

Chapter V

Are the India's trade agreements deep enough to support production networks?

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The analysis so far recognizes the important role of regional integration and/or preferential trade agreements (PTAs) in influencing successful development of international production networks (IPNs). Intuitively, one would expect a positive impact of reciprocal trade liberalization as it should bring about a reduction of border barriers to trade, and make the flows of goods, services and resources easier and cheaper, thus allowing further fragmentation of production and efficient allocation of resources. However, it turns out that in reality PTAs are not necessarily producing these results due to at least two groups of (related) problems. One concerns a transformation of agreements' schedules into actual free and unobstructed trade flows, as it appears that many PTAs are not satisfactorily utilized and that a significant portion of trade ends up being left out of the liberalization coverage. India only recently started to entertain the idea of "substantially all trade" when negotiating the coverage of tariff liberalization. Yet, even if all products were on the list for liberalization, there would be problems in accessing the market under these liberalized conditions. The most frequent culprit for this is found in rules of origin (RoO), so this chapter reviews the substantial empirical analyses done under ARTNeT to highlight implications in the case of India.

The other problematic area is that development of IPNs might not only need smooth and open trade channels for goods, but also harmonization of national policies in several key areas (for example, competition or investment). It is not clear that current PTAs signed by countries, including India, will lead to such integration. We can say "might" because the empirical evidence in this area is still inconclusive with regard to the causal linkages between regional integration efforts and IPNs. ARTNeT (2011), in focusing on a small number of countries and three sectors, summarized extensive theoretical literature that pointed to wards the positive linkages between establishment and the growth of IPNs and preferential trade agreements, including an increase in parts and components trade; however, it failed to find strong empirical evidence about the causal direction.⁸⁸ Furthermore, WTO (2011a) and literature cited therein found that it was deep integration, not just free trade that positively and strongly influenced production network trade. It stated that "...on average, signing deep agreements increases trade in production networks between member countries by almost 8 percentage points" (p. 146). However, the report also acknowledged that it was likely that countries already participating in IPNs might be willing, more than others, to sign deep(er) trade

⁸⁸ Given that most of the PTAs examined in that study were implemented very recently, while the IPNs explored have been established for longer than a decade, it is not surprising that the study failed to confirm that the occurrence of the PTAs could be given credit for the expansion of given IPNs.

agreements in order to secure stable environment for the growth of these IPNs. Thus, the direction of causality between signing deep agreements and the amount of production network trade (in essence, trade in parts and components or intermediate goods) needs further scrutiny. One of the difficulties is the definition and measurement of “deep” integration. Following Horn, Mavroidis and Sapir (2010), WTO (2011a) developed a methodology to measure the depth of the integration achieved through PTAs; later in this chapter the findings of the report are used to comment on the state of India’s efforts in forging preferential trade deals supportive of production network trade as well as the expansion of vertical specialization more generally.

