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The RCEP: Integrating India into the Asian Economy

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The ten member states of the Association of Southeast Asian Nations (ASEAN) will kick off negotiations of a Regional Comprehensive Economic Partnership (RCEP) Agreement with their six Free Trade Agreement (FTA) partner countries, namely China, Japan, South Korea, Australia, New Zealand and India, early this year. The ambition of this ASEAN-driven initiative may lead to the creation of the largest FTA in the world. It is also noteworthy that the two largest developing countries - China and India, will be included for the first time in a regional free trade agreement[1].

The development of the RCEP, which was first endorsed in Bali in 2011, was officially launched during the twenty-first ASEAN Summit held in Phnom Penh in November 2012. There has been a lot of discussion in the past year. Some debates focused on the competition between the initiative and the US-led Trans-Pacific Partnership (TPP). Moreover, will the RECP provide continuous momentum to the fast growing Asian economy? What will be the role of China in the regional bloc and will it bring threats to the regional security with its economic dominance and military presence? And moreover, marking its importance to Indian observers, will it bring India closer to Southeast and East Asian regional integration? This article analyses the initiative and explores possible implications for the region as well as for India in integrating with the Asian economy.

TPP or RECP - That is the Question

The close economic ties driven by various accelerated integration initiatives in the Asia Pacific region, particularly among the Southeast and East Asian countries, have contributed significantly to economic growth and shared

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prosperity in the region in the past decades. However, though proposals were made, for example, to create an East Asia Free Trade Agreement (EAFTA), based on the ASEAN plus 3 model, or the Comprehensive Economic Partnership in East Asia (CEPEA), based on the East Asia Summit (EAS) model, progress has been stalled due to complicated political and economic reasons. The ASEAN is determined to accelerate regional economic integration by developing an RCEP agreement by the end of 2015, among its ten member states and six dialogue partner countries with which the FTA is already in place. The strong political will behind the RCEP initiative is driven by the desire to push forward the stagnate integration process that is hindering economic growth after the global financial crisis in 2008, and to counter balance the influence of the US-led trade initiative - the Trans-Pacific Partnership (TPP), in the region.

Since President Barack Obama of the US announced his "Pivot to Asia" strategy in 2011, the TPP has been the centre of the US economic engagement in the region. This first trans-continental trade agreement soon caught attention amidst the initiatives of various, sometimes overlapping and competing, economic integration in East and Southeast Asia. However, the recently emerging RCEP driven by ASEAN seems to have received more enthusiastic responses in Asia and is regarded as a peer, if not a rival, to the TPP in competing for economic influence in the region.

According to the RCEP framework document released by the ASEAN Secretariat in 2011, the RCEP is planned to include the ASEAN plus 6 countries and may potentially expand to the US and Russia in the future if they conduct FTA negotiations with ASEAN[2]. It is also open to "external economic partners" after its conclusion in 2015. As such, the integration encompasses at least a population of 3.5 billion, with a collective GDP reaching US$ 32 trillion, comprising more than 28.4 per cent of the global GDP and 27.7 per cent of global merchandise trade.

In estimation of potential economic gains, the RCEP appears to have greater incentives for ASEAN member-states and their FTA partners. First, the RCEP will be the first ever FTA in the world with the membership of China and India, making the collective GDP of the RCEP exceed that of the TPP. Second, the TPP is promoted as "gold standard" FTA and demands 'high quality" of trade liberalisation among its members, while RCEP will grant flexibility to different members in deciding their levels of liberalisation commitments and their negotiating approach, and thus will make their participation easier than that in the TPP. Furthermore, the RCEP will provide Special and Differential (S&D) Treatment to less developed countries, namely the CLMV countries (Cambodia, Laos, Myanmar and Vietnam), and will not tackle "sensitive" issues such as environment protection, labour standards and reforms of State-Owned Enterprises(SOEs), making it more welcoming to most of the developing country members. According to the instructions by ASEAN Leaders in November 2012, formal negotiations will start in early 2013 and conclude by the end of 2015, so that it can be realised in the same timeframe as that of the forming of the ASEAN Economic Community (AEC). (See Table 1) However, whether the RCEP or the TPP will move forward and be realised first, and how these two influential trade initiatives will compete with, or complement each other remains to be seen.

