Regional Comprehensive Economic Partnership and India

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Abstract

The geo-economic dynamics with a liberal political landscape has laid the foundation of a free-market trading system. The last decade has witnessed a surge in regional Free Trade Agreements (FTAs) with Africa, Latin America and Asia in the lead. The unprecedented growth has been primarily attributed to the weakening multilateral institutions like the World Trade Organisation (WTO). It is in this context that an FTA, Regional Comprehensive Economic Partnership (RCEP), covering the Indo–Pacific region, has been under negotiation for half a decade. The agreement aims to cover the Association for Southeast Asian Nations (ASEAN) and its FTA partners, namely Australia, China, India, Japan, New Zealand and South Korea.

This report tries to study the significance of the RCEP agreement from India's perspective by laying greater focus on Cambodia and Vietnam from the Mekong region. Further, the report has concentrated on specific areas like Agro-processing, Regional Value Chains (RVCs), and Small and Medium Enterprises (SMEs).

Keywords: RCEP, FTA, Agro-processing, Cambodia, Lao PDR, Myanmar and Vietnam (CLMV), Free Trade, RVC

A General Perspective

In the year 2012, the idea of a free-trade area connecting the 10-member ASEAN community and its six free trade partners was formally launched at Phnom Penh, Cambodia. The RCEP agreement has been proposed to create a modern, comprehensive economic partnership that covers not only goods but also trade in services, investments, technical cooperation, intellectual property, dispute settlement and other related matters. With its final negotiation, RCEP is set to create the largest free-trade area in the world covering 45 per cent of the world's population and 30 per cent of the global Gross Domestic Product (GDP) worth 21.4 trillion USD. As the agreement aims to cover approximately one-third of the global trade in goods and services, the various rounds of negotiations signify that the member countries wish to simplify trade rules in order to boost trade volumes. For India, the region of East Asia has been of significance since 1991, as it holds tremendous opportunities for engagement in the form of presence of strong value chains, extensive shipping lanes, global investment at an astronomical scale and diverse models of growth and development. Indian foreign policy has indicated a shift from focusing on the developed states of ASEAN, as under the Look East Policy, to forging deeper ties with the Mekong region with special focus on Cambodia, Laos, Myanmar and Vietnam (CLMV) through the newly adopted Act East Policy (2014).

In the last few years, the region has gained immense importance, due to various geo-political factors. To begin with, the Obama Administration's shift in focus from the Middle East and Euro-centric foreign policy to its renewed interest in the Asia–Pacific region under the policy of 'Pivot to East'. The region is being used by both China and the US to flex their muscles, indicating a power struggle between a rising power and a waning power. It is in this context that India requires to develop deeper ties with the entire region to safeguard its geo-political, economic and strategic interests. Another reason for the growing importance of the Asia-Pacific region is the diverse growth and development models along with diverse economic growth. On the one hand, states like Singapore, Thailand and Malaysia have well developed Global Value Chains (GVCs) along with stable economies based on re-export of goods and foreign investments. On the other hand, the CLMV states are the fastest growing economies in the region with cheap labour, driving further growth in the already developed ASEAN states. The CLMV region has grown into a manufacturing hub with sectors like garments and textiles, electronics and electrical and footwear dominating the economy.

In this light, it is important to understand the significance of RCEP in relation to India's growth and development architecture, as the trade agreement aims to create a model FTA, going beyond the WTO principles of liberalised, open and free-market trade.

RCEP from India's Perspective

India is on the cusp of unprecedented development and growth. While many Asian countries are ageing (Japan, most notably), approximately half of India's 1.2 billion people are under the age of 26. India is predicted to be the youngest country in the world by 2020, with a median age of 29. By 2025, close to 20 per cent of the world's working age population (15–59 years) will reside in India.

