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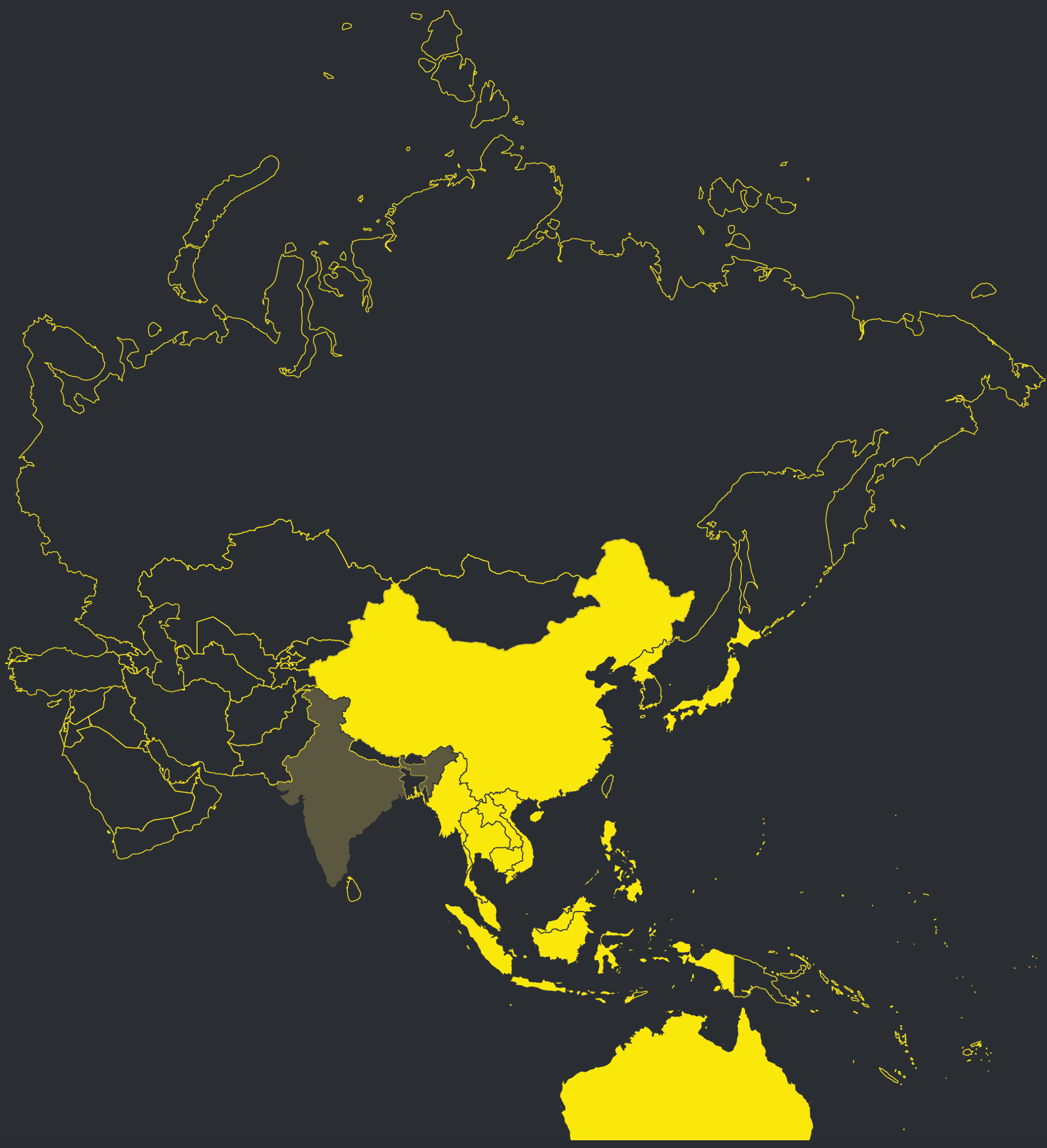

INDIA'S EXIT FROM THE RCEP: WHY AND WHAT'S NEXT

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DISCUSSION PAPER

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ABSTRACT

This paper intends to provide an overview of the RCEP trade deal and look at India's trade with ASEAN countries to understand how its performance under ASEAN influenced its participation in the RCEP negotiations. The various factors that may have influenced India's decision to not participate in the RCEP deal are explored. The paper especially highlights the trade relations with ASEAN due to its massive trade deficit which was the major contributing factor for India's withdrawal from the deal. It also looks at the TPP as a possible alternative, and provides a certain set of recommendations that could be beneficial for India's international trade scenario.

