India’s reservations about the Regional Comprehensive Economic Partnership — a major multilateral pact that would bring together 16 countries in an ambitious effort to liberalize trade — have been well known from months of negotiations. Many have to do with a fear of massive imports from China and other RCEP members that could disrupt its domestic economy. Still, it came as a surprise when New Delhi announced at a summit in Bangkok in November that it was opting out, at least for now, writes Rajaram Panda.

AT THE EAST ASIA SUMMIT meeting that ended in early November in Bangkok, where the issue of concluding the much-hyped Regional Comprehensive Economic Partnership (RCEP) agreement was at center stage, India ultimately decided to opt out, saying its key concerns were not addressed. Making a forceful argument in his address at the summit, Indian Prime Minister Narendra Damodardas Modi said: “The present form of the RCEP Agreement does not fully reflect the basic spirit and the agreed guiding principles of RCEP.” Elaborating, he said: “It also does not address satisfactorily India’s outstanding issues and concerns. In such a situation, it is not possible for India to join [the] RCEP Agreement.” Let me explain.

First, what is RCEP? It is a proposed free-trade agreement between the 10 member states of the Association of Southeast Asian Nations (ASEAN) — Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, Vietnam — and what is now five FTA partners — China, Japan, South Korea, Australia and New Zealand. India, the sixth partner, quit the pact at the November Bangkok summit. In response, China announced that India would still be welcome to join RCEP whenever it is ready.

RCEP negotiations were formally launched in November 2012 at the ASEAN Summit in Cambodia. In 2017, the 16 prospective signatories accounted for a population of 3.4 billion people with a total gross domestic product (GDP) of US$49.5 trillion, approximately 39 percent of the world’s GDP. Had this mega-FTA been concluded in Bangkok, this could have been the world’s largest integrated trading zone and the biggest trade pact since the World Trade Organization (WTO) was formed. Some observers say stepping away is a huge loss for India. However, the issue is complicated from India’s point of view.

WHAT ARE NEW DELHI’S CONCERNS?
India feared that by joining the trade deal, its domestic market would have been swamped by imports, thereby putting its domestic industry and agriculture at risk, an issue that was not addressed at Bangkok. Not joining RCEP also would boost Mod’s “Make in India” initiative and protect the country’s economic interests and national priorities. India runs a large trade deficit with RCEP countries and was looking for specific protections for its industry and farmers from a surge in imports, especially from China. The decision comes amid rising opposition to the pact, with leading political parties stepping up attacks on RCEP.

A joint statement by RCEP countries said that the 15 remaining nations will begin formal work towards inking the pact in 2020, while still trying to resolve India’s concerns and objections. New Delhi also has not shut the door on eventually joining. Academics and analysts in India believe the country should bargain hard in RCEP negotiations with the intention to join, which is the position Modi took in Bangkok. There is almost unanimity of opinion among analysts in India that the country’s current stance is consistent with this prescription. There is room on the Indian side to give up on some of its current demands, but there is also room for India to win concessions on other demands. This was discernible from the fact that statements by the other 15 RCEP countries on India’s position were conciliatory, and neither side has closed the door on further negotiations. The position of the Ministry of External Affairs (MEA) was also that the move was the right step. It has given enough elbow room to India to be able to bilaterally resolve its issues with other countries. The onus is now on other members. If they are unable to resolve India’s concerns, India will remain out of the trade deal.

THE STANCE OF INDUSTRY AND DAIRY FARMERS
Domestic industry and dairy farmers have strong reservations about the trade pact. India’s trade deficit with RCEP nations is US$105 billion, with China alone accounting for US$35.5 billion. The main worry is over Chinese manufactured goods and dairy products from New Zealand flooding Indian markets. The trade agreement was also seen as being detrimental to the government’s Make in India initiative. India was looking for specific rules of origin to ensure that the pact was not abused by non-partner countries and it wanted an auto-trigger mechanism to protect it from a surge in imports. E-commerce and trade remedies were among other key areas of concern that were not satisfactorily addressed. New Delhi had proposed different levels of tariff concessions for China to safeguard its domestic industry from cheap imports. On the other hand, India did not get any credible assurance on market access and non-tariff barriers. India was also worried about keeping 2014 as the base year for tariff reductions.