1. India’s campaign for preferential trading deals

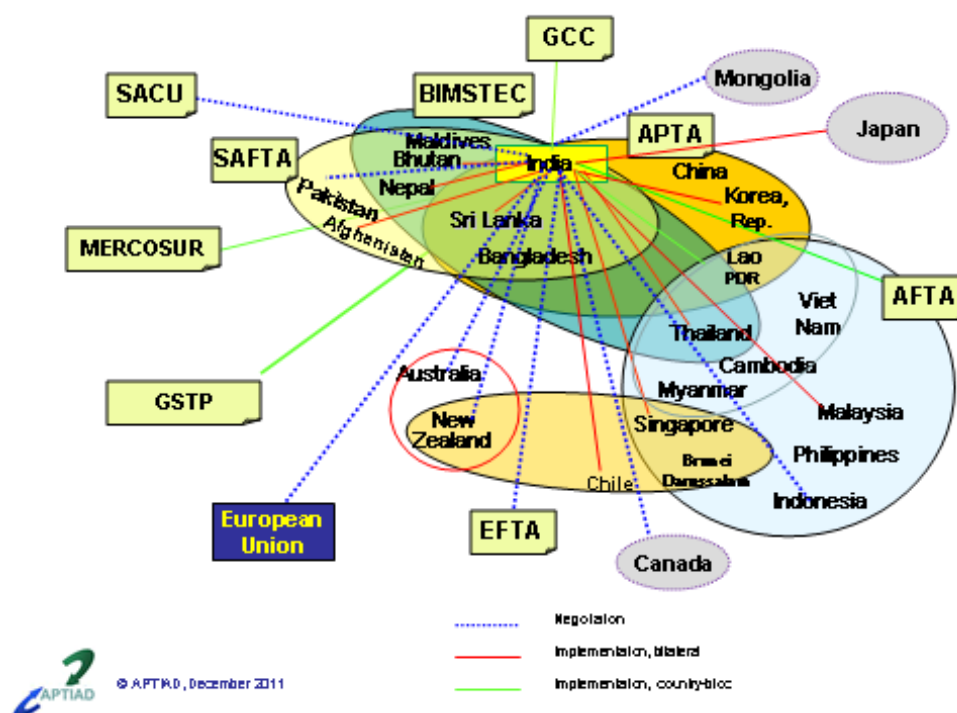
In 1995, India had no bilateral reciprocal preferential trade agreement, but it was a member of the Asia-Pacific Trade Agreement (APTA), (then known as the Bangkok Agreement), South Asia Preferential Trade Arrangement (SAPTA) and Global System of Trade Preferences (GSTP). The first bilateral free trade agreement was signed in 1998 with Sri Lanka; from then until the end of 2011, India signed another nine bilateral and two plurilateral agreements.⁸⁹ Figure 35 reflects how this proliferation of trade agreements signed by India has resulted in a “noodle bowl” phenomenon – the tangle of relationships created by multiple overlapping trading arrangements. With 15 trade agreements already in implementation,⁹⁰ India is well ahead of the Asia-Pacific region’s average of 2.59 agreements and the WTO average of 1.94 agreements per country (as of July 2011).⁹¹

⁸⁹ A full list of other agreements under negotiations are available from the Department of Commerce online information, “Trade: International Trade: Other Agreements/Negotiations” at http://commerce.nic.in/trade/international_ta.asp or from www.uneascap.org/tid/aptiad.

⁹⁰ This number excludes SAPTA since it has been superseded by SAFTA, even though SAPTA provisions are still being implemented.

⁹¹ The average for the region does not include those economies that do not have any PTAs, i.e., Mongolia, Palau, Northern Mariana Islands, New Caledonia, Guam, French Polynesia, American Samoa, Timor-Leste and Democratic People’s Republic of Korea (APTIAD, 2011).

Figure 35. India's "noodle bowl"



Source: Based on "APTIAD noodle bowl", available online at www.unescap.org/tid/aptiad.

As is evident from its negotiating history (see box 1), India initiated several PTAs post-2000, starting with signing the framework agreements in 2003 and followed by PTA negotiations. Most of these agreements were finally signed during 2009-2010. India has embraced regionalism as one of the pillars of its trade policy, which started in early 2000 and is now materializing. Given the increasing opening of the Indian economy after 1995, reciprocal trade arrangements were seen as a tool of obtaining market access for Indian exports as a necessity for sustaining further import liberalization and other market-oriented reforms. Putting more focus on "discriminatory and preferential" liberalization coincided with, on one hand, an international Indian presence of competitive business in some sectors and on the other hand, an impasse in the Doha Development Round negotiations.

Box 1. Evolution of India's approach to preferential trade liberalization

India has stated it is a believer of the rules-based multilateral trading system, and historically it has not used PTAs as a trade policy instrument for its economic engagements until the early 2000s. India's regional engagements were mainly guided by the political affiliations and traditionally the country followed a cautious and guided approach towards PTAs. This can be observed from its engagements in some of the PTAs such as the Bangkok Agreement (1975), GSTP (1988) and SAPTA (1993) or the agreements with Bhutan and Nepal, which has the political objective of regional prosperity. These agreements focused on promoting South-South trade; however, intraregional trade remained insignificant.

While its commitment for regional prosperity and development in South Asia started with SAARC, India started looking outside the South Asian region, especially to the East, with its "Look East Policy" in 1991. Since India's major trade interest was to the West (the developed world), the "Look East Policy" provided it with an opportunity to become a major partner of ASEAN in the areas of trade and investment. Since its beginning, the partnership between India and ASEAN has been developing at quite a fast pace. India became a sectoral dialogue partner 1992, a full dialogue partner in 1995, a member of the ASEAN Regional Forum (ARF) in 1996 and, finally, a summit level partner in 2002.

