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Emerging Dynamics on RCEP

RCEP negotiations, covering 16 countries including India are very important from the point of our future trade and investment regime. If successfully concluded, RCEP will be the most wide ranging FTA that India will be a party to. We therefore need a lot more domestic discussion than is currently taking place.

From a political or strategic perspective, India being a member of RCEP is a no-brainer and something that will further reinforce our Act East policy. It will also give fillip to the concept of Indo Pacific and other strategic architectures we hear about these days. And it could help strengthen the economic pillar of our relations with East and South East Asia, and also perhaps take the people to people relations, to a higher level. Many analysts have bemoaned these as lagging behind in the various strategic or special strategic ties we have developed with countries in this region.

Domestic Strategy for Better Gains

But, are we ready? In a discussion paper that the present author had written last year when he was associated with RIS, he dwelt on the various challenges and some possible ways of dealing with RCEP. And while doing that he was also guided by the general level of dissatisfaction among our trade and industry circles that the earlier FTAs that India had signed such as with ASEAN, Japan and Korea had not brought India commensurate benefits. And that our partner countries fared significantly better. He had therefore suggested that we should be far more careful when we make commitments in RCEP with sufficient flexibilities and phasing options. He had also flagged the need to simultaneously devise and implement a domestic strategy, in the form of reforms and strengthening trade infrastructure and facilitation, that will ensure that we have the capacities and competitiveness to make better use of the concessions we may get in RCEP.

In the same paper, he had also briefly alluded to the need to have greater flexibilities in RCEP in respect of concessions to China in view of India's serious imbalance of trade with that country. India already had FTAs with Korea, Japan and ASEAN countries. It was also separately negotiating FTAs with Australia and New Zealand. We were somewhat more familiar with these economies. The greatest challenge in RCEP would be China, a less familiar territory for us on trade policy, but with which we had a large and growing trade deficit even without an FTA .

Taking on the Dragon

CII had invited me last year to lead a study team to look at the China aspect in RCEP in greater detail. The recent study report identifies a possible approach that could be taken by

RIS *Policy Briefs* are prepared on specific policy issues for the policy-makers.

This Policy Brief has been prepared by Ambassador V.S. Seshadri, based on his remarks made at a breakfast seminar on 'Issues in RCEP negotiations' held at RIS on 29 August 2018. The remarks are based on a detailed study sponsored by CII on 'RCEP: A possible approach considering China's already large presence in the Indian market' which was led by the author.

India on non-agricultural products. The report bases itself on trade analysis supplemented by discussions held with various stakeholders including industry associations, export promotion councils, CII sectoral commiittees. The team had also visited China for this purpose. It had also circulated a questionnaire to which we received some responses. The report focusses upon both the offensive and defensive concerns of Indian industry.

China's average tariff is about 9.5 per cent and for industrial products it is 8.5 per cent. It has export taxes on 217 items discouraging exports in primary form. It also has fairly rigid import control regulations through CCC certifications (China Compulsory Certification) necessary for around 158 products including electrical products, automotive products, agri machinery, toys etc. Most importantly it has 24 FTA partners through 16 FTAs that include ASEAN, Australia, Korea, NZ, Chile, Costa Rica, Peru, Pakistan and the list is growing- Sri Lanka and Maldives. Overall view is that it is a very selectively open economy. The report also reviews China's global trade - import and export structure, key trading partners, and bilateral trade trends between India and China. It also looks at other possible trade links including through re-exports from Hong Kong.

India is the seventh leading export destination for China but in its imports we figure at only 27th. We imported US$ 76 b worth of goods in 2017-18 but exported only US$ 13.3 billion. Our exports were dominated by primary and intermediate goods and imports were mainly capital goods and manufactures. There is also the need to, however, take into account that while China was India's fourth largest export destination, Hong Kong was our third largest export country and much of exports to HK get re-exported to mainland China. Our trade with HK is largely gem and jewellery but they also include hides and skins, fishery items, electrical products and refined petroleum items.

Database on Chinese Subsidies

The report also briefly reviews China's economic progress and policies including programmes such as the Made in China 2025 initiative and also the surplus capacities they have built up in metals and so on. Two issues addressed are of particular importance to RCEP - Is China a market economy? Will China play fair? The report recommends that, unlike some of the other FTAs signed by China with third countries including with several RCEP members which have affirmed the market economy status for China, RCEP should stay away from addressing the issue and leave it to the Dispute Settlement Body of WTO that is currently seized with it. Secondly, considering the difficulties that India has had in successfully taking up NTB issues bilaterally with China, the report recommends that mechanisms should be put in place in RCEP to address this issue and in case of certain items such as pharmaceuticals, bilateral side letters should also be sought to be signed as part of the text. Thirdly India should domestically build a database regarding the forms of subsidies given by China to its trade and industry. This will be very essential should countervailing actions be deemed necessary in any particular case in the future. The report has classified some of the known subsidies in the Appendix. The EU has also come out with an extensive report in December last about the significant distortions in the Chinese economy.

