Free trade agreements

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Why is in news?

India is **likely to lower tariffs on a range of items** including high tariff products such as cars, whiskey and machinery items **for the first time** under the free trade agreements **(FTAs) with developed economies** and is moving away from looking at tariffs as a source of revenue during negotiations, a government official said.

This comes amid internal consultations between the finance ministry and the commerce ministry to assess the impact of the major duty reductions that could be announced as part of the FTAs.

Findings of the assessment:

India is **currently negotiating** FTAs with the **UK, the European Union (EU), Australia and Oman**, and India could lower duties on goods and services sharply.

Tariffs are **customs duties on goods imported** into a country.

New Delhi has the **highest import duty compared to most major economies** with an average Most Favoured Nation (MFN) **rate of 18 per cent**, about **twice the global average**, according to the **World Trade Organization (WTO) Tariff Profile database.**

In trade parlance, the most-favoured-nation clause requires WTO members to offer the same trade terms to all trading partners.

The union government estimates to receive Rs 2.3 lakh crore in revenue from custom duty in 2023-24, **about 11 per cent higher compared to the 2022-23** revised estimates of Rs 2.1 lakh crore according to the official figures.

Customs duties contribute about **8 per cent of the gross tax revenue**. The total import tax collection in 2021-22 stood at Rs 1.99 lakh crore.

India is a high tariff economy. Even if we see the major South Asian countries or the global landscape, the average tariff has gone pretty down. There is a tendency to remove tariff barriers across the globe. It is because of global value chain integration and India is also doing that with the help of free trade agreements.

As **part of the UK FTA**, India is contemplating a reduction in duty for the imports of Scotch whisky from the UK that attracts a 150 per cent and slash tariffs on automobiles that stands at 100 per cent. Under the partial trade deal signed with Australia, India had lowered duty for Australian wines for the first time.

High tariffs are among the **key concerns** raised by trade partners India is negotiating FTA with. The simple average tariff on goods imported into the UK from India is 4.2 per cent but the simple average tariffs on UK exports to India was 14.6 per cent, UK's department of international trade said in a report on India.

India has raised duty even on **intermediate and capital goods** that are used in the manufacturing process which is **higher than competitors such as Vietnam and Indonesia**.

In the last decade, India's trade-weighted average MFN rate jumped from 7.7 per cent to 11.4 per cent, while the global average decreased from 7.5 per cent to 6.9 per cent, **MVIRDC World Trade Center** said in a report.

The report added that duties imposed on capital goods such as electrical machinery, non-electrical machinery and transport equipment are also higher compared to the global average.

FTA:

A free trade agreement is a pact **between two or more nations** to **reduce barriers to imports and exports** among them.

Goods and services can be bought and sold across international borders **with little or no government tariffs, quotas, subsidies, or prohibitions to inhibit their exchange**.

The **concept of free trade is the opposite of trade protectionism** or economic isolationism.

At present, India has signed **13 Free Trade Agreements (FTAs)** with its trading partners.

India's Trade Agreements

Bilateral Agreements

1. India-Sri Lanka FTA (2000)	6. India-Thailand EHS (2004)
2. India-Japan CEPA (2011)	7. India-Chile PTA (2007)
3. India-Korea CEPA (2010)	8. India-Afghanistan (2013)
4. India-Malaysia CECA (2011)	9. India-Singapore CECA (2005)
5. India-Nepal Trade Treaty (1950)	10. India-Bhutan Agreement on Trade & Transit (2016)

Unilateral DFTP Scheme (34 LDCs) (2008)

Afghanistan, Bangladesh, Benin, Burkina Faso, Burundi, Cambodia, Central African Republic, Chad, Comoros, Eritrea, Ethiopia, Gambia, Guinea, Guinea Bissau, Haiti, Lao PDR, Lesotho, Liberia, Madagascar, Malawi, Mali, Mozambique, Myanmar, Niger, Rwanda, Senegal, Somalia, Sudan, Timor Leste, Togo, Uganda, Tanzania, Yemen, Zambia

Regional Agreements

1. India-ASEAN (2010)	Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Thailand, Singapore, Vietnam
2. Asia Pacific Trade Agreement (APTA) (1975)	Thailand, Bangladesh, China, Republic of Korea, Sri Lanka
3. Agreement of South Asian Free Trade Area (SAFTA) (2006)	Bangladesh, Bhutan, Maldives, Nepal, Pakistan, Sir Lanka, Afghanistan
4. India-MERCOSUR (2009)	Argentina, Brazil, Paraguay, Uruguay
5. Global System of Trade Preference (1989)	47 Developing Countries

(As on Sept 2020)

Most Favoured Nation (MFN) principle:

The MFN concept requires countries that are **part of the World Trade Organisation** to accord the most favourable tariff and regulatory treatment given to the products or services of any one member at the time of import or export of "like products" to all other members.