INTRODUCTION

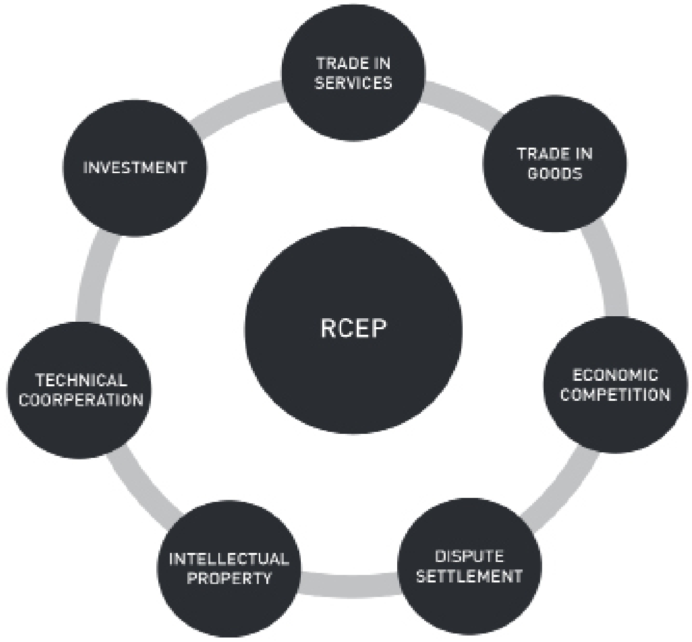
In recent years, mega-regional trade agreements such as the Regional Comprehensive Economic Partnership (RCEP) have caught the fancy of many South-East Asian countries. The RCEP is a proposed mega trade deal which was negotiated between the ASEAN countries and their Free Trade Agreement[1] (FTA) partners (India, Australia, China, Japan, South Korea and New Zealand). While the forecast of RCEP's exact benefits is unclear at this juncture, it is inevitable that for some countries it will be an architect of their global trade, and the opposite for some. While trade deals emerge to benefit nations and their growth, they rarely offer a win-win solution. As the former Australian Prime Minister Tony Abbot said "free trade should be under the right circumstances, not the wrong circumstances" (ANI, 2019). The disagreements may arise from the deal's direct impact on an individual country's domestic growth, investment, enterprises, and employment. Along the same lines, after fiercely negotiating its demands and issues for the past seven years, India decided to opt out of RCEP.

The following analysis intends to provide an overview of the RCEP trade deal and look at India's trade with ASEAN countries to understand how its performance under ASEAN influences its participation in the RCEP negotiations. Furthermore, it aims to provide alternative options for India to explore. The paper is arranged along the following lines: First, the background of the RCEP trade deal is briefly mentioned. Next, India's role in RCEP is analysed in light of its reasons for not participating in the deal, followed by a subsection on India's past FTAs and how it impacts the decision. Finally, based on the findings, alternatives and recommendations are suggested.

WHAT IS RCEP?

It is imperative to understand the aim and significance of RCEP in the region before understanding why India opted out of the deal. The RCEP was launched in November 2012 and the negotiations began in May 2013. It covers the following areas:

1 Free Trade Agreements are arrangements between two or more countries or trading blocs that primarily agree to reduce or eliminate customs tariff and non tariff barriers on substantial trade between them.



