

**IPCS Special
Report**

83

SEPTEMBER 2009



**Institute of Peace and
Conflict Studies**

**B-7/3, Safdarjung Enclave
New Delhi 110029
91-11-4100 1900**

www.ipcs.org

India-ASEAN FTA

The Road Ahead



Conference Report

© 2009, Institute of Peace and Conflict Studies (IPCS)

The Institute of Peace and Conflict Studies is not responsible for the facts, views or opinion expressed by the author.

The Institute of Peace and Conflict Studies (IPCS), established in August 1996, is an independent think tank devoted to research on peace and security from a South Asian perspective.

Its aim is to develop a comprehensive and alternative framework for peace and security in the region catering to the changing demands of national, regional and global security.

Address:

B 7/3 Lower Ground Floor
Safdarjung Enclave
New Delhi 110029
INDIA

Tel: 91-11-4100 1900, 4165 2556, 4165 2557,
4165 2558, 4165 2559

Fax: (91-11) 4165 2560

Email: officemail@ipcs.org

Web: www.ipcs.org

INDIA-ASEAN FTA: THE ROAD AHEAD

CONFERENCE REPORT

BY ANNA LOUISE STRACHAN

Research Intern, IPCS, New Delhi

Chair: Dr. Baladas Ghoshal, Distinguished Fellow, Institute of Peace & Conflict Studies, Visiting Professor, Third World Studies Centre, Jamia Milia Islamia, New Delhi & Visiting Senior Fellow, Centre for Policy Research, New Delhi.

Panelists: Dr. Amita Batra, SIS, JNU. Amb. AN Ram, Former Indian Ambassador to Thailand.

Discussant: Amb. Rajiv Sikri, Former Secretary (East), Ministry of External Affairs.

Dr. Amita Batra

The FTA is India's first with a trade bloc. India-ASEAN trade reached US\$40 billion in 2007/2008 and the regional bloc is India's fourth largest trade partner. The combined GDP of the 11 economies that constitute the FTA is US\$2 trillion in GDP. The combined population is 1.6 billion, bearing in mind that India accounts for most of this population. The FTA will be effective from January 2010. The tariff liberalization schedule allows for a gradual phasing out of tariffs, which will be fully implemented by the end of 2013 and 2016 in respect of two normal tracks which have been identified for this FTA. There is a timeline for tariff reductions for items on the sensitive list. 489 items have been excluded from the list of tariff concessions, 590 items have been excluded from the list of tariff eliminations. These pertain, amongst others, to automobiles, certain auto parts, machinery, certain chemicals, agricultural products, food and textiles. Tariff cuts in terms of some

sensitive items such as palm oil, tea, coffee and pepper will be graduated over a period of ten years and we will see a reduction in tariffs by 2019.

As far as the India-ASEAN FTA is concerned, negotiations were scheduled to begin in 2003 and to conclude by 2005 and would be implemented thereafter. In the original schedule there was supposed to be an Early Harvest Programme (EHP), which was dropped because it could not be implemented due to the prolonged negotiations and the problems that arose in these negotiations due to identification of the items on the negative list. China has started its FTA with ASEAN with an EHP and this includes many products in which China had a comparative advantage but chose to give concessions to the ASEAN countries perhaps in order to derive benefits in terms of political dividends.

The Rules of Origin (RoO) were the other contentious issue that led to the prolonged negotiations. The twin criteria that India generally applies to RoO in all its FTAs are value addition and Change in Tariff Heading (CTH). In the case of ASEAN this had to be diluted as ASEAN did not accept these. Only value addition is included, at 35 per cent. This is lower than what India has with ASEAN's member countries in bilateral FTAs, specifically Singapore.

The negative list has been at the heart of the prolonged negotiations. The sensitivities of Indian farmers were the reason for it taking so long to come up with a final number. The original list of 1410 items was rejected by ASEAN. The

final list consists of 489 items. Concerns of domestic planters mean that tea, coffee, pepper and rubber have been included in the sensitive list. Duties on these items will be cut by 2019. The following information has not been made available publicly but it seems that ASEAN maintains the same negative list that it has with China vis a vis India. This includes 2200 items. It is necessary to question how ASEAN places the 489 items on India's negative list against the 2200 on ASEAN's list. The Indian elections and the political crisis in Thailand also delayed the signing of the FTA. ASEAN demanded twice yearly duty cuts if the treaty was to be signed in 2009 instead of 2008. India refused to agree to this.

