RCEP and Make in India dreams**

Smitha Francis*

The stated objective of the regional comprehensive economic partnership (RCEP) agreement under negotiation is to integrate ASEAN countries and its bilateral free trade partners — Australia, China, India, Japan, New Zealand and South Korea— into a mega regional free trade area. This is the latest in a series of free trade agreements (FTAs) that India has engaged with countries in the region since the mid-2000s. The other major ones have been those signed with Singapore starting in 2005 superseded by the agreement with ASEAN in 2010, and the subsequent ones with South Korea and Japan in 2010 and 2011 respectively. From India's point of view, RCEP will primarily add China as well as Australia and New Zealand as new free trade partners. What is in it for India, especially in relation to our national priority for increasing domestic production and employment through the Make in India mission?

India's decision to go in for the first region-wide FTA involving ASEAN economies in 2010 was significantly influenced by her desire to avoid the perceived negative effects of marginalisation in export markets. As more and more countries in the Asia-Pacific region have become members of region-wide FTAs (including the modified TPP that was abandoned by the US as part of a national strategy to revive its domestic manufacturing), the same fear of marginalisation appears to shift India's approach to RCEP from the earlier reticence to the current TINA (there is no alternative). This marginalisation fear has two major assumptions underlying it.

The first argument in favour of FTAs has been that WTO-plus tariff liberalisation by India will enable our firms to import intermediate products and capital goods from partner countries at lower (or zero) tariff rates and that this will increase the competitiveness of India's final goods exports. At the same time, the lowering of tariffs by FTA partners will provide expanded export market access for Indian goods. (Both of these together would increase India's export growth.) It was on the basis of such bright export prospects for itself that India committed to reducing or eliminating tariffs in a large majority of goods across manufacturing industries in her FTAs with ASEAN, Japan and South Korea.

However, a stocktaking of India's trade performance after eight years of the coming into force of the ASEAN-India FTA reveals that easier access to imports has not pushed domestic firms to become significantly more competitive, either globally, or in the markets of her FTA partners. Despite growing at 13.1% and 9.5% in 2017 and 2018 after three years of negative or dismal growth, merchandise exports stood at USD 322 billion in 2018. This was lower than the peak reached in 2013 (USD 337 billion). An analysis of India's top ten export sectors within manufacturing reveals that all, except four, have seen drop in global export shares in the recent years. This reflects the inability of Indian firms to compete with competitors in her major markets. The four sectors, namely, organic chemicals, pharmaceuticals, vehicles and parts and non-electrical machinery, which have seen some increase in global export shares are precisely the ones wherein specific industrial policy measures until the early 2000s helped to build and maintain the base for a wide spectrum of capabilities in engineering, pharmaceuticals, and vehicles and parts. But even in these four sectors, India's global export shares remain very low. On the contrary, domestic production has got increasingly displaced by imports to the extent that 52 out of 64 manufactured export sectors recorded trade deficits during 2015-18 compared to only 20 during 1996-2001. All these point out that heightened international competition and dependence on imported inputs will not automatically deliver the build-up in domestic capabilities and capacities required to make our production base more competitive.

Indeed, analysis of the impact of India's existing region-wide FTA with ASEAN shows that ASEAN has achieved greater market penetration in India than what India could achieve in their markets. As a result, the ratio of India's trade balance to total trade has worsened with respect to ASEAN. This is true whether we compare the pre-FTA and post-FTA experience in terms of the phases 2002-08 and 2016-2018, or in terms of single years 2009 and 2018. The increasing trade deficit to total trade ratio clearly reflects the fact that India's capacity to compete against these FTA partners in her domestic market too has been declining. Same is the case for India's trade balance with South Korea and Japan, who are also part of the RCEP negotiating group. Clearly, increasing firm-level productivity through liberalised access to imports becomes unsustainable after a point without upgrading indigenous technological capabilities.

Against this backdrop, it is unrealistic to expect that India will be able to achieve significantly higher export growth because of a larger free trade zone through RCEP, especially with China's inclusion in it. Even when India does not have an FTA with China, between 15-17% of India's total imports already originate from China compared with 2.8% in 2000, the year before China joined the WTO. As a result, India's trade deficit with China has ballooned up from USD 743 million in 2000 to USD 74 billion in 2018.

Apart from the promise of increased exports, a second argument in favour of FTAs has been premised on their ability to facilitate foreign direct investment (FDI). Liberalised trade under region-wide FTAs clearly provides greater flexibility to multinational corporations (MNCs) to source components from different FTA partner countries. It has therefore been argued that together with liberal FDI policy, entering into regional FTAs will enable India to attract more FDI inflows and develop its manufacturing industries through greater engagement in GVCs.

The theoretical and empirical bases for these arguments have been found to be untenable. A large body of empirical evidence shows that the very entry of developing country firms into GVCs—whether through FDI or otherwise—is conditional upon their existing level of industrial and technological capabilities. This is because when they undertake FDI for locating production in different locations, technological considerations are intrinsic to the calculations of cost competitiveness of MNCs centrally coordinating GVCs.