India had been consistent about raising these issues from the start of RCEP negotiations. Many of its earlier trade agreements had been lopsided and hurt domestic industry, and New Delhi is keen not to make the same mistakes again. The Modi government feels that previous governments engaged in poor negotiations in reaching free-trade agreements, which is why it wants to review its trade pacts with South Korea and ASEAN. India is now expected to pursue separate trade agreements with some of the countries...
that will be part of the bloc, such as Australia and New Zealand, as well as those with which negotiations have not made substantial progress in recent years, such as the European Union.

The decision to stay away from the mega-trade deal has resulted in a political blame game between the ruling party and the party it ousted from power, Congress. It is the United Progressive Alliance led by the Congress Party that agreed to explore an India-China FTA in 2007 and join RCEP negotiations with 2011-12. The Modi government now blames the UPA for negotiating a lop-sided deal. The impact of these decisions resulted in India’s trade deficit with RCEP nations increasing from US$7 billion in 2004 to US$78 billion in 2014, leaving domestic industry reeling under the impact of those decisions. Therefore, India made a strong case at the RCEP summit for an outcome favorable to all countries and all sectors. In 2018-19, while India’s total imports from RCEP countries was US$172.9 billion, its exports accounted for only US$67.8 billion, leaving it with a deficit of US$105.1 billion. Figure 1 shows the breakdown of import/export figures by country, but in short, the balance of trade for India with all 15 nations in the RCEP group is unfavorable.

Modi said that “when I measure the RCEP Agreement with respect to the interests of all Indians, I do not get a positive answer” and “therefore, neither the talisman of Gandhiji nor my own conscience permit me to join RCEP.” It was a strong rebuttal to the position of the other 15 states. Modi also said that in the last seven years of RCEP negotiations, many things, including global economic and trade scenarios, had changed, and India cannot overlook this. Indeed, India had been proactively, constructively and meaningfully engaged in the RCEP negotiations since their inception and had worked for the “cherished objective of striking a balance, in the spirit of give and take.”

India feared that by joining the trade deal, its domestic market would have been swamped by imports, thereby putting its domestic industry and agriculture as risk. Not joining also would boost Modi’s ‘Make in India’ initiative and protect the country’s economic interests and national priorities.

The Confederation of Indian Industry (CII) said it will continue to support and work with the government in its endeavor to integrate India into the global economy through mutually beneficial trade agreements. While welcoming the RCEP leaders’ joint statement acknowledging India’s legitimate concerns, it hoped that the concerns would be addressed soon to the mutual satisfaction of all RCEP countries.

Dairy farmers welcomed the RCEP news along with small businesses, micro and small entrepreneurs, copper producers, bicycle manufacturers, e-commerce players, data service providers and others. Besides laying down the template for future trade negotiations, the RCEP decision also underscores the need to make the country’s exports more competitive. India has already convinced ASEAN countries to review the FTA with India, and it made similar requests to Japan and South Korea. It is also simultaneously negotiating a trade pact with the US and an FTA with the European Union. Both of these jurisdictions are seeking similar concessions as those deliberated in RCEP, which includes free flow of data, integration of the agriculture market, and so on. India finds both the US and China as among the most difficult jurisdictions regarding market access. So, will India concede? In view of the ongoing trade war between the US and China, it remains unclear what India’s stance would be.

ARGUMENTS FOR AND AGAINST
Some have argued that RCEP could have resulted in opportunities in the manufacturing sector related to the global value chain (GVC). Others, however, take a contrarian view, saying that this too would have been neutralized because of the lack of infrastructure in India. GVC manufacturing allows large corporations to use multiple countries, thus reaping the benefits of cheaper labor. With labor costs increasing in China, these corporations are looking at newer jurisdictions such as Indonesia, Vietnam, Thailand and India to manufacture products. But the fear in India was that Chinese companies would use this window to dump many of their products here. In the past three years, India’s anti-dumping duties against Chinese companies have been the maximum against any country.

Although at the RCEP negotiations India refused to concede space on framing policy seeking local storage and processing of data, its tasks at home are clear cut. India will have to accelerate reforms to make exports more competitive.

