

From FTA to a Common Market: A Tale of India and the ASEAN

Dr. Veena Jha and Mr. Vipin Kumar ¹

Introduction

The adoption of the ASEAN INDIA Free Trade Agreement (AIFTA) increased trade without raising exports significantly. Studies show that rising NTMs could be one of the main reasons for India's export performance with ASEAN². Transitioning from the current Free Trade Agreement (FTA) setup to a common market can provide India with improved market access to ASEAN countries. This may lead to increased scale of operations and also specialisation. It is crucial for India to focus on establishing stronger and broader relationships with ASEAN countries experiencing higher GDP growth rates. Secondly, integration into a common market can make India a more appealing destination for foreign investors from ASEAN countries, resulting in a boost in foreign direct investment (FDI) inflows. Between 2015-2021 cumulative FDIs from ASEAN to India was \$117.88 billion. These were mainly accounted for by Singaporean investments in India (\$115 billion)³. Thirdly, participation in a common market would enable Indian industries to engage in regional supply chains and production networks, leading to improved efficiency, productivity, and competitiveness. This can be seen through the India-ASEAN Free Trade Agreement (FTA), which has facilitated increased trade in goods and services and enhanced competitiveness for Indian industries in sectors such as textiles, chemicals, and automotive components.⁴

On the flip side transitioning to a common market requires adaptation and adjustment by Indian industries, which may be expensive and disrupt existing business practices. Indian industries may be disadvantaged vs ASEAN countries, as the latter have well-developed industries with a global competitive edge. A common market could lead to trade imbalances, which India is already facing. It could entail regulatory harmonisation with the ASEAN Economic Community (AEC) with numerous mutual recognition arrangements (MRAs) for various sectors. This in turn could affect India's policy autonomy in certain areas. Most importantly a Common market between ASEAN and India would entail a common market with China as ASEAN has very deep FTAs with China.

In this context the rest of this paper examines what it would entail to move from an FTA to a common market. First of all it tries to set the parameters of a common market using the EU as an example. Then it examines India's trade with ASEAN focusing on the deficit. Thirdly it examines whether there has been trade diversion from China through the ASEAN. Lastly it sets out the feasibility and desirability of a cooperation if not a common market with the ASEAN.

1. Moving to a Common Market: What is Required

European Union's transition from a free trade agreement to a Common Market setup required a number of steps which are enumerated below:

¹ Dr. Veena Jha is the CEO of IKDHVAJ Advisers LLP. Mr. Vipin Kumar was a Research Associate with IKDHVAJ Advisers LLP.

² Prianka Khatri and Chanwahn Kim, 2023, Impact of India's Free Trade Agreement with ASEAN on Its Goods Exports: A Gravity Model Analysis, Department of G-2 Big Data Management, Gangseo University, Seoul 02447, Republic of Korea, Department of Indian and ASEAN Studies, Hankuk University of Foreign Studies, Seoul 02447, Republic of Korea, *Economies* **2023**, *11*(1), 8; <https://doi.org/10.3390/economies11010008>, <https://www.mdpi.com/2227-7099/11/1/8>,

³ https://www.mea.gov.in/Portal/ForeignRelation/ASEAN_India_Brief_May_2022.pdf

⁴ https://commerce.gov.in/wp-content/uploads/2020/02/MOC_635963409894748315_India_ASEAN_FTA_Outreach_booklet_FIEO.pdf (page 5)

1. Treaty of Rome (1957)⁵: The Treaty of Rome set up the European Economic Community (EEC), bringing together Belgium, Germany, France, Italy, Luxembourg and the Netherlands. Its common market included free movement of goods, people, services, and capital. The customs union that was created abolished quotas and customs duties between its 6 signatories and established a common external tariff on imports from outside the EEC⁶.
2. Single European Act (1986)⁷: It amended the Treaty of Rome to enhance economic integration by removing barriers to the free movement of goods, services, capital, and labour and included several other members.
3. European Commission's White Paper on Completing the Internal Market (1985): This outlined the vision and strategy for achieving the completion of the internal market within the EU.