India's initial attention to PTAs started in 2000 after the European Union initiated plans for its expansion and the United States supported the Free Trade Area of the Americas (FTAA). India felt that if it did not become a party to a major bloc in all likelihood it would be "locked out" of the markets of its major trading partners. It then focused on the SAARC, MERCOSUR and ASEAN markets. India's position in ASEAN was further strengthened after ASEAN signed the Framework Agreement with China, as most of ASEAN's members were slightly apprehensive of the economic size of China and felt that their engagement with India would serve as a counterbalance.

In principle, preferential trade negotiations move faster and produce more tailored results, and thus are preferred by many stakeholders, than a protracted and, at times, frustrating multilateral process. However, the trade disciplines achieved are (not unexpectedly) different across agreements in terms of tariff schedules, sector and/or product coverage, implementation timelines, customs procedures or other conditions important for traders and, most importantly in terms of RoO, that underlie the utilization of negotiated concessions. Therefore, it is appropriate to question the existence and size

of the net benefits of each additional agreement that has been signed.⁹² For the subject matter of this study, however, it is very important to understand how RoO, an unavoidable part of each PTA, may influence operations of IPNs and related trade and investment.

2. Rules of origin

Rules of origin define the conditions that a product must meet to be deemed as originating from the country that has been given preferential access.⁹³ Historically, the *raison d'être* for RoO has been to prevent loss of tariff revenue by a country granting preferential access to its market. This phenomenon is known as trade deflection, whereby products from countries that do not have right to preferential access are redirected through countries with such access to the partner country, in order to avoid payment of the partner country's customs duties. There are other important objectives that RoO could help achieve, including promoting sophistication of domestic production through value addition and the provision of incentives to increase trade and investment in a specific region (cf. Das and Ratna, 2010). However, in reality, loading RoO with multiple objectives appears to have resulted in (a) RoO becoming less transparent, (b) more costly to comply with, and (c) in the end, preventing the use of tariff preferences negotiated in the PTAs. It is not rare to find that the complexity of RoO is used to both accommodate and conceal protectionist intentions. "By attaching multiple criteria for the satisfaction of origin, RoO may be another avenue to effectively exclude product groups from a country's liberalization commitments" (Nag and De, 2011).

Apart from these "policy-driven" reasons for complex setting of the RoO, there is another reason. In the world of fragmented production, with multi-stage processes located in different countries becoming the normal way of production, it is increasingly difficult to ascertain origin to meet the RoO (which originated when the world had different production processes). Thus for a country like India which has aspirations and potential to become better integrated in vertical and horizontal chains in Asia and globally, the RoO as a policy tool becomes very important.

India applies different preferential RoO that are negotiated with each PTA.⁹⁴ A brief comparison of RoO characteristics for the agreements that are currently being implemented is provided in table 20. As reported in WTO (2011b), so far the most important rule used for determining origin is the limit on the foreign content. As table 20 shows, the range of these maxima is wide, from 30 per cent to 70 Per cent. India also uses the rules of sufficient transformation and change in tariff classification to determine

⁹² The "Trade Policy Review on India" (WTO, 2011b) noted that "despite this generally positive view of regional agreements, India has some reservations regarding regionalism because of its complexity and possible trade diversion", referring to India's Ministry of Finance text of 2011.

⁹³ This could be through PTAs or other preferential schemes (such as GSP) but the focus here is only on PTAs.

⁹⁴ WTO document G/RO/N/1, 9 May 1995.

origin. There are product-specific RoO for several agreements, with the number of products subject to such rules varying greatly among agreements (for example, 180 products under the SAFTA, 1,780 products under the BTA with the Republic of Korea and 380 products under the BTA with Singapore.⁹⁵

The preferential RoO provide incentives for producers to change their forward and backward linkages. There are financial incentives (lower or zero tariffs) that sometimes may lead to the replacement of cheaper or better-quality inputs from non-participating members in the PTA by higher-cost inputs from member economies in order to qualify for concessional entry. RoO can also adversely influence investment decisions and give rise to significant compliance and administrative costs for businesses and governments, respectively.⁹⁶

⁹⁵ Department of Commerce online information, “International Trade: Trade Agreements”, available at: http://commerce.nic.in/trade/international_ta.asp?id=2&trade=i.

⁹⁶ Another issue related to different RoO criteria for the same country but under different PTAs also is a cause of concern as exporters get confused over which one to use and because it gives the customs authorities extensive flexibility for evaluating the tariff concessions.

