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A little-known agreement called ITA-1 killed India's IT manufacturing. Now, ITA-2 is in the works

During the 1980s and early 1990s, the Indian IT industry outperformed its counterpart in China on several counts. The situation flipped over after 1997, when New Delhi joined the **Information Technology Agreement** (ITA). Now, another version of the **ITA** is in the works.

To understand why India should be wary of the proposed ITA, we need to understand the pitfalls of ITA-1.

Domestic **IT companies** — both hardware and software — started growing robustly after the economy was opened. The segment was seen to be on solid footing to tackle any onslaught by foreign businesses. Companies such as Wipro and **HCL** not only exported a large volume of IT products but also dominated an expanding domestic market with a significant clout in all types of IT products. In 1995, for example, the share of domestic value-added products was 70.27% — the market demand for computer, electronics and optical (CEO) products was $7.54 billion. However, this share has decreased to around 45% in 2011, shows government records.

A major reason for this fall was because India joined the World Trade Organisation (WTO)'s ITA — now called ITA-1 — and had to eliminate tariffs on a host of IT products. The agreement required the participants "to eliminate and bind customs duties at zero for all products specified in the agreement." These included computers, telecommunication equipment, semiconductors, semiconductor manufacturing and testing equipment, data storage media and software provided on physical media.

An industry on the back foot

Domestic companies lost tariff protection and also had to compete with cheaper imports from China. The higher cost of doing business in India, too, made it difficult for these companies to compete globally and domestically. So many were forced to shut down manufacturing of IT products and some shifted focus to IT services. Though it helped India become a leader in IT services, it made the country dependent on imports for IT hardware.

Industry observers insist electronic hardware and manufacturing suffered in India because of ITA-1 — which now has 82 signatories, representing 97% of the world's trade in IT products. Even the government acknowledges this. "India's experience with the ITA has been most discouraging, which almost wiped out the IT industry from India. The real gainer from that agreement has been China which raised its global market share from 2% to 14% between 2000-2011," says Department of Commerce's website.

Share of domestic value added created in India due to the total demand for CEO products

Year (1)	Total demand ($ bn.) (2)	Domestic value-added as a % of total demand (3)
1995	7.54	70.27
2000	8.60	60.93
2005	17.36	43.65
2008	26.99	37.70
2009	29.17	39.51
2010	30.97	44.12
2011	34.41	45.19

Source- WTO Tariff Analysis Online (TAO).

The Indian IT hardware market was valued at $30.3 billion in 2020, against China's $63.2 billion. While this segment may not be strictly comparable with IT services and software — where India is way ahead with $200 billion in revenue and a workforce of 5 million, according to industry association **Nasscom** — the numbers indicate what the country could have gained if it had kept equal focus on the hardware segment.

ITA-1 has pulled down the IT-based trade in value added (TiVA) goods.
TiVA is a statistical method that helps to identify the sources of value added during the production of goods and services for export and import. In simpler terms, TiVA considers the contribution made by each country in the creation of goods and services that are consumed globally. For instance, if a product is manufactured in one country using materials sourced from another, both countries have added value to the final product. This value is then calculated and attributed to each country accordingly.

ITA-2's potential threats

As India continues to grapple with the repercussions of ITA-1, the WTO is broadening the agreement through the ITA-2. Around 80 WTO member countries are negotiating rules governing, among other things, electronic commerce. Some 201 additional products are being added to the pact. These products were in 2015 — when the ITA-2 was first mulled — estimated to have a global annual trade value of approximately $1.3 trillion. They accounted for approximately 7% of global trade, estimates the WTO.

Though there is no timeline on when the new pact would be operationalised, ITA-1 signatories and others are being encouraged to sign up.

The WTO says the ITA-1 marked a notable step towards further liberalising global trade in information technology products. The rationale given by the agency is that by lowering trade barriers and eliminating tariffs on these products, there would be increased international trade and technological advancements worldwide.

Given that the encounter with ITA-1 led to a near collapse of India's IT and hardware industry, industry experts say the country should not join ITA-2. Experts point out that joining the ITA was unnecessary as it was a plurilateral agreement that was optional. But the country still joined.