One of the justifications for the FTA is that it forms part of India's 'Look East' policy. ASEAN is the ultimate trading bloc. The association with ASEAN is moving this policy forward. The FTA is also a step forward in trade liberalization. FTAs are tools of economic integration. All countries are a part of an FTA. The north has already done regional integration. Asia is lagging behind on this front. FTA's are running parallel to the WTO negotiations. Recently there has been a delay in the Doha round. Time has been poorly utilized in bringing together the interests of developed and developing countries in making equal exchanges in different sectors. Therefore, FTAs are considered to be the right step forward in terms of trade liberalization. The global financial crisis has resulted in a trade shrinkage. The FTA provides an alternative to traditional sources of demand.

It is true that India gains a market of 600 million people but it is necessary to look at the size of the market that ASEAN gains. It is also necessary to consider where India stands in terms of total trade for ASEAN and what the tariff levels are, where the concessions would actually afford any benefits to India. ASEAN comprises 9 per

cent of India's total trade whereas India accounts for just 1 per cent of ASEAN's trade. India needs to consider whether it really counts for ASEAN. Whether the FTA makes a difference to ASEAN should also have been considered.

Tariff changes don't mean much for India as tariffs were incredibly low to begin with. India has a huge deficit with ASEAN at the moment. It is suspected that this will increase as a result of the FTA. India will gain significantly in investment and services potential. India is among the top ten services exporting nations globally. ASEAN is a major services importer. Negotiations on this have not yet begun and they are likely to take a long time. Considering how long negotiations took in the goods sector it is unclear how long the services negotiations will take and when India will actually gain from this. Free flow of labour is a very sensitive issue for ASEAN. Will the free flow of labour at all skill levels be allowed by the Southeast Asian countries?

Plantation sector concerns have been a major issue. Tea, coffee and pepper imports from Malaysia and Indonesia and coconut oil imports from the Philippines have been causes for concern. While there is a ten year period for the reduction of duties, what is really required is an increase in India's productivity. Southeast Asian countries are much more productive than India. Moreover, the costs of production are far higher in India than they are in Southeast Asia. Even if it takes ten years to reduce tariffs it remains to be seen whether India will be able to increase productivity. Major threats are also presented by Thailand and Vietnam in terms of fisheries and other marine products. Will investments and services compensate for India's losses in the goods sector? The government has launched schemes for subsidizing productivity boosting programmes in some areas.

Whether they have been successful is not yet known.

It is also necessary to look at whether there is an India versus China question in terms of economics. It is important to consider whether India and China could have worked in a cooperative framework in China and whether what could have been a collaborative effort in China to bring about gains for both countries has been negated by prolonged negotiations and India's late entry into ASEAN. China's share of global GDP is 5 per cent while India's share is just 2 per cent. There is also a huge difference in their contribution to global growth. China's manufacturing sector is very different from India's. India's manufacturing sector is a fraction of GDP and exports in comparison to China's. A comparative advantage analysis gives the impression that the two economies are similar. Both derive their maximum comparative advantage in human capital and unskilled labour intensive goods. However, at a commodity level India and China's growth paths in terms of manufacturing are divergent. India is still specializing in low skill goods while China has moved ahead to the high skill sector. Therefore the two economies are not really similar or competitive at a global level. The two could however have entered ASEAN at the same time and gained from this entry.

At the heart of the effort towards Asian integration is ASEAN centrality. There are inherent contradictions within ASEAN, which need to be resolved before ASEAN takes the centre stage in terms of Asian integration. The 2007 charter says that ASEAN economic integration won't go beyond ASEAN+3 so talks of ASEAN+6 are at a totally different level. As far as AFTA is concerned, the services agreements they have with each other have a long way to go in terms of integration. The political will in terms of differentials, which exist in the ASEAN region and the

institutional change, which needs to be brought about within the core of ASEAN must also be considered.

If India-ASEAN works out, the larger market will also be opened to South Asia and South Asian economic integration could be accelerated. SAFTA has been taken forward in the last two years but given the basic India-Pakistan problem one has to consider how far SAFTA goes in taking economic integration in South Asia forward. There are existing organisations which bring together parts of South Asia with parts of Southeast Asia such as the Asia-Pacific Trade Agreement (APTA) and the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC). The extent of their achievements in terms of taking Asian integration forward must also be considered. Finally, calls for Northeast India to be developed through integration with ASEAN are questionable. Steps should be taken to integrate Northeast India with the rest of India rather so that Northeast India is not left behind the rest of India.