Table 20. Rules of origin under preferential trade agreements

Agreements	Maximum foreign-content requirements	Minimum cumulative local-content requirements
Regional		
Asia-Pacific Trade Agreement (APTA)	55% of the f.o.b. value (LDCs: 65%)	60% of the f.o.b. value (LDCs: 50%)
Global System of Trade Preferences (GSTP)	50% of the f.o.b. value (LDCs: 60%)	60% of the f.o.b. value (LDCs: 50%)
South Asian Free-Trade Areas (SAFTA) ^a	60% of the f.o.b. value (LDCs: 70%; Sri Lanka: 65%) and change in tariff heading ⁹⁷	50% of the f.o.b. value, ^b and change in tariff heading with a minimum 20% being achieved in the exporting member where last stage of manufacturing done
South Asia Preferential Trade Arrangement (SAPTA)	60% of the f.o.b. value (LDCs: 70%)	50% of the f.o.b. value (LDCs: 40%) with a minimum 20% being achieved in the exporting member where last stage of manufacturing done
Bilateral		
Afghanistan	50% of the f.o.b. value and change in tariff heading	40% of the f.o.b. value and 30% of the f.o.b. value ^b
ASEAN ^a	65% of the f.o.b. value and change in tariff sub-heading ⁹⁸	65% of the f.o.b. value and change in tariff sub-heading
Bhutan	n.a.	n.a.
Chile	60% of the f.o.b. value ^c and change in tariff heading	60% of the f.o.b. value and change in tariff heading
Korea, Rep. of ^a	65% of the f.o.b. value and change in tariff sub-heading	65% of the f.o.b. value and change in tariff sub-heading
MERCOSUR	40% of the f.o.b. value ^c	40% of the f.o.b. value
Nepal	70% of the f.o.b. value and change in tariff heading	n.a.
Singapore ^a	60% of the f.o.b. value and change in tariff heading	60% of the f.o.b. value and change in tariff heading
Sri Lanka	65% of the f.o.b. value and change in tariff heading	35% of the f.o.b. value and 25% of the f.o.b. value ^c with change in tariff heading
Thailand ^d	60% of the f.o.b. value and change in tariff heading	40% of the f.o.b. value and change in the tariff heading
Other preferential areas		
Mauritius, Seychelles, and Tonga	50% of ex-work price of five specific items ^e and 75% ex-work prices for others	50% of ex-work price of five specific items ^e and 75% ex-work prices for others
Least-developed countries	70% of the f.o.b. value and change in tariff classification for not wholly produced or obtained category	70% of the f.o.b. value and change in tariff classification for not wholly produced or obtained category

Source: WTO, 2011b.

Note: Rules of origin are not covered under the India-Bhutan preferential trade agreement.

n.a. = Not applicable.

^a Product-specific RoO apply.

^b Domestic value content in the exporting country.

^c Foreign contents should not exceed 15% of the f.o.b. value for sets, as defined in General Rule 3 of the HS.

^d Not notified to WTO.

^e Manual sewing and knitting machines (and parts thereof) or those which require less than one quarter of one brake-horsepower for their operation; cycles (other than motor cycles) and parts and accessories thereof, excluding rubber tyres and tubes; motor cars including taxi-cabs and articles (other than rubber tyres and tubes) to be used as parts and accessories thereof; motor omni-buses, chassis of motor omni-buses, motor vans and motor lorries, and parts of mechanically propelled vehicles and accessories excluding rubber tyres and tubes; and motor cycles and motor scooters and articles (other than rubber tyres and tubes) adapted for use as parts and accessories thereof.

⁹⁷ Change at 4-digit HS/tariff classification between “non-originating inputs” and export product.

⁹⁸ Change at 6-digit HS/tariff classification between “non-originating inputs” and export product.

Empirical estimates of the restrictiveness of RoO are still not readily available for all PTAs due to their relatively recent establishment as well as the evolving nature of some of them. Restrictive RoO inhibit the growth of intra-industry trade, which often is closely associated with trade in parts and components inherent to existence of IPNs. Complex RoO can harm the natural growth of trade in components, which occurs with the process of development in Asian developing countries. Several studies, including under ARTNeT, have suggested that Indian RoO are relatively restrictive, both bilateral and regional compared to some other agreements in or outside Asia (cf. Nag and De, 2011, Das and Ratna, 2010). Yet there are signs that this restrictiveness is weakening over time.⁹⁹ However, as pointed out above, there is no firm empirical evidence to suggest if these steps have helped the rise in intraregional trade and investment flows. UNCTAD (2003) analysed the India-Sri Lanka FTA and found that, despite being restricted to liberalization of goods, it promoted intraregional investments. The report attributed this result to the design of RoO in that agreement (see box 2). Today, India is the second-largest foreign investor in Sri Lanka, despite not having an investment treaty.

