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Free Trade Agreements and Corporate Global Strategy

Harishanker Subramaniam and Tashi Kaul are advising companies to take full advantage of the FTA opportunity

Picture a world of nominal or zero customs duties, fewer product standards and technical regulations, and no burdensome licensing procedures *et al*. Free Trade Agreements (FTAs) are making this and a lot more else possible. Under the India-Japan Comprehensive Economic Partnership Agreement (CEPA) signed in February 2011, for instance, Japan will eliminate customs duties on about 94 per cent of its tariff lines in a span of 10 years. It is no wonder that any company with a global vision for its production or supply chain management networks is including FTAs as a key component in its growth strategy. A major strategic move of global companies, which cascades down to the lowest tiers in their production networks, is getting the right part or process, in the right numbers, to the right place, at the right time, and at the right cost. FTAs provide an extra impetus to promote the global value chain by generating significant cost savings for companies and facilitating smoother business.

What is an FTA?

An FTA is a legally binding agreement between two or more countries to eliminate or reduce tariffs and non-tariff barriers that hinder the cross-border flow of goods and services into each others' markets. The agreement takes the form of legal commitments undertaken by the FTA parties to liberalise bilateral trade in goods, services, and investment and to provide protection to intellectual property rights. Moreover, some of India's more recent FTAs such as the India-Japan CEPA include even controversial areas such as, government procurement and competition, albeit limited in scope.

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Liberalised binding commitments

The quality and depth of binding commitments under FTAs is typically 'WTO-plus' surpassing the concessions offered under the WTO Agreements. This means that the commitments that countries undertake under FTAs are more liberalising than those that the same countries have made under the WTO Agreements. In any event, given the uncertain fate of the WTO Doha Round, FTAs offer the most effective forum for the removal of business-inhibiting trade and regulatory barriers.

Reduced barriers benefiting auto industry

FTAs aim at allowing faster and greater volumes of business between countries through a reduction in tariff and non-tariff barriers. A reduction in such barriers can translate into significant cost savings for companies. The cost savings implicit in a small reduction in tariff barriers, can, for instance, determine the direction of the global supply chain for a particular good. In certain sectors where business is volume-based, even a small decrease in barriers has triggered a higher flow of goods cross-border. The automobile industry in India, in particular has been quick to realise the benefits under India's FTAs and is devising a strategy to capitalise on the country's prospective FTAs. Automobile companies which have utilised the India-Thailand Early Harvest Scheme (EHS) to their advantage, are a case in point.

In October 2003, India signed an agreement with Thailand to operationalise the Early Harvest Scheme (EHS) under the framework of the India-Thailand FTA negotiations (ITFTA). Under the agreement, 84 products, including auto components, were identified for accelerated reduction of basic duty in three stages which are: 50 per cent by March 31, 2004; 75 per cent by March 31, 2005; and 100 per cent by March 31, 2006. Thailand thus offered India significant duty reduction on certain automobile components like gear box exports from India.

In 2004, after the duty reduction had taken effect, automobile multinationals established manufacturing units in India, with the aim of supplying such ITFTA identified components to their assembly plants located in Thailand, among other countries. Over the subsequent years, exports of one such identified component which stood below USD 1 million in 2003-04, rose consistently to over USD 30 million in 2007-08.

Notably, the primary impetus for

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this trend has come from the India-Thailand trade agreement.

Several automobile companies plan to build their international production network in such a way that their production facilities in India and the ASEAN region will mutually complement one another. The new drive for international production networks is an important strategy for these companies. They plan, for instance, to launch small cars in India with engines imported from the ASEAN countries. These companies are looking to capitalise on the FTAs that India is likely to sign with individual ASEAN countries which may allow them to import goods at significantly reduced duty rates.

India's prospective FTAs

Moreover, companies are monitoring developments in India's prospective FTAs. India is currently actively engaged in negotiating FTAs with numerous trading partners covering trade in goods, services, investment, and intellectual property rights. This stance marks a departure from India's cautious approach towards FTAs in the past. India is negotiating FTAs with key trading partners such as the European Union, ASEAN countries, Thailand, Malaysia, New Zealand, Mercosur (Argentina, Brazil, Uruguay, Paraguay), Canada, EFTA (Switzerland, Norway, Iceland, and Liechtenstein), among many others.

FTAs provide an extra impetus to promote the global value chain by generating significant cost savings for companies and facilitating smoother business

Onus on industry to raise concerns...

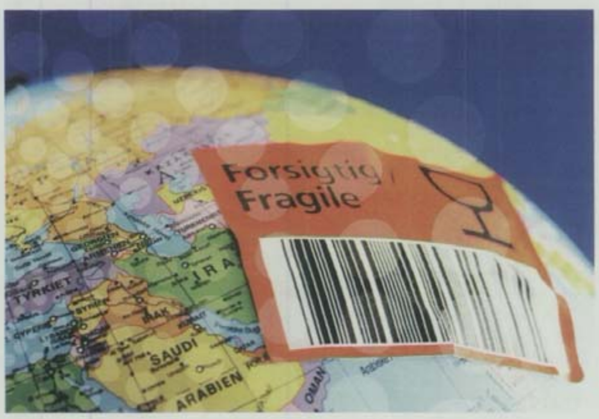
Engaging with the government in the context of India's current FTA negotiations is crucial for companies facing barriers in their trade and investment dealings with any of the above markets. The onus to raise critical concerns regarding trade and investment restrictions with the negotiators on either side falls upon industry. While governments enter into trade agreements on behalf of their domestic industry, only the most proactive among the domestic players reap the maximum benefits from the FTAs. Companies therefore, need to actively engage with the negotiators with regard to concessions that prospective FTAs will cover.

...and avail benefits

In addition, in order to avail tariff benefits under existing FTAs, companies need to examine potential duty savings under such FTAs and to ensure that their products have been duly classified under the correct tariff code so that the concessional duty rate can be availed of. Moreover, the rules of origin requirements, that are an integrated part of every FTA, must be met by every product for making it eligible for preferential concessions under the FTA.

Complex compliance norms

FTA compliance requirements are more complex than those that must be met in day-to-day import and export procedures. These include the supply of accurate and valid information in respect of the product and the importer, completion of all necessary documentation prior to shipment such as those pertaining to proof of origin, maintenance of necessary documents depicting the origin requirements of a product, filing of production and shipment documents, and tracking them for easy retrieval. Personnel that understand the FTA customs compliance requirements as well as the necessity of compliance are therefore, critical to ensuring that companies make the most of India's existing and prospective FTAs.



Conclusion

India's engagement with FTAs with countries worldwide will only intensify in the coming months. This trend offers excellent opportunities to companies to induce the reduction of significant barriers to business. It behoves companies to ensure that the opportunities do not slip past them. ■

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