Chapter 2

# Trade diversion and trade re-orientation: Aggregate analysis

In this section we look in much more detail at the potential loss of market access for excluded countries to either the EU or India arising from an EU–India FTA. For concreteness we consider the impact of improved Indian access to the EU market, but an exactly parallel analysis pertains to EU access to the Indian market. Here, there are four possible outcomes/scenarios:

- *No negative effect on excluded countries*: If prior to any FTA both the excluded country and India face zero tariffs (either because of GSP or EBA, or because the EU's MFN tariff is zero), then any agreement will not change the relative degree of access to the EU market for India.
- *Trade re-orientation effect*: This could occur when an excluded country already benefits from zero tariff access to the EU market, and the proposed preferential partner (India) matches this access through the agreement. Since India now has equal conditions of access to the European Union, there could be substitution across suppliers which would lead to increases in the market share of Indian competitors at the expense of other exporters to the EU. This effect will predominate mainly for excluded countries already benefiting from strong preferences in the EU, such as under EBA.
- *Trade diversion effect*: This could occur when, before preferences are granted, the proposed preferential partner (India) currently faces a tariff into the EU market *equal* to that faced by a excluded country. The removal of the tariff could lead to making the preferential partner a less costly supplier solely due to the preferences.
- *Trade re-orientation and trade diversion effect*: A combination of these two effects would occur when, before preferences are granted, the proposed preferential partner (India) faces a tariff into the EU market *greater* than that faced by excluded countries. The effect of the reduction in tariffs through the agreement can be surmised into two effects. The first would be a possible danger of trade re-orientation that would arise from the preferential partner matching the tariff of an excluded country (the magnitude of which could be determined by the absolute difference between the tariffs). The second would be a danger of trade diversion, the magnitude of which would depend on the height of the excluded country's tariff.

In order to explore these possibilities we compare the access by tariff line (at the 10-digit level) of each excluded country into the EU market against the access that the India may have after signing the agreement[33]. We also consider excluded country access to India compared to that of the EU. This enables us to measure the potential loss of access of excluded countries both to the EU market and to the Indian market.

It is important to note the role of efficiency in the above stated scenarios. In the second case, if India is the most efficient supplier of a given good, matching the preferences will result in trade re-orientation from previously inefficient sources towards Indian suppliers. This will result in an efficiency gain for the EU, but a loss to excluded countries due to the loss in market share as efficient Indian imports are replacing inefficient excluded country imports. If, on the other hand, India is not a more efficient supplier of a given good, then matching preferences should not result in changes in trade patterns with excluded countries[34]. In the event of scenario 3, if India is a less efficient supplier and the agreement improves its access to the EU market (where tariffs are maintained with excluded countries), there is scope for trade diversion since the European Union will import more from a less efficient country. On the other hand, if India is a more efficient supplier, it would have captured the market when it faced the same tariff as other suppliers and, any increases in trade would be creation.

There are also two practical data-related points to note in the exercises that follow. First, we have assumed that if they are eligible for reduced or zero tariffs in the EU, the excluded countries' exports actually get it. In fact, the rules of origin are tight and bureaucratically burdensome, so many exports from ACP countries or LDCs end up paying GSP rates when they are actually eligible in principle for better treatment. See for example Brenton (2003), or Augier et al. (2008 forthcoming) for evidence and discussion of these issues. Thus our estimates below tend to over-estimate trade re-orientation and underestimate diversion relative to the situation on the ground. Whether this means we mis-state the behavioural consequences is not quite so clear, however, for economic behaviour – e.g. decisions about investing and supplying the EU – may well respond to the *de jure* rather than the *de facto* situation.

Second, the data refer to 2004 or in some cases 2003. In both years India's exports of clothing and textiles were still constrained by the Multifibre Agreement. Hence any statistics relying on India's market share may understate the latter as it pertains to 2008 or later. There is little one can do about this, but the reservation should be recorded.

## EU preferences

In the following analysis we have assumed that after the agreement, India will have immediate full tariff-free access to the European Union market in all product lines. This is an important assumption for two distinct reasons; (i) Under art XXIV of the WTO 'substantially all trade' tends to refer to 80 per cent of bilateral trade and; (ii) the 'reasonable amount of time' (Art XXIV) is commonly interpreted as 12 years. We assume 100 per cent *immediate* liberalisation. Given this assumption, our analysis does not allow us to address Indian tariff dismantling sequencing issues. This is important, for example, when we address the effects of the EU–India agreement on South Africa[35]. Our analysis is likely to overestimate the possible negative effects of the EU–India agreement on South Africa.