Box 2. India-Sri Lanka free trade agreement and foreign direct investment

The free trade agreement gives duty-free market access to India and Sri Lanka on a preferential basis. Covering 4,000 products, it foresaw a gradual reduction of import tariffs during three years for India and eight years for Sri Lanka.

To qualify for duty concessions in either country, the RoO criteria spelled out value-added at a minimum of 35 per cent for eligible imports. For raw materials sourced from either country, the value-added component would be 25 per cent.

The effect? Sri Lankan exports to India increased from US\$ 71 million in 2001 to US\$ 168 million in 2002 while India's exports to Sri Lanka increased from US\$ 604 million to US\$ 831 million during the same period. Although the agreement does not address investment, it has stimulated new FDI for rubber-based products, ceramics, electrical and electronic items, wood-based products, agricultural commodities and consumer durables. Because of the agreement, 37 projects are now in operation, with a total investment of US\$ 145 million.

Source: UNCTAD, 2003.

⁹⁹ The change in tariff heading at the 4-digit HS level has now become change in tariff subheading at the 6-digit HS level, which is less onerous to comply. Similarly, the local/regional value added has been reduced from 50 per cent to 35 per cent (or the imported content increased from 50 per cent to 65 per cent).

3. Coverage of agreements

Two-thirds of all India's agreements in force are with one partner only, just one of which is a developed economy (Japan, signed in 2011) and two are high-income developing countries (Republic of Korea and Singapore). The remainder form a combination of membership in plurilateral (regional) trade agreements (table 21).¹⁰⁰ As in the case of other countries in the region, India has also doubled or tripled some of its preferential deals by signing bilateral agreements with countries that are also members of the regional agreements to which India is a party (e.g., Sri Lanka is in APTA, GSTP, SAFTA and BIMSTEC, while Thailand, Malaysia and Singapore are in ASEAN). The Trade Policy Review of India (WTO, 2011b) states that "tariff concessions under bilateral agreements with countries that also belong to regional agreements to which India is a party, are generally wider and deeper than those under the regional agreements, and that the trader can choose which preference to use. With regard to rules of origin, the authorities mentioned that product specific rules of origin are not necessarily the same in the bilateral and regional agreements, but that the original criterion for products not covered by specific rules has, by and large, been harmonized." In practice, it appears that some work remains to be done to improve the utilization rate of, and utility from the Indian PTAs (see, for example, Jha, 2011).

Table 21 Taxonomy of India's PTAs

	Partial scope Agreements	Free trade agreements	Free trade and economic integration agreements
Bilateral trade agreements	3	2	5
Regional trade agreements	1	1	-
Country-bloc agreements	1	1	-
Global (GSTP)	1	-	-
Total	6	4	5

Source: Based on WTO TPR India 2011, and WTO RTA-IS, available online at www.wto.org.

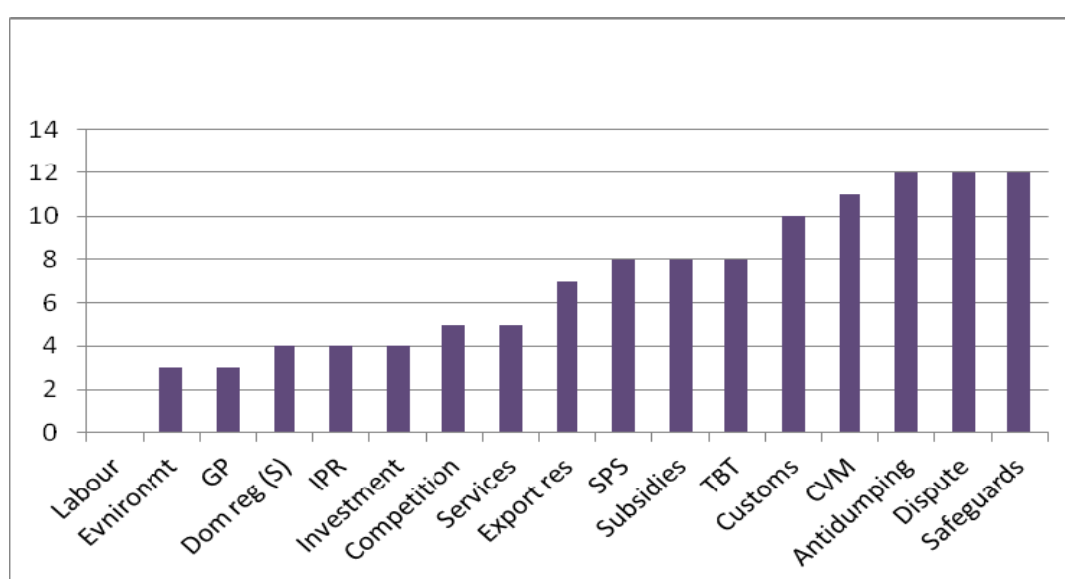
Note: Solid shaded cells represent notification through the Enabling Clause, while the striped cell refers to notification through GATT Article XXIV and GATS Article V.