Under the WTO agreements, countries **cannot normally discriminate** between their trading partners.

In general, MFN means that every time a country **lowers a trade barrier or opens up a market**, it has to do so for the same goods or services from all its trading partners — whether rich or poor, weak or strong.

This is a **bedrock principle of the WTO** and would also be a factor for New Delhi as it negotiates multiple negotiations at the same time.

Others are well within their rights to seek a concession extended by a WTO signatory to another member nation/ bloc.

It is a **priority** in the General Agreement on Trade in Services (GATS) and the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS).

The **loss of MFN status** exposes a country to **discriminatory import tariffs** on its products.

Significance of FTAs:

FTAs give businesses and consumers **improved access to a wider range of competitively priced goods and services**, new technologies, and innovative practices.

FTAs help to **obtain more benefits** from foreign investment.

FTAs **promote regional economic integration** and build shared approaches to trade and investment between the trading partners.

FTAs can deliver **enhanced trade and investment opportunities** that contribute to the economic growth of less-developed economies.

FTAs support **stronger people-to-people and business-to-business links** that enhance overall bilateral relationships with FTA partners.

FTAs can continue to provide **additional benefits to the trading partners** over time, including via in-built agendas that encourage ongoing domestic reform and trade liberalisation.

Major Challenges in finalising FTAs:

Demographic dividend: These Non-tariff issues could pose hurdles for India in reaping the gains of its comparative labour advantage.

Shift of focus: Wrapping up these FTA talks could narrow soon given that India's focus would shift to the series of events linked to India's G20 Presidency.

Influential lobbies can delay it more: Political lobbying from influential lobby groups such as farmer unions and the auto sector could intensify.

Priority to non-tariff issues: In much of the negotiations currently under discussion, climate action, carbon emissions and labour issues are taking precedence over trade issues.

Recessionary conditions: These could potentially offer partner countries a handle to trigger non-tariff protectionist measures as developed nations stare at recessionary conditions.

Environmental issues: Developed countries such as the US have brought up the issue of carbon emissions in the process of manufacturing melted steel as a non-tariff-related issue.

India mostly produces steel generated from iron ore which comes from mining. Most developed countries have resorted to methods to generate it from scrap which results in lower carbon emissions. Thus, there may be a **levy of carbon adjustment tax.**

GSP (Generalised System of Preferences): Currently, we may benefit from the GSP but if they come in a non-tariff barrier by citing labour or environment, then it becomes an issue citing standards, adjustments, child labour as reasons. India had been a **beneficiary of the US' GSP programme** since November 1975, under which beneficiary countries are allowed to export thousands of products to the US without the added burden of duties.

Carbon Border Adjustment Mechanism: The European Union has proposed CBAM to tax carbon-intensive products, such as iron and steel, cement, fertiliser, aluminium and electricity generation from 2026. Here, EU importers will buy carbon certificates corresponding to the carbon price that would have been paid, had the goods been produced under the EU's carbon pricing rules.

Way Forward:

Towards Open and Competitive Economy: The trade policy framework must be accompanied by economic reforms that result in an open, competitive, and technologically advanced economy. Therefore, country looking for FTAs must focus on inclusion of entrepreneurs in global economic networks that will also allow them to pursue greater financial security.