To address the possible negative effects that may arise from the EU–India agreement on excluded countries we carry out the following analysis. Using tariff lines at 10 digits, we

compare final Indian access to the European Union with the access that excluded countries benefit from under the different preferential schemes.

Table II.3 then classifies these according to each of the scenarios outlined above.

The first column of the table considers the role of GSP preferences. As India already benefits from GSP preferences, this suggests that for the remaining GSP countries who thus currently face the same access as India, there is only the possibility of trade diversion, and that the incidence of trade re-orientation would be zero. This is case 3 above. Similarly for countries facing MFN tariffs, matching preferences will not occur since these countries will be facing higher tariffs than India, the negative effects of the EU–India agreement on this grouping will occur only through trade diversion.

Table II.3 indicates that the GSP and MFN groups will either experience zero tariff (55 per cent of tariff headings currently have zero MFN tariff) or trade diversion since India will have better access than they do in just under 45 per cent of the 10-digit tariff lines.[36] In comparison, ACP and EBA countries are likely to suffer predominantly from trade re-orientation. For the ACP countries this covers up to 36.8 per cent of tariff lines, and for the EBA countries up to 44.4 per cent. This conclusion can also be extended to the case of South Africa although with some precaution given the implementation/sequencing issues discussed above.

**Table II.3. Tariff lines affected by the EU–India FTA under different preferential schemes 2003**

| | | GSP | EBA | ACP | South Africa | MFN |
|---|---|---|---|---|---|---|
| No change | Quantity of tariff lines | 7795 | 7865 | 7795 | 7795 | 7795 |
| | Per cent of total | 55.1 | 55.6 | 55.1 | 55.1 | 55.1 |
| Trade re-orientation | Quantity of tariff lines | | 6276 | 5198 | 3348 | |
| | Per cent of total | – | 44.4 | 36.8 | 23.7 | – |
| Trade diversion | Quantity of tariff lines | 6346 | | 522 | 1498 | 6283 |
| | Per cent of total | 44.9 | – | 3.7 | 10.6 | 44.4 |
| Trade re-orientation/diversion | Quantity of tariff lines | | | 626 | 1500 | |
| | Per cent of total | – | – | 4.4 | 10.6 | – |
| **TOTAL** | | **14,141** | **14,141** | **14,141** | **14,141** | **14,141** |

Source: UNCTAD-Trains database

While being informative, this analysis does not consider trading structures. If an excluded country is not exporting heavily in the identified tariff lines, the impact of the EU–India agreement on it will be small. For this reason, this analysis is to be interpreted as the maximum scope of preference erosion after the agreement. Table II.4A adds the trade dimension into this analysis[37]. For each of our countries and country groupings, it considers the share of trade with the EU which is accounted for by the four cases outlined earlier. Hence, the first row of the table indicates that 99.1 per cent of the value of Afghanistan's current

exports to the EU falls in products for which both Afghanistan and India currently face zero tariffs. An EU–India FTA would thus not improve India's relative access to the EU and is thus unlikely to have much impact on Afghanistan. The last column of the table also gives the share of the EU in Afghanistan's total exports, which in this case is 27 per cent.

The table therefore enables us to detail the possible impacts of an EU–India agreement according to the preferential scheme operating. In the case of GSP countries (Brazil, China, Pakistan and Sri Lanka), there will be no trade re-orientation from matching preferences (Case 2), and all the impact is characterised by trade diversion. Overall, the country most liable to be affected will be Pakistan since 78 per cent of its exports to the European Union will face increased competition from India, as we can see in column 3. This implies that, at most, up to US$ 2.3 billion of exports could be displaced by the agreement; meanwhile, nearly 21 per cent of its exports to the EU would be free of any effect as seen from column 2. These numbers are quite important in light of the fact that 25% of Pakistan's total exports go to the EU (column 6). Thus, in total, nearly 20 per cent of total Pakistani exports could be vulnerable to some form of trade diversion (i.e. 78.7% of 25%). Sri Lanka could also be heavily affected with over 58 per cent of exports to the EU facing some possibility of trade diversion. With regards to Brazil, China, and Russia, the affected trade could be up to 28 per cent, 23 per cent and 11 per cent of exports to the EU respectively, in which India would have better access to the EU market than they do[38].

