

Review Article

# The Impact of India's Absence of RCEP on Indo-Pacific Economic Cooperation

Shyi-Min Lu

Energy & Environmental Laboratories, Industrial Technology Research Institute, Hsinchu, Taiwan.

Received Date: 23 January 2021

Revised Date: 25 February 2021

Accepted date: 28 February 2021

**Abstract** - The purpose of this article is to analyze India's economic influence in RCEP through simulation. First, in the RCEP16 simulation, the actual GDP change results are ASEAN +6.0%, Japan +5.1%, China +4.9%, South Korea +7.2%, Australia +3.2%, New Zealand +3.0%, India +7.1%, so RCEP16 proved that it can bring huge economic benefits to participating countries. However, if India does not participate in the RCEP, it will lose a lot of opportunities, especially the economic improvement effect of GDP +7.1%. In RCEP15, India will suffer a 0.2% negative impact, while the rest of the countries will have recovery benefits, especially after the COVID-19 epidemic. This means that trade barriers between RCEP member-countries other than India will be reduced, and their import prices will be lowered, so the import destinations will be changed from India to other countries. This is because RCEP participating countries will produce a "trade order transfer effect." Third, India's RCEP withdrawal will reduce the overall economic pulling effect in the Indo-Pacific region. Taking GDP as an example, ASEAN (6.0%→5.4%), China (4.9%→4.6%), and South Korea (7.2%→6.5%) mean that many relatively negative effects will be made from RCEP 16→RCEP 15.

**Keywords** - RCEP, India, Japan, FTA, Indo-Pacific Economic Cooperation Organization.

## I. THE MEANING AND CHARACTERISTICS OF RCEP

On November 15, 2020, the Regional Comprehensive Economic Partnership (RCEP) was signed by 15 countries outside India. RCEP is a wide-area free trade agreement (FTA) initiated by the ASEAN 10 and Japan, China, South Korea, Australia, New Zealand, and India since they announced the start of negotiations in November 2012. After a long period of negotiations, all countries except India signed on November 15, 2020. RCEP must be approved by at least 6 ASEAN member states and 3 non-ASEAN countries and is expected to take effect by the end of 2021. Even excluding India, the agreement still covers a huge economic area, accounting for 30% of the world's population, GDP, and total trade. For Japan, RCEP 15 will conclude the third wide-area FTA (the so-called mega-FTA)

after the Comprehensive Trans-Pacific Partnership (CPTPP) and the Japan-Europe Economic Partnership Agreement. The Japanese government has set a goal: 70% of the total trade ratio covered by FTA (FTA coverage) in Japan in 2018 will reach 75% of the total FTA coverage due to the signature of RCEP (not including China and South Korea).

Prior to 2000, East Asia had always been an "FTA blank area." However, the trend of institutional integration in support of trade and investment in this region is increasing. ASEAN+3 (Japan, China, South Korea) is the prototype of RCEP, which is derived from the two proposals proposed by China and Japan, one is the East Asia Free Trade Area Initiative composed of China and South Korea, and the other is the East Asia Comprehensive Economic Partnership Initiative proposed by Japan, which is composed of ASEAN+6 including Australia, New Zealand, and India. At that time, there were strategic investment opportunities, but the framework to be chosen has not yet been determined. However, when the US Obama administration launched a policy aimed at leading Asia and accelerating the TPP negotiations, China that remained vigilant on TPP has adopted a flexible stance, so Japan and China agreed and submitted a joint proposal to the ASEAN. In November 2012, RCEP negotiations were launched under the ASEAN+6 framework, and the TPP negotiations began. An agreement was reached before, but when Trump took office as US President, he withdrew from the signed TPP and turned to trade protectionism, and the global free trade system was shaken. Although the goal of the negotiations is to include a high level of liberalization and comprehensive rules as much as possible, due to a large number of emerging countries in the participating countries, the negotiations are not easy to resolve, and it takes a long time to reach an agreement. In the ever-increasing Sino-US trade war, China has actively participated in the RCEP negotiations. The former is considered to be one of the factors that promote the accelerated development of the latter. In November 2019, 15 countries other than India reached a general agreement, but India announced its withdrawal as described below and has not returned to the negotiating table since. Japan and Australia played a central role in encouraging the return of



India but did not make any change. In November 2020, apart from India, 15 countries signed the agreement. RCEP said in a statement after the summit that it will support the promotion of rule-based free trade and play an important role in the economic recovery after the COVID-19 epidemic.