Figure 1.a: India's Demographic Dividend vis-à-vis the World

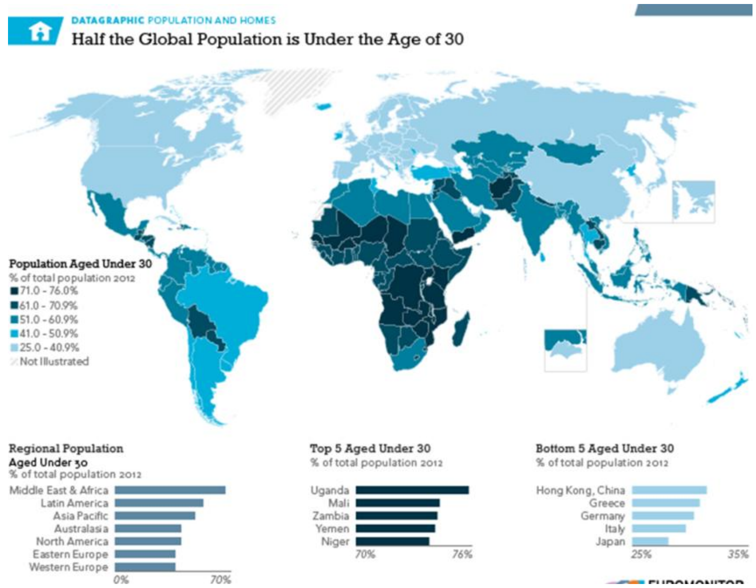


Figure 1.b: India's Demographic Dividend vis-à-vis East Asian Economies

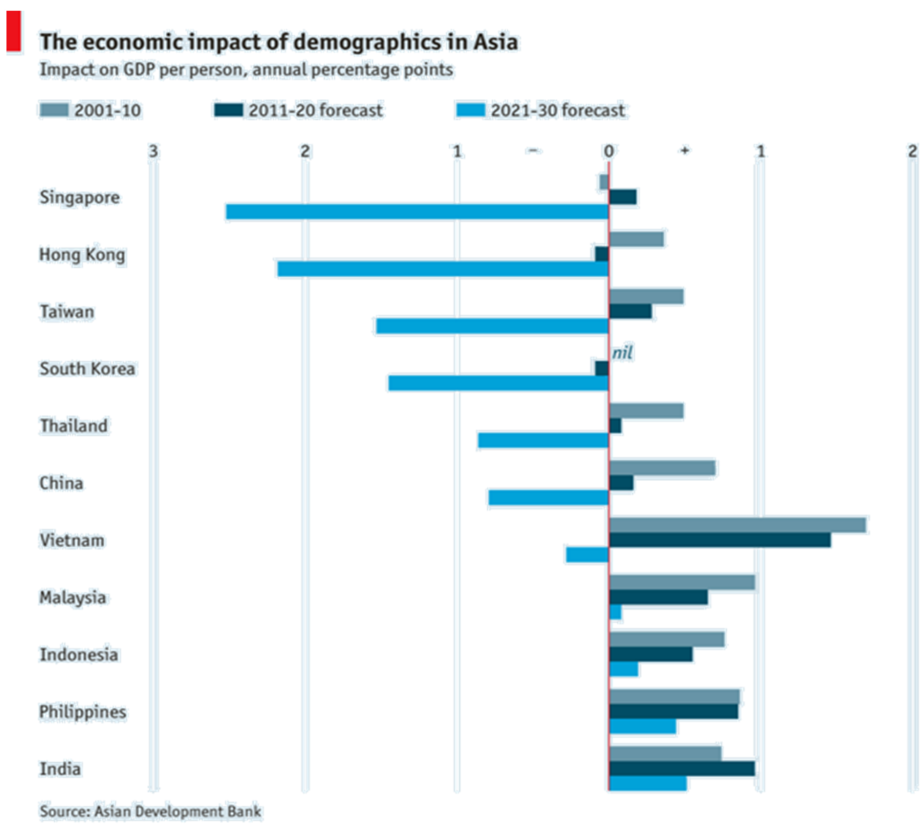
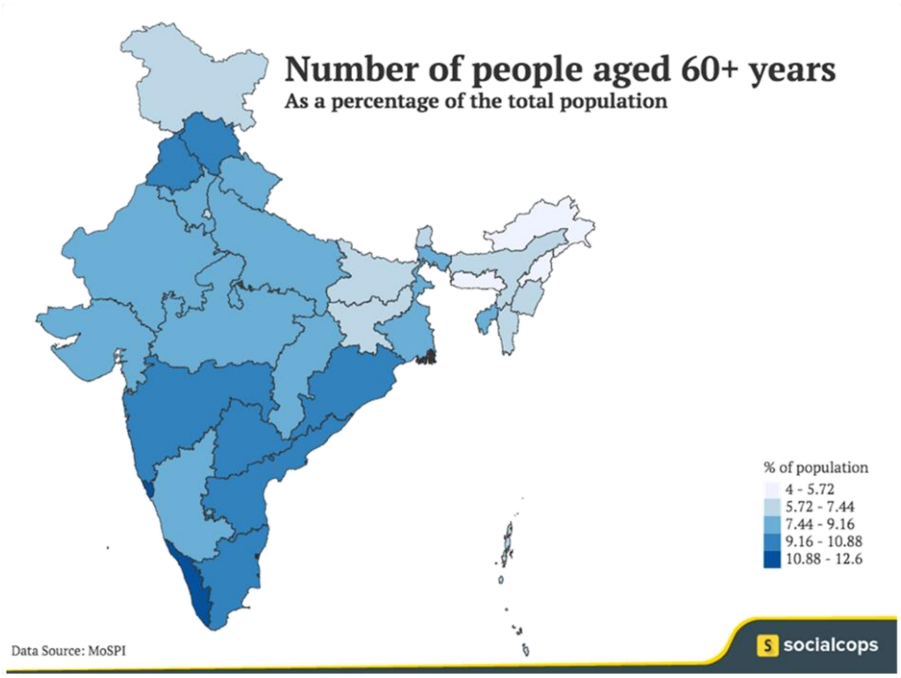