A large part of the effects of the EU–India agreement on the small and poor countries of SAARC (Bangladesh, Afghanistan, Bhutan, Maldives and Nepal) will occur through India's matching their preferences in the EU (i.e. trade re-orientation). Here we see that the countries that could potentially be most severely hit would be Bangladesh and the Maldives: up to 97.5 per cent and 91.7 per cent respectively of their exports to the EU could be subject to increased competition from India (as we see from column 2), with the EU accounting for 62.4 per cent and 20.9 per cent of their total exports.

The exports to the EU of the ACP countries (West Africa, Central Africa, Eastern and Southern Africa, SADC, Caribbean and Pacific) fall mostly into the 'no change' category, but some could be affected both by trade re-orientation (matching preferences) and trade diversion (improved Indian access to the EU)[39]. The smallest impacts appear to arise in the case of West Africa and Central Africa, since over 80 per cent of their exports to the EU will not suffer any change in preferences. Eastern and Southern Africa will be affected more by trade re-orientation (54 per cent) as India matches their access to the European Union, than by trade diversion (9 per cent) as she obtains duty-free access while they do not. The highest threats of diversion arise for the Caribbean and the Pacific regions where 15 per cent and 18 per cent of their exports to the EU respectively may be affected. Finally, in the case of South Africa the likely negative impact will be of small magnitude. In fact, this analysis could be overestimating the effects of the better access of India since the EU-ZAF FTA is under implementation. As a consequence, there should not be better access for India with respect to South Africa.

If one is considering the impact of the EU–India FTA relative to the status quo for excluded countries, the distinction between re-orientation and diversion is moot: in both cases

excluded countries suffer deterioration in their current competitive position. The critical data are in column 1, which shows how much trade to the EU will be unaffected; its complement (i.e. 100% less column 1) tells us how much trade is vulnerable to a change in competitiveness.

The data in Table II.4A define an upper bound to the vulnerability of excluded countries' exports to the FTA. They are based on products for which (a) the target country has positive exports and (b) India will get a competitive boost from a decline in the tariff. They do not tell us, however, whether India is likely to take advantage of the decline in tariff. Of course, knowing that *a priori* is just impossible, but one indicator of whether India can actually produce the product in a form saleable in the EU is whether it actually has any exports to the EU. Some information on this is given in Table II.1, column 2, which tells us how similar India's and the target excluded country's exports to the EU are in cases where India faces a positive tariff. These suggest that there is often relatively little overlap and thus that Table II.4A may be over-estimating the degree of actual vulnerability.

To take an additional look at this we have, in Table II.4B, recalculated Table II.4A, but first applying a filter to exclude any products for which India's exports to the EU account for less than 0.25 (one-quarter) per cent of EU imports. We set the threshold above zero in order to try to exclude products which either have zero actual exports but have recorded trade because of one-off data recording errors or have very small amounts of quite exceptional trade. With an aggregate share of EU imports of about 1.5 per cent, this sets the threshold at one-sixth of India's average share, which seems a reasonable criterion for 'real' trade.

Because it refers to just a subset of the trade headings used in Table II.4A, this exercise naturally reduces the apparent vulnerability of excluded countries to the FTA, but to quite different extents across countries. Thus, for example, for Bangladesh the story hardly changes: in the bulk of trade headings it exports to the EU, India also exports, and the vast bulk of these are still subject to trade re-orientation because Bangladesh currently has tariff-free access while India does not. The filtered trade headings account for 58 per cent of Bangladesh's world-wide exports (as opposed to 62 per cent for her total exports to the EU). And the same applies to the other SAARC countries as well. Essentially, they export rather similar goods to the EU as India and so are more likely to be impinged upon by the new preferences for India.

Turning to the BRICs, however, we see that the filter actually excludes a lot of trade. In each case, well over half of their exports to the EU fall in headings for which India cannot manage even a small degree of market penetration. Moreover, in three of the four cases filtering by the Indian share significantly increases the share of trade for which we record 'no change'. Thus once we introduce the notion that India must be able to exploit the new tariff preferences, not merely receive them, the effects of the FTA on the BRICs seem to be a good deal smaller.

Finally, consider the ACP country groups. For the Caribbean and West Africa, the shares of world-wide exports that seem vulnerable to the FTA decline by factors of five and ten. In other words, through this lens the degree of overlap falls away dramatically, although

a higher share of those remaining in the vulnerable class face Indian tariff declines rather than 'no change'. For the other ACP groups, filtering halves (or more) the extent of vulnerable exports and increases the share of those remaining that are subject to no change. Again, once we ask whether India is a plausible competitor, the FTA appears much less challenging to the ACP countries than was implied by Table II.4A.

