

ANALYSIS OF FTA BETWEEN INDIA AND KOREA: CHALLENGES AND OPPORTUNITIES

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ABSTRACT

Two major economies in Asia, India and South Korea signed the Comprehensive Economic Partnership Agreement (CEPA) on 7th August 2009. The agreement came into force from 1st January 2010. The Government of India contends that the CEPA would facilitate trade in services through additional commitments made by both countries to ease the movement of independent professional and contractual service suppliers. The current paper analyses the challenges and the opportunities ahead of India and Korea. The study tries to assess the possible gains for both the partners after reduction in their tariff levels. The study finds that Services markets in India such as telecommunications, banking, medical and advertising will see massive growth in the years to come. At the same time, the CEPA's easing of restrictions on Korean FDI in the fields such as automotive and electronics manufacturing will also help to expand their market base in India.

Key words –CEPA, MFN, Bilateral Trade, Tariff

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1. Introduction

After a negotiating 3.6 years, two major economies in Asia India and South Korea signed the Free Trade Agreement between them on 7th August 2009. This Agreement is also known as Comprehensive Economic Partnership Agreement (CEPA). It is expected that this agreement will boost up more than 10 Billion US \$ of bilateral trade. (ASSOCHAM, 2010)The main beneficiaries of this agreement is expected to be the South Korean auto parts , Indian service sector and service workers to work for South Korean companies.

The CEPA will also boost exchanges of manpower, particularly in the services sector. Computer engineers, consultants, scientists, public relations experts, English teachers and other professionals in various services would be allowed to freely enter each other's markets. (Spire, 2009)

The Government of India contends that the CEPA would facilitate trade in services through additional commitments made by both countries to ease the movement of independent professional and contractual service suppliers. Both countries have committed to provide national treatment and to protect each other's investments, so as to boost bilateral investment in all sectors.

India, in turn, has agreed to open its telecommunications, accounting, medical, advertising and banking sectors to Korea, creating opportunities for internationally competitive Korean firms to exploit one of the largest and fastest growing emerging market economies in the world.

The CEPA would also see India eventually allowing Korean firms to invest in the automotive manufacturing, machinery and electronics sector a potentially lucrative opportunity for Korean manufacturers to reposition their global supply chains to leverage India's lower cost structure and abundance of skilled human resources.

2. Bilateral Trade between India and Korea-

India and Korea have traditionally been major trade partners for each other. Bilaterally, there was a tenfold trade expansion between India and Korea between 2000 and 2008, i.e., from US\$ 1.26 billion to US\$ 12.12 billion. The relative importance of Korea (for India) and India (for Korea), as a trading partner, has been rising particularly since the early 2000. Korea, which accounted for 1.3 percent of India's total trade in 2000 increased to 2.4 percent by 2008. Similarly, India's share in Korea's total trade increased from 0.7 percent in 2000 to 1.8 percent in 2008.

Table-1: Trade Characteristics of India and Korea

(Million US \$)

Year	Exports	Imports	Total Trade (Export+ import)	Trade Balance	Export/Import ratio
1. India's Trade with Korea					
2000	439.1	817.1	1,256.2 (1.3)	-377.9	0.537
2005	1,519.60	4,412.40	5,932.0 (2.4)	-2,892.90	0.344
2008	3,773.30	8,350.70	12,124.0 (2.4)	-4,577.40	0.452
2. Korea's Trade with India					
2000	1,326.10	984.7	2,310.8 (0.69)	341.5	1.347
2005	4,597.80	2,112.10	6,709.9 (1.2)	2,485.80	2.177
2008	8,977.10	6,581.20	15,558.3 (1.8)	2,395.80	1.364

Source- UN COMTRADE

Note – Figures in the brackets are share of India and Korea in total trade

India's trade with Korea has always been concentrated to few products, even though the composition of major exporting products has changed significantly over time. India's main exporting products to Korea are Mineral fuels (27), Iron and Steel (72), Organic Chemicals (29), Cotton (52) etc. The top exporting products of India to Korea in 2008 accounted for about 85 percent total export to Korea. The details of these products are summarized in *table 2*.

