



India and RCEP: India's Recalcitrance and The Way Ahead

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India's withdrawal from the Regional Comprehensive Economic Partnership (RCEP) at the Bangkok Summit recently, citing harm to domestic and national interest, has sprouted spirited debate. It was essentially a Free Trade Agreement (FTA) between 16 countries spanning the Asia-Pacific region. Tariffs and duties would be nearly nullified so that there would be a free flow of goods between the countries involved. The grouping comprised the 10 ASEAN countries, as well as their 6 dialogue partners: China, Japan, India, South Korea, Australia and New Zealand. The idea for an FTA was conceptualized in 2012 by ASEAN nations, at the Phnom Peh Summit and the countries expected to finalise a deal by 2020.

Significance of the agreement:

The economic implications of the fructification of such a trade bloc are immense. The RCEP countries together make up 45% of the world's population and constitute 33% of the world's GDP, and at least 28% of world trade¹.

For India, the deal would have signalled an opportunity to achieve greater integration into the region. And with the turn of global powers like China and the US towards protectionism, this agreement would have also provided a fresh direction to the global political economy.

The RCEP agreement spelled out a few demands from India. It had to abolish tariffs on more than 70% of the goods from China, Australia and New Zealand, and nearly 90% of the goods from Japan, South Korea and ASEAN countries. After much initial enthusiasm, India found these terms untenable and non-practicable.

Reasons for India's reluctance:

Historically, India's experience with FTAs has not been good. India's existing FTAs with South Korea, ASEAN countries and Japan have proved to be unfavourable for it. Although trade has increased between them, imports to India have risen faster than exports from it. NITI Aayog has

also reported that India has a bilateral trade deficit with most member countries of RCEP² to the tune of \$105 billion in fiscal 2019³. Thus, this would further worsen with the implementation of an FTA in the form of RCEP.

The China factor cannot be ignored in the analysis of India's exit. Of the trade deficit with RCEP nations, China alone accounts for \$52 billion⁴. Thus, free trade would allow Chinese manufactured goods and dairy products to flood the Indian market, making domestic players less competitive. The inclusion of China in the block in the time of an ongoing global trade war between US and China could imply that countries within the block would have to pick sides, causing a geo-political rift within the group. India has signed individual FTAs with all countries of RCEP, except China for the express purpose of not appearing economically and ideologically weak to China.

There were also several demands from the Indian side, which were not met by the member countries. Australia and New Zealand had not reacted favourably to India's request to open up domestic markets for free flow of services, a sector in which India enjoys significant advantage. However, India's competitiveness in services should also not be taken for granted, since China and Thailand have emerged as new service hubs and would compete with attraction of FDI towards this sector, if the FTA was to be implemented.

India was also looking forward to having a Rules of Origin clause to the agreement in order to prevent non-partner countries from abusing its provisions, as well as to prevent the routing of Chinese goods through member countries that have lower or no duty levels. Further, India had also put forward a request for an auto-trigger mechanism. This implied that in the event of an increase in imports above a certain threshold, India would be allowed to raise tariffs on products. However, India did not find much support for this proposal.

Potential domestic vulnerabilities due to the FTA ultimately led to disagreements. For instance, the Make in India initiative which has been a leading government endeavour, could have come under threat due to the prospect of a spiralling increase in imports, especially for industries like aluminium and steel.

The vulnerabilities in agriculture were also among the top reasons for the fallout. The RCEP agreement would have firstly, brought down import duties on most agricultural commodities, thus making Indian agricultural products unviable in the domestic market. Secondly, dumping of agricultural products via free trade would lead to crash in prices of domestic produce, aggravating the current agricultural crisis even further.

The RCEP agreement is not the first time the state of the agricultural sector has dampened the prospects of an economic agreement. The

inability of small and marginal farmers in Indian agriculture to face competition from global agribusinesses, is the reason why agriculture has always been excluded from import liberalisation in WTO negotiations and in bilateral free trade agreements and remains a contentious topic in international economic engagements.

Further, stringent Intellectual Property Rights provisions which the RCEP agreement would involve, would most likely impinge on the freedom that Indian farmers currently enjoy with seed production. The provisions would allow seed companies to get more powers to protect their IPRs, thus potentially criminalising farmers for the saving or exchanging of seeds. These provisions are likely to have an impact on India's self-sufficiency in food production and sustenance.