Nine out of India's 15 PTAs are labelled as free trade agreements (or a combination of an FTA in goods and economic integration agreements [EIA] in services) thus signalling the intention to improve on the multilateral liberalization commitments. Appendix III of this book provides full details of the areas covered by PTAs, and a summary is presented in figure 2. None of the agreements contain clearly designated articles or sections/chapters on labour standards, and only three agreements have included

¹⁰⁰ India is a member of the Bay of Bengal Initiative on Multi-Sectoral Technical and Economic Cooperation (BIMSTEC), signed as a Framework Agreement to form a free trade area by 2012. However, negotiations are still underway.

some provisions related to the environment. The most frequently found provisions (in 12 agreements) are those on dispute settlement, safeguards and anti-dumping (the latter mostly expressing retention of the freedom to use anti-dumping actions as per WTO disciplines). Thus, it is clear that most areas covered in the agreements are linked to disciplines in goods trade, which supports prevalent opinion that, until recently, India had been very much focusing on policy space-related border measures in its PTAs. Agreements with provisions in services, intellectual property protection, investment etc. are found in a few agreements, mostly with either developed (Japan) or higher-income developing partners (Singapore, Republic of Korea and Malaysia).

Figure 36. Areas covered* by PTAs in force



Source: Based on data from WTO RTA-IS, WTO (2011b) and information from the Ministry of Commerce, India

* Mention of the provisions in any of the areas is registered as coverage; obviously, there is a sizable variation between agreements in terms of depth of obligations.

The outline of PTA coverage by PTAs given in figure 36 (and Annex table), while illustrative, is not sufficient to assess how deep Indian regional integration efforts really are. As mentioned above, since deep integration is found to be increasing network trade and enhancing operations of networks, it is important to understand what the components of such deep integration are, so that countries can pursue policies in that direction, if so desired.

In principle, the concept of “deep integration” implies a higher degree of integration than achieved simply by a free trade agreement, which is limited to a removal of tariffs and non-tariff barriers on trade in goods. The traditional literature on economic integration, grades the levels of integration from most shallow (free trade area) to the deepest (fiscal and political union) as shown in table 22. Even the common external trade policy of the customs union will be deemed as just a step towards deep integration. Only

the processes that lead to liberalization in substantively all goods, services and resources, accompanied by the development of some institutions to secure harmonization of certain policies, will deliver deep integration.

A common market concept could be taken as an example of a fairly deep integration. The integration “deepens” based on the expansion of coverage, both in terms of policies and institutions necessary for managing harmonized policies. Lawrence (1996) suggested that strengthening production networks would require harmonization of those national policies facilitating smoother business activities. As harmonized policies also lead to a demand for institutions with supranational power, he argued that countries would move towards deeper integration in time. More recent literature, summarized in WTO (2011a), found that an increase in trade in intermediate products also created demand for deeper agreements.

Table 22. Progression from shallow to deep integration

	From Shallow to Deep Integration						Example
	Removal of mutual trade barrier	+ Harmonization of some beyond the borders standard	+ Common external tariff	+ Free movements of factors (labour and capital)	+ Integrated monetary and exchange rate policy	+ Common fiscal policy	
FTA	☒						India-Sri Lanka
FTA+	☒	☒					India-Singapore
Custom Union	☒	☒	☒				EurAsEC
Common Market	☒	☒	☒	☒			European Union
Monetary Union	☒	☒	☒	☒	☒		Euro Area
Fiscal Union	☒	☒	☒	☒	☒	☒	United States

Source: Adapted and modified from WTO, 2011a, table C.1.