Table: 2- India's Top Export to Korea In 2008

US Mil \$

Products Description/HS Code	Export Value
Mineral fuels, oils & product (27)	1555
Iron and steel (72)	457
Residues & waste from the food (23)	255
Organic chemicals(29)	234
Articles of iron or steel (73)	181
Cotton (52)	159
Nuclear reactors (84)	106
Vehicles o/t rail/tram (87)	102
Ores, slag and ash (26)	76
Oil seed, oleagi Fruits, miscall. (12)	61
Total	3293

Source- UN COMTRADE Database

The composition of major imports from Korea has also been changing over time. In 2008, about 64 percent were accounted by 10 products whose share was 77 percent in 2000. The imports that have exhibited a rising share are: Electrical Machinery (85), Nuclear Reactors (84), Iron & Steel (72) and Vehicles (87). The imports whose value are low but are gaining significance are Paper & Paper Board (48), Plastic articles (39) and Mineral Fuel (27). At a disaggregated level, the fast expanding imports are Electrical machinery (Transmission apparatus, Telephone sets), Nuclear reactors (Engines, Mechanical shovels, Dividing heads), Iron & Steel (Coils), Vehicles (Drive axels, Parts & accessories). The details of these top importing products of India from Korea are summarized in *table 3*.

Table: 3 India's top Import from Korea

US Mil \$

Products Description	Import Value
Nuclear reactors, boilers (84)	1,303
Electrical mchy equip (85)	1,281
Iron and steel(72)	1,156
Mineral fuels (27)	760
Vehicles o/t rail (87)	760
Plastics and articles thereof (39)	430
Articles of iron or steel (73)	412
Organic chemicals (29)	299
Rubber and articles thereof (40)	248
Paper & paperboard (48)	183
Total	6830

Source- UN Comtrade Database

3. Analysis of Tariff Reduction

Under the Korea- India CEPA, the approach to tariff reduction for trade in goods is as follows:

- (i). **Elimination of Tariffs**
- E0: There would be 100% elimination of tariff on entry into force, i.e., year 2010.
 - E5: There would be 20% reduction in tariff on entry into force and tariff elimination to take place in the year 5 i.e., 2014.
 - E8: There would be 12.5% reduction on entry into force and tariff elimination to take place in the year 8 i.e., 2017
- (ii). **RED:** Tariffs to be reduced to 1 to 5% of the base rate in eight years. The base rate for determining the reduction schedule is the MFN applied rate as on 1 April 2006.
- (iii). **SEN :** Tariffs to be reduced by 50% of the base rate in 10 years (for India) and 8 years (for Korea)

- (iv). **Exception:** The tariff lines that would not be subjected to the reduction schedule. (see Table-4)

Table-4 (Refer Bank of Tokyo paper) details the number of tariff lines falling under the above categories of tariff reduction. **For India**, out of a total of 5227 tariff lines, 14.7 percent of the tariff lines have been placed under the *Exception list*, which accounts for 14.5 percent of the import value. Although 71.5 percent of the tariff lines are subjected to tariff elimination, most of this (over 90 percent) is accounted by E8. However, in terms of import value, E0 accounts for 38.4 percent while E8 accounts for 22.1 percent. Compared to this, the combined import significance of RED and SEN is low at 11 percent.

For Korea, out of a total of 11261 tariff lines, about 89 percent is subjected to tariff elimination, whose share in import value is 84.5 percent. Unlike India, about 70 percent of these tariff lines fall under E0 (i.e. zero tariff in 2010) which account for 61 percent of the total imports. The relative importance of E5 is much higher Korea as compared to India. The Exception list accounts for only 7 percent of the imports.

Table-4: Korea-India CEPA Tariff Reduction Schedule

US Mil \$

	India			South Korea		
	No. of tariff lines (HS 6)	Import Value	Share of trade	No. of tariff lines (HS 6)	Import Value	Share of trade
Elimination of Tariffs	3739	2984	74.5	9984	1679	84.8
Immediately	202	1538	38.4	6824	1248	63.0
Eliminated within 5 years	180	560	14.0	2310	205	10.3
Eliminated with 8 years	3357	886	22.1	850	226	11.4
Cut to 1-5% within 8 years	459	342	8.5	34	3	0.2
Cut by 50% within 8 or 10 years	261	96	2.4	478	94	4.8
Exceptions	768	580	14.5	765	205	10.3
Total	5227	4001	100.0	11261	1981	100.0

Source: Bank of Tokyo, Economic Review, October 2009

In examining the level of tariffs of the two countries based on the average tariff rates, (based on the applied tariff rates) for the entire manufacturing industry, India's tariff rate is 10 percent on average; far higher than Korea's 6.3 percent.