Table 1

Comparisons between the TPP and the RCEP

	TPP (P11)	RCEP	Comparison
Participants (potential participants)	Singapore, Brunei, Chile, Peru, New Zealand, Malaysia, Vietnam, Australia, Canada, Mexico	Ten ASEAN member states, China, Japan, Korea, India, Australia, New Zealand	Not all ASEAN Member States are TPP members
GDP (% global share)	29.65 (2011)	28.51 (2011)	The RCEP, if realised, will become the largest FTA in the world in terms of population covered
Merchandise export/import (% global share)	18.97%, 22.5% (2011)	28.1%, 27.2% (2011)	
Issues Coverage	Trade in goods, services, investment, trade facilitation, IPR, competition policy, state owned enterprises, government procurement, labour and environment	Trade in goods, services and investment, customs procedure, technical barriers, IPR, S&D treatment to less developed ASEAN member states	The RCEP will not include issues such as labour and environment, but will include S&D treatment to less developed CLMV countries.
Negotiation approach	Single undertaking	Single undertaking early harvest, sequential liberalisation or other agreed modalities.	The RCEP provides more flexibility
Progress	To be concluded in 2013	To be concluded by the end of 2015	The RCEP, based on ASEAN+One FTA, may take less time for negotiation.
Response from major countries	Japan is interested; China and Korea have not expressed interest yet.	All six FTA partner countries expressed interest and support	China will join the RCEP to counter balance the US-led TPP, India will also join the RCEP, as TPP is not accessible to it.

Sources: Compiled by author

The Rise of China and Its Impact in the Regional Economy

The RCEP has been planned to counter balance the US-led TPP and the US dominance, but ironically, ASEAN member states, and some other East Asian countries too, are also not without concerns about the fast growing influence of China in the region. On the one hand, the rise of China as an economic powerhouse has undoubtedly provided an important growth engine to the phenomenal economic performance in the region in the past two decades. On the other hand, some RCEP members have also been sceptical about China's fast growing economic, political and military influence.

The ASEAN and China signed the Framework Agreement on Comprehensive Economic Cooperation in November 2002 to establish the ASEAN-China Free Trade Area (ACFTA). The ACFTA was realised on 01 January 2010. Since then almost 97 per cent of products classified by the ASEAN-6 (Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore and Thailand) and China in the Normal Track have been eliminated. The tariff reduction between the other four less developed members, or the CLMV countries, will be fully implemented on 01 January 2015.

According to ASEAN Secretariat statistics, in 2010 China maintained its position as ASEAN's largest trading partner, accounting for 11.3 per cent of ASEAN's total trade, while ASEAN was China's fourth largest trading partner, accounting for 9.8 per cent of China's total trade. ASEAN's exports to China reached US$ 113.5 billion in 2010, increasing by 39.1 per cent as compared with 2009 and becoming ASEAN's second largest export destination. ASEAN's imports reached US$ 117.7 billion in 2010, increasing by 21.8 per cent as compared to the previous year. If compared with trade data of earlier years, the global financial crisis has made ASEAN more dependent on China because of the shrinking demand in the Western countries.

At country to country level, according to the WTO statistics, in 2010, China was the largest trade partner of Japan, South Korea, Taiwan, and among ASEAN member states, was the largest trade partner of Malaysia and the second or third largest trade partner of several other ASEAN member states. It is also the largest import source of Indonesia, Vietnam and Cambodia, with fast growth in import trade with other member-states.

According to ASEAN statistics, the Foreign Direct Investment (FDI) flow from China to ASEAN reached US$ 2.7 billion in 2010, declining by 32 per cent from US$ 3.9 billion in 2009. According to China's official statistics, accumulative Chinese FDI in ASEAN region has reached US $12.5 billion, nearly half of which was realised in the past two years after the global financial crisis.

