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India and the RCEP: High Costs of Disengagement

The 16-country Regional Comprehensive Economic Partnership (RCEP) negotiations are heading for a conclusion. However, doubts persist over India's readiness to conclude the deal. This paper looks at India's objections, particularly fears over Chinese imports, and argues these fears overlook its dependence on imports for domestic inefficiencies. It criticises paranoid Indian opinions on free trade agreements and the lack of attention on their economic benefits, primarily through more exports and foreign direct investments, larger share in global markets and higher gross domestic product growth. Arguing that the Indian world view on trade remains stuck in non-alignment, the paper cautions about the high economic and strategic costs that India might have to pay if it disengages from the RCEP.

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The Regional Comprehensive Economic Partnership (RCEP) negotiations are set to conclude by the end of the year, with the region keenly awaiting the finalisation of the world's largest free trade agreement (FTA). Comprising almost half of the global population, around a third of world gross domestic product (GDP), and six of the world's 20 largest economies (that is, China, Japan, India, South Korea, Australia and Indonesia), the RCEP would be a milestone achievement at a time when a trade war is threatening serious disruption to global commerce.

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There is, however, doubt over whether India would go along with other negotiating members and agree to conclude the deal. India has had reservations about the RCEP right from the beginning. Domestic opinions in India, both among government departments and industry, are heavily weighed against the RCEP. As a result, India has been stubbornly resisting demands to concede greater market access at the RCEP negotiations.

India has set up a Group of Ministers headed by Commerce Minister Suresh Prabhu to finalise its position on the RCEP.[2] This reflects India's efforts to reach a consensus among departments and with the domestic industry on the RCEP. However, with the Association of Southeast Asian Nations (ASEAN)-member states and the rest of the RCEP members looking to wrap up the deal by November 2018, and the next RCEP ministerial meeting in Singapore at the end of August 2018 expected to provide the finishing touches, time is running out for India. It needs to decide and act fast.

India's reservations on the RCEP, in many respects, reflect its perceptions on trade issues and its outlook on free trade in general. The most influential opinions on trade in India continue to possess greatly alarmist impressions on trade and opening up. Joining FTAs is seen as tantamount to allowing the country and the economy to be swamped by imports that would obliterate domestic producers. Indeed, it is bizarre that while India has liberalised its foreign investment regime, displaying its eagerness to welcome foreign capital and businesses, it is allergic to the very same businesses exporting to India and is prompt in planting tariffs on the exports.

The China Bogey

One of the biggest issues in India regarding the RCEP is opening up the economy to China. Practically all opinions in India consider the RCEP as a FTA between China and India. Such views smack ignorance about the composition and character of the RCEP, which is ASEAN-centric, comprising ASEAN and its FTA partners (Australia, China, India, Japan, Korea and New Zealand). They also conveniently overlook the fact that while the RCEP would lead to

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[2] "Centre sets up GOM headed by Suresh Prabhu to decide on RCEP talks", *Livemint*, 6 August 2018. https://www.livemint.com/Politics/fPkQ9TRvj3YtMl7Pt7GsGO/Centre-sets-up-GoM-headed-by-Suresh-Prabhu-to-decide-on-RCEP.html. Accessed on 21 August 2018.

India providing preferential market access to China and 14 other member countries, it would also mean India getting similar access in all other countries.

China has been a convenient excuse for raising red flags on market access. Emotional outbursts on Chinese products swamping the Indian economy fail to note the realities of such imports being unavoidable. Many Chinese imports to India, particularly consumer goods, are a result of Indian domestic industry lacking capacities to produce as much of these goods as are wanted by a consumption-driven rapidly-growing Indian economy. Mobiles and smartphones are among the best examples. India's telecommunication revolution could not have happened had its people not been able to afford cheap 2G and 3G service-enabled phones, most of which were assembled in China and East Asia, and imported by India. In more recent times, China has been the largest source of imports of idols of Hindu gods and goddesses being sold by Indian shops all over the country and being purchased by Indian families in millions throughout the year.[3] Needless to say, the brightness of many Indian households, courtesy of the glow of light-emitting diode lamps, is also due to their vast imports from China.