- The average tariff rate for Indian manufacturing, considering the proportion of Korean exports to India, is slightly more than 6%; this means that the country imposes a lower tariff rate on the major Korean exports.
- Likewise, the weighted average tariff rate of Korean manufacturing considering the proportion of Korean imports from India is also lower by approximately 2.5%; hence the considerable gap in the weighted average tariff rate of both countries.
- Accordingly, if the tariffs of both countries are lowered as per the CEPA, the growth of exports from Korean manufacturers is expected to be higher than that of its imports.

India imposes highest level of tariffs on dairy products. The current level of tariffs on dairy items is 10.89 (simple average). Moreover, the tariffs of the machine, steel, and automobile industries are also relatively high. In particular, the automobile industry has a significantly higher weighted average tariff than its simple average tariff rate; India imposes high tariffs on major exports of Korea's automobile industry.

In contrast, Korea imposes relatively lower tariffs on India's key exports including textiles, chemicals, steel, and other manufacturing industries.

**Table: 5 Comparison of exports imports by industry and tariff rates of
Korea and India**

Products	India		Korea	
	Exports to Korea	Tariff Rate (%)	Imports from Korea	Tariff Rate (%)

	USD Million	Rate (%)	Simple Average	Weighted Average	USD Million	Rate (%)	Simple Average	Weighted Average
chemicals	443	9.7	10.64	7.63	190	8.4	6.34	5.79
Textile	136	3	10.03	3.04	284	12.6	10.15	3.63
Steels	493	10.8	8.13	6.51	200	8.8	1.58	1.87
Machinery	665	14.5	10.88	9.02	65	2.9	6.81	7.51
Electricity and Electronics	1,540	33.6	8.39	1.89	44	2	5.22	4.21
Automobiles	482	10.5	5.39	11.25	26	1.2	8.12	8.76
Daily Products	32	0.7	10.89	11.03	27	1.2	7.33	5.95
Other manufacturing	971	17.3	9.77	8.8	1,426	63	4.64	1.5
Total manufacturing (average)	4,581	100	9.9	6.25	2,263	100	6.28	2.51

Source- KIET News Brief, Vol. 450, September 16, 2009

4. India's Export Prospects

Korea offers potential export opportunities to India. When the world exports are expanding relative to that of Korea, duty reductions by Korea can provide potential export opportunities. A comparison of trends in India's export to World and Korea shows that for most products India's exports to World are rising faster than that to Korea. This is particularly the case with Cotton (52), Food residues (23), Ores & Slag (26) and Organic Chemicals (29). For these products, India's share in Korea's total imports is between 1 percent to 3 percent. Even for the products where Korea's share in India's world exports is rising, India accounts for less than 1 percent of Korea's total imports. This is the case with Iron & Steel, Electrical Machinery and Mineral Fuels.

Even at a disaggregated level, the share of Korea in India's world exports is insignificant. India's trade with Korea is in less than 50 percent of the product lines as compared to the world. And, in

terms of value, exports of these product lines to Korea range between 0.1 percent to 0.9 percent across products. Thus, there exist potential export opportunities for India.

5. Import Challenges Analysis

An assessment of import threat is made by analyzing the trends in imports from Korea vis-à-vis that of the world. When the imports from Korea are rising faster than that of the world, duty reductions by India can lead to potential import threat for Indian industry. A comparison of trends in India's imports from Korea vis-à-vis that of the world shows that imports from Korea are rising faster for the following products: Nuclear Reactors (84), Electrical Machinery (85), Iron & Steel (72), Plastics Articles (39), Optical photo (90), Organic Chemicals (29) and Paper board (48). From Korea's perspective, India is emerging as an important market for these products. India's share in total exports of Korea increased significantly. Between 2000 and 2008, Korea's exports to India (as a percent of world exports) increased from 1.5 percent to 5.4 percent for Iron & Steel, from 1.2 percent to 2.3 percent for Plastic Articles, from 0.8 percent to 2.8 percent for Nuclear Reactors and from 0.9 percent to 2.8 percent for Vehicles.

The import trends at the disaggregate level also indicate that India is emerging as an important market for Korea. Across product groups, the number of tariff lines covering Korea's exports to India is more broad based whose share in world exports has increased over the years.