Figure 1.c: Demographics of India



This comparative advantage resonates in the Government of India's development schemes like Make in India, Skill India, Start-up India and Stand-up India. As RCEP aims to boost trade in goods and services, India's demographic dividend will play the pivotal role in the development of manufacturing bases and assembly chains, and setting up start-ups within and outside India in order to gain the maximum from the free trade clauses of the agreement. India is already engaged in FTAs and Comprehensive Economic Partnerships (CEPs) with several states in the Asia–Pacific region. Between 1999 and 2009, ASEAN's exports to and imports from India grew by 4.5 times and 5.6 times, respectively. The increase has been attributed to production networks, especially in machine industries. India's domestic policies, ranging from setting up Special Economic Zones (SEZ) to liberalising the Foreign Direct Investment (FDI) policy, have been designed to reap the advantages provided by FTAs that India has signed in the Asia–Pacific region.

Though the statistical data present a positive image, the reality is different. Even though India has the comparative advantage due to a young population, the government has failed to tap its benefits. The youth of India lack the required skills in order to establish a strong manufacturing sector. This has inhibited India from reaping the full benefits of its FTAs, as it has not been able to integrate with the value chains, both regional and global. The Indian economy is driven by its robust services sector, which has created specialised job profiles that are out of reach for millions of unskilled youth. As India negotiates the RCEP agreement, it becomes imperative for the policymakers to shift their focus on manufacturing, value addition and carving out niches in the services sector with which the country can become synonymous.

RCEP: A Closer Look

As RCEP is being touted as a game-changer, it is important to understand the proposals under negotiation. The RCEP negotiations are based on the General Principles for Regional Comprehensive Economic Partnership. The principles include open accession, economic integration, transparency, economic and technical cooperation and facilitation, special and differential treatment towards the least-developed member countries, consistency with WTO and a periodic review of the working of the modalities. Based on these principles, 17 rounds of negotiations have taken place, the last being held in Kobe, Japan from February 27, 2017 to March 3, 2017. The RCEP negotiations involve a multi-staged process – the ASEAN members and the ASEAN Foreign Partners (ASEAN + 1 FTA partner – Australia, China, India, Japan, New Zealand and South Korea) discuss the issues separately and then the 16 states come together to negotiate the trade agreement. This mechanism has allowed ASEAN to be in the driver's seat. The RCEP negotiations are experiencing the dynamics of global politics like the rise in protectionism from the western world or US President Donald Trump's decision to cancel America's partnership in the parallel trade agreement, Trans Pacific Partnership (TPP). This has not only created an atmosphere where RCEP can be regarded as the gold standard for liberalised free market trade but has also increased the pressure upon the members common to RCEP and TPP[1] to negotiate with increased caution on issues most sensitive to them. During various rounds of negotiations, India voiced its concerns related to single duty structure, influx of inferior quality goods from China, loss to its generic pharmaceutical industry, concerns of food security, government procurement and agricultural subsidies[2]. In order to

[1] The common members of RCEP and TPP are Australia, Brunei, Japan, Malaysia, New Zealand, Singapore and Vietnam (TPP 7). The sensitive issues range from dairy products in case of Australia and New Zealand, pharmaceuticals for Japan and South Korea and the services sector for all the seven common members.

[2] These are the major contentious issues under the WTO Doha Round (2001–present). India managed to negotiate a Peace Clause at Bali in 2014.

protect its economy from a surge in imports and the consequent increase in trade imbalance vis-à-vis China, India postulated a Three-tier Duty Structure regarding trade in goods.