![Figure 1: India’s Imports and Exports with RCEP Members, US$ Billion, 2018-19](source: Indian Government Department of Commerce, commerce-app.gov.in/eidb/default.asp)
A major factor in the Bangkok decision is that Indian manufacturing is not competitive enough. The fear that a flood of imports from RCEP partner countries would wipe out many Indian players also lurks in the minds of policy-makers. As mentioned, out of the 15 other countries in RCEP, India has a total trade deficit of more than US$105 billion. Understandably, India sought safeguard processes such as an automatic trigger safeguard mechanism (ATSM) — a process that automatically increases levies once imports cross a given threshold — which the negotiating partners considered an irritant.

Before expecting the 15 RCEP countries to take a softer position on India’s concerns, India ought to keep its own house in order. This includes round-the-clock quality electricity, cheap and efficient logistics, and access to cheaper and high-quality capital. India’s export-to-GDP ratio dipped from 25.3 per cent in 2012-13 to 19.7 per cent by the end of 2017-18. The list also includes the reforms required to push the micro, small and medium enterprise (MSME) segment. The RCEP countries are aware of such constraints on India and have therefore kept a window open for India to return for a signing of the agreement by February 2020. The onus now lies on India.

In an op-ed article in the Economic Times on Nov. 8, 2019, Columbia University Professor of Economics Arvind Panagariya makes a strong argument for India to reconsider its exit, because staying out would not be in India’s economic interest. He questioned the wide array of assertions from commentators who claim that India’s past trade agreements had harmed its economy and that RCEP would do worse. He also rebutted arguments that demand a return to the inglorious days of “self-sufficiency” and insisted that the withdrawal reflected the weakness of the government against the efforts of protectionist lobbies. Panagariya writes:

During 2000-11, India signed 14 preferential trade agreements (PTAs), 10 of which were bilateral agreements with individual countries (which included Japan, South Korea, Malaysia and Singapore) and four were plurilateral agreements (including with the Association of Southeast Asian Nations … and the Southern Common Market, Mercosur, in South America).

What will likely come as a surprise to most is the fact that the effects of these agreements on trade have been modest. Thus, while India’s imports from its 10 bilateral partners added up to 13.3 per cent of its overall imports in 2007, that number actually fell slightly to 11.8 per cent in 2017. Similarly, exports to these 10 partners added up to 13.7 per cent in 2007, and stayed nearly the same at 14 per cent in 2017. India’s imports under the ASEAN pact, its most significant plurilateral agreement, increased from 9.6 per cent in 2007 to 10.2 per cent in 2017, while exports expanded modestly faster from 9.5 per cent to 12 percent.

He examines the share of the trade deficit contributed by India’s agreements and finds that India actually improved its bilateral positions with FTA partners during 2007-17. He further finds from data that large parts of the Indian economy have not come under stress because of intensified import competition under these agreements, but finds that during 2007-17, the sectors in which imports under trade agreements had grown faster than overall imports from all trading partners by even 25 percent accounted for only 6-7 per cent of overall imports.

Taking a micro view and keeping in mind the larger scope of RCEP — over three billion people and roughly 40 per cent of global GDP — Panagariya argues that access to this market on a “frictionless,” duty-free basis would have provided tremendous advantages to India’s exports. He further observes that “in the absence of trade barriers on its imports (imposed by itself) and its exports (imposed by partner countries), India would have had an excellent opportunity to integrate itself into regional and global value-chains, where India’s participation has been low. India would have been more easily able to attract foreign direct investment (FDI) and to also take over production in sectors that China is now vacating.”

How different would an RCEP agreement be from any potential agreements with the US or the EU? Agreements such as the Trans-Pacific Partnership (TPP) pose a greater challenge. Because the TPP requires concessions over a range of contentious non-trade issues, such as environmental and labor regulations, intellectual property (IP) protection and the operations of state-owned enterprises. In contrast, RCEP focuses on trade liberalization.

True, India runs a huge trade deficit with China, accounting for about 40 per cent of its overall deficit, but had it signed the pact, India could have negotiated hard for expansion of access to the Chinese market in areas of its comparative strength, such as pharmaceuticals and IT services. On the import side, it could have sought exclusions of especially sensitive sectors and a more gradual liberalization schedule. This would have allowed India to simultaneously exploit greater market integration with Asia, while giving itself time and economic space to adjust.

