

# Free Trade Agreements and India

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*The rapid growth in world trade during the past two decades has been achieved not only by reduction in trade restrictions but also by the transformation of production patterns and processes*

**C**OUNTRIES ARE looking for opportunities to expand their export markets through free trade agreements. This has gathered momentum over the last two decades. The urgency for improving the economic fortunes of domestic stakeholders, whether producers, consumers or intermediaries, is stronger in the developing world, as their trade liberalisation policies are becoming more and linked with economic growth and poverty reduction strategies – two most important items of their development discourse. As of November 2011, the number of Free Trade Agreements (FTAs) notified under the World Trade Organisation has reached 505.

An FTA facilitates enforcement of legally binding commitments made by its member nations, either to sequentially reduce or completely eliminate various types of trade barriers facing each other, but keep

those facing non-member nations intact. Thus, FTA members gain an advantage in accessing each other's markets compared to non-members. The degree of coverage of barriers and traded sectors varies depending on the type of FTA formed. Most basic form is known as preferential trade agreements.

Mostly, signatories to an FTA belong to a specific geographical region. For example, the European Union (EU), the North American Free Trade Agreement (NAFTA), the Association of South East Asian Nations (ASEAN) and therefore, they are also called Regional Trade Agreements (RTAs). RTAs are generally conceived as the first stage of deeper economic and even political integration between member states, which could graduate into customs union and monetary union, which give wider access and mobility to stakeholders within such unions with better prospects of raising their living standards.

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## **Motives and Merits of FTAs**

A basic question addressed in the literature on trade agreements is whether multilateral agreements (such as those arrived by the WTO members) are superior to FTAs which are preferential by nature because of restriction of participation to a small set of countries. Multilateral trade liberalisation under the WTO is often considered as the first best option because non-discriminatory market access is granted to all member countries. On the other hand, preferential trade agreements stand the risk of diverting imports from more efficient producers outside a region to those enjoying preferences within a region.

To the extent that preferences granted under FTAs create barriers for non-members from entering markets within the free trade region, such agreements are in conflict with the basic principle of non-discrimination guiding the WTO system. This principle stipulates that if a country improves benefits for one of its trading partners, it has to give the same treatment to all other WTO members, so that they all remain most favoured. But the WTO system allows exceptions to this rule, permitting preferential agreements for the special needs and benefits of developing countries.

Thus, FTAs have proliferated and thrived across the world even as the membership and scope of the multilateral trading system has widened since the formation of the WTO in 1995. A number of alternative explanations exist to explain this duality. Relative ease of negotiations with smaller

membership compared to multilateral system, the motive of advancing trade policy reforms in stages, quicker way to increasing market size, a means to signal openness to foreign investors are some major factors which makes FTAs an attractive option. Governments may sign FTAs to lock-in their trade policy reforms and to weaken the chances of reversal of trade liberalisation policies at the national level. Relative easiness of negotiations also means that deeper levels of trade liberalisation, going beyond tariff reduction in goods to pursue the goals of enhancing cross-border investment and trade in services.

Furthermore, a number of political motives are attributed to the growth of FTAs. FTAs are often used as tool to reinforce diplomatic relationship between countries. Such agreements are entered into with the intention of pooling common resources, to ward-off external threat by showing regional solidarity, to increase collective bargaining power at the multilateral level, etc. For instance, many Latin American countries are observed to have entered into PTAs among themselves in order to improve their competitive position vis-à-vis the US. One of Argentina's key purposes to sign the South American Common Market Agreement (Mercosur) was to secure preferential access to the Brazilian wheat market at a time when Argentinian wheat exports were being threatened by Canadian and US export subsidies.

However, it is important to note that the multilateral trading system and FTAs function under the same guiding principles and share many common objectives.

The basic construct of reciprocity is the backbone of FTAs as well. FTAs are also often seen as building blocks of an eventual multilateral mode of globalisation by building links between them. Currently, there are negotiations between regional trading blocs, such as the European Union and Association of South East Asian Nations. Thus, FTAs are not just limited between two or three countries but are also extending between regional blocs consisting of several countries.