Table 1: Three-tier Duty Structure as Proposed by India

Tiers	Duty Reduction	Country(ies)/ Region(s)	Special Comments
Tier 1	80% of tariff lines	ASEAN (10 members)	India-ASEAN FTA 65% reduction immediately after the commencement of RCEP 15% reduction over a period of 10 years
Tier 2	65% of tariff lines	South Korea and Japan	With these countries, India has existing FTAs
Tier 3	42.5%	Australia, New Zealand and China	India has no existing FTA; in case of China, India is apprehensive about opening up its economy, due to existing trade imbalance in favour of China, dumping of inferior products by China and reluctance on the part of the Chinese to import considerably from India

In the wake of stiff resistance from China, Australia and Japan, India has shelved its proposed duty structure and adopted the Single-tier Duty Structure. This will allow the opening up of nearly 80 per cent of the tariff lines – a boon for the export- and manufacturing-oriented economies – but will certainly create an adverse impact upon India's trade balance and the unorganised sectors of the Indian economy. On the other hand, most states, including Australia and New Zealand, are reluctant to open up trade in services to the level advocated by India. The RCEP members have achieved consensus in sectors like economic and technical cooperation, which will boost transfer of technology, investments and infrastructure development. As the details of the negotiations are not present in the public domain, it becomes difficult to analyse the significance of the agreement in its entirety. Based on the limited data available in the public domain, this report has tried to perform a SWOT analysis of the RCEP agreement from India's perspective.

Chart 1: SWOT Analysis of RCEP from India's Perspective

S for Strength (s)

- Services sector, IT and ITES, skilled professionals, soft power and goodwill among the countries in the Asia–Pacific region
- Strong, stable, vibrant and diversified economy
- Liberal inter- and intra-country trade regime and liberalised FDI regime
- Government of India's focus on Ease of Doing Business
- Policy framework – Make in India, Skill India Mission, Stand-up India and Start-up India

O for Opportunity (s)

- Investment in Greenfield projects
- Deeper market integration
- Integration with RVCs and GVCs
- Access to and development of India's Northeast region
- Increased inflow of foreign investments
- Reduce trade imbalance with China
- Increase defence cooperation in the region
- Diversify export basket for newer industries like agro-processing

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W for Weakness (s)

- Lack of skilled youth to increase manufacturing level and output to reap FTA benefits
- Weak infrastructure facilities like electricity, drinking water, bridges, rail network, highways and ports etc to attract foreign investment on a massive scale
- Lack of uniform tax structure
- Weak labour and environment laws
- Lack of investment summits in various administrative units of India

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T for Threat (s)

- Adverse impact on the generic pharmaceuticals industry
- Potential loss of revenue due to Single-tier Duty Structure
- TRIPS + measures regarding agricultural subsidies, food procurement and food stockholding for food security
- Climate change
- Domino effect due to increased interdependence of economies
- Rising power of China

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RCEP is not an easy negotiation, due to the presence of diverse economies, ranging from CLMV to Singapore and Japan along with economic giants like India and China. It is considered a game-changer agreement, setting the rules for liberal trade, in the wake of an uncertain future of TPP and increasing protectionist posture adopted by the developed world. Even though the pace of negotiations is sluggish, there are several reasons for optimism regarding RCEP. The year 2017 marks the 50th anniversary of ASEAN and the grouping aims to achieve a strong deal in order to commemorate the event. Philippines, the present chair of ASEAN wants to lead the RCEP negotiations to their fruition during its tenure, in order to show the strength of its leadership. With TPP's future becoming uncertain, TPP 7 aims to negotiate a stable deal through consensus at the earliest.

India and CLMV

India shares deep historical and cultural ties with the states in the Mekong region. There was a long break in this relationship during the colonial era. In the Communist era that followed, these states presented a hostile environment for Indian investors. The Cold War politics also created an impervious environment, which became permeable only with the downfall of the Union of Soviet Socialist Republic (USSR) and the rise of a uni-polar world under the hegemony of the US. During Prime Minister P V Narsimha Rao's government, the Indian foreign policy shifted from the Cold War framework in order to suit its liberalised and market-oriented economy image. Due to the increasing geo-political turmoil in West Asia, the historical and traditional trade partner region of India, it became imperative for India to 'Look East' towards the Asian Tigers. In the period of 1991–2014, India has engaged with ASEAN in different capacities, though the engagement has been lacklustre.