Writing for The Hindu, Biswajit Dhar remarks that after the RCEP opt-out, now is the time for a shake-up. He argues that India must shed its defensive mindset in trade deals and, instead, work on creating globally competitive sectors. In an editorial, The Hindu observed that “India must not take the easiest way out on the trade deal and walk out of talks.” The Times of India was a bit more critical of India’s decision to stay out. Commenting in an editorial dated Nov. 7, it said “isolationism is not an option.” Making a forceful argument, it observed: “From a practical standpoint, it’s not realistic to turn inwards in the search for efficiency before opening up again. Being plugged into the global economy through trade agreements and enhancing domestic competitiveness are interrelated. Therefore, [the] government must pursue domestic reforms simultaneously with negotiations to expand India’s basket of trade agreements.”

Indeed, in line with global norms, India has trade agreements with about 54 countries, of which 164 are WTO members. These trade agreements cover more than half of international trade. Taking a critical view of the Modi government’s decision to stay out of the pact, the editorial observed: “Given this backdrop, India’s decision-making should be guided by a major feature of international trade: regional trade agreements can lead to trade diversion. To illustrate, even if India is the most efficient exporter of a certain kind of apparel, a new regional trade agreement which excludes India can lead to a diversion of our exports to a less efficient producer. Consequently, sitting on the sidelines is not an option.”

Now that India is wary of a surge in Chinese exports, if it remains outside of the pact, it needs to explore other partners with which it enjoys economic complementarity, such as the EU, the US or Australia, all of which share strategic interests with India. In contrast, rules and decision-making in China are opaque and it tends to offer market access based on strategic considerations. In order to cope with the changing times and new situations, the Modi government needs to shore up its sagging competitiveness through domestic reforms aimed at enhancing long-term economic strength and unshackling rigid markets while at the same time accelerating negotiations on other trade agreements. With a clear majority, the government should not feel diffident about making major decisions that would be in India’s medium — and long-term economic interests.

In this context, the political blame game must stop forthright. Though the preceding Congress-led UPA government had made a case for join-
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In November 2012, it was not oblivious to a possible surge in Chinese imports and was mindful of adequate safeguards. Therefore, staying out of RCEP is not an option for India. It is necessary that India remains engaged actively so that the agenda and pace of negotiations address India’s concerns. The good thing is that India has not withdrawn acrimoniously. The door is still open. It is unlikely that the Modi government would walk away from its “Act East” policy and leave India wholly disadvantaged.

For the time being, India is not ready, which is why industry and trade experts backed India’s decision not to join the RCEP agreement. India wants stringent rules of origin for all imports under the pact. It wants safeguard mechanisms to prevent import surges to protect the interests of domestic industry. Trade experts say the government must have a clear strategy going forward on trade pacts.

CONCLUDING OBSERVATIONS

China is responsive to India’s concerns. A day after India opted out of RCEP, China, taking a more accommodative stance, said it would follow the principle of “mutual understanding and accommodation” to resolve the outstanding issues raised by India. China also said it would welcome India joining the deal at an early date. Chinese Foreign Ministry spokesman Geng Shuang said that “RCEP is open,” adding, “If it is signed and put into implementation, it is conducive for the Indian goods entry into China and other participating countries. In the same vein, it will also help Chinese goods to enter the markets of India and other participating countries.” India has been cautious in its response, and isn’t easily buying China’s arguments.

The Confederation of Indian Industry (CII) argues that opting out of RCEP will harm India’s exports and future investment flow. CII’s main concern is if India is not a part of RCEP, this would hinder India’s efforts to increase its integration into regional and global value chains, as preferential and comprehensive agreements facilitate investments and foster the growth of value chains. The CII feels that “not being part of the bloc is tantamount to not having an even footing in terms of preferential access and losing export competitiveness.”

The bottom line is that FTAs must be considered for their long-term impact, both on the domestic market and the access they provide. Indian industry is now more focused domestically, but in about a decade’s time, it would like to have greater access to the vibrant region outside of it. Thus far, it has done the impact analysis of FTAs only bilaterally, ignoring how these have been integrated into global supply chains. The problem is Indian industry never looked towards RCEP as an opportunity to gain additional market access and to become integrated into a robust regional value chain.

So far, Indian discourse has remained focused on defensive interests and protection against China. It is time that this narrative changed. India needs to do its homework on undertaking urgent reforms before it launches its plans to integrate its economy with the region. Delay in this endeavor would mean India will miss the bus.

Professor Rajaram Panda is currently Lok Sabha Research Fellow, Parliament of India, and Member of the Governing Council of the Indian Council of World Affairs, New Delhi.

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