

STRATEGY

Trans-Pacific Partnership: Implications for 'Make in India'

India Equity Research | Strategy



The Trans-Pacific Partnership (TPP), a trade agreement involving 12 countries with the US being a prominent partner, was sealed recently. Pact partners include Australia, Canada, US, Japan, Malaysia, Mexico, Peru, Brunei, Chile, New Zealand, Singapore and Vietnam, which cumulatively constitute 2/5th of global GDP. Under the deal, tariff and non-tariff barriers between TPP countries will be reduced or eliminated on agricultural & manufactured products, intellectual property, services and investments. If approved, it will act as a template for international commerce. The pact's implicit goal is to counterbalance China's growing influence on international commerce. India stayed out of TPP due to contentious issues in agriculture, intellectual property and services. In our view, impact on Indian exports, particularly gems & jewellery, will be minimal due to the sector's eco system, while textile and apparel exports could face potential risk from Vietnam.

Risks to Indian merchandise exports

Think tanks are busy debating TPP's impact on India once it is enacted. Prima facie, we believe there are various channels through which the pact can impact India. For example, India's exports may be hit as there will be significant diversion of trade, as well as foreign investments from Indian markets. In FY15, about a quarter of Indian merchandise exports worth USD75bn went to TPP member countries, of which USD42bn were to the US. Gems & jewellery, textiles and pharmaceuticals contribute ~50% of total Indian exports to the US. While impact on the gems & jewellery sector may be minimal due to the sector's eco system in India, textile and apparel exports could face potential risk from Vietnam.

Proposed regional pact could dilute TPP's impact on India

India is negotiating Regional Comprehensive Economic Partnership (RCEP) that includes 10-member countries from ASEAN, Australia, China, Japan, New Zealand and South Korea. The expected deadline for concluding negotiations is 2015. Also, India's existing bilateral free trade agreements (FTA) with TPP members like Japan, Malaysia and Singapore, and FTAs (negotiations of which are in progress) with Australia, Canada and New Zealand, may dilute the impact of the trade diversion caused by TPP, to some extent.

TPP enactment: An uphill task

TPP will need to be signed by leaders of all the member countries and approved by their respective legislatures. This could prove to be a formidable task as the deal has generated considerable opposition in the US; it is being opposed even by leading Democratic candidate Ms. Hillary Clinton.

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Methodology

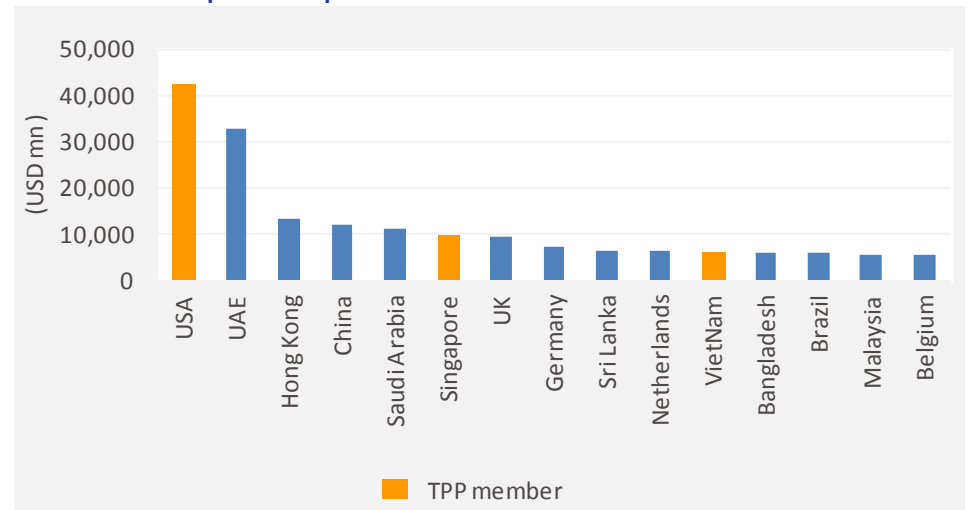
In order to determine impact of the proposed TPP, we have outlined Indian merchandise exports. In FY15, total Indian merchandise exports were ~USD309bn, of which about quarters (USD75bn) were to TPP member countries. US accounts for 57% (USD42bn) of Indian merchandise exports to TPP members. The 3 largest categories of Indian exports to the US in 2014 were gems & jewellery (USD9.5bn), textiles-apparels (USD7bn) and pharmaceutical products (USD5.5bn). These sectors account for ~50% of India’s exports to the US. Though the draft TPP agreement has not yet been made public, we have tried to assess the broader impact on sectors. We will do a detailed impact analysis post the actual draft is made public.

