehensive Economic Cooperation and Partnership Agreements are variants of such arrangements.)

(b) The agreement came into force on 1 January 2010 with regard to Malaysia, Singapore and Thailand. In the case of other ASEAN countries, the agreement will come into force after they complete their internal requirements. Negotiations on Trade in Services and Investment are underway.

**Annex II. Data on exports and imports between India and five trading partners**

All figures are drawn from data available at India Trades, a server-based database provided by CMIE, which gives India's trade data. The data period is from prior to the signing of the RTA up to 2009-2010. The square markers in the figures indicate the year that the agreement came into force.

**Annex figure 1. India's trade with Sri Lanka**
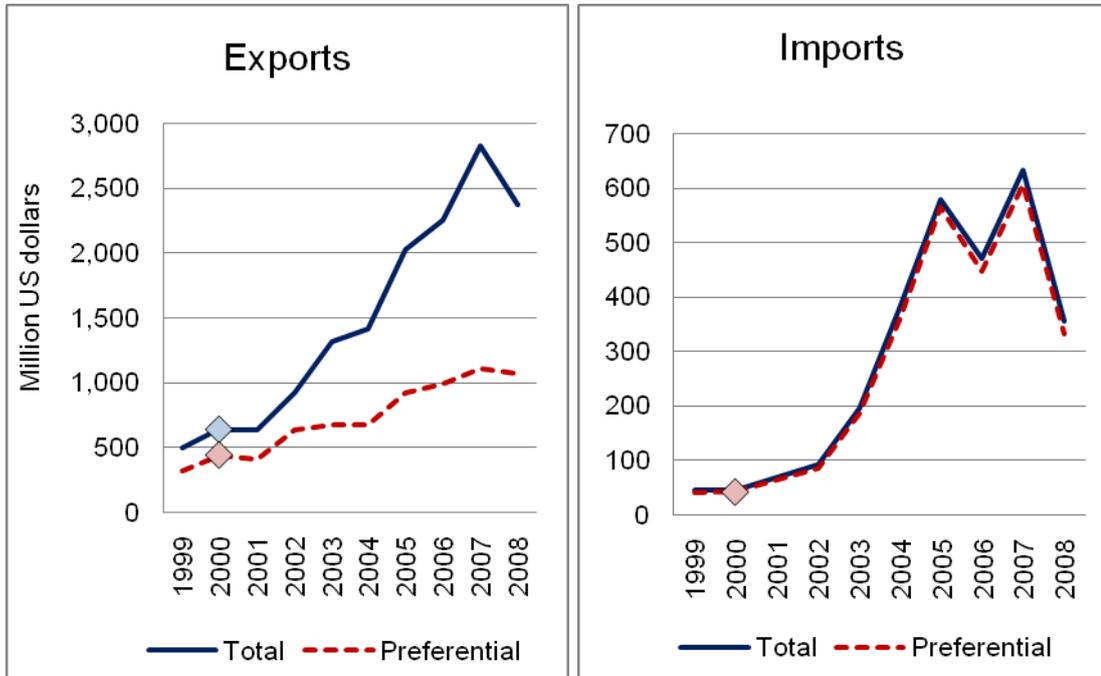


**Annex figure 2. India's trade with Afghanistan**
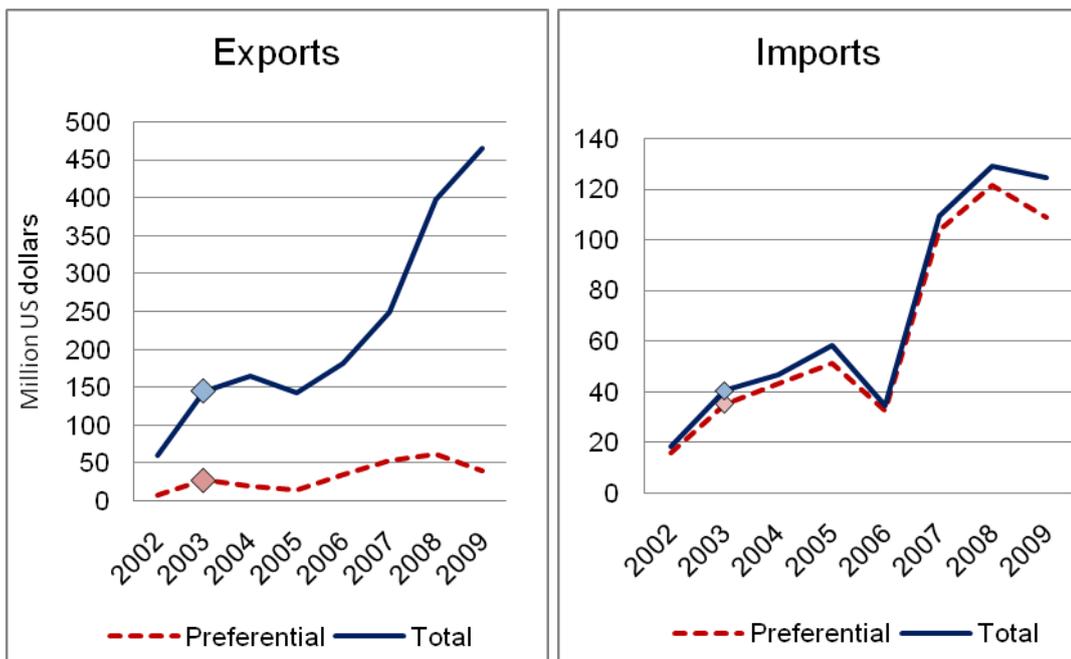
**Annex figure 3. India's trade with Thailand**
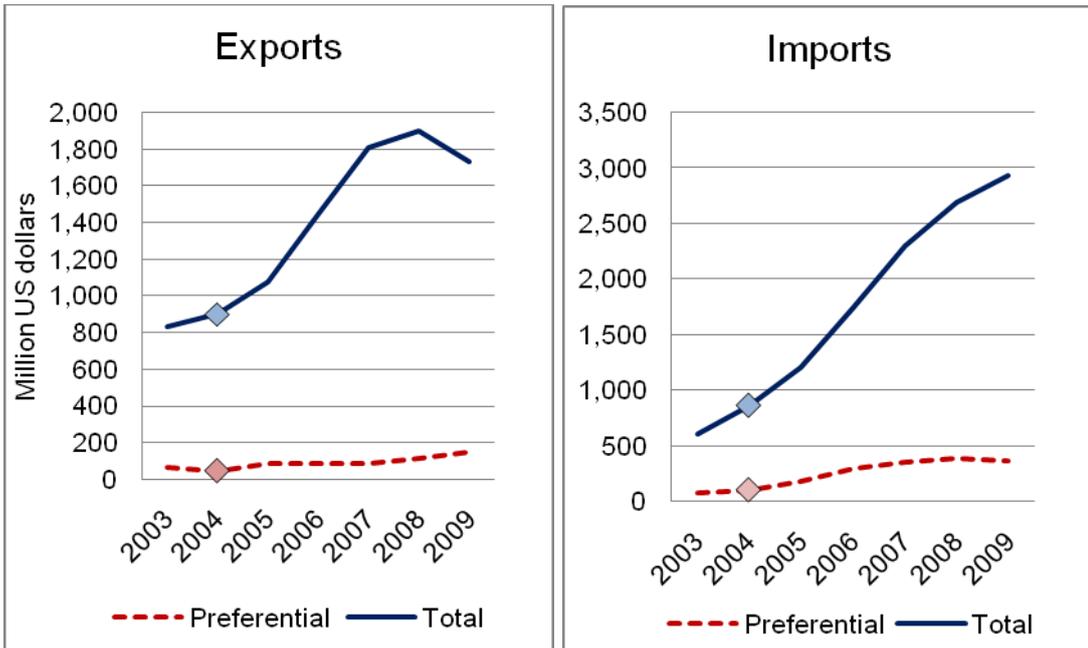