Ambassador AN Ram

Ever since India and ASEAN upgraded their sectoral dialogue partnership to full dialogue partnership in 1995, there have been suggestions that India and ASEAN enter into an FTA. There has been greater pressure and interest from the ASEAN side in an FTA, possibly because of the potential attractiveness of the large and untapped Indian market following economic reforms and the opening up of the Indian economy since the early 1990s. The imperatives of globalization have also been a factor. Although, Indian leaders and officials have repeatedly spoken about the need to integrate the Indian economy with those of Southeast and East Asia – described by our Prime Minister as the “arc of advantage”- and in that context to bring down India's high tariff rates to the

ASEAN tariff levels, there have been reservations expressed on the proposed FTA. These are largely due to fears of being swamped by cheap ASEAN exports, the perceived need to protect the nascent Indian industry in some sectors, the absence of complementarities and the lack of a competitive edge in our major exports. Such fears are largely misplaced, as were fears of our economic survivability following the Marrakech WTO Accord in 1995. It will be recalled that at that time also, critics of the Marrakech Agreements accused the negotiators of selling Indian interests out, but at that time India's two-way trade was under US\$40 billion and today it is worth US\$200 billion.

It was only in 2003 at the Bali Summit that India and ASEAN agreed to finalize a framework FTA in goods, possibly driven by China's swift progress in finalizing an FTA with ASEAN. Other possible factors include the fluid and uncertain economic environment and western markets being increasingly difficult to penetrate due to the protectionist measures adopted by these countries. By this time, the Indian economy had shown resilience to the pressures of globalization and was more confident of withstanding competition and sustaining growth. The Asia-Pacific began to emerge as an important area of focus for India. It has taken over six years of tortuous negotiations to reach partial CECA, including an FTA in goods with ASEAN. As has been pointed out by experts, it is estimated that India-ASEAN bilateral trade, now at nearly US\$40 billion annually and growing at approximately 27% since 2000, will double by 2015. India has agreed to reduce tariffs in phases to zero within six years on a majority of the 5000 goods being traded, keeping 489 mostly agricultural and some manufactured goods (e.g. processed foods, fruit juices, natural rubber, textiles, chemicals and petrochemicals) in the negative list. At a later stage, India hopes to bring trade in services and investments

within the purview of the FTA, which according to experts, will give a major boost to our economic and commercial ties as some of these are sectors of India's core competency and there is complementarity with ASEAN.

The significance of the FTA is as much political as it is economic. The Asia-Pacific is one of the most dynamic regions of the world and India cannot afford not to integrate her economy with this fast growing region. For India, the FTA, deepening relations with ASEAN and the East Asian economies, linkages with Southeast and East Asian institutions like the EAS, Bangkok Agreement, MGC, BIMSTEC, ACD, JACIK, the Chiang Mai Initiative and the proposed FTAs with Japan, Korea and China should be seen as building blocks of a future Asian Economic Community and one day, hopefully, of the Asian Economic Union. India's long term interest would arguably be best served by such Pan-Asian multilateral arrangements. Multilateralism should be our preferred choice and should secure India's interests best. In that sense the FTA with ASEAN is only a beginning and is a stepping stone to a larger strategic vision that India could have in regard to the Asia-Pacific region.

Politically and strategically, India belongs to this region. This is the imperative of our history, geography and today's globalized world. The FTA signals India's desire and determination to become an integral part of this region and to play a pro-active role in shaping its evolving strategic and economic architecture. China is pursuing the same path. India and China need not be adversaries in this space and can work together to further their own and the region's shared interests and goals. There is enough space for both India and China to operate optimally in this very interesting economic space. China, Korea and Japan also have more liberal FTAs with ASEAN. We should endeavour to remain abreast

and not be sidelined, for the stakes in this game are very high. China and Japan are both interested in doing business with India. Japan has submitted its intention to go along with India in the Asia-Pacific region not only in the strategic areas but also in areas of trade and commerce where Japan and India share certain congruencies. China and India too should explore congruencies in the areas where that is possible rather than choosing to become, or to be seen as, adversaries.

Skeptics would argue, as they did after the Marrakech WTO dispensation came into being in 1995, that the India-ASEAN FTA is weighted in favour of ASEAN. Nothing can be further from the truth. We must give credit to our negotiators for safeguarding our interests. This is a win-win agreement and should benefit both, as trade is a two way affair and cannot be sustained in the absence of mutuality of interest. The very fact that Indo-ASEAN bilateral trade today is in excess of US\$40 billion and growing at nearly 27 per cent per annum shows that there is potential for this trade to grow fast and to consolidate itself in a manner that India-ASEAN also emerge as major economic entities just as India-EU, India-US and India-China have emerged.