Why does India import so much from China? India is not an exception. The whole world imports from China. However, for India, the most common cynical explanation of high Chinese imports is that China is subsiding its exporters through cheap land, inexpensive power and easy bank credit, making its imports cheap. The argument overlooks the fact that India offers similar benefits to its exporters located in the Special Economic Zones, as well as those producing outside through various export promotion schemes, such as the Merchandise Export from India Scheme. However, Indian exports have not been able to achieve the same degree of competitiveness as Chinese exports. The issue is, therefore, not of subsidies. The real reason for India's (and most of the world's) dependence on Chinese products is Indian industry lacking the scale and productivity to produce as much and as quickly as Chinese producers to meet rising demand. Indian products also suffer price disadvantages from costs inflicted by poor business conditions at home. The net result of these imperfections is China-made Indian religious idols, phones, lamps and many other items being cheaper for Indian consumers, notwithstanding import tariffs, compared with same products made in India.

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3 "Even religious idols come from China: Seven reasons why 'Make in India' is a distant goal", *Scroll.in*, 28 October 2017. https://scroll.in/article/855392/even-religious-idols-come-from-china-seven-reasons-why-make-in-india-is-a-distant-goal. Accessed on 21 August 2018.

Would the RCEP further increase these imports? Regardless of the RCEP, these imports would continue to increase if their domestic availability is insufficient and their prices are cheaper. Consumer habits and preferences are functions of price, quality and availability, as opposed to the origin of products. However, if the RCEP is found responsible for increasing imports in a manner that is 'injurious' to the domestic industry, India can always take recourse to safeguards and can hike tariffs to block imports. India has been one of the world's leading users of anti-dumping actions to block imports. Even if it cannot do so through the RCEP, all FTAs have provisions for 'safeguards' for all members and so does the RCEP.

Avoiding the RCEP on fears of more imports, particularly from China, hurting domestic industry is a convenient excuse for overlooking domestic inefficiencies that make Indian producers less competitive and Indian consumers dependent on imports. There are yet to be any detailed studies on the RCEP and India that go down to the level of eight-digit disaggregated tariff classification for identifying products that might be adversely affected by more imports through deleterious impacts such as job losses and lower market shares. Such studies, either from the industry or other experts, could have been of great help in enabling Indian negotiators to draw up 'sensitive' or 'negative' lists of products on a country-specific basis for longer tariff phase-outs, maybe as much as 20 years or more. Long phase-outs are integral parts of ASEAN FTAs as these emphasise 'special and differential' treatment for the members, given their domestic market sensitivities, and allowing them sufficient time to open. However, shying away from opening up without backing protective arguments with appropriate evidence is unfortunate.

FTA Paranoia

India's reservations on the RCEP are part of its larger reservations on FTAs and free trade in general. Over the last three years, India has put on hold several FTAs it was negotiating, including those with the European Union (EU), Australia and Canada. The India-EU FTA negotiations are likely to be abandoned.[4] So might be the eventual fate of the India-Australia

[4] "India, European Union may announce end of free trade agreement talks as key differences remain unresolved", *Firstpost*, 19 July 2018. https://www.firstpost.com/business/india-european-union-may-announce-end-of-free-trade-agreement-talks-as-key-differences-remain-unresolved-4774181.html. Accessed on 20 August 2018.

and India-Canada FTAs. The ostensible reasons for these FTAs being held up are the tremendous aversion to imports – across government departments and industries – and the firm belief that India's existing FTAs have deluged the country with imports. Such beliefs exist, notwithstanding studies showing the low utilisation of India's FTAs by both exporters and importers.[5] It is impossible to figure out how FTAs could have contributed to surging imports if they were hardly being used much in the first place.

The other intriguing aspect of the dominating Indian perspective towards FTAs is that of the narrative focusing almost entirely on imports and tariffs. Tariffs are only a small part of modern comprehensive FTAs that include not only services and investment, but also modern trade issues like ecommerce, competition policy and intellectual property, to mention a few. The RCEP also includes some of these. However, rarely does one come across opinions coming out of India on the RCEP that reflect on issues other than tariffs. The only other subject that appears to agitate majority Indian views on FTAs is the movement of its professionals to other countries.