Tariff and Non-Tariff Priorities

The report has identified the priority tariff lines in which India should be seeking tariff concessions/elimination in China that could enable Indian exporters to have a level playing field vis-a-vis many of the ASEAN and other country competitors who already have FTA arrangements with China. The products include those in the marine, chemicals, pharma, textiles and apparel, rubber, iron and steel, non ferrous metals, plastics, and machinery sectors, among others. This identification is largely based on past performance of Indian exports in the Chinese market and also globally by examining the revealed comparative advantage. It is, however, important to also identify and include products and tariff lines in which India may acquire competitive strengths and capacities in the future. The study has tried to include some lines in this regard based on stakeholder consultations with IEEMA, IMTMA, TEXPROCIL, CLE etc.,But a more comprehensive list based on wider consultations would be necessary.

The report further suggests side letters to get more certainty on dealing with non tariff issues in the pharma (bidding guidelines, generic equivalency assessment and clinical trials) and engineering sectors. It has also dwelt on ROO and while most prefer a value added criteria there are also some who prefer a more sector specific or product specific criteria.(gem and jewellery (15 to 20 per cent value addition for cut and polished diamonds), leather products (CTSH/CTH), apparel (minimal two stage processing as in IJCEPA).

The report provides a detailed analysis of the sharp rise in imports from China. While China's share in India's imports was 16 per cent in 2017-18, its share in the imports of certain manufactured goods is far higher going up to even over 80 per cent in several cases.

Flexibilities and Concessions

We are not privy to the RCEP negotiation details. Our understanding is based only on media reports according to which initially India offered a three tier tariff reduction approach, one for ASEAN, one for Japan and Korea and one for Australia, New Zealand and China with whom India did not have any FTAs. The idea was that India's offer will be higher for those with which India already had FTAs. For countries with which India did not have FTAs already, like China, India offered a tariff coverage of 42.5 per cent.

After a couple of years of discussions on this Indian preliminary offer, India was pressured to agree to make a more combined offer for all countries than separate ones and one that was more ambitious. The Indian side had offered to make available tariff concessions for about 80 per cent of tariff lines but India also sought certain flexibilities in the schedule for certain countries like China in the form of longer phase outs and lesser coverage by 5-7 per cent. To a considerable extent what this study has tried to do is to identify tariff lines which definitely need to be in this 5 to 7 per cent group as far as imports are concerned apart from the flexibilities that may be necessary in the form of scheduling, etc.

We have examined the average share of China at the tariff line level during the last five year period. We have suggested that no tariff concession be given in products in which China already has a 40 per cent share in imports. In certain sensitive sectors like steel, where there are also issues like underpricing, the threshold is kept at 25 per cent. Giving tariff concessions to products in which a country already has a dominant share will stifle competition and entrench dominance. That cannot be the objective of an FTA. The report also recommends exclusion of products currently subject to anti-dumping or countervailing actions in India.

Furthermore, to be in harmony with the Make in India 2025 programme and other sectoral policies of the government, the report also suggests that tariff concessions on the rest of the items begin only after 2025 and go on till 2040. (The China-Korea bilateral FTA signed in 2015 provided for a twenty year phase out and with substantial phasing options). It is also proposed that inputs coming from China should not be counted as contributing to the originating element for a product entering India from another RCEP country at least till 2030.

Admittedly, there could be some items on which we could offer tariff concessions from the very beginning and not say every concession will take effect only after 2025. Some suggestions in this regard have been made in the report itself of products that are essential raw materials, intermediates or machinery and there is no threat to domestic industry. A few more such products could be identified and added based on industry consultations. Similarly some limited windows in the form of tariff rate quotas can be considered in certain industrial chemicals, intermediates or components that can be imported on end use basis and provide the industry inputs at competitive prices to spur the Make in India initiative. This could also be linked with the product cluster programme that the government has envisaged in several areas.

Seven-Point Strategy

Since India-China trade is severely imbalanced now, even without an FTA linking them, some time will be needed for India to build up its capacity and competitiveness and face up to the RCEP challenge. The report outlines a seven point strategy has been outlined comprising parallel actions that need to be taken internally in India to enable it to consolidate itself in areas of its strength and also develop competitiveness in several of the value added products. The steps include putting in place a robust industrial and export friendly infrastructure, reorienting India's industrial and trade policies to align with RCEP objectives, significantly advancing India's trade facilitation action plan, ensuring quality imports and exports and providing WTO consistent incentives and support measures for trade and industry.

Phased Regional Integration

Will China and other RCEP countries agree to the proposal? This remains to be seen. But considering the level of its bilateral trade deficit with China India may not have other options. India will have to make a persuasive case since the bilateral trade deficit we have with China is of an exceptional kind. The ratio of bilateral trade deficit to India's exports to China is as high as 502 per cent that is unmatched by any other country in RCEP. Furthermore, India's exports to RCEP countries amounted to only 18.3 per cent of its total exports while imports from RCEP sources made up 29.7 per cent of its total imports over a larger base. Tellingly, India's trade balance with RCEP vis-a-vis total trade with all RCEP members was -40.3 per cent which again distinguished India from other RCEP members.

Trying to pry open the Indian market further at this stage will have limits. A country after all cannot keep running unsustainable trade deficits. It will therefore be in the interest of RCEP countries to allow India a certain time period to enhance its trade capacity and competitiveness after which they would have a much larger market to explore. What this study has proposed is a phased regional integration that is more sustainable and that which will eventually enlarge the pie for the region as a whole.

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