6. Tariff Analysis of India's top Trading Products with Korea

Analyzing the main exporting products of India to Korea we find the 10 mostly exporting products to Korea in 2008, accounts for about 2259 Mil US\$. Out of 5, 8 digit products under 271011(light oils and Prep), 2 products fall under E5, 2 are E0, and 1 under Red list. Out of 42, 8 digit products under 271019 (Other bituminous coal), 36 fall under E5 and 6 fall under EXC list. The all 8 digit level products under 271099 (other mineral fuels) comes under E5. And for all other products, all 8 digit level products fall under E0. It is interesting to find that about 70 percent of Indian exports at the 6 digit level to Korea in the year 2008 come under E0. It is important to note that as most of the top 10 Indian exporting products fall under E0, this will boost Indian exports to many folds.

Table: 6 India's Top Exports to Korea in 2008

HS Code	Product Description	Export Value	Tariff Status
271011	Light oils and preparations	865,168	*
271019	Other bituminous coal	568,586	@
230400	Oilcake and other solid residues	143,657	E0
720241	Iron by weight more than 4 %	140,102	E0
730890	Other articles of iron	126,385	E0
271099	Other mineral fuels	120,565	E5
720110	Non alloy pig iron	93,522	E0
230649	Residues of oil cake	83,282	E0
290244	Mixed xylene isomers	60,138	E0
294200	Other organic compounds.	57,970	E0
Total		2,259,376	-

Source- UN COMTRADE

Note-Figs 1000 \$, *Out of 5 8digit products under 271011, 2 products E5, 2 are E0, and 1 is Red.

@ Out of 42 8digit products under 271019, 36 are E5 and 6 are under EXC.

The Indian imports for the top 10 products (in terms of import value) from Korea in 2008 accounts for about 2830 Mil US \$. Other mineral fuel (271019) was the top importing product of India from Korea in 2008, with import value of 671 Mil US \$. Out of top 10 importing products of India, from Korea 1 product fall under SEN list, 1 under E0, 2 products fall under RED list, 4 under E5, and lastly 2 products fall under E8.

Table: 7 India's Top Imports from Korea in 2008

HS Code	Product Description	Import Value	Tariff Status
271019	Other Mineral fuels	671,845	SEN
852520	Transmission apparatus	562,915	E0
870899	Other vehicles parts	484,569	RED
720836	Of a thickness exceeding 10 mm	267,161	E5
720917	Iron of a thickness of 0.5 mm	188,137	E5
730890	Other articles of iron	175,434	E5
480100	Newsprint, in rolls or sheets.	163,633	E5
400219	Other Rubber products	131,408	E8
310530	Diammonium Hydrogen	96,603	E8
840820	Engines of a kind	88,872	RED
Total		2,830,578	

Source- UN COMTRADE and govt. of India

Note- Figs in 1000 \$

7. Concluding Remarks

By increasing bilateral trade and investment, the Korea-India CEPA, will generate interesting effects on business, reflecting the complementarity between the two economies.

At the initial stage it will open up Korean market access to Indian-based exporters in categories such as gems and jewellery, cotton and textiles, some categories of machinery and transport equipment as well as some forms of iron and steel. As South Korea is one of the 10 largest economies in the world and a full member of the OECD, this is not an insignificant boon to India's leading exporters. The CEPA will thus strengthen the case for foreign direct investment into India's Special Economic Zones, for whom Korea will now form another potential export market.

India's reciprocal opening up of some services sectors to Korean firms will create opportunities in the Korea's direction. Services markets in India such as telecommunications, banking, medical and advertising will see massive growth in the years to come. Market access in these sectors tends to be restricted in most countries and India is no exception, making this is a significant advantage for Korean firms.

At the same time, the CEPA's easing of restrictions on Korean FDI in fields such as automotive and electronics manufacturing will help Korean manufacturers, some of whom are globally competitive, to reposition their supply chains to take advantage of India's lower cost base and abundance of skilled human resources. (Sahoo 2009)

As a result of such free trade agreements and improvements in domestic infrastructure, will developed countries like Korea see a flood of Made in India imports? That depends on how quickly Indian exporters can develop a strong reputation for quality in specific categories to match the low costs they can command. For domestic Indian firms, as well as foreign manufacturers setting up export bases in India, this promises to be the next great game.

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