India for now has left out sensitive products and duty reductions are in phases allowing us time to prepare ourselves. In that sense, it is more of a PTA than an FTA that has been agreed upon. The CECA, when expanded to include trade in services and investments should open new opportunities for India. In any case, the India-ASEAN FTA is neither exclusive nor irreversible. India is also engaged in similar exercises with the EU, US, Japan, ROK, GCC and China. In today's highly competitive and rapidly changing economic scene, India has to seize every option, short and long term, and maximize its opportunities and secure its interests. I believe that the India-ASEAN FTA is an

overdue first step in the right direction. It has been delayed but it has arrived. It has to be seen in context and as a policy option, the imperative of which is inescapable. In terms of the political significance of the FTA, India needs to diversify from the overwhelming focus that it chooses to give to relations with the EU, the USA, China and Russia. The 'Look East' policy notwithstanding, Southeast Asia and Asia-Pacific have only recently started to occupy some space in the Foreign Ministry's thinking. Credit should be given to our leadership and to the Prime Minister who has hastened the pace at which this integration process with Southeast Asia is taking place. India is seeking to develop a strategic architecture with a multi-dimensional base. India, China, Japan and perhaps Australia would be the four pillars of this Asia-Pacific strategic architecture. If India has to play a role in this she will have to make this relationship more solid. Content which will direct this relationship in the future will have to be trade, commerce, science, technology, defence and other areas which will evidently bring out the congruencies which exist between India and Southeast Asia and perhaps allow the relationship to be consolidated in a regional frame. If the Asia-Pacific region is the flavour of this century then India cannot afford to be left out of any agreement

What then is the road ahead for India? India clearly needs a benign, peaceful and predictable economic and strategic regional and global order in which she could pursue her national goals. The bilateral, sub-regional and regional arrangements should be seen as building blocks of an Asian Economic Community, a large free trade area, leading to an Asian Union on the lines of the European Union. A multilateral framework, arguably, would serve and enhance India's long-term interests best. Fortunately, Asia-Pacific is slowly but surely moving in that direction. Until then, we will have to pursue a more

limited approach which will meet the exigencies of the day, but the vision should always remain to create a Pan-Asian economic space in which we have a stake and a responsibility commensurate with our size and strength. In the emerging global order, Asia-Pacific can become a major force only if we have a supra-national vision and work in partnership for progress. The India-ASEAN FTA is a modest but necessary first step to achieve this. The FTA signals to India's neighbours that it is interested in consolidating its relationship with its Southeast Asian neighbours. India should be looking to secure its political, economic and strategic interests equally.

Ambassador Rajiv Sikri

The decision for the FTA was political rather than economic. As a result of various developments in the late 90s and early 2000s ASEAN were looking at engaging India far more seriously. At the end of 2001 India got the indication that ASEAN wanted to invite India for a summit. At the time India's understanding of ASEAN was limited notwithstanding the 'Look East' policy, which had been underway for over five years. ASEAN was a dialogue partner but that was it. There was disagreement among ASEAN countries regarding Indian involvement. Singapore was very much in favour but Malaysia was reluctant. India became a credible partner after the 1st Indo-ASEAN summit and a decision was taken to make the summit an annual event. The China factor also played a part. This was particularly important to the Singaporeans. ASEAN wanted India to balance China as they do not want to be totally dominated by China. The Northeast issues were not part of the initial plan but they became important later.

India's strategic vision has worked. India showed courage in offering an FTA in 2002. By the Bali Summit India had

concluded the work on the FTA framework agreement. India also had an agreement on counter-terrorism. ASEAN were sceptical about this too, but this changed after the Bali bombings. Without the FTA India's 'Look East' policy would have completely floundered. India was a founding member of the East Asia Summit (EAS) in 2005. There was also talk of India joining APEC but this did not happen. India did not emerge on the global stage until it got plugged into ASEAN. India-ASEAN engagement at the summit level and all that followed, helped India to become a credible interlocutor with the major powers including the Western powers. Japan took ASEAN more seriously after the ASEAN summits.

