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Impact of India-ASEAN Free Trade Agreement: A cross-country analysis using applied general equilibrium modelling

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Executive summary

The India-ASEAN Free Trade Agreement (AIFTA) came into effect on 1 January 2010 with regard to Malaysia, Singapore and Thailand. For the remaining ASEAN members it will come into force after they have completed their internal requirements. With this background, the present study analyses the impact of this free trade agreement (FTA) on India and the ASEAN members.

Using the Global Trade Analysis Project (GTAP) database, several simulations were undertaken, involving different scenarios, of India's trade liberalization with the ASEAN region. The results of the simulations were used to assess the impact of this liberalization, both on the external sector and on domestic macroeconomic variables in India and ASEAN. The welfare implications of the FTA for the countries were also studied and the impact on the trade of other countries, including selected South Asian countries, was investigated.

The simulation results reveal that post-FTA, India's exports to ASEAN increase substantially, with the largest accesses gained in Thailand, Cambodia, Viet Nam, Malaysia, the Philippines and the Lao People's Democratic Republic. The main sources of imports are Viet Nam, followed by the rest of ASEAN, the Philippines, Malaysia, Singapore and Thailand. However, India experiences a welfare loss due to both allocative inefficiency and negative terms of trade effect.

In the ASEAN region, Malaysia, Singapore and Thailand show positive welfare gains with the largest gain accruing to Singapore. The smaller countries all enjoy positive welfare gains except Cambodia, the Lao People's Democratic Republic and the Philippines. This welfare gain by ASEAN countries is primarily due to their improved terms of trade.

The simulation results also reveal that the rest of the world experiences a significant market share loss in India and the ASEAN members. In particular, China is affected by a loss of market share in Cambodia, India, Malaysia, the Philippines, Thailand, and Viet Nam. A similar impact of the FTA is seen in the case of the South Asian developing countries, particularly Bangladesh. Thus, trade diversion occurs in the India-ASEAN region as a result of the FTA.

The study also attempted to analyse the long-term effects of the FTA on India. It is argued that after full trade liberalization, India's allocative efficiency will increase, but the terms of trade effect will worsen continuously and remain negative. India will be able to arrest the worsening in terms of trade once the gain in allocative efficiency is used to improve productivity in the export-oriented sectors as well as achieve economies of scale.

Introduction

India announced its “Look East” policy in 1991 in an attempt to increase its engagement with the East Asian countries. Consequently, in 1992, it became a sectoral dialogue partner of the Association of Southeast Asian Nations (ASEAN). ASEAN, which is a geo-political and economic organization with 10 member countries, was formed in August 1967 by Indonesia, Malaysia, the Philippines, Singapore and Thailand. Since then, the membership has expanded to include Brunei Darussalam, Cambodia, the Lao People’s Democratic Republic, Myanmar and Viet Nam. ASEAN’s objectives are to accelerate economic growth, social progress and cultural development among its members, protect the peace and stability of the region, and provide opportunities for the member countries to discuss their differences peacefully.

India became a Full Dialogue Partner of ASEAN in 1995and a member of the ASEAN Regional Forum (ARF) in 1996. India and ASEAN signed a Framework Agreement – the Comprehensive Economic Cooperation Agreement (CECA) – on 8 October 2003 with a view to providing an institutional framework that would enable economic cooperation to come into effect. Negotiations on a trade in goods agreement between India and ASEAN were started in March 2004. The negotiations continued for six years and finally the India-ASEAN Free Trade Agreement (AIFTA) was signed on 13 August 2009 in Bangkok during a meeting of the Economic Ministers of ASEAN. The agreement, which only covers trade in goods between India and the ASEAN members, came into effect on 1 January 2010 in the case of Malaysia, Singapore and Thailand. For the remaining ASEAN members it will come into force after they have completed their internal requirements.

AIFTA will boost bilateral trade between the two regions. ASEAN is a major trading partner of India and it accounted for 9.27 per cent of India’s global trade in 2008. In 2008/09, bilateral trade between India and ASEAN was worth almost US$ 45 billion. India and ASEAN set a target of achieving bilateral trade of US$ 50 billion by 2010, a goal that is likely to be achieved (Dash, 2010). India’s trade with ASEAN is mainly concentrated in Indonesia, Malaysia, Singapore and Thailand. These four countries remain the largest markets for Indian exports in the ASEAN region as well as the largest sources for India's imports from the ASEAN region. Among them, Singapore is the largest destination for Indian goods (45.6% of total exports to ASEAN in 2008) and the largest source of imports for India (31.1% of India's total imports from ASEAN in 2008), followed by Malaysia, Indonesia and Thailand.