It is a fact that in 1997, the decision of the ITA-1 to cut import duty on certain telecom goods to zero went against India's interest, says Gurmeet Singh, Executive Director Electronics and Computer Software Export Promotion Council. India joined that agreement without looking into the interest of the fledgling indigenous electronic hardware industry. Since then, the industry has been struggling to come out of the morass it had drifted into.

One pro-ITA-1 argument was that it would help India to take advantage of a growing global market as the agreement focussed on eliminating tariffs on several products. The promise of a wider global market access for Indian IT hardware products was too good to be ignored — or so it seemed then. Experts say the ITA also provided a platform for international collaboration and to attract advanced technologies and products that could have stimulated domestic innovation and competitiveness. Besides, the country has traditionally been a strong advocate of global multilateral trading frameworks.

When the ITA-1 was operationalised, products such as smartphones and smartwatches were either not prominent or not in existence. That is starkly different from the situation now; and India has a sizeable domestic market in several products proposed to be covered under the ITA-2.

Comparison of share in gross exports of CEO products and share in domestic value added created by CEO products' exports

Country/ Economy	Share in Gross Exports of CEO Products						Share in Domestic Value-Added created by exports of CEO Products					
	2005	2007	2009	2011	2013	2015	2005	2007	2009	2011	2013	2015
China	19.5	24.3	26.8	30.2	33.9	34.8	17.6	23.0	28.0	31.7	34.8	36.4
Germany	2.8	3.5	4.0	4.1	3.8	3.6	3.6	4.4	4.9	4.9	4.6	4.1
Japan	8.2	7.5	6.2	5.8	4.5	4.2	11.4	10.1	8.3	7.7	5.9	5.4
UK	2.1	1.6	1.3	1.2	1.0	1.0	2.4	1.7	1.5	1.3	1.2	1.2
USA	9.3	8.1	6.7	5.6	5.5	5.4	12.9	11.3	9.5	8.0	7.7	7.5
Brazil	0.4	0.3	0.2	0.1	0.1	0.1	0.5	0.4	0.3	0.2	0.1	0.1
India	0.1	0.2	0.4	0.4	0.3	0.2	0.1	0.2	0.3	0.4	0.3	0.2
Malaysia	6.2	5.7	5.1	4.6	4.0	3.9	3.3	3.2	3.0	2.8	2.6	2.6
Thailand	2.5	2.0	2.4	2.4	2.3	2.4	1.7	1.5	1.8	1.6	1.7	1.9
Viet Nam	0.1	0.2	0.3	0.5	0.6	0.8	0.1	0.2	0.2	0.4	0.4	0.5

Source- WTO Tariff Analysis Online (TAO).

So far, India has not given its nod to join ITA-2. Singh calls this a wise decision and insists the country maintain this position.

Learning from mistakes

The Delhi-based Global Trade Research Initiative (GTRI) estimates the world trade in ITA-1 products to be worth $2.2 trillion in 2022, up from $1.5 trillion in 2015 and $400 billion in 1996. India could have pocketed a substantial part of this value if it had focussed on IT manufacturing.

Even without joining ITA-1, India would have been able to export to countries that were members of the agreement, says Ajay Srivastava, cofounder of GTRI. But the domestic industry drowned in the flood of cheaper goods from abroad, and the domestic players did not get any support. "While China was the main beneficiary of ITA-1, the US is the likely beneficiary of ITA-2 whenever it is finalised and implemented," says Srivastava.

ITA-2 will hurt Indian players making rapid strides domestically and globally in a number of promising segments. This is because the new agreement proposes to cover products and services relating to cloud computing, big data analytics, artificial intelligence (AI), 5G wireless technology, quantum computing technology, blockchain technology, virtual reality (VR) and augmented reality (AR), and Internet of things (IoT) devices. "Joining ITA will block any domestic development of these technologies," says Das, adding that the current negotiations on the **Indo-Pacific Economic Framework** (IPEF) and other free trade agreements (FTAs) pose similar challenges for the Indian industry. The government must be very careful and assess the long-term gains before committing to these agreements.

The ITA-1 was a dampener for medical devices, too, as these equipment also have high-tech parts. It hurt local production of instruments such as high-end MRI scans and X-ray tubes.

Industry experts point out that as the government is promoting the production of electronic goods ranging from semiconductors to smartphones, it is advisable to stay away from the new ITA.