The movement of professionals is an issue that most in India are unable to grasp in its entire complexity and implications. Not only are such professional movements difficult to be sanctified through FTAs – as they depend on national labour market regulations, conformity assessment of qualifications and immigration rules – they also need to be reciprocal. India's demand for easy movement of its professionals to other countries needs to be taken up bilaterally with national regulatory agencies to make such movement effective. At the same time, India must also be willing to accept professionals from other countries in its labour market, which would not only mean changing some of its own sector-specific regulations, but also managing political sensitivities. Indeed, those agitating against the RCEP on the ground that some member countries are not opening up their labour markets to skilled Indian professionals, might not have visualised the implications of counter-movement of the RCEP member-economy professionals in its own market. It is difficult to figure out the Indian insistence on the movement of professionals as a concession in exchange for its tariff cuts, simply because the mere inclusion of such provisions in the annexes of FTA documents are not enough for cross-border movements till regulatory compatibilities are reached.

5 "FTA Utllization – An Opportunity in Waiting for Indian industry", Deloitte, 2017. https://www2.deloitte.com/content/dam/Deloitte/in/Documents/tax/tax-2016/in-tax-deloitte-fta-utilization-noexp.pdf. Accessed on 20 August 2018.

However, the most astonishing aspect of the current Indian world view towards FTAs is the complete lack of attention towards the fact that these can be greatly useful in increasing Indian exports. It is remarkable that conversations in India on the RCEP and FTAs tend to be excessively defensive and one-sided focusing either on ‘damage’ from imports or movement of professionals. Indian opinions hardly consider the benefits the country can obtain from FTAs through higher exports of both goods and services from preferential access in some of the world’s robust, high- and middle-income markets. Without deep preferential access to major markets in Asia-Pacific, Europe and North America, India cannot hope to capture greater shares of these markets and increase its share in global trade – a necessary condition for lifting its GDP growth to the eight-per cent plus trajectory. The FTA with the EU, for example, would have given Indian exporters, particularly garment exporters, access to the vast European market and worked wonders for the domestic textile industry.

Paranoid Indian views on FTAs must note that it is not for nothing that the rest of the world is engaging actively in FTAs. Even the United States (US), notwithstanding the Donald Trump administration’s disregard for multilateral trade rules and launching of the trade war, continues to stay engaged in FTAs, such as the North American Free Trade Agreement and the US-Korea FTA, while trying to persuade Japan and the EU to get into bilateral FTAs with the US. India’s engagement in FTAs would have made it an attractive destination for export-oriented foreign direct investments that would have not just increased domestic investments, but also increased national exports. However, the current Indian thinking on FTAs seems to be completely oblivious to these prospects, creating serious doubts over the success of flagship initiatives like ‘Make in India’.[6]

What Lies Ahead

Disengaging from the RCEP, as well as other FTAs, is not just economically damaging for India. It would be paying a high strategic cost for disengagement. It is evident to most that India’s engagement with the world, while robust in foreign policy and diplomatic overtures,

[6] “FTA Strategy: India may well give up hope to become global manufacturing hub and exporter: here is why”, *Financial Express*, 7 December 2017. https://www.financialexpress.com/economy/fta-strategy-india-may-well-give-up-hope-to-become-global-manufacturing-hub-and-exporter-here-is-why/964126/. Accessed on 21 August 2018.

is not matched by its engagement in trade. In this respect, India's trade policy outlook seems to have remained stuck in the notion of disengagement characterising its view of the world during the era of non-alignment,[7] while its foreign policy has moved much ahead. The divergence between its foreign and trade policy outlooks is stark and can prove costly.

Modern FTAs like the RCEP are not just trade deals, but also important strategic and geopolitical understandings. The dithering on the RCEP has cast strong doubts over India's sincerity in engaging with the region through the much-hyped 'Act East' policy. Backing out of the deal at this stage would undo years of hard work put in by successive Indian governments and agencies in positioning India as a key strategic actor in the Asia-Pacific. It would be an irreparable loss. If it decides to leave the RCEP, it must do so fully prepared for the high economic and political costs it would incur by its decision.

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[7] "Indian trade is stuck in non-alignment", *Financial Express*, 23 August 2018. https://www.financialexpress.com/opinion/indian-trade-is-stuck-in-non-alignment/1288878/. Accessed on 24 August 2018.