A few examples of countries that transitioned from a free trade agreement to a common market setup are provided below:

1. Mercosur: Mercosur is a regional trade bloc in South America, which began as a free trade agreement in 1991 among Argentina, Brazil, Paraguay, and Uruguay. Over time, it aimed to harmonize economic policies and eliminate barriers to trade and movement of goods, services, and people⁸.
2. Caribbean Community (CARICOM): CARICOM began as a free trade agreement in 1973. CARICOM member states aim to remove trade barriers, coordinate economic policies, and facilitate the free movement of goods, services, and people⁹.
3. Eurasian Economic Union (EAEU): The EAEU started as a free trade agreement in 2010 between Belarus, Kazakhstan, and Russia. Since then, Armenia and Kyrgyzstan have also joined, and the EAEU aims to develop into a common market, harmonizing trade policies and facilitating the free movement of goods, services, capital, and labor¹⁰.
4. East African Community (EAC): The EAC is an intergovernmental organization in East Africa. It started as a free trade agreement in 2000 among Kenya, Tanzania, and Uganda. Many positive strides have been made in the integration process with achievements of the Customs Union (2005), Common Market (2010) and the signing of the Monetary Union Protocol in November, 2013. Burundi and Rwanda joined later, and the EAC aims to evolve into a common market, promoting the free movement of goods, services, capital, and labor within the region¹¹.

⁵ <https://netaffair.org/documents/1957-rome-treaty.pdf>

⁶ <https://www.consilium.europa.eu/en/documents-publications/library/library-blog/posts/treaty-of-rome-reading-references/#:~:text=The%20Treaty%20of%20Rome%20set,people%2C%20services%2C%20and%20capital.>

⁷ <https://www.europarl.europa.eu/about-parliament/en/in-the-past/the-parliament-and-the-treaties/single-european-act>

⁸ <https://www.britannica.com/print/article/375563>

⁹ <https://caricom.org/our-community/who-we-are/>

¹⁰ <https://www.chathamhouse.org/2022/07/what-eurasian-economic-union#:~:text=The%20Eurasian%20Economic%20Union%20consists,Kazakhstan%2C%20Kyrgyzstan%2C%20and%20Armenia.>

¹¹ <https://www.eac.int/common-market>

2. India's FTA with ASEAN: What it has achieved

India's trade with ASEAN countries has shown a varied trajectory over the past eight years. Export figures experienced a decline of -21.00% in 2015-16 but rebounded with positive growth rates in subsequent years, reaching a peak of USD 37.47 billion in 2018-19. However, there were setbacks in 2019-20 (-15.82%) and 2020-21 (-0.19%), followed by a notable growth of 34.43% in 2021-22. Import figures displayed fluctuations but demonstrated significant growth of 43.57% in 2021-22. The value surged even higher to USD 87.57 billion in 2022-23, showcasing a remarkable growth rate of 28.62%. Despite increasing total trade volume, the trade deficit persisted throughout the period, indicating that India consistently imported more than it exported to ASEAN countries, reflecting a trade imbalance (Table 1).

The trade figures in respect of ASEAN region for the last seven years (April – March) are as under (Table 1): Figures in USD Billion

India's trade with ASEAN	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23
EXPORT (USD Billion)	25.13	30.96	34.20	37.47	31.55	31.49	42.32	44
%Growth	-21.00	23.19	10.47	9.56	-15.82	-0.19	34.43	3.96
IMPORT (USD Billion)	39.91	40.62	47.13	59.32	55.37	47.42	68.08	87.57
%Growth	-10.75	1.77	16.04	25.86	-6.66	-14.36	43.57	28.62
TOTAL (USD Billion)	65.04	71.58	81.34	96.80	86.92	78.90	110.4	131.57
TRADE BALANCE (USD Billion)	-14.78	-9.66	-12.93	-21.85	-23.82	-15.93	-25.76	-43.57

Source: Ministry of Commerce¹²

3. What is needed to transition to a Common market

Tariff Rates¹³

India implemented tariff reductions on 75% of its tariff lines. However, Indonesia, the largest ASEAN economy, only eliminated tariffs on 50.4% of its lines. India prioritized protection for its agricultural products, while ASEAN economies did not lower tariffs for sectors such as base metals, machinery, vehicles, and miscellaneous manufactured articles, where India had capacity strengths. Additionally, the ASEAN-China Free Trade Agreement provided China with deeper access to ASEAN markets compared to India's access under ATIGA, placing India at a relative disadvantage.

