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SHUT THE DOOR ON RCEP BUT LET'S GET OUR ACT TOGETHER AT HOME

Relevant for: International Relations | Topic: RCEP and India

Economic openness is necessary but not sufficient: it succeeds only when combined with strategic industrial policy

The third summit of the Regional Comprehensive Economic Partnership (RCEP) held in Bangkok, which concluded this week, sought to finalize a mega free-trade agreement among 16 countries from Asia and Oceania, which are home to one-half of the world's population and account for about 40% of the world's gross domestic product (GDP) and trade.

The quest for RCEP was driven by two objectives. For one, each participating country hoped to capture the benefits of regional cooperation through deeper economic integration. For another, it was a strategic geopolitical attempt to create a bloc with a voice and influence in the world. However, the process of plurilateral negotiations, which began in 2012, between countries that are diverse in terms of economic size, income levels and national interests, was inevitably complex. The prolonged uncertainty ended when Prime Minister Narendra Modi announced India's decision not to join the group, and RCEP was born with only 15 member-countries.

In this context, it is important to note that India already has free-trade agreements with Asean since 2009, South Korea since 2009, and Japan since 2011. In addition, RCEP includes China, Australia, and New Zealand. The experience since then has been instructive. Between 2014-15 and 2018-19, India's trade deficit increased from $13 billion to $22 billion with Asean, from $9 billion to $12 billion with South Korea, and from $5 billion to $8 billion with Japan. Obviously, these agreements led to a far greater increase in imports than in exports. In fact, India's exports to these markets witnessed a stagnation, just as its total exports did.

Over the same period, India's trade deficit with China rose from $48 billion to $54 billion, while that with Australia and New Zealand went up from $8 billion to $9 billion. Thus, in 2018-19, India's trade deficit with its potential RCEP partners alone was $105 billion, which was larger than its total trade deficit of $104 billion with the world as a whole, which included imports of crude oil and petroleum.

It is no surprise that there was massive resistance to the idea of joining RCEP across sectors in India, most of which are vulnerable to the import surges that could and might follow a RCEP kind of free-trade agreement. This is obvious in the manufacturing sector, which has been hurt by imports of goods from China, so much so that deindustrialization is discernible. The problem would certainly have been exacerbated by joining RCEP, as rules-of-origin can be easily circumvented and Chinese goods could have been routed through other member countries.

The agricultural sector, which is protected by tariffs in the range 30-40%, could have been even more vulnerable. The plantations sector, particularly in Kerala, would also have been at risk. India might be the largest producer of milk in the world, but its tiny dairy farms simply could not have competed with scale-economies and superior-technologies of the dairy industry in Australia and New Zealand. The story would have been similar for mining. Output and employment would have been the casualties. Such fears led to a chorus of protests, which could not be ignored by an elected government in a political democracy.

Government negotiators bargained for safeguards that would protect the domestic industry from import surges and also for provisions for market access in services that could be competitive. This was not forthcoming. Under the circumstances, it was both necessary and desirable to opt out of the free-trade agreement.

However, the government was wrong in its belief that the pact would have been more balanced if there were some compensation in services and investment. India does have a comparative advantage in software exports, but that is not true of business services, financial services or telecommunication services, where other RCEP countries, such as Japan, South Korea, Singapore, and China, are far ahead. Much the same could be said about investment. Such agreements on services and investment can seriously constrain the policy space because they stipulate what governments can or cannot do in the sphere of domestic economic policies, unlike agreements on trade that are confined to tariffs imposed on goods that cross borders.

The government said that the decision not to join RCEP is final for now. However, the joint statement of leaders at the end of the summit and the subsequent statement of India’s commerce minister suggest that India might consider joining the agreement at a later stage, perhaps next year, if the differences are resolved. This ambiguity is a cause for concern. The desire to rush into a free-trade agreement with the US or the EU on the rebound is more worrisome.

It is essential to shut the door on RCEP and other free-trade agreements until we get our act together at home by creating an economy that is competitive in the world market. Economic openness is necessary, but not sufficient. The revival of industrialization in India requires using interest rates and the exchange rate, calibrating trade policy, influencing foreign investment to pursue national development objectives, and providing industrial finance. Strategic coordination of these policies with a long-term perspective is described as industrial policy.

This is the primary lesson that emerges from the success stories in Asia—be it Japan, South Korea, Singapore, Taiwan or, more recently, China. Economic openness was combined with strategic industrial policy that was implemented by effective governments. The advocacy of free trade by these countries came only after they succeeded at industrialization.

India must follow this path. Until then, it must do everything it can to strengthen the multilateral trading system embedded in the World Trade Organization, instead of rushing into free-trade agreements in an elusive quest for development.

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