## **Indian Aspirations and Prospects**

As one of the founding members of the General Agreement on Tariffs and Trade (GATT, 1947) and as a major player involved in its transformation into the WTO, India has contributed and benefitted immensely from the multilateral trade liberalisation process. Following the economic reforms which started in early 1990s, trade liberalisation has been actively pursued as a key strategy for accelerating growth and the country values its participation in the WTO process highly.

However, the slow rate of progress in multilateral trade negotiations and examples of success stories of FTAs elsewhere influenced India's reconsideration of prospects offered by preferential trade agreements. A turn in its trade policy outlook was necessary and by late 1990s the government started responding to it by actively seeking new avenues of preferential trade relations. The result was several FTAs and Comprehensive Economic Cooperation Agreements and many more are in the process of negotiations.

The basis of such initiatives is India's trade policy goals of fast expansion of export markets. The current foreign trade policy covering the period of 2009-14 aims to provide a stable and conducive environment for increasing exports. Some of its key objectives include 25 percent annual growth in exports by 2014, doubling of Indian share in global trade by 2020, improving export-related infrastructure, reducing transaction costs through trade facilitation measures, and securing enhanced market access, among others. It also aims for diversification of its export markets with focus on new markets like Africa, Latin America, Oceania and emerging Central Asian nations.

India's engagement in PTAs can be broadly divided into two phases. The first phase entails the formation of PTAs as a result of various political considerations and the prevailing international setting. Agreements that were formed on this basis include the India-Bhutan Treaty of 1949, the India-Nepal Friendship Treaty of 1950 and the Bangkok Agreement of 1975.

The second phase, starting from South Asian Preferential Trading Agreement in 1993, saw more focussed decisions on FTAs through a domestic consultation process with due consideration of potential economic gains. However, in the initial part of this phase, the consultation process was largely limited among the central government ministries and apex chambers of commerce. Gradually, other stakeholder groups are engaged in this process.

India's first new generation FTA, the India-Sri Lanka FTA, was signed in December 1998. Another important agreement is the

Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation. It is an important element in India's 'Look East' policy and was signed in February 2004. It marked the first instance of involvement of academia, business and the government in the form of a "group of experts" laying out the contours of negotiations and the Framework Agreement itself. India-Thailand FTA of 2003, India-Mercosur PTA of 2004, India-Singapore CECA of 2005 are some major arrangements which followed.

Since 2005, a number of proposals for trade agreements with non-traditional markets like Israel, several Central Asian and African countries etc. were mooted. An ongoing negotiation with EU is one of the most ambitious initiatives amongst these new proposals. One of the major achievements during this period is the long and hard-drawn FTA with ASEAN signed in 2009, the latest being a CECA with Malaysia signed in February 2011.

The history of India's negotiation of FTAs reveals that apart from an upturn in stakeholder involvement in the formulation of such agreements, there are developments along other lines. Most notably, prioritisation of economic benefits through FTAs by setting specific targets as well as efforts to strike a balance between economic as well as non-economic objectives show the high level of commitment and maturity the country has shown in its trade negotiations.

Moreover, a higher degree of employment of economic diplomacy in its neighbourhood is now evident. Continuing bilateral trade talks with Bangladesh, Nepal

and Pakistan and initiatives to rejuvenate the South Asian Free Trade Agreement are all positive signals indicating India's readiness to assume a larger role in regional prosperity.

## Conclusions

The rapid growth in world trade during the past two decades has been achieved not only by reduction in trade restrictions but also by the transformation of production patterns and processes. The current global trend of specialisation and fragmentation of production processes is a result of access to efficient, reliable and low cost supply chains and other factors determining of competitiveness of firms as well as countries. Transport and other supply chain costs have been significantly reduced because of scale economies as trade grew and this has further inspired more trade and commerce.

Kick-starting this circular link of progress is an unavoidable prescription for all countries. If increasing dependency on FTAs worldwide is an indication that such agreements are a catalyst for progress, India cannot afford to neglect this global trend. Mutual dependency is both a necessity and a reality of today's world. Time has also come to acknowledge positive spin-offs from FTAs in the form of peace dividends at a time when divisiveness looms large as the most potent threat to global prosperity. At this juncture, the question facing emerging global leaders like India is not whether to pursue an FTA agenda or not, but how best to do it. □

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