Table 2

China's Trade with Asian Countries in 2011

	Bilateral trade (US$ 100m)	Growth Rate	Export (US$ 100m)	Growth Rate	Import (US$ 100m)	Growth Rate Rate
Japan*	3,428.89	17.2	1,482.98	22.5	3634.72	14.0
Korea*	2,456.33	15.1	829.24	20.6	1,627.09	17.6
Taiwan*	1,600.32	10.1	351.12	18.3	1,249.20	7.9
India	739.18	19.7	505.43	23.5	233.75	12.1
Indonesia	605.22	41.6	292.22	33.1	313.00	50.5
Malaysia*	900.35	21.3	278.90	17.2	621.45	23.2
Philippines	322.54	16.2	142.54	23.5	180.00	11.0
Singapore	634.82	11.2	355.70	10.0	279.12	12.9
Thailand	647.37	22.3	256.97	30.2	390.40	17.6
Vietnam	402.07	33.6	290.92	25.9	111.16	59.1
Asia	19,030.28	21.5	8,991.42	22.8	10,038.87	20.3
Total Trade	**36,420.58**	**22.5**	**18,986.00**	**20.3**	**17,434.58**	**24.9**

Source: Ministry of Commerce, China, http://yzs.mofcom.gov.cn/aarticle/g/date/p/201202/20120207946820.html

Note: Country marked with * has China as the largest trade partner.

In addition to trade and investment, tourism is another important sector that has benefited ASEAN economy since China adopted the policy to encourage its citizens to travel overseas to Southeast Asia. According to the ASEAN statistics, in 2010 ASEAN received around 5.4 million tourist arrivals from China, increasing by 28.9 per cent as compared with 2009. In 2011, the number of Chinese tourist arrivals further reached 7 million, accounting for 9 per cent of total tourist arrivals. China has replaced Japan to become the second largest source of tourists for ASEAN, next only to the EU (27). China pledged to realise two-way tourist arrivals to 15 million by 2015.

As demonstrated by the above statistical review, China's huge market demands have not only made it one of the most desired markets in the world, but have also made an increasing number of countries more and more dependent on the Chinese economy for their sources of economic growth. One important indicator is the Global Risk Report (GRR) published by the Switzerland-based World Economic Forum (WEF). The report finds that despite the rise of the Chinese economy having been beneficial to the world economy, it has at the same time, become a risk factor because of its immediate negative impacts on the world economy when its market demands are shrinking.

To be more concrete, based on a comprehensive survey of experts and opinion leaders from around the world, since 2007 the GRR has graded "Chinese economic hard landing" as one of the top global risks in the world economy. In 2009 and 2010, "the Slowing down of Chinese economy (<6%)" was graded in the two consecutive years as the second highest global risk in the world economy. These phenomena indicated the increasing dependence of, if not the whole world, a great number of countries on China, both as a major destination of their exports and as an import source of parts and semi-finished materials in supply chains, particularly after the global financial crisis.

Economic Integration and Security Issues

While most economies, especially those being benefited from enhanced trade and investment activities with their neighbour countries, believe that economic integration brings positive effects and reduces political and security tension or risks in the region, what has happened between a number of countries in the region in the past few months demonstrates that economic integration does not avoid political disputes or tension. It hence, gives the region an opportunity to revisit the issue of trade and economic security. It also poses the question whether RCEP, when it is realised, will bring economic benefits to the region without creating any political risks.

Various integration initiatives have led to the complication of integration processes, higher transaction costs and increased instability and unpredictability of trade regimes. Most of all, political wrestling between major economic powers behind various initiatives very likely give little policy space for smaller economies in the region. Bigger powers may gain more political and economic benefits at the cost of smaller economies.

One recent example is the China-Philippines relations. China and the Philippines are among the six claimants to waters and island groups in the South China Sea, which boasts of some of the world's most heavily travelled maritime lanes and rich fishing grounds with a reported potential wealth of mineral resources.

The latest standoff between China and the Philippines began on 10 April 2012, when the Philippines navy accused Chinese fishing boats of fishing illegally around the Panatag Shoal, otherwise known as the Scarborough Shoal, or in Chinese, the Huangyan Island, where the Philippines claimed to have full sovereignty. After the incidents of the dispute, in May, China was reported to have unilaterally suspended various forms of bilateral exchanges and activities with the country, including halting imports from the Philippines that included a million tonne of bananas, which is the major trade item between the two countries. China was also reported as suspected of sending Chinese tourists to visit the country and checking various infrastructures and loans in the Philippines. As a result of these unilateral actions, the business community in the Philippines began to exert pressure on their government to restore normal relations with China to save their trade and commercial activities from going into a disaster.