The RCEP is meant to be the biggest trade deal after the World Trade Organisation with almost one-third of the world's GDP, and involving half of the global population. It encompasses the first ever agreement covering China, India, South Korea, and Japan. The agreement aims at creating the world's largest free trade area, seeking to boost commerce across groups by lowering tariffs. It has the potential to facilitate business transactions and harmonise rules across various FTAs in East Asia, thus serving as a building block for the multilateral trading system. The RCEP includes provisions to simplify trade and investment and to further improve transparency and promote participating countries in global supply chains (ASEAN 2019). It embodies a desire to achieve a more focused and integrated regional participation unlike the other mega-regional trade deal, the Trans-Pacific Partnership (TPP). Furthermore, it aims to provide an opportunity for the participating members to benefit from deeper economic engagement and cooperation.

INDIA AND THE RCEP

East Asia is crucial to India's economic and trade interests (Seymour and Wilson 2019). As India is not a member of Asia-Pacific Economic Cooperation (APEC) and TPP, the RCEP deal could have been the means for India to achieve its goal of integrating with the East Asian economies and a path towards its Act East policy. This deal had lucrative potential for sectors such as technology, business process outcomes, and telecoms. However, sharp differences were evident between the requirements of RCEP and India's personal interests. Trade in its very essence promotes efficiency and encourages expansion of economies, but the dynamics of this process also depend on the particularities of trade deals such as the nature of goods being traded and with whom (Anand et al. 2015). The RCEP intended to expand privatisation for sectors like healthcare, electricity, education, and water and waste management. Furthermore, it prevented governments from taking control of the service sector even when the private benefactors failed to deliver. The pressure of tariff reduction mounted over India as its average tariff is higher than corresponding ASEAN countries. The deal also demanded a drastic decrease in import duties alongside eliminating tariffs and non-tariffs on all trade in goods to create free trade among members

(Tansey and Gilbert-Cossar 2018).

Contrary to the requirements of the RCEP and with a motive to gain from this deal, India demanded three mechanisms. Firstly, a safeguarding measure that would allow the country to pause import or levy heavy duties if the domestic market gets flooded with foreign goods. Secondly, strict rules were suggested to ensure that other nations do not send their products through different partner countries. Lastly, India requested to keep sectors such as agriculture and dairy outside the purview of RCEP. The RCEP members refused to agree with these terms.

India's reticence to participate in the RCEP was also due to the concern over giving greater market access to other non-FTA partners like New Zealand and Australia and its negative trade balance[1] with the RCEP members. Another point of contention was the effect of this deal on the domestic producers due to increased imports of commodities from countries like China and New Zealand. For instance, India's dairy industry would have faced a threat as it has only a small share of export in this market and influx of import especially from New Zealand would have destabilised the local market. Even the country's solar industry would have been adversely affected. In 2018, China accounted for nearly 84% of India's imports of solar modules which was an increase from the previous year (Pratheeksha 2018). India's past FTAs also restrained it from becoming a member of the RCEP (Mahadevan and Nugroho 2019).

INDIA'S TRADE DEFICIT WITH RCEP COUNTRIES

TABLE 1:

(IN US $ BILLIONS)	
YEARS	TRADE DEFICIT
2016-2017	-40.2
2017-2018	-84.45
2018-2019	-103.63

1 Trade balance is the difference between the monetary value of exports and imports of output in an economy.

Table 1 indicates that India's trade deficit[1] increased in the periods of 2017–2018 and 2018–2019 as compared to the previous year. Trade deficit depends on the fluctuations of the import and export of commodities due to demand and supply in the international and domestic market and currency fluctuations, etc. India's total exports in October 2019 were USD 26.38 billion compared with USD 26.67 billion in October 2018 resulting in a negative growth of 1.11%. This was mainly due to the lower shipment in its top 10 export goods, including petroleum products, RMGs of all textiles, and cotton yarn and related products. During this period, imports plummeted to 16.3% year on year to USD 37.39 billion (Trading Economics n.d.).

