

# BRIEFING PAPER



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## Regional Comprehensive Economic Partnership Agreement in Asia *Challenges and Opportunities for India*

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*In light of Asia's rapidly growing economic influence in recent years, the region has gained significant strategic importance in international trade relations. With two major regional trade agreements vying for the attention of Asian countries, their participation, or lack thereof, in these preferential trading agreements (PTAs) will result in both increased opportunities and challenges for each of these countries. As global partnerships such as these are beginning to increasingly redefine the contours of the Indian economy, there is a need to assess both the challenges and opportunities that these partnerships present.*

*India is currently involved in negotiations for a Regional Comprehensive Economic Partnership (RCEP) Agreement. Once concluded, the RCEP Agreement will have the potential to be the world's largest free trade area with a total gross domestic product (GDP) of almost US\$20tn and an integrated market of over three billion people accounting for more than a quarter of world trade. Having recently concluded the second round of negotiations in late September 2013, this paper will give a brief analysis of India's participation in RCEP and provide recommendations on a way forward in these negotiations.*

### Overview

In the last two decades, South and Southeast Asia have experienced a wave of regionalism that has been characterised by a spike in regional trade agreements (RTAs). While the reasons for the proliferation of RTAs remains embroiled in much debate among academics and policymakers alike, it is still very unclear whether this sharp increase in RTAs is proving to be an alternative channel to multilateral liberalisation as a response to the particularly precarious state of the Doha Round, or an emerging growth hindering phenomenon. Though the need to understand the overarching implications of these agreements on the multilateral trading system is important, it is also important to assess the implications of these agreements on specific countries.

Previous experience has shown that India's increased participation in RTAs with other Asian developing countries has expanded its exports contributing to its much-needed economic gains. According to UNCTAD's South-South Trade Monitor, 77 percent of all South-South exports are from Asia and almost three quarters of this is within Asia. This intra-Asian

trade is becoming increasingly important for India as the demand for more than half of its merchandise exports is fuelled by its neighbouring countries.

As one of the initial proponents of the RCEP Agreement, India's interest in this RTA is reflective of the benefits it stands to gain by further integrating itself into the Asian markets; however there also lie a number of challenges of which India needs to take heed if it stands to fully benefit from this RTA. RCEP presents a number of opportunities and challenges for India and Table 1 presents a non-exhaustive list that will be discussed in the paper.

### What is the RCEP Agreement?

The idea of the RCEP Agreement was mooted in November 2011 at the ASEAN Leaders Summit in Bali and launched at the 21<sup>st</sup> Association of Southeast Asian Nations (ASEAN) Summit in Cambodia on November 20, 2012 by the leaders of the 16 participating countries, namely: the ten members of ASEAN and the six countries with which ASEAN has existing Free Trade Agreements (FTAs) – Australia, China, India, Japan, Korea, and New Zealand. The first RCEP

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**Table 1: Summary of India's Opportunities and Challenges**

Opportunities	Challenges
1 Integration into regional production networks	Different development needs
2 Consolidation of overlapping FTAs	Regional financial constraints
3 Increased trade and development opportunities	Complex negotiation of existing rules
4 Easing geopolitical tensions	India's manufacturing sector
5 Congruence with foreign policy	Existing negative trade balance

Ministerial meeting was held in Brunei on August 19, 2013.

Given the plethora of FTAs within the Asian region, the viability of yet another FTA has been widely questioned. However, unlike other FTAs that have established exclusive bi- or pluri-lateral arrangements, RCEP seeks to reconcile two long-standing proposals, the East Asian FTA and the Comprehensive Economic Partnership, into one large region-wide trade agreement. Additionally, RCEP's open accession scheme also creates an opportunity for any other regional neighbours to join this agreement.

The first round of RCEP negotiations was held in Brunei Darussalam during May 09-13, 2013 where working groups on Goods, Services and Investment were established. Leaders announced that RCEP would be "a modern, comprehensive, high-quality and mutually beneficial economic partnership agreement establishing an open trade and investment environment in the region to facilitate the expansion of regional trade and investment and contribute to global economic growth and development".

Although the RCEP Agreement does not seem to have garnered a lot of media attention, if it is negotiated strategically, it stands to be the world's largest free trade area with a total gross regional domestic product

of almost US\$20tn and an integrated market of over three billion people combined accounting for more than a quarter of world trade. Thus far, India had opted to remain outside of the recent discourse on trade liberalisation in the Asia-Pacific region.

However, as one of the initial proponents of RCEP, India is now faced with an opportunity to reassert both its geo-economic and geo-political position in Asia. India's inclusion into RCEP will allow it to play a role in influencing the emergence of a regional trade architecture that is geared towards achieving a free trade area of the Asia Pacific.