In 2011, the Philippines' exports to China reached US$ 18 billion, increasing by 11 per cent as compared with 2010. China was the Philippines' fifth largest export destination and the fourth largest import source. If exports to China and Hong Kong are combined, China (including Hong Kong) accounts for around 24 per cent of the Philippines' total exports. In terms of the banana industry, which is the Philippines' fifth largest export industry, Japan is the country's biggest export market for bananas where the Philippines supplies 90 per cent of the Japanese requirement followed by China and the US. In 2011, the Philippines exported a total of $366.68 million bananas to China, supplying more than 92 per cent of its total banana requirements.

Faced with the unexpected development, the Philippines President Aquino had directed concerned agencies to diversify the country's banana exports to cushion the effects of Chinese actions. However, though bananas from Philippines have export potentials in other countries such as Australia, the Middle East, Russia and Scandinavian countries, the country has to face various challenges, including very high import tariff rates ranging from 10 to 40 per cent, various SPS systems and measures, and high transportation costs, among others.

Relations between the claimant countries of South China Sea have also soured in 2012. Since last year, the island disputes between China and Japan arousing heated responses from Chinese citizens have made headlines in the world. Although the Chinese government did not officially announce an economic retaliation against Japan, Japan is experiencing suspension of Chinese tourists and a nation wide "Anti-Japanese Campaign" initiated by civil groups in China to boycott Japanese products and services. These incidents raise a timely issue, that after decades of economic integration and cooperation promoted by free trade advocates and governments, there is a need to revisit the issue of economic and trade security under a formal regional or multilateral institution. The case of China and the Philippines may happen in other countries or economies that have close economic ties. Since global economic organisations, for example, the World Trade Organisation (WTO), are not equipped to discuss such issues, regional institutions should play a more active role in the future.

What Does the RCEP Mean for India?

The India-ASEAN economic relations can be dated back to when India first adopted the "Look East" policy in early 1990s. In 1992, India first developed a sectoral dialogue partnership with ASEAN and then in 1995, moved to a full dialogue partnership. The year 2012 marks the twentieth anniversary of the ASEAN-India Dialogue relations.

Over the past two decades, India and ASEAN have developed wide and deep engagement and cooperation that covers economic, political, social and security aspects. Through the dialogue partnership, India has also developed full scale engagement with ASEAN's other dialogue partners.

However, in economic cooperation, volume of trade and investment flows between India and ASEAN remained relatively low compared with other dialogue partners, mainly China, Japan and South Korea. In 2011, the total trade between India and ASEAN was US$ 68.4 billion, growing by 23.4 per cent from 2010. It accounts for only 2.9 per cent of the total ASEAN trade, far behind that of China (11.7 per cent), Japan (11.4 per cent), Korea (5.2 per cent), or non-dialogue partner countries such as Hong Kong (4.0 per cent) and Taiwan (3.4 per cent). In terms of FDI, between 2009 and 2011, the total volume of FDI from India into ASEAN was US$ 2,119 million, accounting for 1.8 per cent of the share to the net inflow into ASEAN. During the same period, Japan made a total of US$ 29.56 billion, accounting for 11.7 per cent, while China made US$ 10.67 billion, accounting for 5.3 per cent.

India is one of the six FTA partner countries to ASEAN that are invited to participate in the RCEP. India signed the ASEAN-India Framework Agreement on Comprehensive Economic Cooperation, followed by the signing of the ASEAN-India Trade in Goods (TIG) Agreement in August 2009. The negotiations of the ASEAN-India Trade in Services and Investment Agreements were concluded by the end of 2012, awaiting formal signature this year. These important pillars, together with the TIG, will mark a full fledged Indian engagement in the East Asian economy, contributing to both Indian and ASEAN economic growth. The RCEP may bring India closer to Southeast and East Asian economy by further liberalising trade and investment between India and ASEAN, as well as India and the other five FTA partner countries, including China.