TABLE 2:

REGION	IMPORT (IN US $ BILLIONS)	
	2017-2018	2018-2019
NE Asia	118353.14	122425.84
West Asia	64079.19	79715.68
ASEAN	47873.41	58425.13
EU Countries	47133.69	59321.32
North America	35269.81	44641.92

Source: Ministry of Commerce and Industry 2019

1 Trade deficit is an economic measure of international trade in which a country's imports exceed its exports.

Table 2 shows the top 5 regions India imported from over the last two years. North-East Asia and the ASEAN countries are among the top 3 regions from where India imports. North East Asia comprises China, Japan, Taiwan, North Korea, South Korea, and Mongolia, of which three countries (China, Japan, and South Korea) are members of the RCEP trade deal along with ASEAN countries. Furthermore, India's imports from these two regions have only increased in the past two years whereas its exports (Table 3) have decreased, leading to a negative trade balance between India and its trade partners (Table 4).

TABLE 3:

REGION	EXPORT (IN US $ BILLIONS)	
	2017-2018	2018-2019
North America	54167.42	59099.25
EU Countries	53597.93	57172.26
NE Asia	39467.59	41979.05
West Asia	39390.64	41621.97
ASEAN	34203.7	37473.72

Source: Ministry of Commerce and Industry 2019

Table 4 is a comparative illustration of India's trade balance with the RCEP member countries in 2017-2018 and 2018-2019. As illustrated, India's trade deficit significantly increased with six countries, namely, Singapore, Vietnam, Malaysia, Brunei, Korea RP, and Japan while there was a marginal decrease in trade deficit with China, Australia, New Zealand, Indonesia, Thailand, and Laos. India had a trade surplus with the Philippines, Myanmar, and Cambodia. Despite the decline in trade deficit with six countries and a surplus with three, India's overall trade deficit increased by USD 8917.5 million in 2018-2019, of which the highest is with China.

TABLE 4:

Trade Balance with the RCEP member Countries [US $ million]						
Country	Export		Import		Trade Balance	
	2017-2018	2018-2019	2017-2018	2018-2019	2017-2018	2018-2019
China	13333.53	16,752.20	76380.70	70,319.64	-63047.17	-53,567.44
Australia	4012.32	3,520.44	13993.75	13,131.21	-9981.43	-9,610.77
New Zealand	352.85	379.87	643.71	630.78	-290.86	-250.91
Korea RP	4460.98	4705.07	16361.77	16758.97	-11900.79	-12,053.90
Japan	4734.22	4861.73	10973.35	12772.67	-6239.13	-7,910.94
Singapore	10202.82	11572.27	7466.99	16281.64	2735.83	-4709.37
Vietnam	7813.08	6507.38	5018.55	7192.23	2794.53	-684.85
Malaysia	5701.56	6436.30	9011.58	10818.60	-3310.02	-4382.3
Indonesia	3963.77	5275.60	16438.8	15849.67	-12475.03	-10574.07
Thailand	3653.83	4441.40	7134.46	7441.81	-3480.63	-3000.41
Philippines	1692.83	1743.64	764.36	581.10	928.47	1162.54
Myanmar	966.12	1205.60	639.64	521.49	326.48	684.11
Cambodia	121.41	195.98	55.84	42.63	65.57	153.35
Brunei	63.19	56.19	434.83	591.10	-371.64	-534.91
Laos	25	39.38	168.63	1.04	-143.63	38.34
Total	61097.51	67,693.05	165486.96	172,934.58	-104389.45	-105,241.53

Source: Ministry of Commerce and Industry 2019

There's no denying that proliferation of cheap products from China in the Indian market has been affecting domestic producers for a long time. In that context, China stood to benefit from this deal as it has cheaper manufacturing (Niggi 2019) and RCEP would have provided a leeway for China to export its products to India. As can be seen in Table 1, India's export to China increased by USD 3,418.67 million while its import from China decreased by USD 6,061.06 million. Despite the increase in India's exports, its trade deficit remains the highest with China at USD -53,567.44 million. In sum, if India had chosen to join RCEP, it would have entered the deal with a trade deficit with twelve member countries, most of them sizable.