Risks to Indian merchandise exports

India exports: US leading destination

Exports have incrementally played a vital role in India’s economic growth in the past 2 decades. Especially, exports to the US (~14% of India’s total exports in FY15) have registered rapid growth during the past 5 years—~11% CAGR since 2011.

Chart 1: India’s exports to top 15 destinations



Source: CMIE, Edelweiss research

TPP and impact assessment on Indian exports to US

Since the US already has bilateral agreements with 6 TPP members, the pact's incremental impact on India's exports will be restricted from balance 6 members. India accounts for ~1.9% of total merchandise imports to the US. We attempt to assess the pact's impact by profiling Indian merchandise exports to the US.

Table 1: US import trade scenario with TPP nations

TPP Nations	US - Existing FTA	% of Total US Imports
Canada	Y	14.8
Mexico	Y	12.5
Singapore	Y	0.7
Australia	Y	0.5
Chile	Y	0.4
Peru	Y	0.3
Japan	-	5.7
Vietnam	-	1.3
Malaysia	-	1.3
New Zealand	-	0.2
Brunei	-	0.0

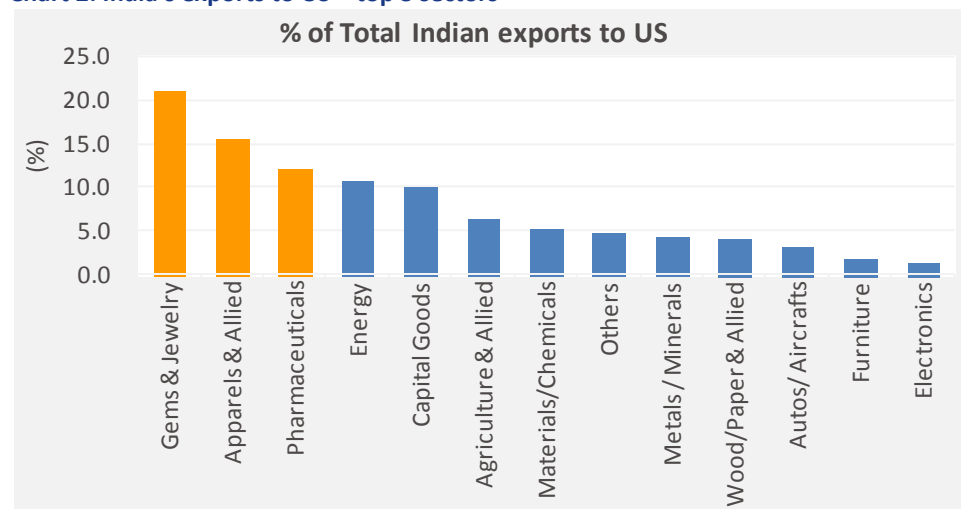
Source: USTR, Edelweiss research

Trade and investment diversions are likely to impact Indian trade. However, some of this impact may be mitigated with India's inclusion in RCEP and other bilateral agreements.

Sectoral impact

The 3 largest categories of Indian exports to the US in 2014 were gems & jewellery (USD9.5bn), textiles-apparels (USD7bn) and pharmaceutical products (USD5.5bn). These sectors account for ~50% of India's exports to the US.

Chart 2: India's exports to US – top 3 sectors



Source: CMIE, Edelweiss research

Textile & apparels

India's textile & apparel exports face potential risk of market share loss in the US. Vietnam could particularly benefit in the segment as current US import tariffs are relatively higher for the sector. A key part of the proposed TPP is "yarn forward", according to which only fabric produced from yarn made by a TPP country will qualify for the trade agreement's duty-free status. The rule is intended to ensure that the pact's trade benefits apply only to signatory countries. Countries like Vietnam have pushed for more flexibility in this rule, which seems to have been accepted as TPP now includes a "short supply" rule which permits raw materials "not commercially available with TPP members to be sourced from non-TPP members and used in the production of apparel in the TPP region without losing duty preference.