## Opportunities

### *Increasing Trade and Development Opportunities*

Although India is a major proponent of multilateralism under the aegis of the World Trade Organisation (WTO), in recent years it has increasingly begun engaging in free trade agreements especially with its neighbouring countries. These RTAs have become an essential component of its trade policy. RTAs are able to promote structural and regulatory changes that facilitate trade flow among participating countries and while India already has much trade with many of the RCEP countries (four of which fall within India's top 20 trading partners) this regional economic partnership provides an opportunity to further cement economic ties and improve pre-existing trade relations which undoubtedly would have a positive impact on the economic development of both India and its trading partners.

### *Integration into Regional Production Networks*

As Asia has become known as the world's factory, the RCEP agreement also presents an opportunity for India to further integrate into regional production networks and increase its participation in global value chains (GVCs). Research has shown that as countries increase their participation in GVCs, their GDP growth rates tend to increase as well. According to UNCTAD, although India is ranked 16<sup>th</sup> in the top 25 global exporters it has the lowest GVC participation rate of these countries.

**Table 2: India's Bilateral Trade and Trade Partner Rankings**

RCEP Country	Bilateral Trade in 2012 (US\$mn)	Rankings in 2012
China	68,869	2
ASEAN	36,568	-
Japan	18,778	11
Republic of Korea	17,751	12
Australia	15,561	20
New Zealand	1,069	72

*Source: ITC Trade Map and Ministry of Commerce and Industry (Accessed on August 13, 2013)*

South Asia however, has been experiencing the fastest regional growth of GVCs in the past few years and if India strategically approaches this agreement it could leverage this growth to its benefit. GVCs make extensive use of services and with India's services sector entailing 60 percent of GDP, its engagement with RCEP could prove to be highly beneficial. Additionally, the adoption of regional standards and the simplification of Rules of Origin (ROO) with provisions such as a cumulative ROO would support the fragmentation of production processes across the region and drastically reduce the distortionary effects of trade barriers.

### ***Consolidation of Overlapping FTAs***

Due to the large number of overlapping regional FTAs, Asia has become a mesh of multiple trade rules. The RCEP Agreement however seeks to use this to its advantage and build upon the existing provisions within the plethora of FTAs. The guidelines state that "[t]he RCEP will have broader and deeper engagement with significant improvements over the existing ASEAN+1 FTAs" and "[t]he economic and technical cooperation provisions in the RCEP will build upon existing economic cooperation arrangements between ASEAN and ASEAN's FTA partners participating in the RCEP."

This RTA presents an opportunity to harmonise these FTAs to reduce the complexity of trading within the region drastically reducing trade barriers. Additionally, RCEP's move to increase consistency with WTO agreements coupled with the consolidated FTAs will have spill-over effects into their participation within the multilateral trading system. In the area of investment rules, where no WTO agreement exists, the RCEP will also be able to promote easier FDI flows and technology transfers by multinational corporations.

### ***Easing Geopolitical Tensions***

In addition to standard trade gains, regional trade agreements have also been known to ease geographic tensions by increasing the opportunity cost of conflict. As a region troubled with regional land disputes, increasing trade relations between these countries through RTAs such as RCEP presents an opportunity to facilitate improved interactions. Political scientists and historians insist that historically, the ultimate objective of RTAs such as the integration of Europe was to prevent the reoccurrence of another World War and that even MERCOSUR was established in part to temper the military power in Brazil and Argentina which stood as potential threats to regional stability. RCEP's open accession clause also leaves room for other parties to join the RTA

presenting an opportunity for furthering political cooperation between nations in the region.

### ***Congruence with Foreign Policy***

In the 1990s, India's 'Look East Policy' paved the path for greater political and economic integration with South-East Asia. This policy served to forge both economic and strategic relations within the region as it sought to overturn its previous protectionist and insular economic policies. As India continues to establish its strategic position in the global economy, the RCEP Agreement presents an opportunity for India to further pursue that goal by establishing deeper economic ties with its neighbours. The RCEP Agreement is able to act as a channel towards greater integration complementing India's existing FTAs within the region. This strategic move towards increased regional liberalisation will result in India's increasing participation within the region.

### **Challenges**

#### ***Different Development Needs***

The Guiding Principles of the RCEP Agreement state that the RTA will take "into consideration the different development levels of the participating countries and will include appropriate forms of flexibility including provision for special and differential treatment, plus additional flexibility to the least-developed ASEAN Member States".

Many of the RCEP participating countries are at growth levels that are at complete opposing ends of the development spectrum and the sheer difference in both GDP and population size poses a significant challenge that may only allow the agreement to achieve limited trade and investment liberalisation if the protection and exclusion of specific sensitive sectors plays a large role in negotiations. Without clear criteria and a timeframe to phase out this protection, this flexibility may delay a deep and full commitment to liberalisation and economic integration. If this were to occur, in such a situation, a truly free and well integrated economic and trading region will not be able to exist.