Of course, all this is predicated on the suggestion that if India does not currently export a good to the EU, it is not likely to do so significantly as a result of the FTA. This is not likely to be universally true, but neither is it likely to be grossly misleading.

**Table II.4A. Value and percentage of exports to the European Union potentially affected by EU preferences to India under the EU–India FTA (by partner, in 2003, in US$ 000)**

| | 1 No change | | 2 Trade re-orientation | | 3 Trade diversion | | 4 Trade re-orientation/ diversion | | 5 % share of export to EU out of total exports |
|---|---|---|---|---|---|---|---|---|---|
| | Value | % of total exports to EU | Value | % of total exports to EU | Value | % of total exports to EU | Value | % of of total exports to EU | |
| Afghanistan | 55,592 | 99.1 | 482 | 0.9 | – | – | – | – | 27.0 |
| Bangladesh | 101,782 | 2.5 | 3,893,460 | 97.5 | | – | – | – | 62.4 |
| Bhutan | 581 | 94.0 | 37 | 6 | – | – | – | – | 0.5 |
| Maldives | 1,945 | 8.3 | 21,627 | 91.7 | – | – | – | – | 20.9 |
| Nepal | 20,643 | 39.1 | 32,140 | 60.9 | – | – | – | – | 8.1 |
| Pakistan | 634,075 | 21.3 | – | – | 2,348,697 | 78.7 | – | – | 25.0 |
| Sri Lanka | 606,006 | 41.2 | – | – | 865,707 | 58.8 | – | – | 30.3 |
| Brazil | 14,594,890 | 74.4 | – | – | 5,034,075 | 25.6 | – | – | 26.9 |
| Russia | 43,958,076 | 92.1 | – | – | 1,650,391 | 3.5 | 2,134,377 | 4.5 | 35.7 |
| China | 75,525,180 | 71.4 | – | – | 30,204,056 | 28.6 | – | – | 24.1 |
| South Africa | 12,736,777 | 83.7 | 470,948 | 3.1 | 1,624,947 | 10.7 | 387,043 | 2.5 | 48.4 |
| Caribbean | 1,927,872 | 60.8 | 756,429 | 23.8 | 308,896 | 9.7 | 180,107 | 5.7 | 19.1 |
| Central Africa | 4,474,861 | 90.6 | 248,885 | 5.0 | 3,110 | 0.1 | 212,719 | 4.3 | 41.4 |
| Eastern and Southern Africa | 1,769,348 | 36.7 | 2,603,743 | 54.1 | 442,310 | 9.2 | 1,726 | 0 | 45.1 |
| Pacific | 362,068 | 61.2 | 120,412 | 20.4 | 108,875 | 18.4 | 13 | 0 | 7.9 |
| SADC (no S Af) | 3,741,448 | 73.6 | 1,152,674 | 22.7 | 98,799 | 1.9 | 89,395 | 1.8 | 65.6 |
| West Africa | 11,087,584 | 84.4 | 1,867,084 | 14.2 | 30,707 | 0.2 | 156,323 | 1.2 | 38.3 |

Source: UNCTAD-TRAINS database

**Table II.4B. Value and percentage of exports to the European Union potentially affected by EU preferences to India for headings in which India's share of the EU imports exceeds 0.25% (by partner, in 2003, in US$ 000)**