Participation by WTO members in ITA and ITA-2

Member	Average bound rate of ITA products before the economy joined ITA	Date of initiation of tariff reduction/elimination under ITA	Date of completion of tariff elimination under ITA	Whether Member of ITA - 2
Germany	1.00	26-Mar-97	01-Jan-00	Yes
Japan	0.17	26-Mar-97	01-Jan-00	Yes
Korea	4.33	26-Mar-97	01-Jan-05	Yes
United Kingdom	1.00	26-Mar-97	01-Jan-00	Yes
United States	0.53	26-Mar-97	01-Jan-00	Yes
Argentina	34.16	Not a Member	No Schedule	No
Brazil	31.14	Not a Member	No Schedule	No
China	1.33	24-Apr-03	Acceded	Yes
India	17.77	26-Mar-97	01-Jan-05	No
Indonesia	39.44	26-Mar-97	01-Jan-05	No
Malaysia	12.69	26-Mar-97	--	Yes
Turkey	3.57	26-Mar-97	01-Jan-00	Yes
Singapore	0.96	05-Aug-97	01-Jan-00	Yes
Thailand	5.89	30-Jan-98	01-Jan-05	Yes
Vietnam	3.80	27-Oct-08	01-Jan-14	No

Source- WTO Tariff Analysis Online (TAO).

Kalantri gives another reason: Discouraging the import of electronic goods would not only support domestic manufacturing but also safeguard India's security interests. As imported electronic goods carry higher cyber security risks, there is a case for reducing import dependence for electronic hardware and equipment used in defence, railways, aerospace, healthcare, power and other strategic sectors, he adds.

ITA hurt trade in value added

Abhijit Das, former head of the Centre for WTO Studies, says the standard narrative is that countries can benefit by plugging into global value chains of IT hardware by importing parts and components and adding some value domestically. But the success of some of the prominent players of computer, electronics and optical (CEO) products has been because of a large homegrown ecosystem.

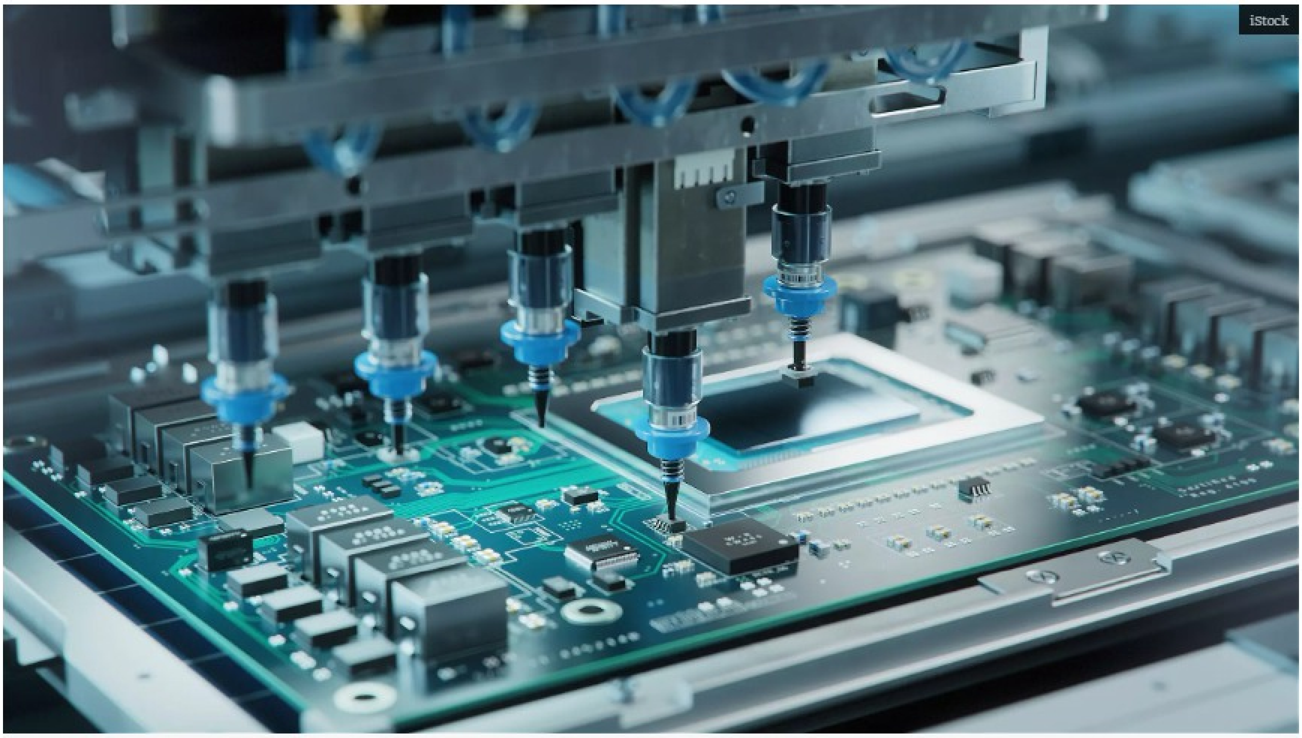
He adds that during 2005-2011, domestic value-added contributed around two-thirds of the demand for CEO products in China, Japan, Korea, Chinese Taipei and the US. Although these countries are participants in ITA-1 and -2, their success in CEO products was driven less by foreign inputs and more by domestic value-addition.