**Annex figure 4. India's trade with Singapore**
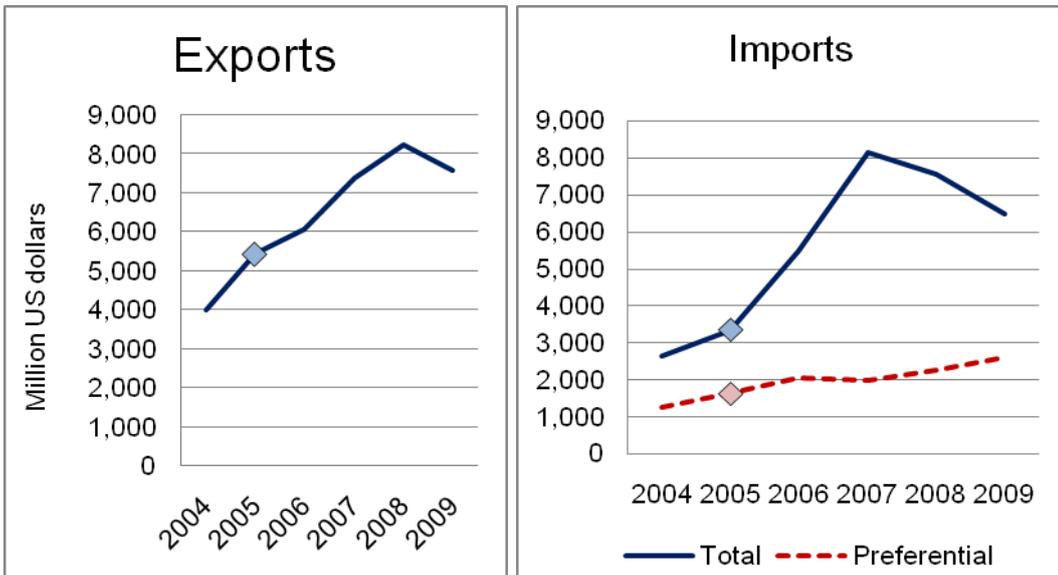


*Note:* Preferential imports under Singapore here are the 506 items exchanged at the HS 8-digit level that were given immediate zero duty concessions under the EHS scheme; if all 5,121 items that are covered under CECA are taken into account, the gap between the two lines will narrow.

**Annex figure 5. India's trade with Chile**



**Annex III. Top 10 export and import products between India and five trading partners**

All tables are calculated from Comtrade data available from World Integrated Trade Solution (WITS) database (http://wits.worldbank.org/wits/). The shaded HS codes in the tables below are traded under preferential terms.
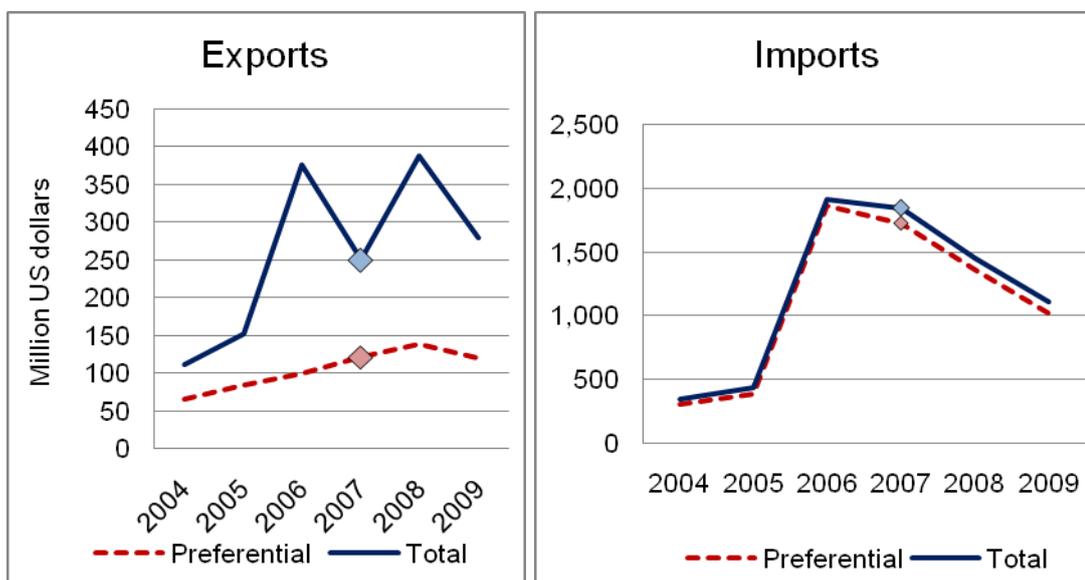
**Annex table 1. Top 10 export items to Sri Lanka**

| HS Code | Product description |
|---------|---------------------|
| 271019 | Other petroleum oils, ATF, HSD etc |
| 271011 | Light petroleum oils |
| 870321 | Cars with cylinder capacity <1000 cc |
| 720719 | Other semi-finished products of iron and non-alloy steel |
| 871120 | Motorcycles with cylinder capacity between 50 cc and 250 cc |
| 170199 | Other sugar, sugar cubes |
| 300490 | Other medicines, ayurvedic, unani, homeopathic etc. |
| 740811 | Copper wire |
| 230400 | Oilcake/residue from soya bean extraction |
| 090420 | Chillies, powder/fruit/seeds |

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**Annex table 2. Top 10 import items from Sri Lanka**

| HS Code | Product description |
|---------|---------------------|
| 151620 | Vegetable fats and oils |
| 854419 | Insulated wire, other than copper |
| 090411 | Pepper, neither crushed nor ground |
| 090700 | Cloves |
| 740319 | Other refined copper, unwrought |
| 230990 | Animal feed, other than dog/cat food |
| 680221 | Marble |
| 400121 | Natural rubber in smoked sheets |
| 470790 | Waste and scrap of paper of paper-board, unsorted |
| 740312 | Wire bars of refined copper |