## II. REVIEW THE BACKGROUND

RCEP is based on East Asian rules that strengthen economic ties. On the one hand, the regional framework is a concrete example of the establishment of a trade and investment system. It can be said that it was established in response to the strategic environmental changes in the Pan-Asia-Pacific region. The importance of RCEP comes into being if the concept of "Free and Open Indo-Pacific (FOIP)" initiated by the former Japanese Prime Minister Shinzo Abe in 2016 looks at it. According to the Japanese government, its significance is even more obvious. FOIP is a transoceanic regional organization that connects fast-growing Asia and potential Africa, as well as the Pacific and Indian Oceans, and should aim for cooperation between the two sides. It also pointed out that if Japan follows the basic principles of FOIP, it will cooperate with any country. Specific policy pillars include: (1) the rule of law, freedom of navigation, dissemination, and establishment of free trade; (2) connectivity (quality infrastructure) and strengthening economic cooperation including EPA/FTA; and (3) peace and stability. The United States, India, Australia, and the ASEAN countries have announced their respective Indo-Pacific plans, which are indicators of regional diplomacy. RCEP is positioned as an important economic cooperation initiative, which embodies the concept of FOIP, thereby promoting the formulation of free and fair trade and investment rules in the Indo-Pacific region and contributing to the economic prosperity of the region.

With the establishment of RCEP, Japan, China, and South Korea will sign a new free trade agreement, while the existing free trade agreement will be abolished (Table 1). With India's accession, a new free trade agreement will be formed between India and New Zealand. Regarding the signed agreement, RCEP contains 20 chapters<sup>1</sup>. According to the announcement of the Japanese government, the liberalization rates of Japan's export tariff to ASEAN, Australia, and New Zealand are 86-100%, 86% to China, and 83% to South Korea based on the quantity of goods. For industrial products, about 92% of tariffs will be eliminated. Regarding imports to Japan, ASEAN, Australia, and New

Zealand have been eliminated 88% of tariffs, 86% for China, and 81% for South Korea. Among them, there are 5 important commodities (rice, wheat, beef/pork, dairy products, and sweets) not included. Within 10 to 20 years, customs lists and exemption schedules will be established for many items. As a result of the cumulative system, the RCEP region has adopted a variety of rules of origin. Namely, the materials of other contracting parties can be regarded as national materials, such that the value is added 40% or more. RCEP's preferential tariffs have become more susceptible to the influence of multinational supply chains. In the original FTA signed between ASEAN and Japan, South Korea, China, Australia, New Zealand and India, the FTA between ASEAN foreign countries has no connection, and the rules of origin system are also different. Therefore, there is a problem that the company is not easy to use. Therefore, It can be said that the biggest advantage of RCEP is that it has completed a seamless FTA network under common rules. In addition to the traditional third-party certification, the certification process also requires certified exporters, as well as all exporters and manufacturers, to implement a self-assessment system<sup>2</sup> within a certain period of time. For companies, these friendly elements have been included.

Table 1. Existing FTA among RCEP participating countries<sup>3</sup>

	ASEAN	Japan	China	South Korea	Australia	New Zealand	India
ASEAN	-	AJCEP	ACFTA	AKFTA	AANZFTA	AANZFTA	AIFTA
Japan	ACFTA	-			JAEP, CPTPP	CPTPP	JIEPA
China	ACFTA		-	CKFTA	CAFTA	NZCFTA	
South Korea	AKFTA			-	KAFTA	NZKFTA	IKCEP
Australia	AANZFTA	JAEP, CPTPP	CAFTA	KAFTA	-	ANZFTA, CPTPP	
New Zealand	AANZFTA	CPTPP	NZCFTA	NZKFTA	ANZFTA, CPTPP	-	
India	AIFTA	JIEPA		IKCEP			-

<sup>2</sup> Cambodia, Laos and Myanmar require all exporters and producers to implement the self-reporting system within 20 years, while other contracting parties should implement it within 10 years.

<sup>3</sup> AJCEP: Japan-ASEAN Comprehensive Economic Partnership Agreement, ACFTA: ASEAN-China Free Trade Agreement, AKFTA: ASEAN-Korea Free Trade Agreement, CKFTA: China-Korea Free Trade Agreement, AANZFTA: ASEAN-Australia-New Zealand Free Trade Agreement, JAEP: Japan-Australia Economic Cooperation Agreement, CAFTA: China-Australia Free Trade Agreement, KAFTA: Korea-Australia Free Trade Agreement, NZCFTA: New Zealand-China Free Trade Agreement, NZKFTA: New Zealand-Korea Free Trade Agreement, ANZFTA: Australia-New Zealand Free Trade Agreement, AIFTA: ASEAN/India Free Trade Agreement, JIEPA: Japan-India Economic Partnership Agreement, IKCEP: India-South Korea Comprehensive Economic Partnership Agreement.