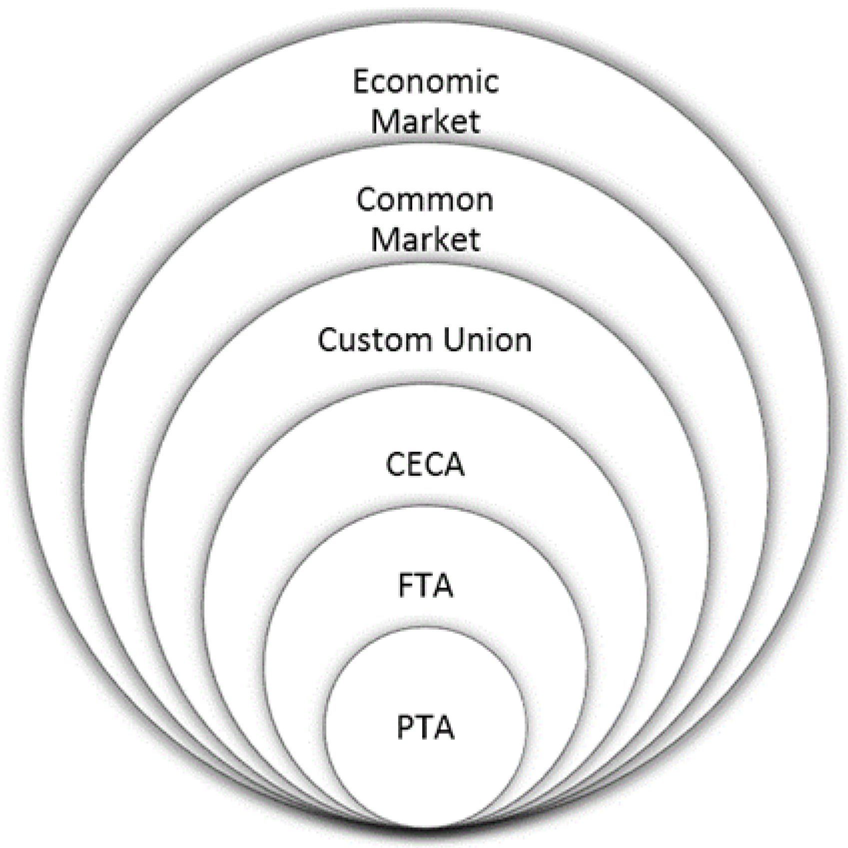
Strengthening MSME Sector: With a contribution of about 29% to the GDP and 40% to international trade, MSMEs are the key players in achieving the ambitious export targets. It is important for India to link Special Economic Zones with the MSME sector and incentivize small businesses.

Enhancing Domestic Base: India needs to **strengthen its domestic manufacturing base** in value-added products like engineering goods, electronic products, drugs and pharmaceuticals, textiles, and agriculture machinery, that could be used to boost exports.

Infrastructural Evolution: A robust infrastructure network – warehouses, ports, testing labs, certification centers, etc. will help Indian exporters compete in the global market. It also needs to adopt modern trade practices that can be implemented through the **digitisation** of export processes. This will **save both time and cost**.

Scrutiny of FTAs: The Committee on Commerce should be tasked with scrutinizing FTAs, discussing different aspects of agreements and negotiations, thus ensuring executive accountability to the legislature.

Other types of economic engagements:



Preferential Trade Agreement (PTA): In a PTA, two or more partners **agree to reduce tariffs on an agreed number of tariff lines**. The list of products on which the partners agree to reduce duty is called a positive list. India MERCOSUR PTA is such an example. However, in general PTAs do not cover substantially all trade.

Free Trade Agreement (FTA): In FTAs, **tariffs on items covering substantial bilateral trade are eliminated** between the partner countries; however, each maintains an individual tariff structure for non-members. For example: India -Sri Lanka FTA.

Common Market: Integration provided by a Common market is one step deeper than that by a Customs Union. A common market is a **Customs Union with provisions to facilitate free movements** of labour and capital, harmonize technical standards across members etc. For example: The European Common Market is an example.

Economic Union: Economic Union is a Common Market extended through further harmonization of fiscal/monetary policies and shared executive, judicial & legislative institutions. European Union (EU) is an example.

Comprehensive Economic Cooperation Agreement (CECA) and **Comprehensive Economic Partnership Agreement (CEPA):** These terms describe agreements which consist of an integrated package on goods, services and investment along with other areas including IPR, competition etc. The **India Korea CEPA** is one such example and it covers a broad range of other areas like trade facilitation and customs cooperation, investment, competition, IPR etc.

Custom Union: In a Customs union, partner countries **may decide to trade at zero duty among themselves**, however they maintain common tariffs against the rest of the world. Example: Southern African Customs Union (SACU) amongst South Africa, Lesotho, Namibia, Botswana and Swaziland. The European Union is also an outstanding example.

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