| | 1 No change | | 2 Trade re-orientation | | 3 Trade diversion | | 4 Trade re-orientation/ diversion | | 5 % share of export to EU in covered headings in total exports to world |
|---|---|---|---|---|---|---|---|---|---|
| | Value | % of total exports to EU in covered holdings | Value | % of total exports to EU in covered holdings | Value | % of of total exports to EU in covered holdings | Value | % of total exports to EU in covered holdings | |
| Afghanistan | 36,299 | 98.9 | 401 | 1.1 | 0 | 0.0 | 0 | 0.0 | 17.7 |
| Bangladesh | 73,540 | 2.0 | 3,637,612 | 98.0 | 0 | 0.0 | 0 | 0.0 | 58.0 |
| Bhutan | 228 | 90.8 | 23 | 9.2 | 0 | 0.0 | 0 | 0.0 | 0.2 |
| Maldives | 655 | 9.8 | 6,021 | 90.2 | 0 | 0.0 | 0 | 0.0 | 5.9 |
| Nepal | 13,379 | 30.3 | 30,706 | 69.6 | 0 | 0.0 | 0 | 0.0 | 6.8 |
| Pakistan | 516,419 | 18.6 | 0 | 0.0 | 2,253,242 | 81.4 | 0 | 0.0 | 23.2 |
| Sri Lanka | 495,475 | 38.2 | 0 | 0.0 | 799,938 | 61.8 | 0 | 0.0 | 26.7 |
| Brazil | 5,427,169 | 76.7 | 0 | 0.0 | 1,646,677 | 23.3 | 0 | 0.0 | 9.7 |
| Russia | 5,764,793 | 90.4 | 0 | 0.0 | 199,021 | 3.1 | 413,212 | 6.5 | 4.8 |
| China | 28,793,466 | 62.1 | 0 | 0.0 | 17,606,495 | 37.9 | 0 | 0.0 | 10.6 |
| South Africa | 4,118,693 | 86.9 | 251,923 | 5.3 | 330,641 | 7.0 | 36,128 | 0.8 | 15.1 |
| Caribbean | 182,712 | 27.9 | 427,117 | 65.2 | 44,779 | 6.8 | 68 | 0.0 | 3.9 |
| Central Africa | 1,191,623 | 99.1 | 11,232 | 0.9 | 1 | 0.0 | 5 | 0.0 | 10.1 |
| Eastern and Southern Africa | 923,568 | 36.0 | 1,614,835 | 62.9 | 28,475 | 1.1 | 200 | 0.0 | 24.0 |
| Pacific | 208,470 | 86.1 | 33,547 | 13.9 | 0 | 0.0 | 0 | 0.0 | 3.2 |
| SADC (no S Af) | 2,215,674 | 95.1 | 111,813 | 4.8 | 2,100 | 0.1 | 108 | 0.0 | 30.1 |
| West Africa | 937,688 | 69.4 | 405,927 | 30.0 | 8,215 | 0.6 | 137 | 0.0 | 3.9 |

Source: UNCTAD-TRAINS database.

## India Preferences

We now turn to the analysis of the effects of the EU–India agreement on excluded countries that could arise from the concession of Indian preferences to the EU. The analysis is similar to the preceding insofar as we assume that the effects on excluded countries will arise from the type of concessions already granted to excluded countries, and how these will be matched/improved for the EU. To this end, Table II.5 investigates the number of tariff lines at 8 digit level that could be threatened by increased EU competition in the Indian market[40].

For this analysis, we distinguish according to the preferential schemes that India operates.

India applies preferential tariffs to its SAARC (SAFTA) partners; however, it differentiates across SAARC partners according to levels of development. In Table II.5, SAARC (LDC) refers to Bhutan and Nepal[41], whereas the SAARC preference grouping comprises; Pakistan and the Maldives. The preferences granted to the SAARC LDCs outstrip those of the other SAARC members. There are also special preferential agreements in place with Afghanistan, Bangladesh and Sri-Lanka.

Further to these preferences, India extends a Global System of Trade Preferences (GSTP) to developing countries. Much like the EU GSP, the GSTP provides differential access to the Indian market according to the level of development. We distinguish between these in Table II.5.

**Table II.5. Tariff lines affected by the EU–India FTA under different preferential schemes (2005)**

| | Afghanistan | Bangladesh | Sri Lanka | SAARC (LDC) | SAARC | GSTP (LDC) | GSTP | MFN |
|---|---|---|---|---|---|---|---|---|
| **No change** | | | | | | | | |
| Quantity of tariff lines | 287 | 287 | 287 | 287 | 287 | 287 | 287 | 287 |
| Percentage of total | 2.5 | 2.5 | 2.5 | 2.5 | 2.5 | 2.5 | 2.5 | 2.5 |
| **Trade re-orientation** | | | | | | | | |
| Quantity of tariff lines | 313 | 481 | 9121 | 291 | 0 | 0 | 0 | 0 |
| Percentage of total | 2.7 | 4.1 | 78.0 | 2.5 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Trade diversion** | | | | | | | | |
| Quantity of tariff lines | 5,644 | 5,455 | 833 | 5,633 | 9,662 | 11,221 | 11,221 | 11,406 |
| Percentage of total | 48.3 | 46.7 | 7.1 | 48.2 | 82.6 | 96.0 | 96.0 | 97.5 |
| **Trade re-orientation/diversion** | | | | | | | | |
| Quantity of tariff lines | 5,449 | 5,470 | 1,452 | 5,482 | 1,744 | 185 | 185 | 0 |
| Percentage of total | 46.6 | 46.8 | 12.4 | 46.9 | 14.9 | 1.6 | 1.6 | 0.0 |
| **TOTAL** | **11,693** | **11,693** | **11,693** | **11,693** | **11,693** | **11,693** | **11,693** | **11,693** |

Source: UNCTAD-TRAINS database.

