Understanding India's exit from the Regional Comprehensive Economic Partnership

In walking away the Regional Comprehenisve Economic Partnership Agreement (RCEP) in Bangkok earlier this month India signalled to the world it could not compete in a free trade arrangement with the other 15 member countries of RCEP. It has has exposed the weak underbelly of the world's third largest economy (in PPP terms), the fastest growing major economy, etc.

However, RCEP is a play with many acts and Bangkok was only the end of act 2. There will be other acts to follow. China, the prime mover behind RCEP, has already signalled that India's concerns would be addressed and so has Australia and other RCEP partners. Where we go from here remains to be seen. But why did India walk away? Biswajit Dhar (*The Hindu, 7 November, 2019),* Deepak Nayyar *(Mint 8 November 2018)* and others, have explained why India had little choice but to withdraw at this stage.

First, Indian industry cannot compete with industrial products from China but some other RCEP partners without tariff protection. India initially negotiated for tariff elimination for 80% of imports from ASEAN countries and only 42.5% of imports from China but was later forced to accept much wider tariff elimination. It was also unable to secure strict rules of origin and other safeguards. So RCEP, it was feared, would lead to a surge of industrial imports.

Second, low productivity Indian agriculture, largely based on small and marginal farms, cannot compete with high productivity agri-business from other countries. But agriculture is the main livlihood for a large share of the Indian workforce. India has therefore resisted liberalisation and tariff reduction for agriculture in all multilateral and bilateral FTAs. Similarly, India is the worlds largest dairy producer of milk but is inefficient and needs tariff protection from New Zealand and Australia. All this would be history with RCEP.

A third issue is E-commerce. Following WTO, imports to RCEP countries through E-commerce platforms will have no tariffs, implying a much larger opening of domestic markets beyond tariff cuts. RCEP provisions on cross border transfer of information and server location would also conflict with the draft national policy on E-commerce and data security. There is a similar conflict between the cross border investment provisions in RCEP and India's stand in bilateral invetsment treaties.

For these and other reasons virtually all stakeholders including business and industry, trade unions, farmers orgainsations etc. lobbied against signing on to RCEP. So did all groups across the political spectrum from the BJP and its affiliate, the Swadeshi Jagran Manch,to the Congress party to the CPM. Politically the Modi government had little option but to walk away.

Only economists who believe a low tariff free trade regime can force Indian enterprises to become more competitive have lamented India's exist from RCEP. It is seen as part of a reversal of the liberal trade regime estabslished 25 years ago. Instead of going down average tariffs in manufactuirng have gone up from 11% to around 14% in the last three years while that in agriculture has gone up from around 33% to nearly 39%. Quantitative trade restrictions have also slipped in in different ways.

However, it is important to look at the evidence. India's experience with most of its FTAs is disappointing. India has a trade deficit with most of these countries/groups. While trade has grown following the FTA so has India's trade deficit with the the FTA partner. It was believed that India had a comparative advantage in services. However, as Amita Batra has pointed out (*Business Standard 28 August 2018*), India has not benefitted any more from FTAs in services than in goods. There is little evidence that FTAs have in any way nudged Indian enterprises towards greater competitivenes.

So where do we go from here? Global value chains (GVCs) have emerged as the dominant channels of international trade and these GVCs are concentrated wihin regional FTAs. So to grow it's export India has no choice but to join a regional FTA. In Asia, after Trump walked away from the US led Trans Pacific Partnership (TPP), desigend to exclude China, the China led RCEP is the only game in town. It's a mega regional FTA, with it's members accounting for about 40% of world GDP, an even larger share of world population and a large share of global trade. All the members of the Comprehensive and Progressive Trans Pacific Partnership (CPTPP), which rose from the ashes of TPP, are also members of RCEP. So RCEP is still India's best option. Whether it can achieve in a few months the better terms it has failed to acheive in seven years is doubtful. But it must try to keep the RCEP option as long as possible. Meanwhile, India should energetically explore FTA options in other geographies such as Europe, the Americas and Africa.

Membership of FTAs is a necessary but not sufficient conditions for rapid export growth. It will also require Indian enterprises to be strive more energetically for higher productivity. The 'miracle economies' of east Asia, Japan, Korea, China, Taiwan, etc. have shown how 'hard' states have made this happen through industrial policy. Identify strategic industries important for rapid growth, pick winners in those industries, support them to grow to global scales, then force them to be globally competitive or lose state support. There is nothing particularly equitable about this approach, but this is how east Asian countries came to dominate the global economy. Whether or not India's soft state has the capacity and the will to follow this path will determine whether the Indian economy emerges as a model of successful state led capitalism or it flounders in the morass of crony capitalism.