The RCEP will have significant implications for Indian economy and trade. First of all, the RCEP mandates to have at least 90–95 per cent of liberalisation of tariff line coverage. This means that not only does India have to further expand the level of liberalisation between India and ASEAN member states, based on the TIG, Services and Investment Agreements, but it also has to get into negotiations with those that it currently does not have an FTA with, namely China, Australia and New Zealand. The former means that the tariff line coverage of the ASEAN-India Goods Agreement, currently around 85 per cent, will need to increase to 90–95 per cent.

It needs to be mentioned that in the existing TIG, India has committed to eliminating only around 78.8 per cent of all tariff lines after the transition period. This level is not only lower than the other four ASEAN+1 FTA between ASEAN and its dialogue partners, which have all committed to more than 90 per cent, it is also even lower than some of the ASEAN member states, including Singapore, Malaysia, Thailand and the Philippines. If the RCEP adopts the 90 per cent threshold, India will have to review its trade structure and allow at least several hundred more products for liberalisation in the future.

Another critical implication will mean that a bilateral trade agreement will need to be negotiated between India and China if India participates in the RCEP. Under this bilateral trade agreement, India and China may have to open their markets to each other with at least 90 per cent of tariff lines elimination. One shall recall that India and China jointly announced their willingness to develop a China-India FTA in 2006 and conducted a joint FTA feasibility study through their think tanks. The study was completed but the results were not made public. Nor was it followed by consultation or negotiation of an FTA, as is usually the case.

India has an increasing trade deficit with China. In 2011-2012, India exported only US $18.08 billion to China while imported from China US$ 57.52 billion, with a trade deficit reaching US$ 39.44 billion[3]. India is also one of the several countries that have openly rejected procurement of certain high technology equipment from China out of national security concerns. However, under the RCEP, it will be unavoidable for India to further engage and open up its market to Chinese products and services. This may change the nature of India-China economic relations and have important political, economic and security implications.

Conclusion

The past two decades have seen accelerated proliferation of the FTAs and RTAs in the Asian region. There have been overlapping proposals and initiatives such as the ASEAN plus 3, the ASEAN plus 6, East Asia Summit (EAS) and East Asia Free Trade Agreement (EAFTA). The development of the RCEP in the future poses great opportunities for its members as well as countries not included in the initiative, but in the mean time it also raises some concerns. One of the concerns is whether this ASEAN-led integration process will help ASEAN to sustain more economic autonomy and less dependence on big economic powers, such as China. Given the influence of the Chinese economy at regional and national level, the RCEP or other integration mechanisms will by no means have to face the rising concerns of national economic security. The ASEAN member states need China for their economic growth; but they also have to face potential risks in the future.

The recent development of China-Philippines relations is a timely example that economic integration and interdependence can be a two-sided sword. When economy and trade is used as a means of retaliation, the World Trade Organisation (WTO) or other global trade institutions can hardly provide effective timely remedy. How can and should regional trade architectures, such as the institution of ASEAN and its members, respond to such political risks? Can ASEAN mechanisms or RCEP be negotiated to address such concerns? This will be a difficult challenge for all countries that will participate in the RCEP.

What will participating in the RCEP mean for India? India has limited trade and investment with ASEAN countries despite a dialogue partnership between India and ASEAN having been developed for two decades. The comparatively low level of tariff line elimination of the ASEAN-India FTA and prolonged delay in negotiating bilateral services and investment agreements keep India far from deeply integrating with the East and Southeast Asian economy when compared with other ASEAN FTA partner countries. The RCEP may provide an opportunity for India to accelerate its integration with the regional economy, but it may also bring political implications beyond economic engagement, particularly for India-China relations.

Notes :

[1] India and China are both members of the Asia Pacific Trade Agreement, also known as Bangkok Agreement. However, the APTA is often considered as a preferential trading

arrangement, designed to liberalize and expand trade progressively among developing countries in the Asia Pacific region, and not an FTA according to WTO definition.

[2] Being part of the "ASEAN + 8", the US and Russia were invited to participate in the East Asia Summit and became formal partners in 2012.

[3] Export Import Data Bank, Department of Commerce, Ministry of Commerce & Industry, India.

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