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# Good news from India and South Korea

How the historic free trade agreement  
between India and Korea is a sign of the  
times

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*The Comprehensive Economic Partnership Agreement (CEPA) between two of Asia's top five economies, signed in August 2009, is bound to have a significant impact on regional business. For a start it may open up the Korean market to Made in India products, while allowing greater access to the booming Indian market for Korean technology exports and foreign direct investment. But its significance goes beyond that. It symbolizes the growing economic and political weight of India in the regional balance of power. When South Korean President Lee Myung-bak called the settlement a historical pact, he was not exaggerating. Will bilateral free trade agreements herald a China-like flood of Indian goods into Asian markets?*

### **India and Korea's Comprehensive Economic Partnership Agreement**

The free trade agreement signed between South Korea and India in August 2009 represents a bid to double the value of trade between two of Asia's biggest economies. The agreement is also known as the Comprehensive Economic Partnership Agreement (CEPA). It aims to grow bilateral trade primarily by slashing tariffs (particularly in the automotive and manufacturing fields), encouraging investment and promoting exchanges of skills.

### **Specifics of the Agreement**

The CEPA, which will come into effect in 2010, has provisions for substantial cuts in both tariff and non-tariff barriers. These will be implemented in a phased manner. Tariffs would be reduced or eliminated on 93 per cent of Korea's tariff lines and 85 per cent of India's tariff lines.

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<sup>1</sup>.

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<sup>1</sup> The Hindu Business Line, India, Korea agree to cut tariffs to boost trade ties, 7 Aug 09

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.

### **The case of automotive manufacturing**

When countries negotiate free trade deals, the automotive industry is perhaps the most important and sensitive industry to be considered. Apart from its role as a job creation engine, the fortunes of “national” automotive manufacturers, as with airlines, are often the focus of national pride. In the case of the India-Korea CEPA, the interests of major automotive manufacturers on both sides are at stake (Hyundai-Kia and Tata Motors), as well as access to India's booming domestic automotive market.

Under the CEPA, duties on Korean automotive parts, one of the country's most traded items, would be slashed from the existing average of 12.5 per cent to one per cent over the next eight years.

On rules of origin, both countries agreed that the level of local content should be a minimum of 35 per cent for these rules to apply.

## **Hope Riding High**

"Bilateral relations will be further solidified and the CEPA sends signals to the world that the two countries are committed to free trade and are against protectionism," South Korean Trade Minister Kim Jong-hoon said after signing the trade pact. The Trade Minister also highlighted that it is the first trade pact between South Korea and a member of the BRIC group, comprising Brazil, Russia, India and China<sup>2</sup>.

South Korean President Lee Myung-bak, during a meeting with India's Minister of commerce and industry, Anand Sharma, welcomed the settlement, calling it a historical pact. "The pact is expected to render not only more solidified bilateral economic relations, but also cultural and societal developments in both countries," President Lee said.<sup>3</sup>

"Overall, the India-Korea CEPA is a step in the right direction given the slowdown of world trade. The reduction and abolitions of tariffs through the CEPA will result in an increase in trade and investment relations between two of the largest economies in Asia," cited Associate Professor, Pravakar Sahoo of the Institute of Economic Growth (IEG) in Delhi.<sup>4</sup>

## **Changing the playing field in India and Korea?**

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

For a start, 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<sup>5</sup>. Given that South Korea is one of the 10 largest economies in the world and a full member of the OECD, this is not an

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<sup>2</sup> China View, S. Korea, India sign bilateral trade agreement, 7 Aug 09

<sup>3</sup> International Business Times, India inks FTA with South Korea, bilateral trade set to double, 8 Aug 09

<sup>4</sup> East Asia Forum, India-Korea CEPA: A step in right direction, 15 Sept 09

<sup>5</sup> Ministry of Commerce, Government of India data on India's leading exports

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 reverse 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.

Given the differences in economic structure between Korea and India, the benefits of these changes will probably outweigh the risks of increased competition from one another's countries. However the significance of the CEPA goes beyond trade and business.

The CEPA reflects the desire of two of Asia's large economies to develop counter-weights to dependency on China and the USA as trading partners. The Government of India has for a long time pursued an explicit "Look East" policy aimed at moving Indian business away from a traditional fascination with the US and UK. In Korea, as in Japan, there is a growing consciousness of a need to hedge supply chain risks by nurturing alternative centres of international production to China. This is sometimes referred to as pursuing a "China plus one" policy. It explains why Japanese FDI into India may exceed that into China in 2010, according to some forecasts.

Both India and Korea would also be keenly aware of the need to cultivate new export markets to compensate for sluggish growth in the US and Europe as a result of the global financial crisis of 2008-2009.

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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