Moreover, region-wide FTAs with a large number of partners also makes it easier than before for MNCs to locate the entire production process for particular products in a single country that it considers the most "suitable or consolidate them in existing vertically integrated locations across a few countries, and import them duty-free into all other markets in the free trade zone. India-ASEAN FTA's regionally cumulative rules of origin support such production restructuring.

A number of RCEP negotiating countries (including China) have well-diversified and more developed supplier bases than India, thanks to their pro-active and ingenious government support for domestic production and technology development using strategically tweaked trade and FDI policies during earlier years/decades. In such a scenario, incentives for local production in India gets eroded under region-wide FTAs. Ironically, this implies the exact opposite outcome of the proposition that RCEP will help increase FDI inflows into India.

That is, in the absence of strategic policy support that help build up indigenous capabilities and create the incentives for localisation, extensive trade and investment liberalisation across large region-wide FTAs leads to an erosion of the incentives for maintaining/upgrading local production in India by foreign producers. In addition to oft-repeated infrastructural woes, this forms a significant part of the explanation for the relatively low level of real FDI inflows into creating new capacities in the Indian manufacturing sector.

The lack of level playing field in domestic markets from intensified import competition and the option of importing various intermediate products and capital goods duty free, erode indigenous manufacturers' incentives for local production too and weaken existing domestic backward linkages. Thus whatever local production by both foreign and domestic investors take place become increasingly dependent on imports from abroad, as reflected in India's growing import and trade deficit figures. (This is also why our imports/trade deficits decline/improve whenever there is an export slow down or a generalised industrial slow down).

India will therefore only disadvantage its Make in India mission further by joining this mega-regional FTA.

Indian agriculture, including the dairy sector, will also get seriously affected, particularly because of the inclusion of New Zealand and Australia in RCEP. Even if many of the RCEP negotiating countries were to eventually make some opening up to Indian professionals in the area of services, it would be imprudent for India to risk further erosion of its remaining production bases in many manufacturing sectors. The latter will worsen the already ailing financial health of indigenous manufacturing firms, and lead to more takeovers of Indian companies by foreign owners. This is hardly the prescription for an aspiring world power.

Crucially, the RCEP negotiations are continuing without any transparency also regarding the inclusion and nature of investment, e-commerce and intellectual property rights (IPR) chapters also. By restricting the space for industrial and technology policies, all of these will compound India's challenges related to industrialisation.

Even where India has liberalised and continues to liberalise its regulations related to foreign investments, legal binding of autonomous national FDI liberalisation under FTAs would mean that any changes to India's FDI policy can make our government liable to face large compensation claims from foreign investors for alleged violation of FTA provisions. WTO-plus provisions in existing FTAs relating to broad definition of foreign investments, rules on the operations of investors, indirect expropriation ("state takeovers"), and the arbitration system of investor-state dispute settlement (ISDS) mechanism, all reduce host government's policy sovereignty in ensuring that the FDI that comes in can be used to serve national technology upgradation and export growth objectives. ISDS clauses allow foreign investors to sue a host government at international arbitral forums (that remain totally outside national jurisdiction), if they interpret any host country measures or laws as leading to a change in their business profitability or prospects.

There is also significant pressure from Japan and South Korea to include IPR provisions that expand and introduce new monopolies for pharmaceutical corporations. Such provisions will significantly weaken the Indian generic pharmaceutical industry, which provide cheaper sources of medicines globally. Extension of IPRs for commodities ranging from seeds to medicines will have serious adverse consequences for our food security and public health.

Clauses in the e-commerce chapter or elsewhere committing to free cross-border data flow will scuttle India's chances to catch-up with digital industrialisation. Any GATS-plus or TRIMs-plus commitments under RCEP including in services such as telecommunication services, cloud computing (and any other new IT service areas), etc. can prevent us from implementing national laws related to data. Such WTO-plus provisions can also prevent us from being able to utilise the government procurement route in the procurement of services. Both of these are critical policy tools in the unfolding data-based economic growth trajectories.

Thus the fear that India may lose out if it does not join RCEP is way out of place. It is our tragedy that we as a country still fail to imagine our way around a nationalistic development strategy even after witnessing the rise of the Chinese economy despite the WTO rules. China has created global tech giants like Huawei and Alibaba that have taken on the Silicon Valley giants, whether in electronics or the digital economy, precisely by ring-fencing their domestic markets. The presence of industrial policy in our competitors makes the strongest yet case for industrial policy at home. Rather than competitive liberalisation, this calls for competence in strategising economic policies from a national security point of view. RCEP is not the panacea to all our economic woes arising out of an absence of the latter. On the contrary, at this juncture, more than ever before, getting RCEP out of the way will be the critical first step towards a prudent national development strategy.

*** Smitha Francis is Consultant at the Institute for Studies in Industrial Development (ISID). The views expressed are personal.**

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