Similarly, the inclusion of New Zealand and Australia in the matrix of RCEP means that their advanced dairy and plantation sectors would also compete with India's. Australia is a big player in the export of wheat and sugar, two commodities which are politically sensitive for India.⁵ South East Asian countries have much larger and cheaper production of plantation crops like rubber, coconut, palm oil in comparison to India. New Zealand is the second largest exporter of milk and milk products and since the production process is much more efficient there, they would get a significant price advantage in India's market. To give an example of the potential impact, currently the bound tariff

for dairy products is 35%. However, RCEP would bind countries to reduce the level of tariffs to zero within the next 15 years⁶.

Looking Ahead: Key Takeaways for the Future

Although India has stated that it would not be party to this agreement, unless "significant outstanding issues" are resolved, there are several merits to signing the agreement or a similar agreement in the near future:

Favourable trade agreements with RCEP nations can allow India to leverage sectors over which it has a significant advantage, such as ICT and IT enabled services, healthcare and education services. Increasing trade with the vibrant economies of the east can also boost its exports. Inflow of diverse products for a sector would introduce healthy competition among domestic players. They would be forced to innovate on the services offered by them and improve the quality and affordability of products.

It could also bring a large measure of stability to an unpredictable world market. When coupled with domestic reforms, joining global value chains such as RCEP could boost growth, create better jobs and reduce poverty. Jobs linked to global value chains have the potential to earn one-third more than jobs focused on the domestic market⁷.

Not signing this trade deal, gives China an avenue to extend its soft power in a region where India is trying to make inroads. Thus, it may have

adverse implications for its Look East policy, vis a vis China. The stance taken by India runs contrary to the Prime Minister's plans to ramp up its engagement with ASEAN countries through the Act East policy and its desire to promote maritime cooperation in the Indo-Pacific region.

Despite the positive consequences of joining a trade bloc, the fact remains that India's domestic capabilities need to be bolstered in order to not let such opportunities slip by in the future. Land, labour and legal reforms need to be strengthened in order to accommodate economic integration measures. It remains to be seen whether the 15 other RCEP members will go ahead with signing the pact in its present form or try to create conditions for inclusion of India. India on its part must rise up to the challenge of priming its domestic infrastructure, in order to compete with leading Asian powers in the future.

The imperative to join RCEP is strategic, long term and bound to its national interests. India has envisioned a future for itself where it stands as a global manufacturing hub. However, India now finds itself excluded from the two main economic security structures in Asia: RCEP and the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). This is a dangerous road to traverse as these partnerships will configure global value chains for manufacturing and India not figuring in either, could delay its ambitions even further.

(Disclaimer: The views and opinions expressed in this article are those of the author and do not necessarily reflect the position of the Centre for Air Power Studies [CAPS])

Notes

¹ "China-backed RCEP trade pact in final stage," Reuters, November 14 2018. <https://www.reuters.com/article/us-asean-summit-trade/china-backed-rcep-trade-pact-in-final-stage-deal-eyed-in-2019-singapore-idUSKCN1NJ1DW>

² ICICI trade Securities LTD shows that in Fiscal Year 2019, India registered a trade deficit with 11/16 RCEP countries. https://www.icicisecurities.com/CMT/UPLOAD/ArticleAttachments/ICICI_Securities_Limited_Annual_Report.pdf

³ "India failed to benefit from free trade agreements with ASEAN," Down To Earth, November 13, 2019. <https://www.downtoearth.org.in/news/economy/india-failed-to-benefit-from-free-trade-agreements-with-asean-report-67740>

⁴ "Why opting out of the RCEP deal was a Hobson's choice for India," Livemint, November 07, 2019. <https://www.livemint.com/market/mark-to-market/why-opting-out-of-the-rcep-deal-was-a-hobson-s-choice-for-india-11573061009083.html>

⁵ "After RCEP opt-out, the challenges of a shape-up," The Hindu, November 07, 2019. <https://www.thehindu.com/opinion/lead/after-rcep-opt-out-the-challenge-of-a-shape-up/article29902806.ece>

⁶ "Why India needs to rethink its decision to opt out of RCEP," The Economic Times, November 15, 2019. <https://economictimes.indiatimes.com/news/economy/policy/why-india-needs-to-rethink-its-decision-to-opt-out-of-rcep/articleshow/72061734.cms?from=mdr>

⁷ "After RCEP reticence, need for reform recalibration," The Hindu, November 11, 2019. <https://www.thehindu.com/opinion/lead/after-rcep-reticence-need-for-reform-recalibration/article29938553.ece>