India did not develop the capacities required to integrate itself in the well-developed GVCs and RVCs in the ASEAN region. The major reasons for India's lack of deeper engagement with ASEAN include but are not limited to the short-sighted vision of the policy makers, policy shortcomings[3], coalition politics, vote-bank politics, focus on agriculture but not on value addition, agro-processing or nutrition fortification, overgrown welfare state, politics of appeasement and systemic discouragement to innovation and merit. Along with these hurdles, India viewed ASEAN as a homogeneous region and focused on states like Singapore, Thailand, Malaysia and Indonesia in order to have a deeper integration with the region. This led to the neglect of the CLMV region at the policy level from India's side. The Indian government made negligible efforts to push private Indian investments in this relatively pristine region with some of the fastest growing economies in ASEAN. India has not made complete use of the India–ASEAN FTA, which allows tariff liberalisation of over 90 per cent of products, including the so-called 'special products' such as palm oil (crude and refined), coffee, black tea and pepper, traded between the two dynamic regions. Tariffs on over 4000 product lines were eliminated by 2016. Apart from the trade in goods, India and ASEAN have signed a services and investments trade agreement, which allows for liberalised trade of services like IT and ITES, financial services, insurance and banking, etc. Key to India's interests is a brief annex in

[3] Lack of focus on manufacturing, red tapes, lack of vocational training and skill development, lack of a conducive environment for start-ups, rigid FDI policy etc

the agreement on the movement of natural persons that defines business visitors, intra-corporate transferees (managers, executives and specialists) and contractual service suppliers. Even under the present milieu of FTA with ASEAN in general and CLMV in particular, neither the Indian government nor India Inc pushed for greater interaction with the latter states. With a few exceptions like Aditya Birla, Reliance, Kirloskar and TATA along with the Government of India's investment in the exploration of oil and natural gas, Indian efforts to make the best use of India–ASEAN FTAs are, at best, inadequate.

India's Opportunities vis-à-vis Cambodia and Vietnam

This section tries to understand and explain how, even without RCEP, India can move ahead to engage two of the relatively strong and stable economies of the CLMV region. These economies enjoy the benefits of duty-free imports by developed states like the US and the members of the European Union (EU) under WTO'S Generalised Scheme of Preferences and EU's Everything but Arms, respectively. India can exploit these duty benefits on the goods produced in Cambodia and Vietnam by setting up manufacturing hubs, leasing agricultural land, shifting assembly lines and integrating with the vast network of value chains, linking these two economies with the rest of ASEAN and the world. The sector that has the potential to integrate these advantages is agro-processing. The governments of Cambodia and Vietnam have selected this sector as the focus area. The two economies are export-driven economies with manufacturing and services playing a major role. On the other hand, these two economies have high agricultural yield with a considerable section of the population engaged in farming activities. The governments of Cambodia and Vietnam aim to diversify their economies for several reasons. First, these economies do not wish to be driven by the export of a single commodity, due to the catastrophic impact such an economic model can have, owing to price fluctuations in the wake of reduced demand. Second, these states aim to become middle-level economies without falling into the middle-income trap. Hence, these states have focused on several sectors in order to boost the per capita GDP, purchasing power, national savings and disposable incomes to attract FDI. Third, sectors like agriculture can play a crucial role in diversifying the said economies through agro-processing by providing value addition to the agricultural produce. At present, these two states export raw agricultural produce to neighbouring states including Thailand and Singapore, who, in turn, process the raw agricultural imports and re-export the products, earning substantial revenues on value addition. Agro-processing will also reduce post-harvest wastage, boost employment, attract investments and hence lead to diversification in the export basket.

Where does India Stand?[4]

- India ranked 12th in the world in exports of food and food products in 2015
- Major industries that constitute the Indian food processing sector are grain milling, sugar, edible oils, beverages, fruits and vegetables processing and dairy products
- In 2014–15, Gross Value Addition (GVA) in food processing grew by 5.78 per cent; the share of the food processing sector in GVA of the manufacturing sector was 8.6 per cent in the same period
- Food processing industry is one of the major employment-intensive segments, contributing 11.69 per cent of employment generated in all registered factory sector in 2013–14

These figures though not impressive are optimistic. India has the potential to take a giant leap in the agro-processing sector. Accounting for about 32 per cent of the country's total food market, the Government of India has been instrumental in the growth and development of the food processing industry. The government through the Ministry of Food Processing Industries (MoFPI) is making all efforts to encourage investments in the sector. It has approved proposals for joint ventures (JV), foreign collaborations, industrial licenses and 100 per cent export-oriented units.

Along with massive capacity building, India needs to engage in developing niches in various sub-sectors like agro-machinery to meet the requirements of Cambodian and Vietnamese agriculture to make India their most favoured foreign destination for agro-machinery.

Along with agro-processing, India can collaborate with Cambodia and Vietnam on SMEs. The Royal Government of Cambodia aims to get 80 per cent of the Cambodian SMEs registered in order to boost the availability of credit at affordable rates. As SMEs employ majority of the

[4] Ministry of Statistics and Program Implementation

population along with boosting export volumes, they become imperative to create linkages between agro-processing SMEs and value chains. This will aid in reaping maximum benefits in terms of increasing employment opportunities, raising incomes, diversifying the export basket and market, thus, increasing the level of economy, standard of living and presence in the world.