#### ***Regional Financial Constraints***

Many of the decisions agreed upon within negotiations will require substantial financial contributions from member countries to ensure the successful implementation of the RTA. Certain countries within the region, however, are beset by financial constraints that may hinder the effective enactment of this agreement. The RCEP guidelines note that the agreement will include "[p]rovisions for technical assistance and capacity building ... to the developing and least-developed countries participating in the RCEP

to enable all parties to fully participate in the negotiations, implement obligations under the RCEP and enjoy the benefits from the RCEP.” As one of the larger economies in this RTA, India may be called upon to bear a substantial amount of the financial burden required to support some of the infrastructural development necessary to implement the agreement.

### ***Complex Negotiation of Existing Rules***

Given the large number of FTAs that are already in existence within the region, harmonising all the current ASEAN+1 FTA agreements in place could be a daunting task. The existing five ASEAN+1 and 23 ratified bilateral FTAs vary greatly in terms of almost everything up for negotiation. On trade in goods, for example, ASEAN+6 countries use different tariff classifications for their tariff concessions. Additionally, it is not only that different countries use different tariff schedules, but the same countries also use different schedules for their FTAs with different countries.

In addition, tariff concessions from the same country differ depending on FTAs, and tariff elimination rates are different across ASEAN+1 FTAs. Though the basic liberalisation commitments and modality of negotiation have already been made and set through the ASEAN FTA+1 agreements, the next more difficult key step is to harmonise, broaden and deepen these commitments.

### ***India’s Manufacturing Sector***

Unlike India’s services sector, India’s manufacturing industry stands to suffer the most due to the inevitable competition it will face from its Chinese counterparts. Given India’s intention to increase the ambit of its manufacturing sector as a means to reduce its dependence on agriculture through initiatives such as its National Manufacturing Policy, discussions on the sector will most probably prove to be a particularly sensitive area in negotiations. India may think to make use of the RCEP Agreement’s flexibility clause to protect its national interests but this would need to be approached with particular caution given that such recourse is known to prompt retaliatory action. To avoid such a situation India may need to consider implementing transition rules such as temporary income support or retraining to deal with the economic and political fallout but this will most certainly be an area of contention.

### ***India’s Trade Imbalance***

The salient issue of India’s large trade imbalance remains a contentious point in trade negotiations as was recently reflected by the stalled discussions on the establishment of an FTA with China. With the RCEP Agreement, however, India has decided to enter into

<b>Table 3: India’s Bilateral Trade Balances</b>	
<b>RCEP Country</b>	<b>Trade Bilateral in 2012 (US\$mn)</b>
ASEAN	<b>-10,307.55</b>
Australia	<b>-9,678.02</b>
China	<b>-40,821.04</b>
Japan	<b>-6,415.01</b>
Republic of Korea	<b>-9,259.76</b>
New Zealand	<b>-383.89</b>

*\*Source: Government of India, Ministry of Commerce and Industry, Export Import Data Bank (Accessed 14 August 2013)*

an RTA which not only includes China but countries with which it also has negative trade balances.

Despite the increase in trade opportunities that are most likely to open up following the establishment of the RTA, India will need to ensure that its participation in RCEP will serve to increase not only its trade opportunities, but more specifically and more importantly, increase its export opportunities in order to offset its current negative trade balance.

### **Conclusion**

If RCEP negotiations come to a successful conclusion, Asia could stand to benefit from a regional trading block that could have major implications for both Asian countries and the world economy. Having thus far opted to stay out of recent discourse of regional trade liberalisation, India now stands to play a key role in these negotiations.

There are a number of opportunities that India stands to benefit from by being a part of this agreement. By further integrating itself into the Asian market, India will be able to benefit from integrating into regional production networks that have characterised the economic landscape of the Asian region. Not only will this agreement also contribute to increased trade and development opportunities, but India will have the opportunity to gain from the consolidation of overlapping FTAs within the region. The RCEP Agreement also stands to contribute to the easing of geopolitical tensions that have marred the Asian region by establishing closer economic ties that are oftentimes followed by closer political ties.

Although RCEP presents a number of opportunities, India will need to tread carefully in negotiations. The diversity of countries joining this agreement could prove to be a challenge given their varying levels of development and the consequent financial constraints some of them will face in implementing certain



requirements of the RTA. Additionally, negotiations that include India's manufacturing will need to be approached prudently given the strategic importance of this sector. In all discussions, India's current trade imbalance will be at the forefront of India's strategy given that India is about to enter into an FTA with countries with which it currently has negative trade balances.

While India must proceed with caution in order to circumvent the challenges that may arise in joining the RCEP, the opportunities presented by the RCEP Agreement could result in many benefits for India that could contribute to the attainment of India's development objectives. Overall the RCEP Agreement has the potential to prove to be a successful regional partnership both in increasing India's trade opportunities and asserting its strategic position within the Asian region.

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