WTO (2011a) expanded on the methodology developed by Horn, Mavroidis and Sapir (2010) in order to empirically measure the depth of integration obtainable through a country’s PTAs. Box 3 provides some details on the methodology used. A derived measure represents two dimensions of integration: (a) an improvement of the specific agreement in covering more than just removal/lowering of tariffs, this being identified as the lowest common denominator in integration; and (b) an advance in introducing new institutions to manage areas under harmonized policies.

Box 3. Methodology for determining depth of integration

The methodology consists of three steps: (a) identification of policy areas classified into two groups (WTO+ provisions that are in the current WTO mandate and commitments, and WTO-X provisions that are obligations outside the current WTO coverage; see the table below for the list of 52 of these policy areas); (b) determining the policy areas included in a PTA and legally enforceable (e.g., a policy area would not be deemed enforceable if the legal language is unclear or loose); and (c) exploration of how much the policy area and its enforceability matters in practice. For a more detailed description refer to WTO (2011a).

WTO+ and WTO-X policy areas in PTAs

WTO+ areas	WTO-X areas	
PTA industrial goods	Anti-corruption	Health
PTA agricultural goods	Competition policy	Human rights
Customs administration	Environmental laws	Illegal immigration
Export taxes	IPR	Illicit drugs
SPS measures	Investment measures	Industrial cooperation
State trading enterprises	Labour market regulation	Information society
Technical barriers to trade	Movement of capital	Mining
Countervailing measures	Consumer protection	Money laundering
Anti-dumping	Data protection	Nuclear safety
State aid	Agriculture	Political dialogue
Public procurement	Approximation of legislation	Public administration
TRIMS measures	Audio-visual	Regional cooperation
GATS	Civil protection	Research and technology
TRIPS	Innovation policies	SMEs
	Cultural cooperation	Social matters
	Economic policy dialogue	Statistics
	Education and training	Taxation
	Energy	Terrorism
	Financial assistance	Visa and asylum

Source: WTO, 2011a.

The final results show that of all the policy areas tracked, five consistently matter to deep integration, and understood to be motivated to promote production networks. In other words, these five policies combined within an agreement would contribute most to the expansion of production network trade. The five policy areas include measures for state trading enterprises (STEs) and TRIPS from the current WTO mandate, and competition policy, intellectual property rights and investment from the areas not covered by current WTO agreements. The WTO exercise unfortunately contained only seven of the India's 15 PTAs (bilaterals with Chile, the Republic of Korea and Singapore, and with ASEAN and MERCOSUR as well as the two plurilaterals of APTA and SAFTA). Only the agreements with the Republic of Korea and Singapore were assessed as meeting the condition for deep integration.¹⁰¹

It is not very difficult to see why these policy areas have important implications for production networks. Competition policy provisions – which were proposed for inclusion under the WTO mandate as one of the so-called Singapore issues and later dropped except for trade facilitation – are there to ensure that abuse of market power does not minimize benefits from liberalization. In the economic literature, competition policy is often seen as an extension, and in special cases a substitute, for trade and investment liberalization policies in goods and services areas.

While not many PTAs have separate competition policy chapters, there are numerous competition-related provisions embedded in chapters on other policy areas, such as services liberalization (especially financial and telecommunications services), investment, intellectual property protection and government procurement chapters. These policy areas are responsible for provisions identified in this book and elsewhere as key factors for the operation of IPNs (e.g., infrastructural services, protection of investment or intellectual property). Another benefit of adding competition policy provisions where possible under the PTAs is their non-discriminatory character. As in other policies that are part of regulation, it is more costly to design them to be discriminatory among firms belonging to different countries than to not do so; therefore, this produces an additional pro-competitive effect and improves transparency.

Similarly provisions on STEs are meant to remove the potential for trade distortion caused by government involvement in the decisions and activities of an enterprise. STEs are not a feature of only developing countries; in fact, many developed countries nurture STEs in their agriculture and other sensitive sectors, or the areas linked also to social and other special government strategies such as food security. For a

¹⁰¹ Because India had still not finalized its agreement with Japan at the time of the WTO study, that agreement was not included in the original assessment. Given the features of the agreement, it is suggested that it be added to the list of deep PTAs. The database is available at www.wto.org/english/res_e/publications_e/wtr11_dataset_e.htm.

multiplicity of reasons, operations of STEs appear to suffer from low transparency. Opening this policy area through PTAs would at least help to improve transparency.