2. INDIA'S EXPERIENCE WITH PAST FTAS

In the past few years, India's trade policy has shifted its focus from global to regional and it currently has 14 FTAs. Here, we'll look at India's FTAs with ASEAN, Korea and Japan in reference to RCEP. Ever since India has signed these FTAs, its bilateral trade has increased; however, the import from these countries have shot up compared to its export (Table 4). Its trade balance as presented in Table 4 clearly indicates that the imports from Korea RP, Japan and ASEAN increased by approximately USD 15455.49 million in the year 2018-2019. The FTA with ASEAN has also affected the domestic sectors. According to the UN Harmonised system of product classification, products can be categorised into 99 chapters and further into 21 sections such as chemicals, textiles, etc. The categorised key sectors accounted for almost 75% of exports in FY17 as part of India's worsening trade balance with ASEAN (Saraswat et al. 2016).

India was self-sufficient in rubber production till 2010 when it signed an FTA with ASEAN. By 2013, the country was importing 0.26 million tonnes of rubber which nearly doubled in the next two years. The producers significantly suffered from the FTA. After entering FTA with Vietnam and Sri Lanka, pepper growers also suffered losses as the price of domestic pepper crashed from INR 770 to INR 330 in 2018, which was below the production costs. The increase in import clearly indicates India's inability to take advantage of the opportunity of the increased market access through the agreements. Some analysts have argued that the Indian market has been exploited by the FTA partners as Indian exporters were unable to capitalise on the lower tariffs (Dhar 2019). In her analysis of India's FTAs, Rupa Chanda, as quoted in the Union Budget 2016-17 has also concluded that the country has not efficiently used its trade agreements to boost exports. Her analysis reports an increase in imports through the most-favoured-nation route (MFN), to which she further suggests relaxation of the structural and regulatory factors to increase exports (Ministry of Finance 2017).

Therefore, India joining the RCEP would have meant digging a deeper hole of negative balance in its three FTAs with ASEAN, Japan and Korea RP. It would have also meant agreeing to preferential duties which would have helped China, and importing Chinese products would have been an obligation for India. Given these circumstances, India was correct not to sign the mega trade deal. The immense trade deficit and tariff structures would have adversely affected the economy and domestic producers. However, it should not be understood as India's way to move towards a protectionist approach, rather as an opportunity for the Indian government to reflect on its poor trade policies and its competitiveness level which has hindered its participation in the major trade agreement. The Indo-ASEAN FTA has fulfilled only partial expectations. It can be assumed that this partial fulfilment is due to various reasons including imperfect market reforms, absence of economies of scale, or poor labour reforms (Chakraborty et al. 2019).

ALTERNATIVES

The discussion above raises two key questions: First, whether India should continue to sign FTAs, and second, how it should position itself in future trade deals. This section will try to find answers to these questions and also explore agreements which can yield desired outcomes in terms of growing trade between India and its partners.

1. European Union: Time For Deeper Ties

India and the EU's relation dates back to the 1960s with India being among the first nations to establish a diplomatic relation with the European Union committee. Both India and the EU belong to a multilateral order based on democratic principles. They are considered natural partners in the field of international relations but are driven by divergent geo-political constraints and regional interests. Their foreign policies focus on the aspirations of citizens which, while giving legitimacy to their foreign policies, also entails a series of constraints (Peral and Sakhuja 2012). There are approximately 6000 EU companies present in India, providing direct employment to 1.7 million workers and indirect employment to 5 million (European Union External Action 2017).

The European Union and India launched negotiations for a comprehensive FTA (Broad Based Trade and Investment Agreement) in 2007 which was later suspended in 2013 due to a gap in the level of ambition between the two parties. Other issues such as inadequate market access and high tariffs on wines and automobiles, legal services, retail etc also led to the deal getting shelved. For instance, Brussels wanted to sell fully manufactured cars to which India pointed out its policy of local manufacturing (Sibal 2013). The EU was also seeking further liberalisation on FDI in multi-brand retail. On the other hand, India's concerns were in terms of liberalisation for movement of professionals, market access for agriculture products, textiles, pharmaceuticals, and visa regime (European Parliament 2017).