<sup>1</sup> (1) Open/general definition, (2) Trade in goods, (3) Rules of origin, (4) Customs procedures/trade facilitation, (5) Sanitary and phytosanitary measures, (6) Voluntary standards/mandatory standards /Quality Assessment Procedure, (7) Trade Remedy, (8) Service Trade, (9) Movement of Natural Persons, (10) Investment, (11) Intellectual Property, (12) E-commerce, (13) Competition, (14) SMEs, (15) Economic and Technical Cooperation, (16) Government Procurement, (17) General Regulations/Exceptions, (18) Institutional Matters, (19) Dispute Resolution, (20) Final Regulations.

Trade-in services include areas beyond the liberalization commitments of the WTO and existing FTAs, or a positive list method (only the regions that need to be liberalized) or a negative list method (all other regions must be liberalized), which are adopted for reserved domestic measures countries that have a positive list approach are also obliged to initiate the procedure and move to the negative list within a certain period of time after the agreement enters into force. Financial services, telecommunications services, and free professional services also have regulations. The investment chapter not only includes the protection of investment property but also includes provisions on investment liberalization, and on the basis of the negative list, it is allowed to provide national treatment and most-favored-nation treatment principles<sup>4</sup> during the investment permission stage (before establishment). In addition, regulations prohibiting performance requirements, such as local procurement and technology transfer requirements, are also placed. This is the first time that China has included this content prior to all investment agreements.

E-commerce includes the formulation of some rules that have been carried out, such as not imposing tariffs on electronic transmission, prohibiting installation requests for installing computer-related equipment (such as servers), protecting privacy, ensuring the freedom of cross-border information transmission (data flow), and network security. On the other hand, there is no provision prohibiting requests to disclose the source code contained in the CPTPP. In addition, SMEs and economic and technical cooperation are stipulated to improve the capabilities of SMEs and promote activities related to economic and technical cooperation. The final clause stipulates that a new registration may be made 18 months after the agreement takes effect, but India, the initial negotiating country, can register without waiting for this period.

Due to the above characteristics, RCEP has a high degree of liberalization, comprehensive rules and exceeds the scope of cooperation between ASEAN and other single countries. At the same time, it has successfully integrated CPTPP and other elements and has flexibility, which can provide convenience for latecomers. RCEP can be assessed as an easy-to-use and well-balanced FTA for companies. However, there is still room for improvement in the level of liberalization and the content of the rules. It is expected that a review will be conducted every five years after its entry into force to reach a better agreement.

### III. THE SECESSION OF INDIA

At the RCEP summit held in Bangkok in November 2019, India announced its intention to withdraw from RCEP negotiations. Since then, India has not participated in the negotiations.

One of the reasons India withdrew from the RCEP negotiations is that promoting trade liberalization with RCEP member states may lead to a large influx of cheap products (especially from China) and further expand the long-term trade deficit. In particular, the "Made in India" advocated by the Modi government has set a goal that the share of manufacturing in GDP will increase to 25% by 2022. So far, due to the government's efforts to improve transportation and power infrastructure, tax reforms, land expropriation, and labor laws, India's business environment is improving, but the growth of its manufacturing industry is still slow, and it has not yet created enough jobs. Although it is believed that RCEP can make a high contribution to the competitiveness of the manufacturing industry, people are always worried that RCEP will not be able to win the competition between India, ASEAN, and China. Another consideration is the politics of India. The Bharatiya Janata Party (BJP), led by Prime Minister Modi, won an overwhelming advantage in the elections for the House of Representatives in the spring of 2019, but the results of the provincial assembly elections held in the suburbs of Delhi and western Maharashtra in October did not perform well in the rural voting. In addition, Swaddy Sea Jagaran Munch (SJM) is the largest supporter of BJP; namely, the Swedish Sea Movement (popular with domestic products) organization is related to the Hindu Nationalist Group/National Service Group (RSS), and it is said that "Amur" cooperative (GMMF) responsible for the sale of Gujarat dairy product strongly opposes RCEP, which has a major impact on the Modi government's decision (Palit, 2019).