Overall, Table II.5 suggests that a large proportion of tariff lines across selected partners potentially suffer from increased competition from the EU in their access to the Indian market. This arises from the low level of preferences that are currently being granted by India to excluded countries (except Sri Lanka). For Afghanistan and Bangladesh, the EU would match current access to the Indian market in around 5 per cent of tariff lines, but if there was complete liberalisation of tariffs between the EU and India, it would have better market access in over 95 per cent of tariff lines. In the case of SAARC countries, we see that preferences are granted only on 1744 tariff lines and, in fact, these offer only small reductions in the tariff rates of these lines. The EU is likely to surpass SAARC partner's market access in India in over 97 per cent tariff lines. Compared to other SAARC

partners, SAARC LDCs benefit from a few more concessions in the form of 291 tariff lines gaining zero tariff entry to India, and from reduced tariffs in 4,029 products[42]. The EU will improve its access to India over these countries in 95 per cent of tariff lines. With regards to GSTP countries, who benefit from lower tariffs in 185 products, the EU will also significantly increase its market access to the Indian Market. India's only 'serious' FTA to date is with Sri Lanka, and here the predominant effect is trade re-orientation since the European Union will match its preferential access to the Indian market in nearly 78 per cent of the tariff lines.

Overall, the potential impact of extending preferential market access to the Indian market for the EU could have important implications for excluded countries in terms of tariff line access to India. However, the true effect will depend on how strongly these excluded countries export to India in the identified lines. As before, Table II.6A, adds a trade dimension to the above tariff exercise to try to provide upper bound estimates of the effects of Indian tariff liberalisation with respect to the EU on excluded countries. Once again we distinguish across the four scenarios identified at the beginning of this section.

We suggest that the size of the effects on excluded countries of India granting preferences to the EU will depend largely on the value of their exports to India and on the degree of comparative market access enjoyed by the EU as a result of these preferences. From Table II.6A, we see that the countries whose exports are most heavily concentrated on India are Bhutan and Nepal (column 5). Granting EU exports better access to India is likely to increase competition and could negatively impact these countries. The amount of 'affected trade' could be over 90 per cent of Bhutan's exports to India and 60 per cent of Nepal's exports to India[43]. We see that this negative impact will come in the form of both trade diversion and trade re-orientation. Following this logic, the effects on Sri Lanka and Afghanistan would be smaller, with those for Bangladesh, the Maldives and Pakistan being negligible. It is important to note that, even at this high level of disaggregation, the products produced by the EU could be qualitatively different from those produced by excluded developing countries and we thus might be over-estimating the degree of competitive threat that the latter face[44].

With regards to the ACP countries, Table II.6A suggests that exports to India are very small, and that even though the EU will gain better access to the Indian market in over 99 per cent of tariff lines, the negative impact will be very small. This can also be extended to BRICS whose share of exports to India is small, with the mild exception of South Africa.

Overall, Table II.6A suggests that Indian preferences granted to the EU will impact most heavily on Bhutan and Nepal. However, given that the similarity of EU exports to India with Bhutanese and Nepalese exports to India is low (as shown in Table II.2), the overall negative effect is likely to be small[45]. Thus, even though the EU, as a result of the EU–India agreement, will have a much better access to India than any partner country analysed, the negative impact on excluded countries is likely to be muted due to the dissimilarity in export structures and the slight importance of exports to India in excluded countries' total exports.

**Table II.6A. Value and percentage of exports to India potentially affected by Indian preferences to EU under the EU–India FTA (by partner, in 2005, in US$ 000)**