Table 2.a: Cambodia – Exports and Imports

Type of Goods	Exports	Imports
Raw Materials	2.58%	3.39%
Intermediate Goods	3.83%	55.71%
Consumer Goods	89.61%	23.37%
Capital Goods	3.93%	17.24%

Table 2.b: India-Cambodia Trade

Year	2010-11	2011-12	2012-13	2013-14	2014-15
Exports	66.94	99.45	112.28	141.31	142.53
Imports	8.01	7.27	11.90	12.72	17.96
Total Trade	74.95	106.72	124.18	154.05	160.49
% Growth		42.39	16.36	24.04	4.19
Trade Balance	58.93	92.18	100.38	128.59	124.57

VALUE IN MILLION US$

Table 2.c: Trade in Agro-processing Sector

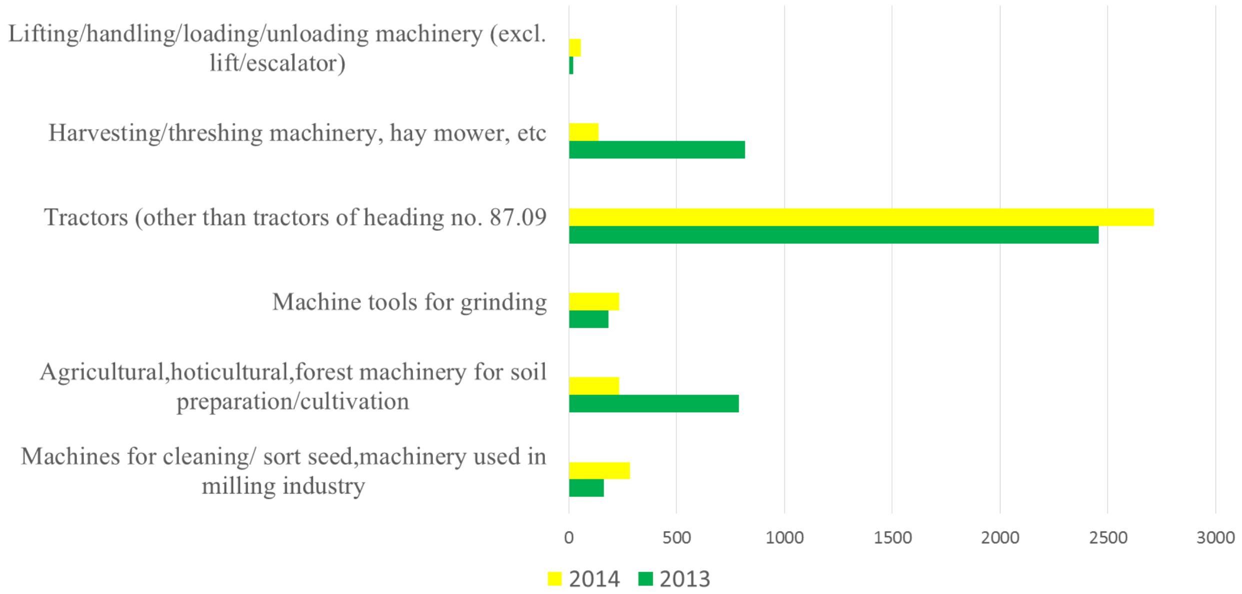

Table 2.d: Indian Diaspora in Cambodia and Vietnam

Cambodia	Vietnam
• Around 1500 Indians • Majority reside in the capital, Phnom Penh • India Association - Cambodia • Considerable presence of traders from Uttar Pradesh • Kirloskar Brothers Limited, TATA South-east Asia (Cambodia) Limited, Bank of India	• Between 1500-2000 Indians • Majority reside around Ho Chi Minh city • Indo-Vietnamese Chamber of Commerce and Industry • Kirloskar Electric Company Limited, TATA Steel, Essar Steel, ONGC Videsh Limited

Conclusion

RCEP in its present form (under negotiations) appears to be less advantageous, as far as India is concerned. By concentrating more on trade in goods, the negotiations have kept services and investments in cold storage. Considering the composition of the Indian economy, India may be getting peanuts for diamonds. India has to be assertive in order to push its national interests vociferously at the negotiating table[5].