It is said that other countries' allegations and concerns related to the negotiation of RCEP with India include: (1) Since 2014, India has increased tariffs on certain ICT products (such as mobile phones and communication equipment) (Mohan Kumar, 2019). In recent years, the effective tax rate has increased, although it has not exceeded the concession tax rate promised in the WTO agreement. India insists on changing the base year (the executive tax rate) of the concession table from 2014 to 2019, in addition to being used as a benchmark for tax reduction negotiations, also using high tax rates as the goal of liberalization. (2) Considering imports from China, India requires emergency import restrictions (safeguarding measures) on more than 200 industrial and commercial products, but China firmly opposes it (SankeiBiz, 2020). (3) The rules of origin require strict standards, but India has not adopted them. Instead, a combined system has been adopted, in which existing FTAs with other countries and ASEAN must meet both the customs number change standard and value-added standards, but these strict rules of origin allow companies to use FTA, which may be a factor hindering operations. (4) Under the same conditions (giving most-favored-nation treatment), one principle is to give preferential tariff rates to participating countries, but by 2025, India will spend 90% on Japan and

<sup>4</sup> The most-favored nation treatment does not apply to Cambodia, Laos, Myanmar and Vietnam.

South Korea, 86% on Australia and New Zealand, and also 80% on China, and these are required to be abolished (Shigekawa Shigeya, 2019). (5) The non-tariff barriers between ASEAN and China have not yet been resolved. Specifically, it seems to refer to the barriers to enter the Chinese pharmaceutical market. (6) Concerns about importing dairy products from New Zealand. (7) In the form of service trade (personel mobility)<sup>5</sup>, Japan requires open services, especially the mobility of IT engineers, but other participating countries are unwilling.

At the negotiating meeting last year (2020), it seemed that India was the focus of returning to the negotiations. According to media reports, a proposal was made to India to suspend commitments on market access and only reach partial agreements in areas that can be negotiated. However, it is said that India did not respond because in the face of the new populist wave. Now, with increasing political and economic uncertainty at home and abroad, it is not the right time to make a decision (Amiti, 2020).

#### IV. THE ECONOMIC IMPACT OF INDIA LEAVING RCEP

We will use the general balance model (CGE) to analyze the economic impact of India's departure from RCEP. The assumptions for explaining models and scenarios will be minimized, and the simulation results will be mainly introduced. The analysis uses the Global Trade Analysis Project (GTAP) model and the 10th edition of the database (the base year 2014). For model specifications and scenario assumptions, the content used in the 2018 RCEP analysis by Kikuchi et al. (2018) is used. In order to briefly explain the scenario assumptions, we assume that RCEP will reduce the tariff and non-tariff barriers of commodity trade (mainly to assume trade facilitation<sup>6</sup>), as well as reduce the cost of service trade. Two scenarios are simulated. One is that all 16 countries have joined RCEP, and the other is that India left the RCEP of 15 countries.

Table 2 summarizes the simulation results of actual GDP changes and the changes compared to the baseline (when RCEP is not implemented). In RCEP16, the actual GDP changes are ASEAN +6.0%, Japan +5.1%, China +4.9%, South Korea +7.2%, Australia +3.2%, New Zealand +3.0%, and India +7.1%. RCEP has been proven to bring huge economic benefits to participating countries. Take Japan as

an example. Because of the signature of new FTAs with major trading partners such as China and South Korea, relatively high tariffs have been reduced, and tariffs on exports of automobiles (including second-hand cars) to ASEAN and Australia have been reduced. The effect is very good<sup>7</sup>. In addition, non-customs barriers have been greatly reduced, especially in emerging countries. RCEP also has the role of expanding trade through regional supply chains and increasing the income of emerging countries to expand Japan's exports. As far as the ASEAN is concerned, the existing FTAs have reduced tariffs, but their effects are limited, while RCEP has a great effect in reducing non-tariff barriers. Import costs have fallen, industry competitiveness has improved, and exports of products with comparative advantages have increased. Exports of electronic equipment products from Malaysia, the Philippines, Singapore, Thailand, and Vietnam have increased significantly, while clothing products in Cambodia and Vietnam have increased significantly. Take India as an example. It has the effect of lowering the customs and non-tariff barriers of China and ASEAN (they are the main export destinations), but more importantly, it has the effect of reducing India's high-level customs and non-tariff barriers. Lower import costs will increase the competitiveness of industries where India has a comparative advantage and increase exports of services such as chemicals, metals, machinery, and finance. Simulation results have shown that exports of automobiles and electronic products have also increased significantly. This shows that India may use RCEP to increase its participation in the East Asian manufacturing supply chain. Employment in industries where exports are growing will also increase notably. On the other hand, India's comparative advantage in the light industry is very small, and the export growth of textiles and clothing is small.