Economic engagement led to engagement on the defence side. The engagement on the defence side only came into being because India engaged with ASEAN as a whole. Improved bilateral relations with individual Southeast Asian countries also occurred as a result of India's engagement with ASEAN. It is necessary to have an FTA with ASEAN if you want to be a player in this region, when everyone else in the region has an FTA with ASEAN otherwise India would not even have been on the starting block. India lost ground in the delay in the conclusion of the FTA. ASEAN was disappointed by the loss of momentum because China is there in a big way and is sucking all these countries into its economic whirlpool, which they don't like. The uncertainties of the Doha Round made the imperative of signing FTAs with important trading partners important from an economic point of view. 60-70 per cent of global trade is under Regional Trade Agreements (RTA). The FTA has led to bilateral agreements with a number of Southeast Asian countries. India-ASEAN has been a learning process for India. Without the ASEAN FTA, India would not even be looking at possible FTAs with the USA and the EU. The FTAs are also seen by the political leadership as a way of

pushing internal reforms. The FTA will open up many opportunities for India.

When the United Party Alliance (UPA1) came into power they had great reservations about FTAs. The Prime Minister deserves credit for understanding the strategic significance of FTAs. There are many stakeholders, which have to be considered. The fact that it took six years instead of two years shows how careful the government and the negotiators have been to take the concerns of stakeholders into account. India's interests have been reflected. There is a negative list and a list of sensitive products. Because of market conditions there is almost no duty on these items today. There are safeguard provisions, which are quite extensive. One also has to consider why Kerala farmers have only started to oppose the FTA now, when everyone knew what was being negotiated over the last six years. This is an opportunity to reform our agricultural sector. India should have a positive rather than a defensive approach. All FTAs, even the India-Sri Lanka FTA, involve some economic losses. In this case they should be weighed against the overall strategic gains. The India-ASEAN FTA is a very important brick in our engagement with the rest of the world.

Discussion

Questions

- The Indian community in ASEAN countries is significant. Why does India not make use of this community?

India has no policy in this regard. Indians living overseas invest more in China than in India. Red tape in India is a deterrent. The Indian diaspora don't invest directly in India unlike overseas Chinese. India must do something to utilize these communities.

- The bulk of India's trade with ASEAN is by sea. Is India thinking to improve land connectivity?

There is a plan for a Delhi – Hanoi railway dating back to 2002. The plan is to extend broad gauge railway to Manipur. India has already upgraded the Mandalay – Yangon stretch of railway track, but India has been slow to progress with this. It should speed up. The trilateral highway project is bogged down in bureaucracy. The government does not give priority to the Northeast as it doesn't consider it to be important. More needs to be done in Myanmar.

- Is there thinking across ministries regarding FTAs or is it only the Ministry of Commerce who works on this?

The FTAs are not driven by the Ministry of Commerce. In fact they are the most reluctant player but they are responsible for the negotiations. The Ministry of Agriculture is also involved.

- Why can't Garuda fly to India?

There used to be an Air India flight to Jakarta but it only went three times a week. This meant that it was useless for business travelers. Air India eventually cancelled the flight as it was losing money. When Garuda was banned from the EU due to concerns about their safety record, the director of Garuda twice made appointments with the Indian Ambassador in Jakarta, but both appointments were cancelled. There is not enough demand for India-Indonesia flights at present.

- Why does the productivity differential between India and ASEAN occur?

The reason for this is unclear. Perhaps it is due to different agricultural practices and the fact that Southeast Asian countries are

Special Report

No , September 2009

more export orientated. Agricultural reform in India is certainly required.

- China is far ahead in the manufacturing sector. Why does India compete in this sector at all? Why can't it compete in the services sector where India has an advantage?

No offer has been made in terms of services. This FTA is only about goods so comparisons can only be made in terms of manufacturing.

- Has anything been built into this FTA regarding services and investments?

Nothing has been built into this agreement regarding services and investments. What comes later remains undecided.

Comments

- The space for both India and China is definitely there and we want cooperation and collaboration wherever possible. At present, however, this is wishful thinking as China is opposing and obstructing wherever it can.
- What is going to happen to succession laws, land holdings and farm lands? Over the last ten years the number of people having holdings has gone up. Agricultural reform won't happen as it should. The size of holdings must be fixed if productivity is to be improved. It is also necessary to improve the efficiency of domestic industry.
- The absence of agricultural reforms has ensured political stability in India. Such reforms cannot go ahead without bringing about a revolution.
- India must have a comparative advantage in some goods as total exports are now worth US\$200 billion. Moreover, India is head and shoulders

above China in the knowledge sector so there is no need for concern regarding India's ability to compete. China and ASEAN are the growth areas for India and India must capitalize on this.

- India will need a dozen or more agreements to safeguard its economic interests. There is a possibility of third country agreements on the back of ASEAN goodwill. Africa is important and India must move fast in this respect.