At the same time, India needs to augment its engagement with the CLMV region, even though these economies are small with low per capita GDP and have less demand and disposable incomes. India needs to make the best use of the advantages this region offers to her in terms of cheap labour costs, liberalised trade policies, incentives for foreign investment, SEZs etc in order to increase its presence in the Asia–Pacific region, which, at present, is dominated by China. As stated by Alfred Thayer Mahan, "[6]The history of sea power is largely, though by no means solely, a narrative of contests between nations, of mutual rivalries, of violence frequently culminating in war. The profound influence of sea commerce upon the wealth and strength of countries was clearly seen long before the true principles, which governed its growth and prosperity were detected. To secure for one's own people a disproportionate share of such benefits, every effort was made to exclude others, either by the peaceful legislative methods of monopoly or by prohibitory regulations, or, when these failed, by direct violence."

Apart from the geo-political point of view, engaging with the CLMV countries will boost employment levels in India, improve the standard of living indicators, increase per capita GDP and disposable income along with diversifying India's trade markets. This becomes significant in the wake of liberal principles of trade taking a backseat with rising right-wing politics in the western world, comprising the traditional markets of India.

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[5] The 18th round of RCEP negotiations will be held in Philippines.

[6] The Influence of Sea Power upon History, Alfred Thayer Mahan, 1660–1783

India should boost the capacity of forums like the Mekong–Ganga Cooperation[7], which at present concentrates on cultural aspects and soft power. India should engage with the CLMV region at the earliest to take full benefits of FTAs between ASEAN and China, and ASEAN, Australia and New Zealand.

The Government of India needs to take pragmatic steps in order to achieve its development goals and for that, it cannot leave behind the advantages offered by the CLMV region. India should complete the connectivity projects like India–Myanmar–Thailand (IMT) trilateral highway and Kaladan Multimodal Project, increase air connectivity with the region and take the IMT project further to connect with Cambodia and Laos, as proposed during the fourth India–CLMV Business Conclave[8] held in Jaipur in February 2017.

In order to gain advantage from RCEP, if it gives preference to goods over services after the final negotiations, India should alter its economic model from focusing on export of services to boosting consumption driven economic growth. This requires skill creation at a massive scale and better employment opportunities in order to raise the disposable incomes to fire the engines of consumption-led growth. Agro-processing will play a major role, as close to 51 per cent of the Indian population are employed in agriculture. Value-addition techniques will boost farm income, leading to the cyclic model of growth and development.

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[7] The Mekong–Ganga Cooperation (MGC) was established on November 10, 2000 at the First MGC Ministerial Meeting in Vientiane. MGC comprises six member countries – India, Thailand, Myanmar, Cambodia, Laos and Vietnam. It emphasised four areas of cooperation – tourism, culture, education and transportation linkage – to build a solid foundation for future trade and investment cooperation in the region. The organisation takes its name from the Ganga and the Mekong, two large rivers in the region.

[8] The fourth India–CLMV Business Conclave was aimed at identifying specific project opportunities and seeking business partnerships in the region. The conclave focused on sectors such as pharma, healthcare, agro business, food processing, gems and jewelry, textiles, leather, renewable energy and education.

CLMV Conclave:

The CLMV Conclave is an annual feature, which provides Indian business leaders an opportunity to interact with government and business stakeholders representing the four countries. The conclave facilitates to create and provide a platform for the decision makers from the CLMV countries to interact with a range of Indian business companies involved in trading, manufacturing, processing, engineering, consultancy, construction etc.

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Appendix

Chart 2.a: Cambodia – Disposable Income

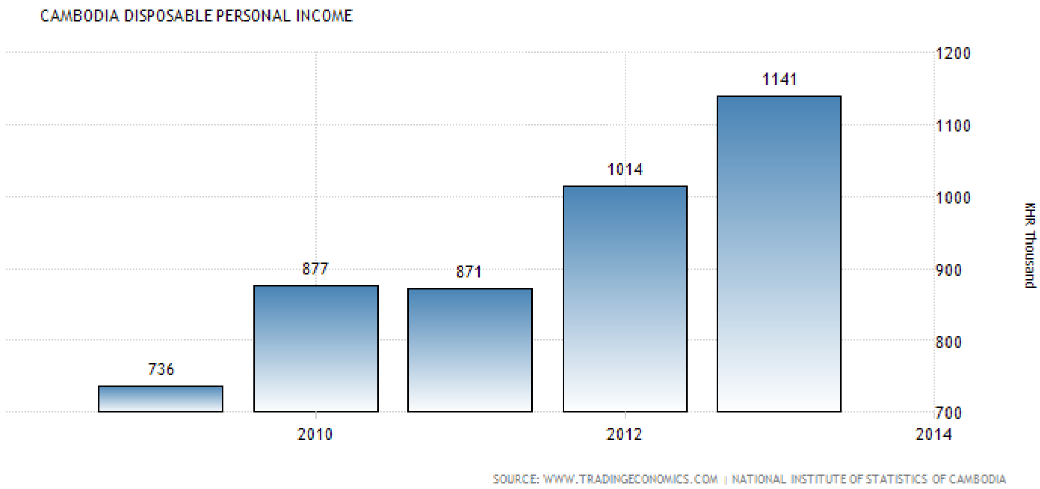

Chart 2.b: Vietnam – Consumer Spending

Chart 2.c: Vietnam – Annual Population Growth (in per cent)