**Annex table 3. Top 10 export items to Afghanistan**

| HS code | Product description |
|---------|---------------------|
| 854140 | Photosensitive semiconductor devices |
| 540761 | Woven fabrics of synthetic filament yarn containing ≥85 per cent polyester by |
| 540710 | Woven fabrics obtained from high-tenacity yarn of nylon or other polyesters |
| 540752 | Woven fabrics, dyed |
| 401120 | Tyres used on buses or lorries |
| 300490 | Other medicines, ayurvedic, unani, homeopathic etc. |
| 300420 | Antibiotics other than penicillin |
| 240399 | Other tobacco, chewing, snuff etc. |
| 090240 | Other black tea (fermented) |
| 020230 | Boneless meat of bovine animals, frozen |

**Annex table 4. Top 10 import items from Afghanistan**

| HS code | Product description |
|---------|---------------------|
| 080420 | Figs |
| 130190 | Natural gums |
| 080250 | Pistachios |
| 080620 | Grapes, dried |
| 080212 | Almonds, shelled |
| 081310 | Apricots, dried |
| 080211 | Almonds, fresh or dried, in shell |
| 090940 | Seeds of caraway |
| 081340 | Other fruit, dried |
| 080719 | Melons, other than watermelons |

**Annex table 5. Top 10 export items to Thailand**

| HS code | Product description |
|---------|---------------------|
| 710239 | Diamonds, non-industrial, cut/worked but not mounted or |
| 740311 | Cathodes and sections of cathodes of refined copper |
| 230400 | Oilcake and other solid residues |
| 720110 | Non-alloy pig iron |
| 271019 | Other petroleum oils, ATF, HSD etc. |
| 520100 | Cotton, not carded or combed |

| HS code | Product description |
|---------|---------------------|
| 870840  | Gear boxes |
| 740811  | Copper wire |
| 710399  | Semi-precious stones |
| 294200  | Other organic compounds |

**Annex table 6. Top 10 import items from Thailand**

| HS code | Product description |
|---------|---------------------|
| 840820  | Engines for vehicles, other than railway or tramway |
| 847170  | Storage units of automatic data processing machines |
| 852812  | Reception apparatus for colour televisions |
| 760120  | Aluminium alloys |
| 400121  | Natural rubber in smoked sheets |
| 841510  | Air-conditioning machines, window or wall types |
| 720421  | Waste and scrap stainless steel |
| 390740  | Polycarbonates |
| 590210  | Textile fabrics of nylon or other polyamides, for |
| 870899  | Other parts and accessories of motor vehicles |

**Annex table 7. Top 10 export items to Singapore**

| HS code | Product description |
|---------|---------------------|
| 271019  | Other petroleum oils, ATF, HSD etc. |
| 271011  | Light oils and preparations; motor spirit |
| 760110  | Aluminium, not alloyed |
| 890590  | Floating docks, platforms etc. |
| 890190  | Other vessels for transportation of goods and persons |
| 890520  | Floating or submersible drilling/production platforms |
| 710239  | Diamonds, non-industrial, cut/worked but not mounted |
| 740311  | Cathodes and sections of cathodes of refined copper |
| 711319  | Jewellery articles of other precious metal, |
| 290220  | Benzene |

**Annex table 8. Top 10 import items from Singapore**

| HS code | Product description |
|---------|---------------------|
| 271019  | Other petroleum oils, ATF, HSD etc. |
| 490700  | Unused postage, revenue or similar stamps |
| 290250  | Styrene |
| 847330  | Parts and accessories of the automatic data processing |
| 847150  | Digital processing units |
| 890190  | Other vessels for transportation of goods and persons |
| 847130  | Laptops, palmtops etc. |
| 847170  | Storage units of automatic data processing machines |
| 271011  | Light oils and preparations; motor spirit |
| 880330  | Other parts of aeroplanes/helicopters |

**Annex table 9. Top 10 export items to Chile**

| HS code | Product description |
|---------|---------------------|
| 870321 | Motor vehicles of cylinder capacity more than 1,000 cc |
| 420329 | Gloves and mittens of leather |
| 283329 | Sulphates |
| 850423 | Electrical transformers having power handling capacity of >10,000 kva |
| 300490 | Other medicines, ayurvedic, unani, homeopathic etc. |
| 401120 | Tyres used on buses or lorries |
| 630492 | Other furnishing articles of cotton, not knitted or crocheted |
| 294200 | Other organic compounds |
| 721049 | Other products of iron/non-alloy steel, plaited or coated with zinc |
| 551511 | Polyester fabrics, mixed with viscose rayon staple fibres |

**Annex table 10. Top eight import items from Chile**

| HS code | Product description |
|---------|---------------------|
| 260300 | Copper ores and concentrates |
| 261310 | Molybdenum ores and concentrates |
| 280120 | Iodine |
| 080810 | Apples, fresh |
| 480100 | Newsprint, in rolls and sheets |
| 282520 | Lithium oxide and hydroxide |
| 283691 | Lithium carbonates |
| 252890 | Natural boric acid and calcium borates |

*Note:* The top eight items only are reported for import from Chile as other imports are very low in value.