Market access issues¹⁴

India needs to ensure full tariff elimination in areas in which it has export strengths and capacities. This will not be easy since the ASEAN countries as a group and individually have entered into several FTAs which are quite deep. Even under RCEP, ASEAN countries have undertaken significant levels of tariff elimination and reduction covering over 90% of tariff lines and 92% of the goods trade among the parties. Should India seek a similar level of ambition in the ASEAN markets, there will be

¹² <https://commerce.gov.in/about-us/divisions/foreign-trade-territorial-division/foreign-trade-asean/>

¹³ <https://www.delhipolicygroup.org/publication/policy-briefs/preparing-for-a-review-of-the-asean-india-trade-in-goods-agreement-aitiga.html>

¹⁴ <https://www.delhipolicygroup.org/publication/policy-briefs/preparing-for-a-review-of-the-asean-india-trade-in-goods-agreement-aitiga.html>

reciprocal requests from the ASEAN countries. Another objective would be to include certain elements under the supply chain resilience pillar of the Indo-Pacific economic framework (IPEF)¹⁵ in AITIGA.

Rules of Origin (ROO)

- It is time to discard the dual requirement of having a) a minimum regional value addition of 35%; and b) a change in tariff subheading as stipulated in AITIGA. ROO should comprise a single criteria of a minimum value addition set at 40%.
- Product-specific rules should be defined for key exports like refined petroleum products and cut and polished diamonds to ensure eligibility for tariff concessions. Flexibilities for non-originating preservatives are also necessary to prevent disqualification of Indian marine exports. Third, the question arises if India should agree to a cumulation provision that allows the exporting ASEAN party to use inputs from other ASEAN parties, irrespective of whether the input itself satisfied the origin criteria. It may also enable formation of supply chain units in India that have backward integration inputs coming from countries like China, Korea and Japan. .
- It will be useful to simplify the process of ROO certification and declaration.
- India has had some issues on the verification of COOs. In 2018-19, there was suddenly a spike in imports from Singapore and Vietnam, raising doubts about FTAs being misused for declaring third country goods as originating goods from FTA parties.

Trade/customs facilitation

- The trade facilitation provisions currently in AITIGA are essentially confined to a single Article 14 on customs procedures and are couched in best endeavour terms emphasising transparency and simplification in customs procedures and prompt clearance of goods. In contrast, all recent FTAs, including India's own FTAs with the UAE and Australia, have separate chapters with detailed provisions on this issue.
- Trade facilitation is also an area in which ASEAN countries have generally done well, and a Common market would facilitate that.

Objectives on standards and regulations

AITIGA is very brief with a single Article 8 devoted to non-tariff measures, basically requiring compatibility with WTO agreements on technical barriers to trade and SPS measures. A common market should provide sectoral mutual recognitions for future negotiations. India seeks fast-tracked procedures for pharmaceutical mutual recognition, which a common market can provide. Additionally, there is potential for mutual acceptance of testing by authorized agencies, including for organic product exports. India's agricultural exports to ASEAN have improved but require greater predictability and consolidation, given the proximity and shorter transit time to these markets.

4. The big Bottleneck to India-ASEAN Common Market

The biggest obstacle to an India-ASEAN Common Market is the possibility of Chinese goods being diverted to India through ASEAN. While with an ATIGA as well this possibility exists, a Common market would make such trade diversion much easier. As Table 2 below shows the top imports from ASEAN for India also coincide with the top imports of ASEAN from China. Further these imports have been growing at over 40% in most cases and those from China to ASEAN also show huge growth.