Chart 2.d: Cambodia – Annual Population Growth (in per cent)

Chart 3: Growth of Food Products – Cambodia and Vietnam

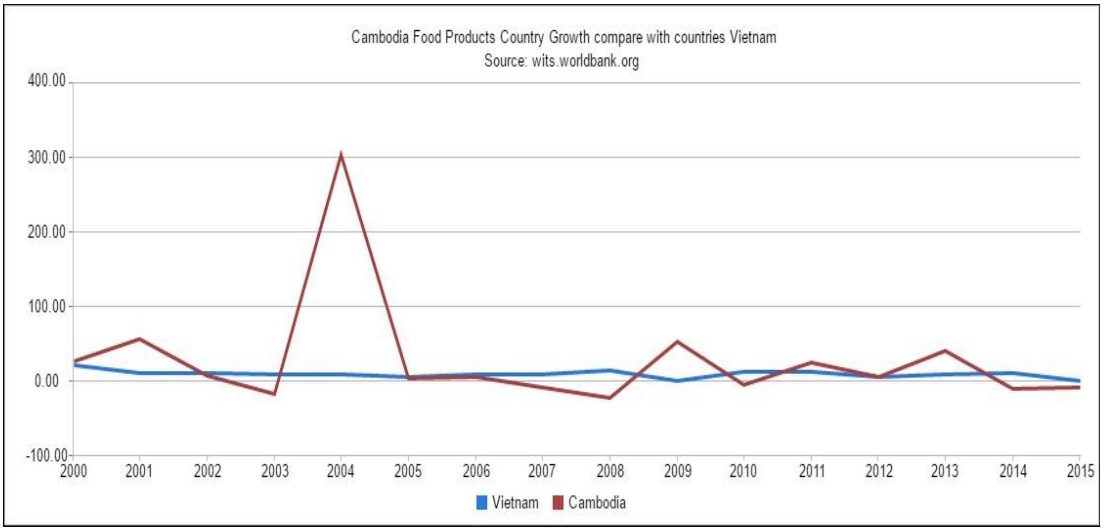

Chart 4: Growth of Vegetables – Cambodia and Vietnam

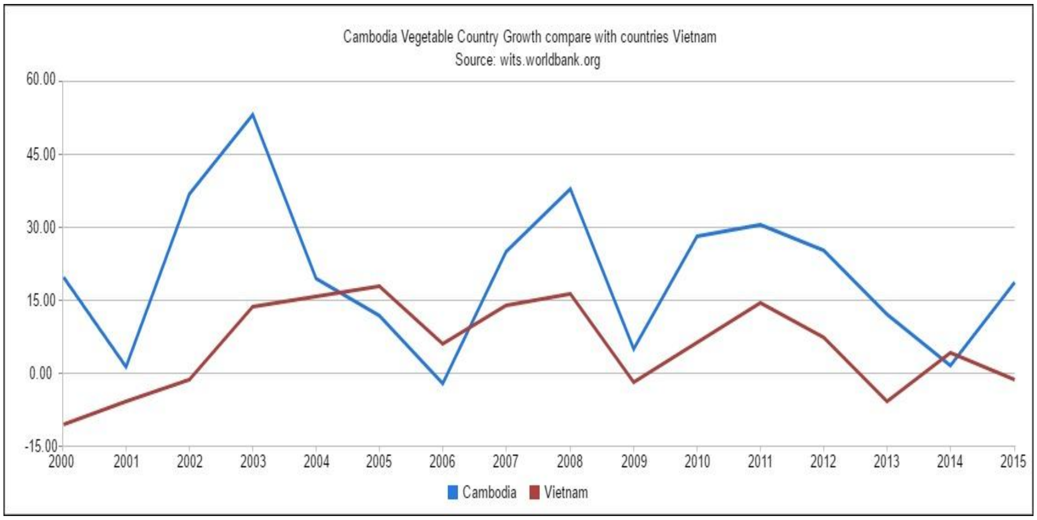

Chart 5: Cambodia – per capita GDP

Chart 6: Vietnam – per capita GDP