Table 1. India's exports to, and imports from ASEAN members, 2004-2008

(Unit: US$ '000)

ASEAN members	Exports					Imports				
	2004	2005	2006	2007	2008	2004	2005	2006	2007	2008
Brunei Darussalam	4 956	4 395	44 462	8 814	17 155	455	832	225 719	234 094	325 861
Cambodia	16 74	21 350	48 089	44 826	53 854	234	425	1 482	1 245	4 271
Indonesia	1 205 594	1 390 066	1 869 806	1 878 196	2 659 314	2 427 665	3 018 949	3 610 443	4 840 346	6 431 337
Malaysia	1 040 207	1 143 775	1 331 365	1 850 254	3 034 408	2 214 486	2 435 996	4 655 925	5 725 558	7 461 390
Myanmar	112 698	117 246	124 088	162 757	237 333	410 685	489 162	702 698	809 067	906 267
Lao People's Democratic Republi	953	6 540	2 362	2 939	4 591	92	72	376	80	525
Philippines	362 923	482 110	596 836	571 413	755 025	180 851	203 196	208 768	173 536	227 640
Singapore	3 416 459	5 427 555	6 127 250	6 390 068	8 853 900	2 492 155	3 159 416	5 184 562	6 901 607	8 304 751
Thailand	856 828	1 059 267	1 350 985	1 673 337	2 005 280	750 164	1 196 597	1 550 809	2 192 368	2 664 791
Viet Nam	534 846	633 465	874 098	1 241 477	1 812 607	73 208	127 378	159 826	153 134	371 605
Total	7 552 218	10 285 769	12 369 341	13 824 081	19 433 467	8 549 995	10 632 023	16 300 608	21 031 035	26 698 438
Per cent share in India's total expo	9.95	10.25	10.21	9.48	10.69	-	-	-	-	-
Per cent share in India's total impo	-	-	-	-	-	8.64	7.55	9.15	9.62	8.46

Source: International Trade Centre trade maps.

The trade agreement between India and ASEAN has already come into effect with regard to all these countries, with the exception of Indonesia. Starting from January 2010, the tariff liberalization under the India-ASEAN FTA was to gradually cover 75% of the two-way trade between India and the ASEAN member countries. The FTA will lead to the elimination of tariffs on some 4,000 products including electronics, chemicals, machinery and textiles. Of these 4,000 products, 3,200 products will have duties reduced by the end of 2013, while duties on the remaining 800 products will be lowered to zero or almost zero by the end of 2016.

Under the Trade in Goods Agreement, the Schedules of Tariff Commitments has been drawn up by all the member countries, indicating product-wise tariff concessions or no concessions. The tariff commitments of India are divided in the three categories (table 2).

Table 2. India's tariff commitments under India-ASEAN trade in goods agreement

Tariff elimination	Tariff reduction	Negative List/Exclusion List
Normal Track 1: 7,775 products (at the HS 8-digit level) through annual cuts between 1 January 2010 and 31 December 2013.	**Sensitive Track:** Reduction to 5% on 1,805 (at HS 8-digit level) products through annual cuts between 1 January 2010 and 31 December 2016.	No tariff concession is offered for 1,297 products (at the HS 8-digit level).
Normal Track 2: 1,252 (at the HS 8-digit level) products through annual cuts between 1 January 2010 and 31 December 2016.	**Highly Sensitive Track: Reduction** to 37.5% on crude palm oil, 45% on refined palm oil, coffee, tea and 50% on pepper through annual cuts between 1 January 2010 and 31 December 2019.	

Source: Dash, 2010.

The main exports by India to the ASEAN region include meat, edible vegetables and fruit, cereals, cotton, tobacco, mineral fuels, salt, sulphur, organic chemicals, pharmaceutical products, iron and steel, copper, electrical and electronic equipment, and machinery. The main imports by India from the ASEAN region include mineral fuels, animal and vegetable fats,