Many would argue that trade and investment decisions are increasingly being made by the same players in the market, and therefore liberalizing one policy area without the other is not optimal. Provisions for liberalization of flows of capital, including human capital, would allow MNCs to establish production based on relative costs and would encourage FDI flows into those locations that are recognized as having all necessary ingredients to be part of production sharing.

In summary, PTAs cannot be identified as delivering (deep) integration. In India that is definitely not the case; despite an avalanche of PTAs signed in the past five years, only three have potential for creating environments for IPNs. The positive news is that all three agreements belong to the most recent vintage of PTAs, which might signal a change in a general policy towards regional integration, from shallow and protectionist to deep and trade enhancing. In addition, all partners in these agreements (Japan, the Republic of Korea and Singapore) are important players in Asian production networks. However, the fact cannot be ignored that trade and investment areas are not the only source of obstacles for IPNs. It is also important to note that there are many more factors involved in establishing and the functioning of production networks and in integrating producers from different markets, including having good physical connectivity, efficient infrastructural services and institutions for the protection of intellectual property (cf. Bhattacharyay and De, 2009).

The empirical literature indicates that improving the depth of PTAs would increase the production network trade, especially so in the sectors that are regulation-intensive. For example, a 1 per cent rise in the depth of integration increases trade in automotive parts and ITC products by 81 per cent and 56 per cent, respectively (Orifice and Rocha, 2011). For India, both these sectors are at the top of industrial development priorities. Thus, it would not make sense to exclude any of these products from the lists of covered goods for tariff cuts as appeared to be the case for car parts in the past.

Furthermore, countries already participating in IPNs are more likely to be signing deep PTAs subsequently, as IPNs create awareness and demand for them. This appears to be the case in East Asia, where IPNs were established as a consequence of the region undergoing de facto integration (that is, by market forces rather than contractual obligations). According to Orifice and Rocha (2011), the almost five times higher chance that a deep PTA would be signed between countries at different levels of development was confirmed by Indian practice as well as the example of other agreements by Japan in Asia.

4. Conclusion

While there is a clear need to expand trade and deepen economic and other relations among developing countries in the Asia-Pacific region, evidence from empirical research finds that the agreements between countries at a similar and relatively low level of development remain shallow and fail to provide support to operation of production networks. On the other hand, if shallow agreements are the only possibility, it is better to have them than nothing. Shallow trade agreements, while rarely having concrete trade enlargement effects, might work towards developing trust and thus could help to generate trade in the long term. It is also helpful to know that countries that increased trade with partners with whom they had no preferential trade agreements have not been exceptions in this region (see APTIAD, 2011).

In addition to contributing relatively little towards the deeper integration of India, its current trade agreements are also disappointing in terms of utilization by traders (exporting and importing firms).¹⁰² In principle, utilization of preferences is inversely proportionate to the complexity of the rules of origin, given the margin of preference – the more complex the rules of origin, the more expensive the compliance, resulting in low propensity to use the preferences. Frequently, traders just use so-called “most-favoured-nation” rules of origin without using preferential market access. This practice may result in agreements that do not effectively increase trade. This is a serious problem, but it is difficult to provide much more than anecdotal evidence in this regard as data are not readily available.

¹⁰² Jha (2011) estimated the utility of India-Sri Lanka FTA, which represents one of the more effective of India’s PTAs, to be 11 per cent.

References

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Annex
Deep integration components in India's PTAs

	Anti dumping	Competition	CVM	Customs	Dispute	Dom reg	Environment	Export res	GP	IPR	Investment	labour	SPS	Subsidies	TBT	Safe guards	Services
Chile - India	x		x	x	x			x					x		x	x	
India - Afghanistan	x				x											x	
India - Bhutan																	
India - Japan	x	x	x	x	x	x	x	x	x	x	x		x	x	x	x	x
India - Malaysia	x	x	x	x	x			x		x	x		x	x	x	x	x
India - Nepal																	
India - Singapore	x	x	x	x	x	x		x	x	x	x		x	x	x	x	x
India - Sri Lanka	x	x	x	x	x									x		x	
Korea, Republic of - India	x	x	x	x	x	x	x	x	x	x	x		x	x	x	x	x
India-Thailand	x		x		x											x	
ASEAN - India	x		x	x	x	x	x	x					x		x	x	
MERCOSUR - India	x		x	x	x								x	x	x	x	
APTA- Accession of China	x		x	x	x											x	
SAFTA	x		x	x	x			x					x	x	x	x	x
ALL	12	5	11	10	12	4	3	7	3	4	4		8	8	8	12	5