In 2018, the EU imported more manufactured goods (83%) than primary goods (17%) (Eurostat 2019). Partnering with the EU will help India realise its "Make in India" goals. Its growing manufacturing sector will benefit from partnering with the EU by exporting cheap products. The EU-India FTA would be mutually beneficial in sectors such as gems and jewellery, textile and agriculture with increased market access (Sen 2019). There are also positive spin offs of the Brexit decision on an EU-India FTA such as lowering of duties on spirits and wines from the Scotch makers of UK (India Inc.Staff 2018). With the UK out of the picture, at least one crease could be easily ironed out. Furthermore, India and the European Union can consider a step by step approach. This means that both regional blocs should consider approaching sector-based trade agreements. Although an FTA is a priority for both the EU and India, a gradual approach would deepen their trade relations and could deliver concrete results out of the trade negotiations (Aspengren and Nordenstam 2019).

However, both sides should realise that the FTA will not be profitable in all sectors. India needs to make a strategic move deviating from the past and needs to focus on what will benefit the producer as well as the consumer. It should re-evaluate the areas and the sectors that are major obstacles in the negotiation process. Both the EU and India should focus on evolving a more transparent framework and recognising technical regulations and standards. Calibrating the right amount of ambition for the partnership, both parties can achieve common benefits, while keeping a realistic approach that does not overstretch their capabilities.

2. TPP: An Option?

The Trans-Pacific Partnership is a free trade agreement negotiated between 11 countries, namely, Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, and Vietnam. Its objective is to strengthen the relationship between these countries and promote trade by eliminating tariffs and non-tariff barriers, creating better opportunities for businesses and fostering competition. It can be interpreted from Table 4 that RCEP and TPP share 7 common members of which India has the highest trade deficit with Australia followed by Japan and an overall trade deficit of US$ 28,084.05 million with the TPP countries.

Existing literature suggests that India should participate in TPP instead of RCEP. However, TPP forces equal rules on unequal partners. Most of the TPP member countries are developed and industrialised and seek uniform tax and low level regulation to reduce the operational cost of the multinational companies. The TPP would forbid many policies such as low interest subsidised credit in the name of fairness for the developing countries. Moreover, the deal aims to reduce tariffs and other protective trade policies like RCEP demanded. This would result in major competition for the local manufactures (Rowden 2015).

Liberalisation of tariffs is the most traditional component in the TPP deal and as compared to the other FTAs such as ASEAN, NAFTA[1] etc., that is signed between the TPP members, India uses tariffs as a protection shield for its vulnerable sectors such as agriculture. Lowering tariffs would mean that there would be a larger influx of foreign products in the Indian market and as India aims to boost its manufacturing sector, it would not be beneficial for the country. However, low tariffs would draw supply chains and create job opportunities. Thus, India needs to be strategic and clever in terms of its tariff imposition. With countries like China and in trade deals such as RCEP and TPP, India shall maintain its position on high tariffs whereas with EU it could lower its tariffs on some sectors that would be beneficial for both. It should be mindful of the long-term benefits instead of temporary short ones.

India's past experience in FTAs should be a lesson for future deals. TPP might be beneficial for India in the future, however, for now it should focus on its existing trade deals especially ASEAN. It should realise its potential with ASEAN and should learn how to gain from the deal. Prior to signing any future trade deal, India should strengthen its agriculture and manufacturing sector. It needs to adopt the right set of policies and needs extensive promotion and marketing of its domestic industry. It should also revise its existing trade deals with long-term benefits for both consumers and industries.

1 North Atlantic Free Trade Agreement.

CONCLUSION

The analysis so far suggests that India experienced partial fulfilment from the Indo-ASEAN deal. This experience had a major influence on its decision to not join RCEP. The cautious approach by India towards the deal can be explained by the increasing trade deficit and its experience with past FTAs. Apprehensions about import from China and its growing trade deficit with the country is already a major concern for India. Its growing trade deficit with most of the ASEAN countries would have further worsened the situation for India if it participated in RCEP.

However, this does not mean that India should not partake in trade agreements and move to a protectionist stance. At this stage of development, trade is crucial for India as it promotes economic prosperity, creates jobs, and boosts output. Going forward, India needs to focus on its trade with the EU especially because it is a preferred market and with a trade surplus India could reap benefits in the region. Utilising existing agreements better while proactively exploring new opportunities in other geographies will diversify India's market as well as its export basket.

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