**Table 2. Economic effects of RCEP (changes in real GDP)**

	RCEP16		RCEP15	
	%	US\$ Billion	%	US\$ Billion
ASEAN	6.0	148.3	5.4	132.6
Japan	5.1	232.9	5.0	227.4
China	4.9	504.5	4.6	473.2
South Korea	7.2	102.2	6.5	91.9
Australia	3.2	46.2	2.9	42.6
New Zealand	3.0	6.0	3.0	6.1
India	7.1	144.0	-0.2	-3.2

Source: The author's estimate based on the GTAP database (10)

Next, we will turn to RCEP15 (except for India), focusing on analyzing the impact of India's departure. First of all, India will lose a lot of opportunities if it does not participate in RCEP, especially if it misses the economic

<sup>5</sup> Countries that adopt the positive list approach are also obliged to initiate procedures to move to the negative list within a certain period of time after the agreement enters into force.

<sup>6</sup> In the analysis of Kikuchi et al. (2018), referring to the World Bank's Doing Business database, the number of days and costs required for customs clearance and paperwork are used as indicators of non-tariff barriers to promote trade through trade agreements. It is assumed that these measures will reduce costs. Generally speaking, the cost of customs clearance in emerging countries is higher than that in developed countries. The above data shows that Japan's import declaration time is 1.8 days, while India's is 14.3 days.

<sup>7</sup> However, it should be noted that since the ASEAN and Australia have reached a bilateral free trade agreement, the simulation results may be too high.

boost of GDP+7.1%. Secondly, in RCEP15, India will suffer a 0.2% negative impact, while the rest of the countries will have recovery benefits. This means that trade barriers between RCEP member-countries other than India will be reduced, and import prices will be lowered, so the place of imports will be changed from India to another country. This is because RCEP participating countries will produce a "trade order transfer effect." Third, India's withdrawal will reduce the overall pulling effect. Taking GDP as an example, ASEAN (6.0%→5.4%), China (4.9%→4.6%), and South Korea (7.2%→6.5%) have been relatively negatively affected. A specific example is that India and Malaysia may be adversely affected by the export of energy resources to India. Thailand and Vietnam may also be adversely affected by the export of chemical products, automobiles, and electronic equipment to India. But the impact on Japan is limited, only 0.1%. In fact, India's departure will have little impact on other RCEP members. We hope that the Indian economy will grow in the future, but in the long run, leaving RCEP will have a significant impact on India's economy.

## V. CONCLUSION

The completion of RCEP as a framework with a generally high level of liberalization and comprehensive rules can be said to be an important milestone in promoting economic cooperation in the Indo-Pacific region. On the other hand, it still has a major regret, that is, India, an important strategic partner of the Indo-Pacific, did not join this time.

As a characteristic of ASEAN's economic integration, it takes into account the differences in the economic development and political systems of various countries and adopts the flexibility to gradually promote liberalization. Signing the RCEP provides special treatment for India's return and has been designed to be flexible. It is necessary for RCEP15 countries to continue discussions with India and continue to make unremitting efforts until India is ready to participate.

As an important governance strategy for India, promoting the "Made in India" policy, steadily advancing infrastructure construction, and legal development are crucial. It will take some time for the effects of these economic policies to appear, but the results are gradually appearing. For example, inward direct investment is increasing year by year. In addition to the development of important infrastructure, industrial human resources must also be developed through the dissemination of education. The use of digital technology is considered to play an extremely important role in disseminating education.

In the framework of the Indo-Pacific concept, the United States International Development Finance Corporation (DFC) is taking the lead in cooperating with Japan and Australia to promote high-quality infrastructure investment.

On the other hand, such as "Bull" and "Blue Dot Network," which are also an initiative to support India's infrastructure development and human resource development, to this end, the focus is on promoting economic cooperation between Japan, the United States, Australia, and India in this area, such as strengthening connectivity through high-quality infrastructure investment and digital technology.

In the future, it is conceivable that if SASEC<sup>8</sup>, as a sub-regional organization in South Asia, strengthens cooperation with India, it will be important to increase the number of RCEP participating countries.

## ACKNOWLEDGMENT

The research was not supported by any fund or organization.

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The South Asian Subregional Economic Cooperation (SASEC) program is a project-based partnership that brings together Bangladesh, Bhutan, India, Maldives, Myanmar, Nepal, and Sri Lanka to promote regional prosperity, improve economic opportunities, and improve the quality of life of the people in the subregion. The SASEC countries share a common vision, that is, to promote trade and cooperation within South Asia, and at the same time, through Myanmar, develop links and trade with Southeast Asia with China and the global market.