Foreign value-added contributed around half of the demand in countries not participating in ITA-2 — such as Argentina, Brazil, India, Indonesia and Vietnam. This is another reason these five developing countries have not warmed up to the ITA-2.

“It is relevant to note that in India, the domestic value-added in CEO products declined sharply from 45% in 2005 to around 34% in 2015. It is clear that during the implementation of ITA, the domestic producers of CEO products took a massive hit,” Das says, adding their study did not find support for the claim made by some experts that the success of India’s IT services exports was on account of zero-duty imports of IT hardware under the ITA.

Muscle flexing?

The developed world has been persistently pushing the ITA-2 on countries that haven't yet warmed up to it. India had to face a precarious situation due to the trade disputes that arose as a result of the complaints filed by three geographies — the EU, Japan and Taiwan.



The real gainer from ITA-1 has been China which raised its global market share from 2% to 14% between 2000-2011.

In 2019, the European Union dragged India to the WTO alleging that the country had import duties of 7.5-20% on a wide range of IT products, overstepping the commitment to the WTO tariff schedule. The same year, Japan and Taiwan filed similar complaints. In 2018, the US, China, Canada and Norway, among others, had raised concerns over the tariff on high-end mobile phones and other items, including smartwatches, machines and apparatus for the manufacture of semiconductor boules or wafers, electronic transformers, telephone sets, particularly cell phones, transmission apparatus for radio or television broadcasting, electronic integrated circuits, oscilloscopes, and measuring or checking instruments, among others. The verdict is not out in many of these cases.

Way out for India

Experts suggest that despite such disagreements, developing countries must critically scrutinise the evidence of gains from the ITA. They must also take into account the experience of the producers of computer, electronic and optical products in countries that have suffered after implementing the agreement.

Nitin Kunkolienker, President Emeritus, Manufacturers' Association of Information Technology, suggests the government set up an expert fact-finding team to first analyse the demand for IT products and components. There are programmes like the Production-Linked Incentive (**PLI**) schemes for manufacturing that are making a difference and states are also aggressively competing with each other to attract companies, he adds.

Besides, India will not lose anything by staying out of this agreement, as even non-signatory countries can have duty-free market access to the ITA goods in the signatory countries. By staying out, India has a policy flexibility to hike or reduce import duty on select electronic goods and protect domestic manufacturing. So, it makes sense to remain out of the ITA-2 and tweak the policy based on the evolving domestic needs, says Kalantri, chairman of MVIRDC WTC.

Das of the Centre of WTO Studies points out that the success in the IT hardware sector relies heavily on several factors. One is the availability of many parts and components domestically. Another is the availability of indigenous technology; and a third is the capability for undertaking activities related to non-manufacturing segments in the life cycle of IT hardware. If none of these elements is present in a country, then participating in an expanded ITA is unlikely to create substantial economic value. "Any binding commitments will erode the much-needed policy space and reduce the ability of the governments to generate additional revenues," Das adds.

As India continues to grapple with the repercussions of ITA-1, policymakers should learn from the past and proceed cautiously to protect the domestic interests.

Edited by Ram Mohan.
(Originally published on Aug 04, 2023, 09:46 AM IST)