Table 2: India third largest textile exporter to US

Country	Textile exports to US (USD bn)	Comments
China	53.0	
Vietnam	11.9	TPP member
India	6.7	
Indonesia	6.2	
Mexico	5.8	FTA / TPP member
Bangladesh	5.1	
Pakistan	3.1	
Honduras	2.7	
Italy	2.7	
Cambodia	2.6	

Source: USTR, Edelweiss research

Pharmaceuticals

TPP is anticipated to expand existing intellectual property (IP) protections on pharmaceutical products, which will ultimately impede pharma manufacturers' access to markets. However, in our view, the impact on Indian pharmaceutical companies will be minimal as the world's largest pharma exporting countries to the US are non-TPP members.

Table 3: India fourth largest pharmaceutical exporter to US

Country	Pharma exports to US (USD Bn)	Comments
Ireland	20.6	
Germany	14.3	
Switzerland	10.5	
India	5.5	
United Kingdom	5.2	
Belgium	4.7	
Israel	4.6	FTA
Canada	4.5	FTA / TPP member
Denmark	3.3	
Italy	2.7	
France	2.7	

Source: USTR, Edelweiss research

RCEP may dilute impact on India

Ms. Nirmala Sitharaman, India's Commerce Minister, when asked about India not being part of TPP said, "we are very actively engaged in RCEP, which comprises ASEAN and ASEAN FTA countries." India has started preparing for RCEP (16 members) with its set of demands and offerings, but has not taken any stand on TPP. It needs to ensure that pending FTAs are concluded expeditiously, which may dilute the impact of trade diversion caused by TPP to some extent.

Fig. 1: Overlap of TPP and RCEP

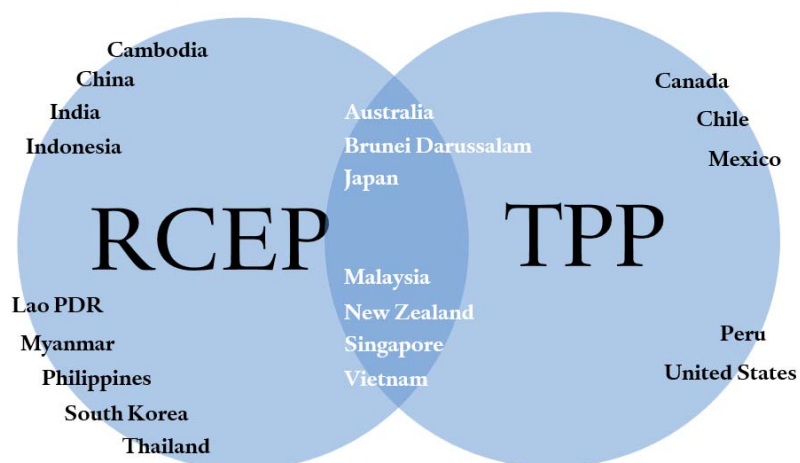


Figure 1: Overlap of Countries in Negotiations for Regional Comprehensive Economic Partnership and Trans-Pacific Partnership

Source: Forbes

TPP enactment: An uphill task

TPP will need to be signed by leaders of all member countries and approved by their respective legislatures, which is likely towards early 2016. This could prove to be a formidable task as the deal has generated considerable opposition in the US; it is being opposed even by leading Democratic candidate Ms. Hillary Clinton.

Conclusion

As Vilfredo Pareto remarked, "from the point of view of the protectionist, treaties of commerce are ... what is most important for a country's economic future." A new trade treaty ostensibly leads to reduction of tariff barriers. However, in reality there exist veiled non-tariff barriers which impede market access and create monopolies on an international scale.

The TPP agreement, one of the largest trade accords, will act as a template for manufacturing standards. Indian companies will have to evolve their manufacturing practices for accessing markets of TPP members.

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