| | 1 No change | | 2 Trade re-orientation | | 3 Trade diversion | | 4 Trade re-orientation/ diversion | | 5 % share of export to India in total exports |
|---|---|---|---|---|---|---|---|---|---|
| | Value | % of total exports to IND | Value | % of total exports to IND | Value | % of total exports to IND | Value | % of total exports to IND | |
| Afghanistan | 474.2 | 0.8 | 20,385.3 | 35.0 | 12,370.6 | 21.3 | 24,966.8 | 42.9 | 28.0 |
| Bangladesh | 685.2 | 0.5 | 4,824.4 | 3.8 | 47,051.8 | 36.9 | 74,929.4 | 58.8 | 2.0 |
| Bhutan | 72.6 | 0.1 | 28,055.8 | 24.1 | 29,272.8 | 25.2 | 58,810.5 | 50.6 | 99.0 |
| Maldives | 0 | 0 | 0 | 0 | 1,968.6 | 99.3 | 13.3 | 0.7 | 1.8 |
| Nepal | 1,120.6 | 0.3 | 30,009.4 | 7.3 | 187,020.8 | 45.5 | 193,073.4 | 47 | 63.0 |
| Pakistan | 17.3 | 0 | 0 | 0 | 52,731.5 | 29.3 | 127,444 | 70.7 | 1.5 |
| Sri Lanka | 3,404.3 | 0.3 | 553,258 | 48.8 | 13,991.5 | 1.2 | 562,008.5 | 49.6 | 23.3 |
| Brazil | 10,563.7 | 1.2 | 0 | 0 | 862,576.5 | 97.7 | 9,336.5 | 1.1 | 1.2 |
| Russia | 2,923,150.7 | 27.1 | 0 | 0 | 7,784,072.2 | 72.1 | 92,809 | 0.9 | 2.5 |
| China | 2,630.7 | 0.1 | 0 | 0 | 2,014,980.7 | 99.9 | 0 | 0 | 1.5 |
| South Africa | 2,988.1 | 0.1 | 0 | 0 | 2,295,329.5 | 92.5 | 182,622.4 | 7.4 | 7.9 |
| Caribbean | 82.2 | 0.2 | 0 | 0 | 35,046.8 | 92.8 | 2,641 | 7 | 0.2 |
| Central Africa | 38.8 | 0 | 0 | 0 | 113,014.8 | 99.9 | 27.2 | 0 | 0.9 |
| Eastern and Southern Africa | 6,849.3 | 3.5 | 0 | 0 | 184,660.1 | 95.4 | 2,112.7 | 1.1 | 1.8 |
| Pacific | 132 | 0 | 0 | 0 | 295,538.9 | 99.8 | 448.3 | 0.2 | 4.0 |
| SADC (no S Af) | 452.5 | 0.2 | 0 | 0 | 197,228.5 | 99.6 | 380.9 | 0.2 | 2.6 |
| West Africa | 2,009.6 | 0.2 | 0 | 0 | 773,900.1 | 72.6 | 289,889.7 | 27.2 | 3.1 |

Source: UNCTAD-TRAINS database

To check these hypotheses further, we also applied the same market presence filter to Table II.6A as to Table II.4A: that is we re-calculated Table II.6A excluding any heading for which the EU did not provide at least 0.25 per cent of Indian imports. (In this case, the threshold is about one hundredth of the EU's average share.) As with the previous table, this necessarily reduces the share of world-wide exports that appear to be vulnerable to the FTA. In the cases of the BRICs and the ACP countries, this reduces small numbers to very small ones and so hardly changes the situation qualitatively. Similarly for Bangladesh, the Maldives and Pakistan. For the remaining SAARC countries, however, the changes are more significant. For Afghanistan and Sri Lanka, the filtering basically eliminates the cause for concern: for the former, there is no vulnerability, whereas for the latter only 5 per cent of total exports look vulnerable. For Bhutan and Nepal, filtering reduces very high figures to merely high ones: even with the filter, a significant share of

their total exports would face a strong increase in competition from the EU in India, although, as we have noted above, this ignores any differences in quality between EU and the SAARC countries' varieties.

**Table II.6B. Value and percentage of exports to India potentially affected by Indian preferences to the EU for headings in which the EU's share of Indian imports exceeds 0.25% (by partner, in 2005, in US$ 000)**

