FTAs and the Race to the Bottom*

C.P. Chandrasekhar

The competition among Asian countries to win a slice of export markets currently controlled by China is intensifying. In a recent development, Vietnam has finally ratified a free trade agreement with the EU, under which more than 70 per cent of Vietnam's exports to the EU and 65 per cent of the EU's exports to Vietnam would be rendered duty free as of August when the agreement takes effect. Of the remaining goods, tariffs on items that would add up to 99 per cent of the two-way trade would be phased out by the EU over seven years and by Vietnam over 10 years.

Coming at a time when the moves against China's alleged big power ambitions have triggered imposition of tariff and non-tariff barriers across the globe to imports from that country, the EU-Vietnam FTA is seen as likely to help Vietnam displace China in some sections of the European market. The only other Asian countries that have similar FTAs with the EU are Japan and Singapore, which do not compete with Vietnam in areas such apparel, footwear and seafood, which are the leading exports of the latter. Though not huge, at $42 billion in 2019, Vietnam's exports to the EU amount to around 15 per cent of its total exports and far exceed its imports from the Union ($15 billion). That benefit will only grow as a result of the FTA, with official Vietnamese estimates projecting exports to be higher by more than 40 per cent in 2025, when compared with a scenario without an agreement.

Moreover, foreign investors in China are looking for an alternative site for locating production capacities, given rising costs in that country and pressures on firms from developed country governments, especially the US government, to disengage with China. The preferential access that Vietnam's exports would receive in the EU, and the market friendly environment created after economic reforms privileged growth above social objectives, make that country an increasingly attractive location for foreign investors competing for international markets. Foreign investment in Vietnam was already at a record high of $38 billion in 2019. The FTA with the EU is expected to further increase foreign investment geared to linking Vietnam to global production chains.

Vietnam has on its part had to accept a range of demands from the EU as part of the trade deal. Besides opening up its services sectors, such as banking and shipping, Vietnam has ratified an investment treaty that protects intellectual property rights, geographical indications (champagne and feta cheese, for example), and investor interests and promises equal treatment to EU firms in public procurement in Vietnam. Many of these are WTO-plus measures, going beyond even the controversial requirements set by the Uruguay Round agreement.

But given the level of Vietnam's development and the government's economic growth aspirations, officials clearly see these as a small cost to pay as compared with expected gains. But for developing countries as a group trade is currently a zero sum game. Coming at a time when world trade has contracted, the projected expansion of Vietnamese exports to the EU after the FTA, if it materializes, would adversely affect other countries. This is strengthening the hands of sections within other developing countries, including in Asia, wanting their governments to sign into similar free trade agreements and bilateral investment treaties, which would involve making significant concessions in areas that would undermine their own efforts to industrialise without excessive dependence on and subordination to foreign capital.

India is a typical case where such pressures are visible. Exports in four areas are expected to be affected adversely: footwear, garments, marine products and furniture. In the case of marine products and apparel, India and Vietnam currently export goods of similar value ($1 billion and $ 7 billion). India is reported to have exported $900 million worth of seafood to the EU in 2018-19 and is its third largest foreign supplier after the US and Japan. But with imposts on imports from Vietnam falling to zero, while those on imports from India will remain at 9 per cent in the case of apparel and in the 4 to 18.5 per cent range in the case of marine products, India would find it extremely difficult to compete with Vietnam. Business Line quotes Ajay Sahai from the Federation of Indian Export Organisations (FIEO), who argues that: “In footwear, where Vietnam exports $7.5 billion worth of items compared to India’s $1.6 billion, the advantage will be enhanced once EU reduced tariffs for Vietnam to zero from 8 per cent. Similarly, in furniture, where India had started making inroads into the EU with imports of over $900 million, Vietnam’s share of $1.5 billion is likely to increase several-fold when the import duty of 6 per cent is eliminated.” Exporters argue that the only way in which this issue can be resolved is by speedily concluding the negotiations on an EU-India FTA, which began in 2007, were halted in 2013 and revived only in 2018.

Disagreement between the two sides persists on a host of issues, besides incorporation of social and environmental clauses in a trade agreement. Important among these are India’s reluctance to accept strong investor protection provisions including clauses for investor-state dispute settlement abroad, which India has sort to drop even form bilateral investment treaties. There are also disagreements, reportedly, on rules that would apply to drug patents, tariffs on second-hand cars, agriculture, services, and the list of sensitive items that would be provided special protection. The majority view is that the EU’s template for these FTAs require concessions from India that are detrimental to India’s development.

The avowedly “reformist” Modi government, whose inclinations are to sign into bilateral trade and investment treaties, has faced difficulty in pushing this agenda because of criticism from within its own political base, besides from the opposition. Moreover, the evidence is that India has been adversely impacted by free trade agreements it has signed with ASEAN, Japan and Korea. India’s trade deficit with the ASEAN rose from $5 billion in 2010-11 to $22 billion in 2018-19, that with Japan from $3.5 billion to $8 billion, and that with Korea from around $7 billion to $12 billion.

The pressure this puts on the NDA government became clear when, having more or less committed to joining the Regional Comprehensive Economic Partnership (RCEP) involving 16 Asia-Pacific partners, it withdrew at the last moment. Besides small producers and peasants, who would have been adversely affected by the regional liberalisation, business too was opposed to the agreement. Concerns were expressed by industry leaders in sectors like iron and steel, dairy, marine products, electronic products, chemicals and pharmaceuticals and textiles, that the significant tariff reduction the RCEP implied would lead to a surge in imports into India, with damaging effects on domestic production.

All this, however, was clear well before the government and official negotiators sent out signals that India would finally join the agreement, with a few minor modifications. The only reasonable explanation for that stance is that the government was being led by its unthinking adherence and fascination with a neoliberal agenda, that gives a 'liberal' veneer to its deeply conservative social and political positions. This paves the way for continuous trade and foreign investment liberalisation, which is easier done as part of a multilateral agreement rather than as standalone national policy, because a multi-country arrangement appears to be one in which sacrifices are made in some areas for gains in others. Perhaps the NDA government hoped that, despite apprehensions at home, it could find a place in the RCEP by persuading its partners to limit the ambition of the agreement. Finally, that strategy did not work.

The signing of free trade agreements with the EU by some of India's Asian trade competitors provides another opportunity for the NDA government to push its trade liberalisation agenda, since the intensified competition ramps up business support for an EU-India FTA. This occurs at a time when, faced with a pandemic and the accompanying economic crisis, the government has decided to implement a slew of pro-business reforms of labour laws, agricultural trade rules, mining laws, and much else. It may well use the new environment to accelerate negotiations with the EU and arrive at a free trade deal. But that depends on how it would manoeuvre past its own constituencies that may oppose the deal. Especially since enhancing domestic production and making India "self-reliant" seems to be the rhetoric it has recently adopted.

*** This article was originally published in the Frontline Print edition: July 3, 2020.**