¹⁵ <https://ustr.gov/trade-agreements/agreements-under-negotiation/indo-pacific-economic-framework-prosperity-ipef>

**Table 2: India's Imports from ASEAN and ASEAN Imports from China
(Millions of USD)**

HSCode	Commodity	India's imports from ASEAN				Growth during 2020-2022	ASEAN's imports from China			
		2020	2021	2022	2020		2021	2022	Growth during 2020-2022	
	Total	44052	64700	88959	102	298609	386666	460962	54	
85	ELECTRICAL MACHINERY AND EQUIPMENT AND PARTS THEREOF....	7047	8000	10148	44	102790	128474	140773	37	
84	NUCLEAR REACTORS, BOILERS, MACHINERY AND MECHANICAL APPLIANCES...	4493	6114	7482	67	49132	61937	69580	42	
39	PLASTIC AND ARTICLES THEREOF.	1955	3493	3933	101	12933	17435	19486	51	
29	ORGANIC CHEMICALS	1845	3413	3730	102	5853	8604	13179	125	
38	MISCELLANEOUS CHEMICAL PRODUCTS.	1105	1656	1916	73	5303	7599	10777	103	
28	INORGANIC CHEMICALS; ORGANIC OR INORGANIC COMPOUNDS OF PRECIOUS METALS...	597	1091	1815	204	2743	4157	5284	93	
90	OPTICAL, PHOTOGRAPHIC CINEMATOGRAPHIC MEASURING, CHECKING PRECISION, MEDICAL OR SURGICAL INST...	1055	1488	1687	60	6258	7897	8113	30	
87	VEHICLES OTHER THAN RAILWAY OR TRAMWAY ROLLING STOCK,	556	901	964	73	5709	8481	11614	103	
76	ALUMINIUM AND ARTICLES THEREOF.	465	604	856	84	4465	6355	7898	77	
73	ARTICLES OF IRON OR STEEL	533	796	779	46	9493	11926	14219	50	
31	FERTILISERS.	362	306	743	105	1525	2430	2778	82	
55	MAN-MADE STAPLE FIBRES.	164	260	326	99	3290	3763	3937	20	
52	COTTON.	25	27	207	728	2013	2363	3210	59	
54	MAN-MADE FILAMENTS.	92	189	205	123	3077	3905	5667	84	
78	LEAD AND ARTICLES THEREOF.	132	127	170	29	36	77	136	278	
59	IMPREGNATED, COATED, COVERED OR LAMINATED TEXTILE FABRICS...	86	151	161	87	1642	2064	2384	45	
88	AIRCRAFT, SPACECRAFT, AND PARTS THEREOF.	33	54	118	258	536	436	442	-18	

86	RAILWAY OR TRAMWAY LOCOMOTIVES, ROLLING-STOCK AND PARTS THEREOF...	7	10	21	200	273	485	1186	334
----	--	---	----	----	-----	-----	-----	------	-----

5. Geopolitical issues in deeper ASEAN-India Economic Cooperation

China is an important player in ASEAN. India's recent border issues may become more confrontational in future. In ASEAN, while countries like Cambodia and the Philippines may favour Chinese investment and geopolitical support, Vietnam is uncertain in political-security spaces such as the South China Sea.

The ASEAN-India dynamics have been further complicated by the emergence of the Quadrilateral Security Initiative (the Quad). The Quad which was initially a trade group at the WTO could emerge as a significant security institution in the region, possible to counter China. ASEAN does not wish to be entangled in a possible power transition taking place in the Indo-Pacific region which may force a choice between China and India.

6. Conclusions and Way Forward

While a Common Market may be a distant dream, there are specific steps which can be taken to deepen ties between the two. India and ASEAN need to have greater e-commerce and digital connectivity. Countries such as Vietnam, Indonesia, Malaysia and Thailand have booming digital economies with high-growth and domestic innovation in sectors such as e-commerce, ride sharing, mobile gaming and financial technology. India too has a vast and burgeoning start-up sector with a digitally proficient human capital base. For example, India's Aadhaar system can be replicated in the ASEAN region.

India intends to build 100 smart cities and ASEAN intends to create a network of smart cities. Some cooperation is already underway to this end. For instance, Singapore's Surbana Jurong is assisting with a smart city development in Maharashtra.

The two sides can also develop an ecosystem like that in Silicon Valley to promote new ideas, new technology, and new business. On Climate change and sustainability, India and ASEAN can cooperate on technologies and solutions to combat climate change, leveraging competitive advantages in sectors such as renewable energy, waste management, pollution control and disaster mitigation, among others.

Lastly, both India and ASEAN can cooperate on security issues and thus build goodwill and deepen existing relations between the governments and the people on both sides.