| | 1 No change | | 2 Trade re-orientation | | 3 Trade diversion | | 4 Trade re-orientation/ diversion | | 5 % share of export to India in covered headings in total exports to world |
|---|---|---|---|---|---|---|---|---|---|
| | Value | % of total exports to India in covered headings | Value | % of total exports to India covered headings | Value | % of total exports to India covered headings | Value | % of total exports to India covered headings | |
| Afghanistan | 474 | 30.4 | 0 | 0.0 | 136 | 8.7 | 948 | 60.8 | 0.8 |
| Bangladesh | 685 | 1.8 | 4,444 | 11.8 | 4,109 | 10.9 | 28,562 | 75.6 | 0.6 |
| Bhutan | – | 0.0 | 28,056 | 41.6 | 28,594 | 42.4 | 10,766 | 16.0 | 57.5 |
| Maldives | – | 0.0 | – | 0.0 | 1,340 | 69.6 | 586 | 30.4 | 1.7 |
| Nepal | 943 | 0.5 | 8,189 | 4.6 | 81,500 | 46.0 | 86,384 | 48.8 | 27.1 |
| Pakistan | 17 | 0.0 | – | 0.0 | 40,420 | 84.9 | 7,151 | 15.0 | 0.4 |
| Sri Lanka | 3,404 | 1.2 | 262,359 | 92.0 | 10,330 | 3.6 | 9,159 | 3.2 | 5.9 |
| Brazil | 10,564 | 3.5 | – | 0.0 | 270,008 | 88.8 | 23,457 | 7.7 | 0.4 |
| Russia | 2,630 | 0.1 | – | 0.0 | 1,787,424 | 99.2 | 12,603 | 0.7 | 0.4 |
| China | 2,915,412 | 36.3 | – | 0.0 | 4,921,549 | 61.2 | 199,126 | 2.5 | 6.0 |
| South Africa | 2,988 | 0.2 | – | 0.0 | 1,973,246 | 99.7 | 2,148 | 0.1 | 6.3 |
| Caribbean | 82 | 0.4 | – | 0.0 | 22,391 | 97.4 | 509 | 2.2 | 0.1 |
| Central Africa | 39 | 0.1 | – | 0.0 | 74,839 | 99.5 | 367 | 0.5 | 0.6 |
| Eastern and Southern Africa | 6,849 | 5.3 | – | 0.0 | 121,495 | 93.7 | 1,375 | 1.1 | 1.2 |
| Pacific | 132 | 0.1 | – | 0.0 | 255,075 | 99.9 | 43 | 0.0 | 3.4 |
| SADC (no S Af) | 452 | 0.7 | – | 0.0 | 67,657 | 99.1 | 137 | 0.2 | 0.9 |
| West Africa | 2,010 | 0.5 | – | 0.0 | 364,219 | 99.0 | 1,847 | 0.5 | 1.1 |

Source: UNCTAD-TRAINS database

## Notes

33 This analysis excludes cross-product effects (i.e. the tariff on good *i* affecting trade in good *j*) and general equilibrium effects of tariff reductions. This means, for example, that a tariff reduction in wheat does not affect trade in, say, rice. We also assume that tariff liberalisation of the EU–India agreement will be of 100 per cent.

34 Assuming perfect competition and perfect substitutability between origins of imports.

35 EU tariff dismantling on South African products used in this study are from 2003 and are sequenced, implying that they encapsulate planned reduction for 2003.

36 In the case of MFN countries, percentages do not add 100 since we have not considered those tariff lines in which the preference rate was higher than the MFN tariff in TRAINS database.

37 We have aggregated the results obtained at 10 digits into 6 digits in order to match the tariffs lines with trade values.

38 In the case of Russia, it is important to note that we assume that Russia faces the EU's MFN tariff since it is not under any preferential scheme.

39 We have used here the 'Preferential for ACP countries' definition on TRAINS, which, so far as we can see, refer to Cotonou preferences (i.e. Lome IV until 2007)

40 In this analysis, we assume that trade liberalisation will be immediate and will cover 100 per cent of EU goods. The level of disaggregation was constrained by data availability.

41 Even though Bhutan and Nepal have preferential access to the Indian market, this is mainly concentrated in goods that are transiting. Both partners have signed Trade and Transit agreements with India. These treaties suppose free trade, however, there does not seem to be a formal accord. For the purposes of the study and in the absence of conclusive evidence, we assume that preferences granted to these two partners follow the SAARC LDC preferences which are, in turn, informed from TRAINS database.

42 Tariff is above zero but below MFN.

43 Bhutan and Nepal are landlocked, of course, and there may well be confusion between their exports to India and those merely transiting India to other destinations. Thus, these proportions may be misleading.

44 Information on prices in the affected tariff lines could help us to differentiate across qualities, and so cast light on this issue. Unfortunately such data are not readily accessible and would require a separate research exercise.

45 Bhutan and Nepal are important exporters of electricity to India. In Bhutan, electricity exports to India account for 25 per cent of GDP (Bernard and McKechney, 2007). These values are not recorded in our statistics. However, it is highly unlikely that the EU–India agreement would affect these sectors.